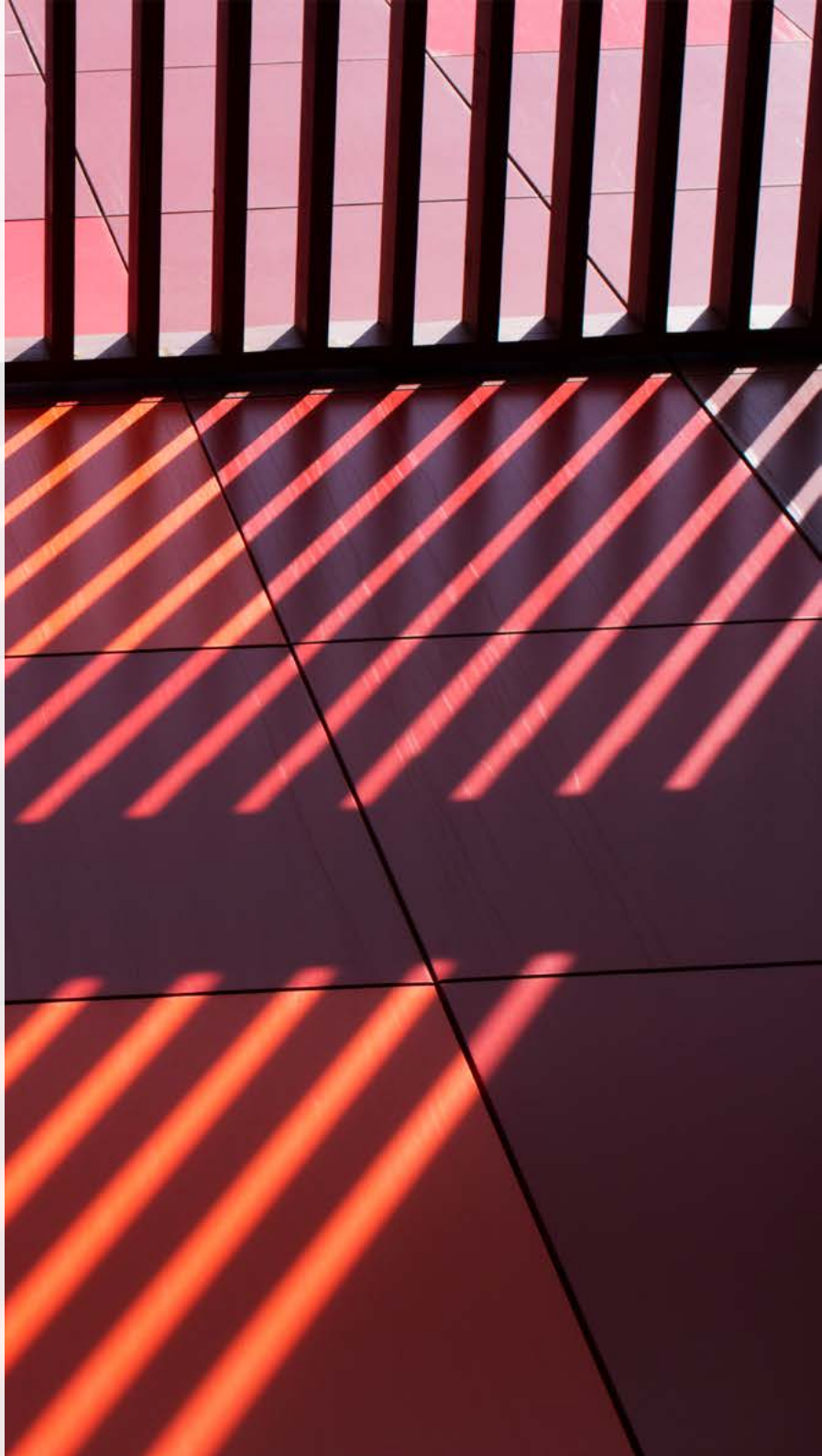
BDO

A-REIT SURVEY 2019

SHAPESHIFTING SHAKES UP THE SECTOR

FINDINGS FROM BDO'S 25TH ANNUAL SURVEY OF AUSTRALIAN REAL ESTATE INVESTMENT TRUSTS

CONTENTS



SHAPESHIFTING SHAKES UP THE SECTOR

FINDINGS FROM BDO'S 25TH ANNUAL SURVEY OF AUSTRALIAN REAL ESTATE INVESTMENT TRUSTS

Since its inception 25 years ago, the annual analysis of Australian Real Estate Investment Trusts (A-REITs) has provided investors and the financial market with insights into the sector as an asset class. Today, there are 39 A-REITs listed on the Australian Securities Exchange (ASX). They continue to offer an opportunity for investors to directly access the commercial real estate market and are a popular investment due to their liquidity, stable yields, potential for capital growth, and diversification of asset types.

Record low interest rates combined with high quality, diverse property portfolios has allowed A-REITs to withstand market volatility and outperform the S&P/ASX 200 Index by 6.2 per cent, generