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# A-REIT SURVEY 2021

## A STRONG REBOUND

# WELCOME TO BDO IN AUSTRALIA'S 27TH ANNUAL SURVEY OF AUSTRALIAN REAL ESTATE INVESTMENT TRUSTS

## A STRONG REBOUND: FINDINGS FROM BDO IN AUSTRALIA'S 27TH ANNUAL SURVEY OF AUSTRALIAN REAL ESTATE INVESTMENT TRUSTS

Despite the 2021 financial year (FY21) being marked by prolonged uncertainty and seemingly interminable lockdowns, Australians demonstrated a nation-wide display of resilience. This also stands true for Australian Real Estate Investment Trusts (A-REITs), which highlighted their resilient nature during FY21.

The A-REIT sector has staged a remarkable recovery for FY21, outperforming the S&P/ASX 200 Index by 7.1 per cent, and delivering a positive return of 31 per cent. All market sectors, including industrial, retail, office, and diversified, delivered positive returns for FY21 – a first since FY18.

The strong rebound comes after a challenging FY20 for A-REITs, where the onset of the COVID-19 pandemic and the ensuing economic downturn had an adverse impact on the wider A-REIT sector. Specifically, intermittent federal and state government closures saw the office and retail sector categories hit especially hard.

Australia's vaccine rollout, changes in consumer behaviour, and the uptake of flexible and shared working arrangements throughout 2021 had a big role to play in the turnaround. These factors ensured that A-REITs continue to maintain their desirability among investors who value their liquidity, stable yields, capital growth potential, and diversification of asset types.

## 1. VACCINE UPTAKE AND BOLSTERED CONFIDENCE

The expected uptake in the COVID-19 vaccine during FY21 and surge in vaccinations subsequent to year end, boosted confidence in the office and retail sector categories as Australians anticipated a return to a pre-pandemic life.

Real Capital Analytics' Q3 2021 edition of Asia Pacific Capital Trends highlights that, of the Asia Pacific markets where commercial real estate activity fell last year, only Australia is well ahead of pre-pandemic levels.

Despite the shift towards a flexible working environment for most of the office-based workforce causing low vacancy rates, prime office locations in areas such as Sydney and Melbourne have been able to experience price growth, driven by the record low interest rates and monetary stimulus injected by the Australian Government.

### 2. E-COMMERCE CONTINUES TO REIGN

With forced shutdowns troubling non-essential businesses to shut their physical stores, consumers were limited to online shopping and in turn, there was an astonishing five years of online retail growth in just six months in the Australian e-commerce industry.

However, during the year and with easing restrictions, retail locations have exhibited an ability to rebound and improve foot traffic within COVID-19 affected locations by implementing click and collect services. Nevertheless, the overall market exhibited caution with the retail category given the potential for any future retail shutdowns, the speed of the vaccine rollout and easing restrictions.

It is a point of note that A-REIT landlords have also provided more than $1 billion in support under the government mandated Leasing Code of Conduct, with more than 90 per cent delivered by owners of retail properties. This continues to weigh on the retail sector's recovery.

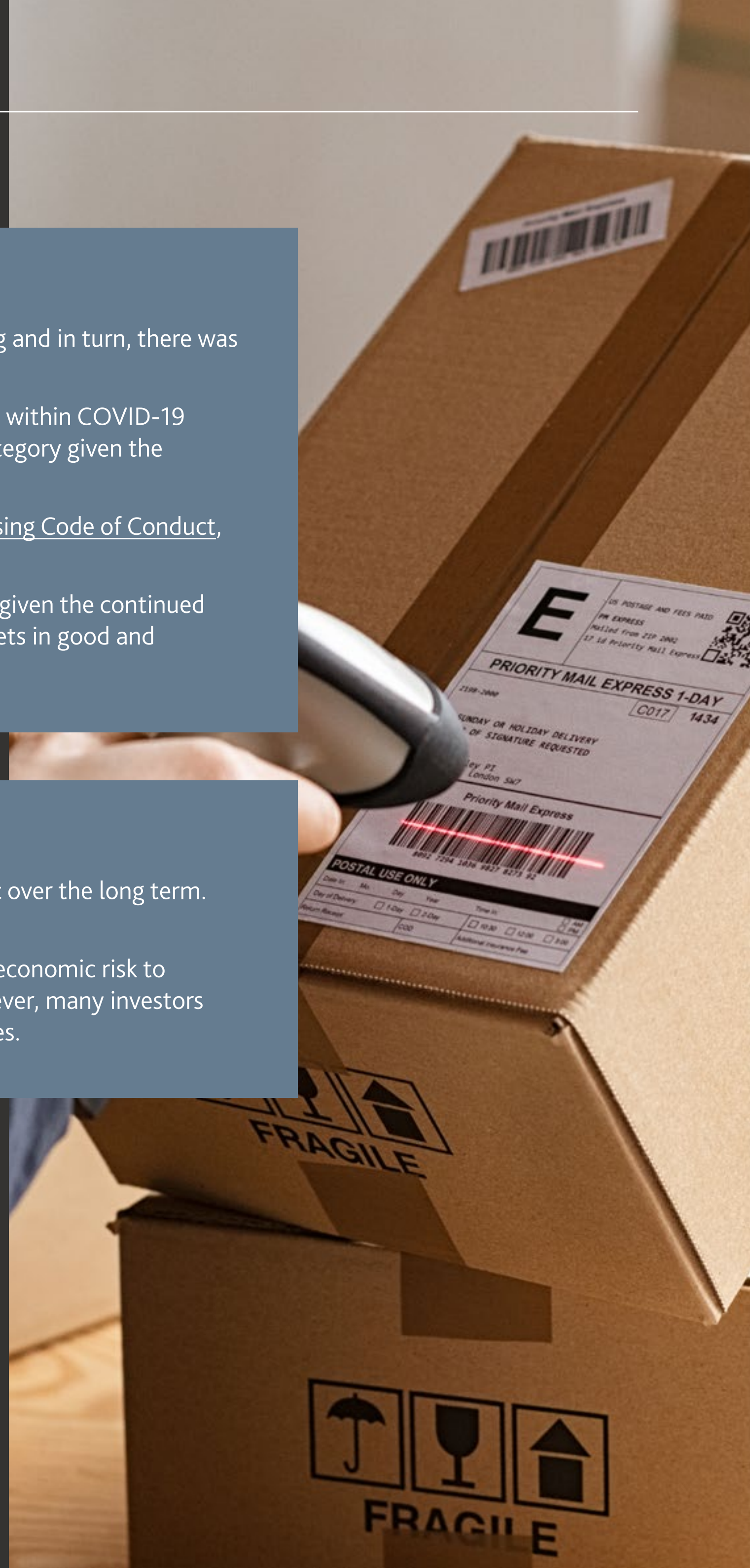
Juxtaposing the struggles of the retail sector category, the industrial sector category was a beneficiary of the push to e-commerce given the continued growth in returns (FY21: 41.4 per cent), extending the category's returns experienced in FY20. Evident in FY21 is that industrial assets in good and accessible locations remains paramount to providing supply chains solutions for the heighted demand driven by online shopping.

### 3. PLAYING THE LONG GAME

With the uptake of non-traditional "niche" assets, A-REITs will look to capitalise on the tailwinds brought forward by the pandemic over the long term. These include assets such as data centres, petrol stations, childcare, and hospitality (pubs and hotels).

Long term growth however is threatened by predicted rising interest rate and inflationary pressures, presenting the highest macroeconomic risk to A-REITs. UBS analysts predict that for every 1 per cent increase in interest rates, A-REITs will suffer a 4 per cent hit to profits. However, many investors may choose to turn to commercial real estate which provides rental growth through inflation-linked or fixed rental escalation leases.

SEBASTIAN STEVENS
PARTNER, ADVISORY



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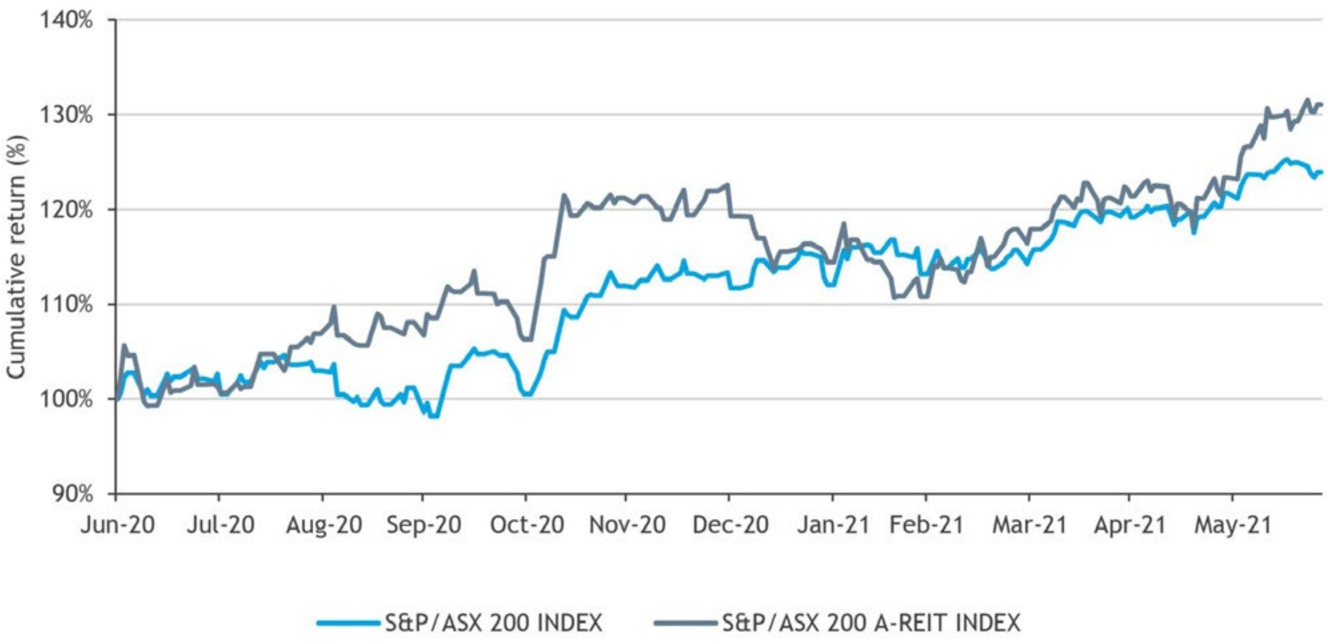
# KEY FINDINGS IN 2021

## A-REIT SECTOR PRICE RETURN

The S&P/ASX A-REIT 200 Index returned 31.0 per cent in FY21, outperforming the broader market index (S&P/ASX 200 Index) by 7.1 per cent. The A-REIT sector conducted a steady recovery during the fiscal year with sporadic lockdowns imposed by federal and state governments significantly dampening performance of the retail and office categories in Sydney and Melbourne. However, results of the US election and news of an incoming vaccine rollout bolstered stock prices over the December quarter.

### S&P/ASX A-REIT 200 ACCUMULATION INDEX VS S&P/ASX 200 INDEX

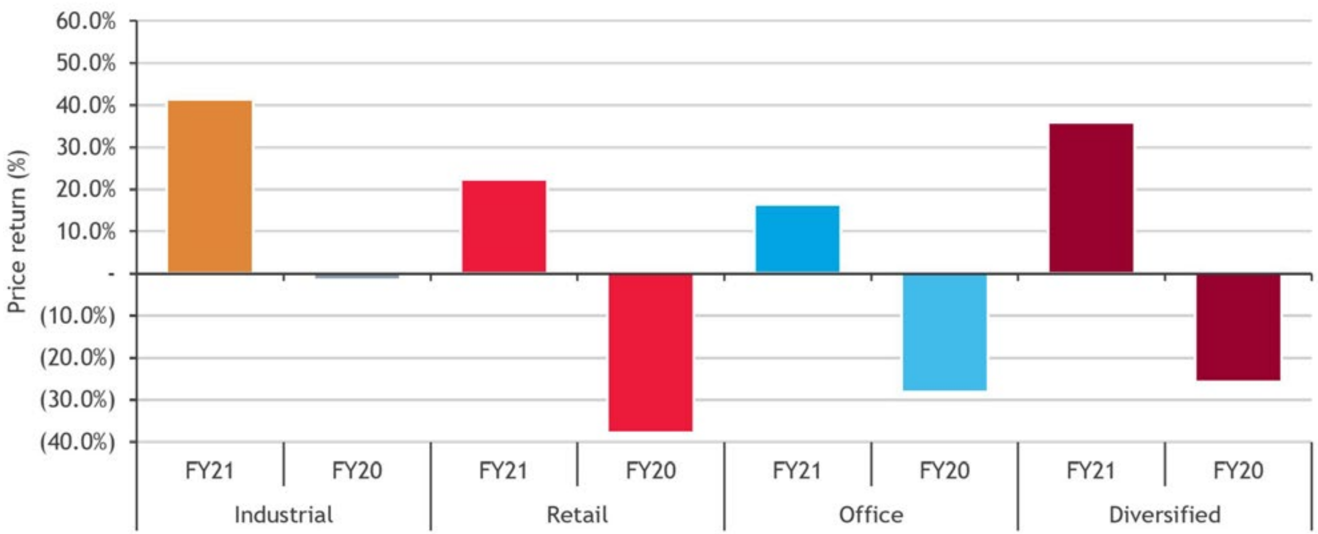



*Source: CapitalIQ and BDO analysis*

## INDIVIDUAL CATEGORY PERFORMANCE

All categories outperformed their FY20 result during FY21 with the industrial category performing the best with 41.4 per cent (FY20: -1.5 per cent), followed by diversified with 35.9 per cent (FY20: -25.7 per cent), retail with 22.4 per cent (FY20: -37.8 per cent), and office with 16.4 per cent (FY20: -28.2 per cent).

## 2020 A-REIT SECTOR PRICE RETURNS




*Source: CapitalIQ and BDO analysis*

## INDUSTRIAL

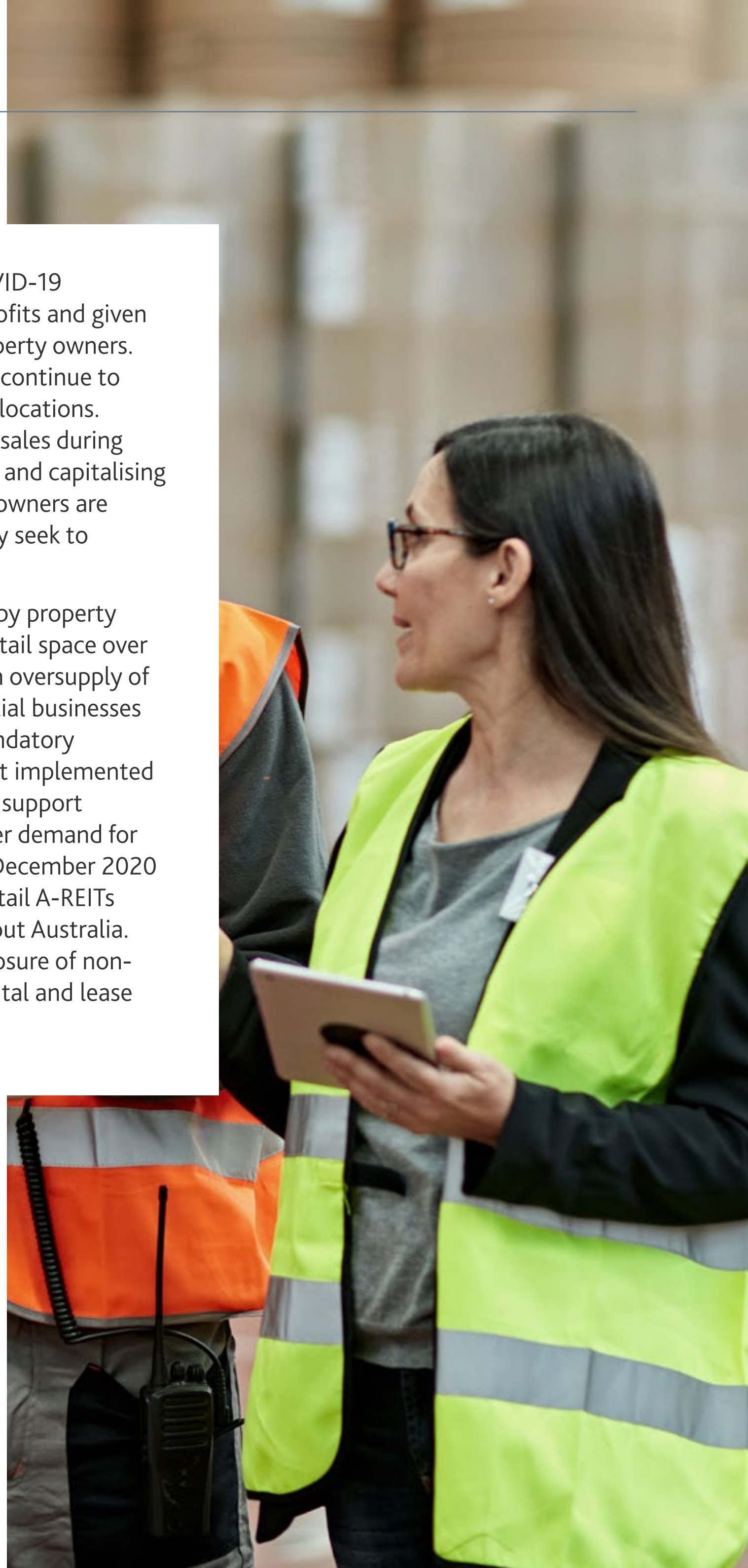
The overall demand for industrial facilities has increased from 2020 to 2021 due to demand from e-commerce growth and supply chain pressures. As occupier confidence returns to the market and the economy improves from COVID-19 induced lows, market rents are projected to rise. Increases in online shopping due to closure of retail shops has boosted demand for warehousing, transport, and logistics facilities. Moreover, business confidence coupled with low interest rates encouraged investment in more geared investments such as industrial property. Restrictions imposed by the Federal Government have limited downstream industrial property tenants' operations and demand leading to rental negotiations or lease terminations from less profitable tenants.

Decreases in total merchandise imports and exports has reduced the leasing of warehouse and distribution facilities for merchandise manufacturing and storage. This has the capacity to hinder future industry expansion. As business inventories increase and supply chains are stretched, industrial storage facilities and logistics operators will be able to leverage their bargaining power. Business inventories increased over FY21 as e-commerce and online retailing trended upward. However, other manufacturers, such as mining companies, have opted to build and operate their own on-site storage facilities. Rental yields and vacancy rates are projected to return to levels witnessed prior to the outbreak of the COVID-19 pandemic. Private investors are likely to be attracted to industrial A-REITs due to comparatively high investment yields and investment metrics such as the longer weighted average lease expiries (WALE) compared with commercial buildings.

## RETAIL

The retail sector has been severely affected by the COVID-19 pandemic. Specifically, lower foot traffic has limited profits and given cause for rental negotiations between tenants and property owners. As mentioned, online retailing and e-commerce trends continue to grow which has constrained demand for physical retail locations. Certain retailers, such as supermarkets, have bolstered sales during sporadic lockdowns by shifting to non-contact services and capitalising on consumers' inability to eat at restaurants. Property owners are predicted to refine their tenant selection criteria as they seek to maximise their respective WALE.

Low interest rates have increased capital expenditures by property operators, which in-turn increased supply of lettable retail space over FY21. This has adversely affected rental yields due to an oversupply of rental space. COVID-19 induced closures of non-essential businesses were overcome and retail trade improved after the mandatory closure policies were lifted and the Federal Government implemented business support packages and wage subsidies. Federal support packages and monetary policy have increased consumer demand for retail trade, thus increasing revenues for retailers. The December 2020 and March 2021 quarters saw a marginal recovery in retail A-REITs as news of the pending vaccine rollout spread throughout Australia. Although, this was somewhat negated by the forced closure of non-essential businesses forcing property operators into rental and lease negotiations with tenants.



## OFFICE

The outbreak of the COVID-19 pandemic led to interesting trends in the office sector of the A-REITs industry. Social distancing restrictions constrained industry demand as employees began working from home and employers were forced to adopt flexible working conditions for most of the workforce. Continually low RBA cash rates have driven transaction volumes and capital investment by industry operators, and investment by institutional investors such as superannuation funds rose over FY21 as capital markets recovered from the effects of the COVID-19 market disruption. Federal and state government implemented social distancing and work from home policies intended to limit the spread of COVID-19 resulted in many office facilities continuing to be partially operational during FY21, especially in Sydney and Melbourne. Tenants were able to leverage this in rental negotiations, which affected industry revenue. Lease terms were also the subject of negotiations in attempts to reduce costs.

Australia's economy has gradually shifted from a manual labour and industry-based economy to a service-based economy. This trend has driven demand for office spaces as most service economies do not own their office space. Although, low vacancy rates and lower rental yields during FY21 and FY20 due to COVID-19 have hindered profitability over the short term. Despite these changes, prime office locations in areas such as Sydney and Melbourne have experienced price growth throughout FY21. This, compounded with declining commercial building vacancy rates due to the number of non-manual labour employees in Australia rising, has contributed to expected increases in industry revenue forecasts over the next five years.

## PREMIUM/ DISCOUNT TO NET TANGIBLE ASSETS (NTA)

The median premium/ discount to NTA for A-REIT's in FY21 was 0.86 per cent. This premium to NTA has been driven by the recovery of the sector from the impact of COVID-19 depressing both shareholder returns and property valuations across the sector.

## GEARING LEVELS

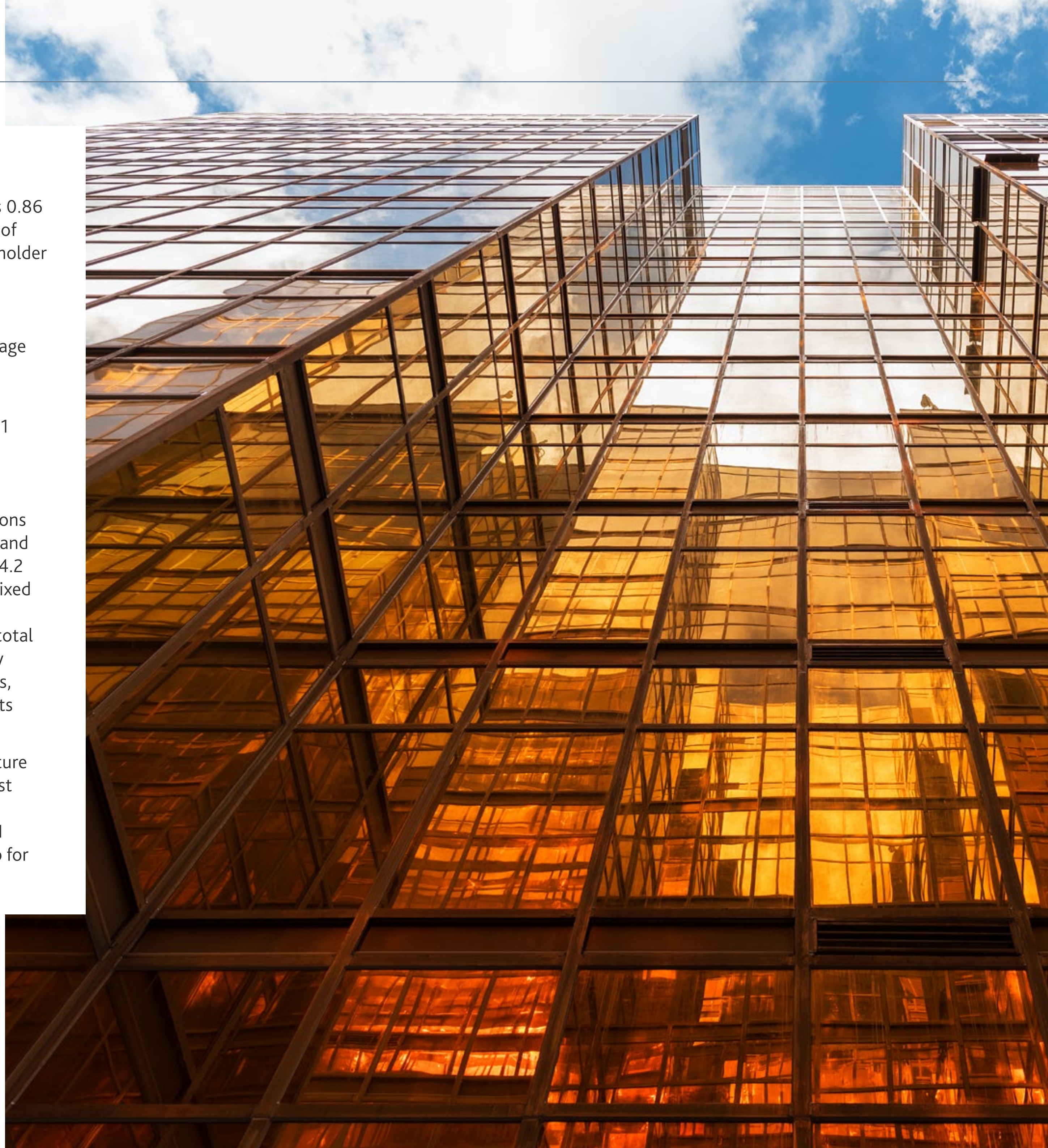
A-REITs continue to maintain lower gearing levels, with an average c.25 per cent gearing in FY21. This compares with the sectors long-term gearing levels of c.30 per cent.

The weighted average cost of debt for the A-REIT sector for FY21 is 2.5 per cent.

## CAPITAL RAISING

FY21 saw a flurry of deals flood the market with many transactions occurring in both the merger and acquisition space and in debt and equity capital raisings. The total amount of capital raised was $4.2 billion in FY21, with the largest transaction of the year being a fixed income debt raise by Unibail-Rodamco-Westfield valued at $1.1 billion. This figure is significantly lower than FY20 which saw a total of $11.6 billion raised through a combination of debt and equity raisings. Continued market uncertainty and stemmed cash flows, from decreased consumer activity, has led to market participants requiring capital to fund either transactions or operations.

Two notable transactions include Macquarie Group's Infrastructure and Real Asset (MIRA) investment arm acquiring the Vitalharvest Freehold Trust for $357.4 million, following a bidding war with Private Equity firm, Roc Partners, and Dexus' acquisition of APN Convenience Retail REIT through acquiring APN Property Group for $319.9 million.



# TOP 10 A-REITs 2021

# 01 CHARTER HALL GROUP

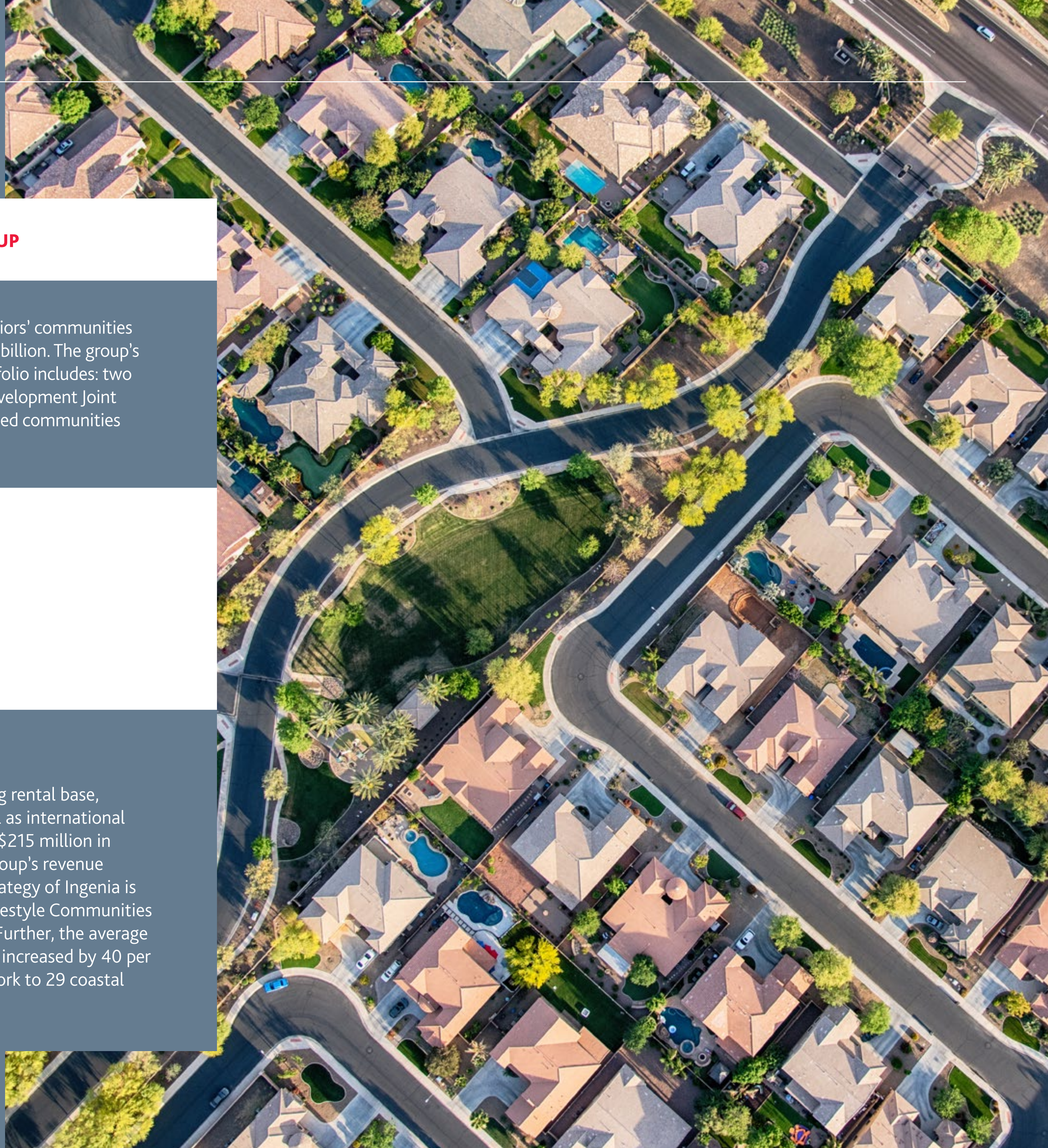
Charter Hall Group (ASX:CHC) is an integrated property group that manages listed and unlisted property funds on behalf of wholesale, institutional and retail investors. Assets within the portfolio are mixed, including office, industrial, retail, and social infrastructure, and the total property investment portfolio totals $2.4 billion.

Highlights:

- **65 per cent** one-year return
- **158 per cent** three-year return
- **240 per cent** premium to NTA
- **10 per cent** operating cash yield.

## ANNUAL REPORT INSIGHTS

Charter Hall Group has $52.3 billion in funds under management, which increased by 29.0 per cent over FY21. This makes the group the largest sector-diversified commercial property portfolio in Australia. The group's focus on resilient and defensive assets ensured that the business grew despite setbacks in various parts of the Australian economy. The group ensures the success of this strategy by partnering with large tenants and maximising continued business, evidenced by the fact that 76 per cent of tenants lease more than one property from the group. Over FY21, Charter Hall's property investment portfolio WALE has grown to 9.1 years as tenants look to extend favourable lease terms.



# 02 INGENIA COMMUNITIES GROUP

Ingenia Communities Group (ASX:INA) manages and develops seniors' communities and holiday parks. Ingenia has a market capitalisation of over $2.6 billion. The group's balance sheet portfolio consists of 90 communities. Ingenia's portfolio includes: two greenfield lifestyle community developments owned through a development Joint Venture with Sun Communities, Inc (NYSE:SUI); and nine established communities through the Group's managed funds.

Highlights:

- **14 per cent** operating cash yield
- **108 per cent** premium to NTA
- **39 per cent** one-year return
- **110 per cent** three-year return.

## ANNUAL REPORT INSIGHTS

Ingenia Group's financial performance was bolstered by a growing rental base, increased development, and a strong demand for domestic travel as international border closures forced Australians to holiday at home. A total of $215 million in new acquisitions during FY21 contributed to an increase in the group's revenue producing sites to 10,379, up 26 per cent from FY20. The core strategy of Ingenia is the residential communities business. Sales across the Ingenia Lifestyle Communities increased 17 per cent from FY20 to 380 new home settlements. Further, the average home sale price increased and revenues within the rental market increased by 40 per cent. The holiday and mixed-use portfolio has increased its network to 29 coastal parks and revenue increased by 38 per cent from FY20.

# 03 GOODMAN GROUP

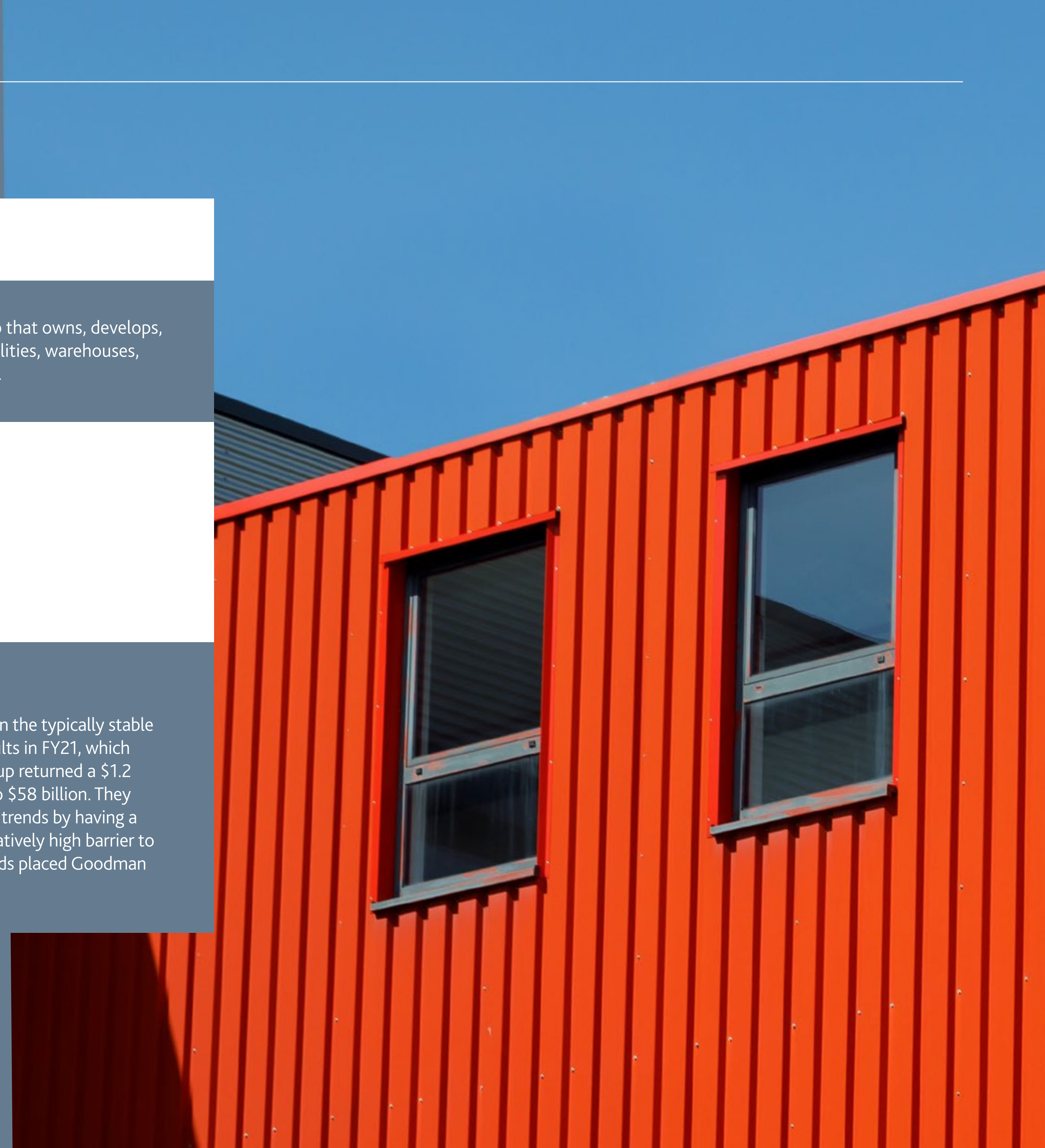
Goodman Group (ASX:GMG) is a global industrial property group that owns, develops, and manages modern industrial real estate including logistics facilities, warehouses, and business parks in strategic locations throughout 14 countries.

Highlights:

- **240 per cent** premium to NTA
- **129 per cent** three-year return
- **45 per cent** one-year return
- **9 per cent** operating cash yield.

## ANNUAL REPORT INSIGHTS

Goodman Group places a focus on being innovative and agile within the typically stable REIT sector. This has allowed them to maintain market leading results in FY21, which was an uncertain year filled with market disruption. Goodman Group returned a $1.2 billion operating profit and grew their assets under management to $58 billion. They maintained a strong position to capitalise on growing e-commerce trends by having a portfolio occupancy of 98.1 per cent. The industrial sector has a relatively high barrier to entry, and high occupancy rates combined with growing rental yields placed Goodman Group in good stead to take advantage of robust demand.



# 04 ARENA REIT

Arena REIT (ASX:ARF) is an internally managed trust which has a focus on sectors such as childcare healthcare, education, and government tenanted facilities. An emphasis is placed on maximising the portfolio WALE with the objective to generate strong, predictable distributions to investors. Their current portfolio contains over 240 social infrastructure properties housing a diverse range of tenants.

Highlights:

- **15 per cent** increase in NTA to $2.56
- **50 per cent** premium to NTA
- **71 per cent** one-year return
- **87 per cent** three-year return.

## ANNUAL REPORT INSIGHTS

Arena's strategy is to build a portfolio of long-term tenanted social infrastructure properties, exemplified by their 20.1 year WALE. This long-term focus combined with the sheer necessity for their tenant's services has allowed them to maintain strong results over a tumultuous FY20 and FY21. Moreover, the group completed $106 million of acquisitions and development during FY21. Arena's net operating profit increased by 18.5 per cent to $51.9 million during FY21, driven by contracted annual rent growth, acquisition of operating early learning centre properties, and completion of developmental projects.

# 05 ELANOR RETAIL PROPERTY FUND

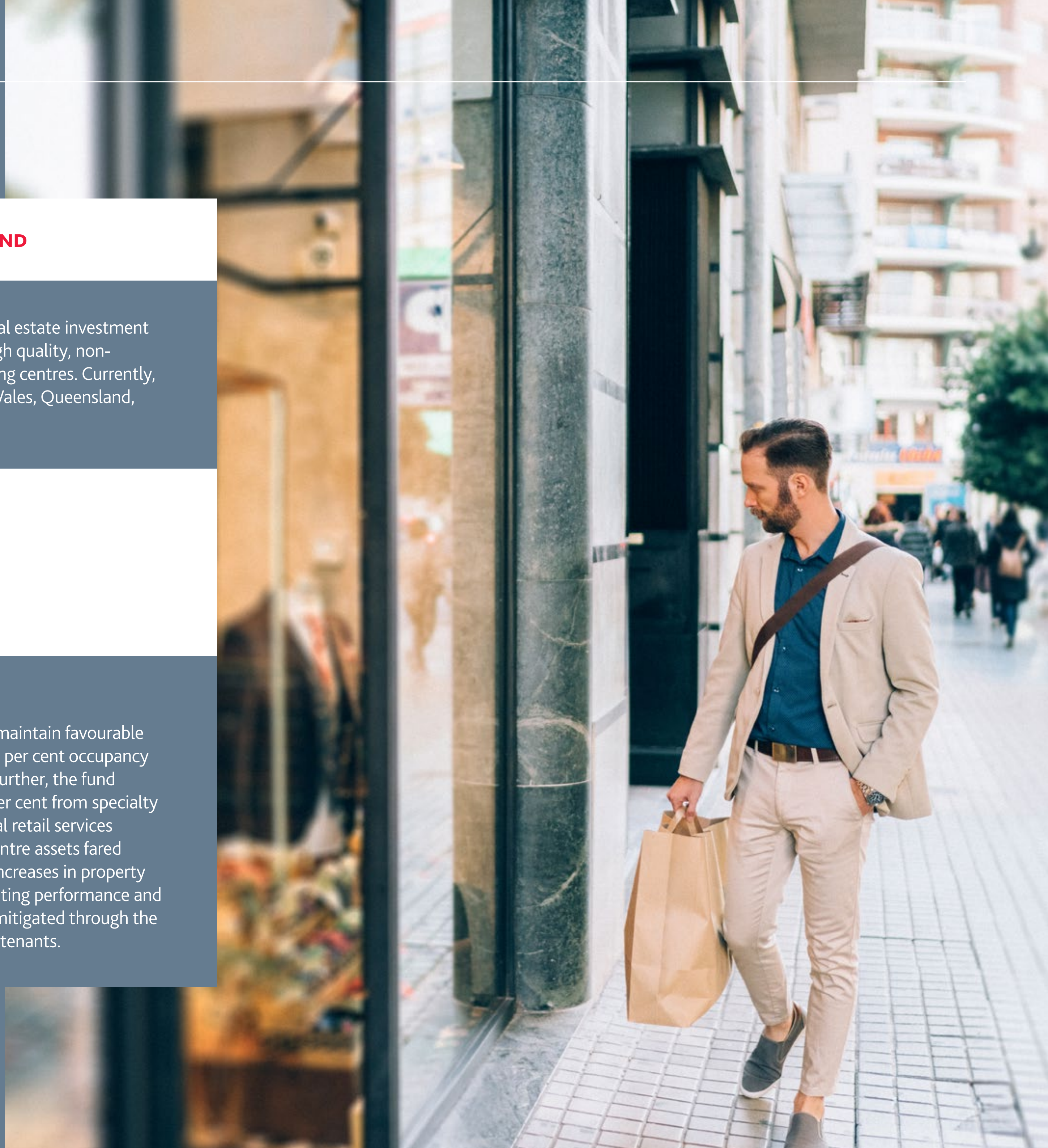
Elanor Retail Property Fund (ASX:ERF) is an externally managed real estate investment fund with a focus on Australian retail property. The fund targets high quality, non-discretionary retail-based neighbourhood and sub-regional shopping centres. Currently, the portfolio contains seven shopping centres within New South Wales, Queensland, and Tasmania.

Highlights:

- **18 per cent** distribution
- **100 per cent** tax advantaged distribution
- **34 per cent** one-year return.

## ANNUAL REPORT INSIGHTS

The fund focuses on maintaining high occupancy rates in order to maintain favourable and predictable distributions. This is exemplified by the fund's 95.3 per cent occupancy rate and 18 per cent distribution paid to unitholders during FY21. Further, the fund generates 46 per cent of its income from major retailers, and 48 per cent from specialty retailers. Although government mandated closures of non-essential retail services continued through FY21, the fund's focus on defensive shopping centre assets fared well given the geographic and non-discretionary diversity within. Increases in property valuations of 2.7 per cent to $215 million were due to strong operating performance and improved market sentiment. Risks associated with COVID-19 are mitigated through the fund's active portfolio management and regular engagement with tenants.



# 06 HOME CONSORTIUM

Home Consortium (ASX:HMC) is a fund manager investing in high conviction and scalable real estate assets. It is also the manager of the HomeCo Daily Needs REIT (AX:HDN) and HealthCo Healthcare and Wellness REIT (ASX:HCW). Home Consortium has a market capitalisation of approximately $2.3 billion and has $208 million in direct property investments and $32 million in co-investments.

Highlights:

- **87 per cent** one-year return
- **80 per cent** premium to NTA.

## ANNUAL REPORT INSIGHTS

Home Consortium had the largest one-year return in the sector, which is a testament to their strategy of owning and developing long duration assets. In addition to developing long duration assets, Home Consortium in the calendar year 2021 established and manages two ASX-listed vehicles in real estate sectors which have plenty of opportunity being exposed to global trends.

# 07 AVENTUS GROUP

Aventus Group Limited (ASX:AVN) is Australia's largest fully integrated owner, manager, and developer of large format retail centres. The group owns 19 centres nationally and has approximately $2.3 billion of assets under management with 591 retailer tenancies with an occupancy rate of 98.8 per cent.

Highlights:

- **26 per cent** increase in NTA to $2.69
- **32 per cent** premium to NTA
- **59 per cent** one-year return
- **61 per cent** three-year return.

## ANNUAL REPORT INSIGHTS

Aventus has four growth strategies: driving assets performance, maximising consolidation opportunities, maintaining a development pipeline, and maintaining a conservative capital structure. These foundations allow the group to optimise a diverse tenant mix, selectively acquire assets, identify and deliver value-enhancing opportunities, and diversify the debt profile of the company. These factors have driven growth during a period of uncertainty. Aventus delivered a net profit of $409.7 million, which was a 622.6 per cent increase on FY20. Much of this growth came from increases in valuation of investment properties driven by increased market sentiment in real estate assets.

# 08 STOCKLAND CORPORATION

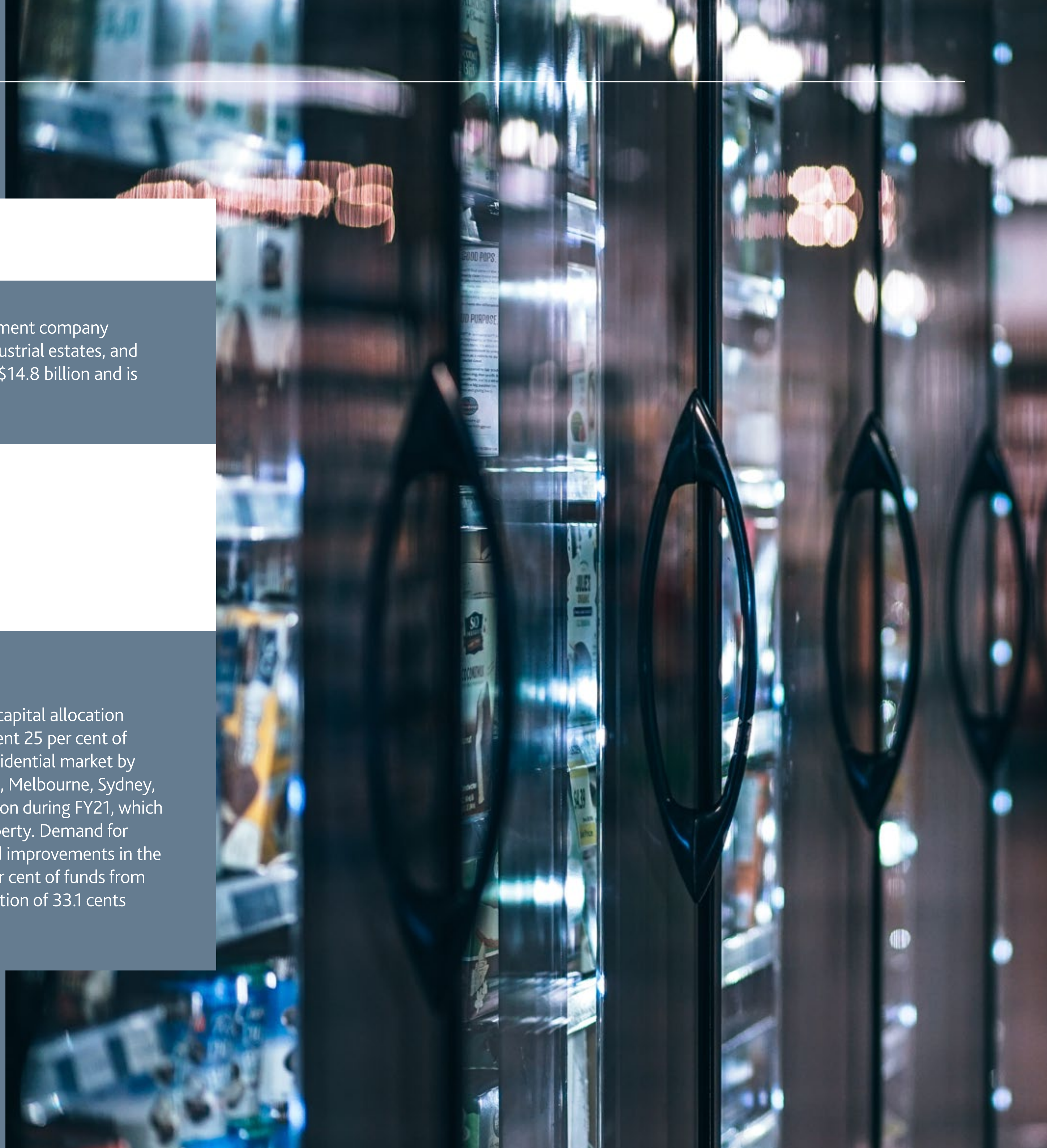
Stockland Corporation (ASX:SGP) is a diversified real estate investment company which has investments in shopping centres, residential estates, industrial estates, and retirement villages. Stockland's portfolio of 179 assets is valued at $14.8 billion and is located across the nation.

Highlights:

- **11 per cent** operating cash yield
- **48 per cent** one-year return
- **21 per cent** premium to NTA.

## ANNUAL REPORT INSIGHTS

Stockland employed strategic shifts during FY21 by increasing the capital allocation to logistics, life sciences, and technology assets, which now represent 25 per cent of the portfolio. Further, they have capitalised on the underserved residential market by providing approximately 12,000 lots across Southeast Queensland, Melbourne, Sydney, and Perth in FY21. Stockland returned a statutory profit of $1.1 billion during FY21, which was largely due to $432 million in revaluations in commercial property. Demand for Stockland's products were also driven by government stimulus and improvements in the overall Australian economy. This has led to Stockland paying 75 per cent of funds from operations as distributions to unitholders, culminating in a distribution of 33.1 cents per unit.



# 09 ASPEN GROUP

Aspen Group (ASX:APZ) is a leading provider of accommodation in the form of residential, retirement, and park communities. Aspen identifies Australia's significant demand for suitable, affordable accommodation as a major opportunity and a contributor to their sustained growth.

Highlights:
- **56 per cent** three-year return
- **38 per cent** one-year return
- **82 per cent** tax advantaged distribution.

## ANNUAL REPORT INSIGHTS

Aspen maximises the profitability and value of their properties by continually optimising the product and consumer mix based on demand, relative pricing and expenses, regulatory requirements, and capital costs. This strategy also diversifies the risk of their portfolio. FY21 posed many operating challenges, including Woodside Petroleum's lease expiry at the Aspen Karratha Village. These challenges were managed by pivoting the traditional holiday cabins between short and long stay leases, improving property amenities, and reducing costs. This led to an increase in statutory net profit after tax of 114 per cent from FY20, which in turn allowed the group to increase distributions by 10 per cent to 6.60 cents per unit.

# 10 MIRVAC GROUP

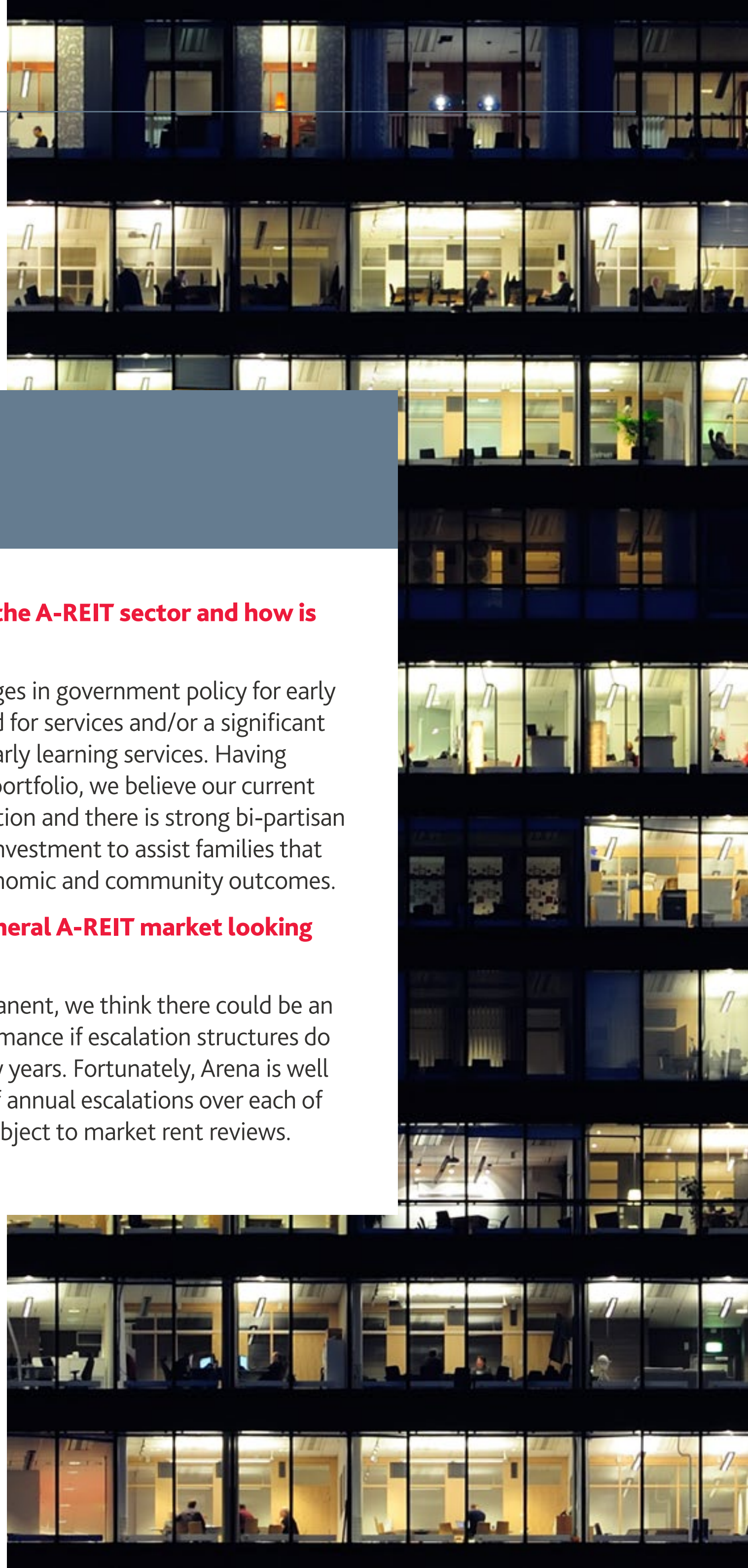
Mirvac Group (ASX:MGR) is an Australian property group which owns and manages assets across the office, industrial, retail, and build to rent sectors. Currently, Mirvac Group has $25 billion of assets under management. The group has an integrated approach which exposes them to the entire lifecycle of a project from construction through to management and long-term ownership.

Highlights:

- **39 per cent** one-year return
- **49 per cent** three-year return
- **12 per cent** premium to NTA
- **59 per cent** tax advantaged distribution.

## ANNUAL REPORT INSIGHTS

Mirvac was able increase their operating profit to $550 million which allowed the group to pay a distribution per stapled security of 9.9 cents. A point of pride within the group is their ability to pivot their operations to suit a more environmentally conscious world. This is evidenced by Mirvac reducing their carbon footprint by over 80 per cent during the financial year. This feat was completed because most of the office and retail assets within the portfolio are now powered by renewable energy. Mirvac's flexibility as a group is further evidenced by their response to the COVID-19 pandemic. Prudent capital management allowed Mirvac to exceed estimations on returns per stapled security by 9 per cent.



# A-REIT INSIGHTS

**ARENA REIT**

Samantha Rist – Head of Investor Relations and Sustainability

### What does Arena REIT attribute its stellar performance in FY21 to?

Arena's portfolio exclusively invests in social infrastructure properties which accommodate tenant partners who deliver essential services to Australian communities. These essential services continued to trade and pay rent throughout the pandemic, which provided Arena a relative comparative advantage to traditional office and retail landlords. Investors have also been attracted to Arena's long contracted lease profile of over 20 years; the fact that the portfolio has been 100 per cent occupied for over six years consecutively and has delivered annual like-for-like rent increases of three per cent per annum over this period. These strong and consistent portfolio metrics, even during the pandemic period, are an outcome of a consistent team focus on achieving our investment objective. This being, delivering our investors a predictable distribution with the prospect of growth over the medium term.

### What learnings have come from the pandemic for Arena REIT and how has general sentiment shifted this year compared to last?

Having a strong team culture, and positive relationships with our business stakeholders, particularly our tenant partners, provided an early comparative advantage for Arena. We were able to understand the pressures on the services that we accommodated early in FY21. Investor sentiment has changed from interest in rent collection to: how does the business perform in a re-opening environment, do consumers act differently, what does that mean for underlying demand of the services Arena accommodates?

Pleasingly, early indications are positive and with extra government funding for early learning announced by the federal government, we anticipate increased demand for services. Additionally, in an acceleration of the pre-existing theme of social impact, we are seeing investor expectations increase for portfolios like Arena's.

### What are the key macroeconomic risks for the A-REIT sector and how is Arena REIT positioned to respond?

The key macro risks for Arena are negative changes in government policy for early learning. This may lead to a reduction in demand for services and/or a significant net new supply response of healthcare and/or early learning services. Having developed more than a third of Arena's current portfolio, we believe our current portfolio is well positioned for any new competition and there is strong bi-partisan government interest in increasing government investment to assist families that use early learning services to provide better economic and community outcomes.

### Are there any other observations on the general A-REIT market looking forward that you are able to share?

Whether inflation is transitionary or more permanent, we think there could be an interesting divergence of long WALE REIT performance if escalation structures do not capture increased inflation over the next few years. Fortunately, Arena is well positioned in this regard with over 91 per cent of annual escalations over each of the next three years being either CPI linked or subject to market rent reviews.

## ASPEN GROUP

John Carter – Joint Chief Executive Officer

**What does Aspen Group attribute its stellar performance in FY21 to?**

There were a number of factors that contributed to the strong performance in 2021. We focussed our asset management team to do more development within the portfolio and also improved our sales efforts which led to a 220 per cent increase in development and trading profits. Our development profits as a percentage of total profits are still modest. We diversified the type of accommodation assets by adding more residential which did well during COVID-19 and reduced the impact of tourism assets. We pivoted between short- and long-term tenants in our cabins at our Tourism Parks during COVID-19 to improve cashflow. We were able to acquire assets with attractive return prospects over the previous 2 years, and we held net corporate overheads steady despite upgrading the team.

**What learnings have come from the pandemic for Aspen Group and how has general sentiment shifted this year compared to last?**

Our approach of having residential, retirement and parks communities positions us well for shocks if they occur. We need to be nimble to react to changes in market conditions. Residential and retirement assets have been very resilient. A strong residential market has led to increases in prices for our retirement houses. Finally, even though there is a large amount of capital available for assets we have still been able to acquire assets at attractive prices.

**What are the key macroeconomic risks for the A-REIT sector and how is Aspen Group positioned to respond?**

There are signs of inflation especially in labour costs and building materials due to shortages of labour and supply chain issues. At Aspen Group, we have been able to increase prices and rents so far so that margins have been maintained. Low unemployment, which we expect to continue to lower in 2022, makes hiring employees and contractors more difficult and expensive. As a result of this, it has been challenging in some markets to hire employees and contractors. We have been able to do so but often we have had to increase the rates paid. We have also added new components to our employment packages to retain managers and head office staff.

There is likely to be a government response to reduce housing price growth so that affordability does not worsen. Aspen Group is well positioned with lower price points and rents than most of our competitors as we have purchased properties with lower site values which builds in a buffer for changes in prices. Therefore, we can often get an uplift on the site value and a profit on the home sale as we have purchased well.

**Are there any other observations on the general A-REIT market looking forward that you are able to share?**

Some real estate including some parts of retail and commercial are going through massive disruption presently. In the next year or so we should see the end of capitalisation rate compression at the same time interest rates are rising. We believe that moving forward, there will be strong demand for alternatives including our accommodation focus as alternatives are only a small proportion of the Australian REIT market.

# MACRO OVERVIEW

FY21 contained plenty of uncertainty and volatility as outbreaks of COVID-19 caused government implemented lockdowns throughout the country. Anticipation of the nation-wide vaccine rollout has bolstered confidence within the office and retail sectors as foot traffic gradually increases. Moreover, e-commerce trends have strengthened the foundations of the industrial A-REIT sector as supply chain constraints demand efficient logistics and warehouse services.

Global pressures such as investment from overseas institutions and supply chain issues are causing global shortages in a variety of products. Well-managed A-REITs are positioned to benefit from these trends as they are a relatively stable asset class with a lower risk profile than that of other assets. As a result, the current macroeconomic backdrop presents a challenge in the pricing of A-REITs and any future acquisitions in determining how occupancy rates and future rent assumptions will be impacted by these factors. In FY21, the Australian economy was faced with falling consumer confidence caused by COVID-19. In response, the Reserve Bank of Australia continued to lower interest rates to record lows. This bodes well for the attractiveness of A-REITs as an investment class, as RBA Governor Phillip Lowe has stated that he “finds it difficult to understand why rate rises are being priced in next year or early 2023” however, a rate hike in late 2023 and 2024 is plausible.

Our view that interest rates present the biggest threat to A-REITs remains, as any future increases in bond yields will have adverse impacts on discount rates, cost of debt, and earnings. Recent government bond selloffs have shaken inflation vulnerable sectors such as over-leveraged A-REITs. Further, A-REITs will be the most vulnerable to increases in interest rates as rental moratoriums and favourable lease covenants are ended. As predicted by UBS analysts, for every 1 per cent increase in interest rates, A-REITs will suffer a 4 per cent hit to profits as many have increased levels of c.30 per cent. Our analysis has noted that the current average across the sector for FY21 is c.25 per cent. The yield on the 10-year Australian Government bond reached 0.73 per cent on 30 June 2021, up from pandemic lows of 0.60 per cent in March 2020.

# EXPLANATION OF CRITERIA AND RANKING

## 1 EXPLANATION OF CRITERIA AND RANKING

A brief explanation of each criterion used to rank REITs in the 2021 Survey is provided below.

### 1.1 FINANCIAL CRITERIA

- **Operating cash yield on average net assets**

  Calculated by dividing operating cash flow (including interest expense); by the average of opening and closing net assets for the period.

  The financial year end of the entity has been used in all cases, except for 31 December entities where 30 June 2021 figures have been sourced from half year reports.

  Where accounts have been prepared for a period of less than one year, the operating cash measure has been annualised.

- **Distribution return on investment**

  Calculated by dividing the distribution per Security paid for the entity's financial year by the average ASX price of the Security through the year. The average ASX price is calculated on a daily closing price basis, with prices sourced from S&P Capital IQ.

  Where accounts have been prepared for a period of less than one year, the distribution has been annualised.

- **Tax deferred distribution component**

  The percentage of the total annual distribution from each entity which is tax deferred.

  Where this information was not disclosed in the annual report, BDO attempted to obtain the detail required from other sources.

- **Movement in NTA per security**

  Calculated by assessing the percentage increase (or decrease) in NTA per Security over the entities' financial year by using the opening and closing figures for NTA per Security.

  Where an entity was listed during the year, BDO has assessed the opening NTA as being equal to the issue price.

  In all cases the financial year end of the entity has been used, except for 31 December year ends where we have used NTA from the 30 June 2020 and 2021 half year reports.

- **Premium/ discount to NTA**

  Calculated by subtracting the average of NTA per Security (being opening NTA plus closing NTA divided by two) from the average ASX price per Security and dividing this by the average NTA per Security.

  We have ranked entities trading at a premium to NTA as having the highest ranking in this metric.

### 1.2 INVESTMENT CRITERIA

- **Total return**

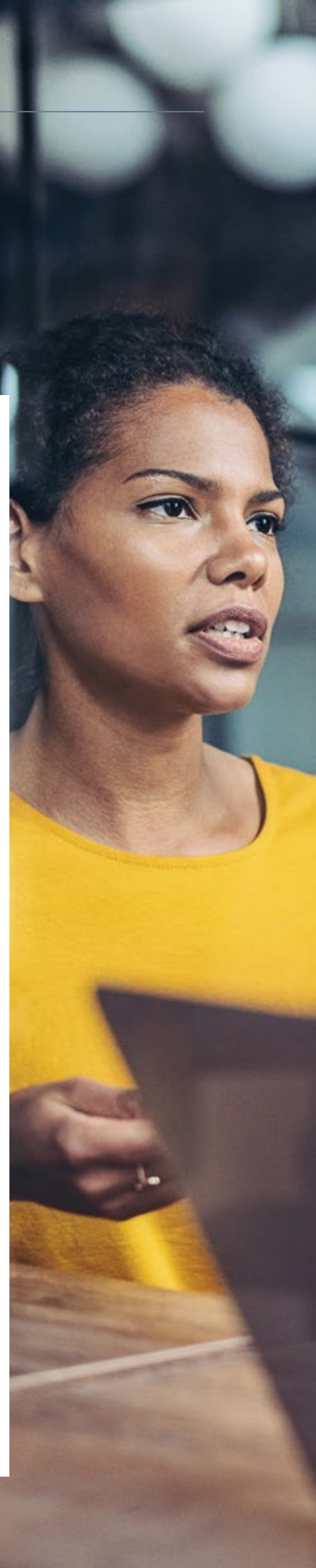
  This measure, over both the one year and three years to 30 June 2021, records both the income return (i.e. distributions) and capital appreciation (i.e. movement in ASX price).

  Information sourced from the ASX has been used to compile this criterion.

- **Volume of trading on ASX (liquidity)**

  This liquidity measure is expressed as a percentage and is calculated by dividing the total volume of Securities traded in each entity for the year ended 30 June 2021 by the weighted average total number of Securities on issue.

  This provides an indication of relative liquidity, irrespective of entity size.



## 1.3 METHOD OF RANKING

A total score of 100 (maximum) has been used, comprising 65 points for financial criteria and 35 points for Investment criteria. In determining the final rankings, the scores on each component were aggregated (not the rankings) such that the relative performances within each criterion are maintained in determining the overall rankings.

- **Financial criteria**

  The tests used in the financial criteria and assigned weightings are as follows.

| FINANCIAL CRITERIA | SCORE |
|---|---|
| | **2021** |
| Operating Cash Yield (on net assets) | 15 |
| Movement in NTA | 15 |
| Premium/Discount to NTA | 15 |
| Distribution Yield | 10 |
| Tax Deferred Distribution Percentage | 10 |
| **PERFECT SCORE** | **65** |

  In each of the above tests the scores were scaled so that the top performer in each test received the maximum available score for that criterion. Rankings were then assigned based on the scaled scores.

- **Investment criteria**

  The tests used in the investment criteria and assigned weightings are as follows.

| INVESTMENT CRITERIA | SCORE |
|---|---|
| | **2021** |
| Total Return (One Year) | 20 |
| Total Return (Three Year) | 10 |
| Volume of Trading on ASX | 5 |
| **PERFECT SCORE** | **35** |

  The above tests have been ranked using a variable points system for each test, based on the number and importance of aspects considered. In each of the tests, the scores were scaled so that the top performer in each test received the maximum available score for that criterion. Rankings were then assigned based on the scaled scores.

- **Median results**

  For an entity which could not be scored equitably in a particular metric, due to its recent listing, the unique nature of an entity's activities, or lack of available information for the relevant criteria, that entity was allocated a median result for the purpose of ranking. This ranking was then weighted and scored as usual. For all such instances 'N/A' appears in the result column for the individual criteria tables.

# ABOUT BDO IN AUSTRALIA

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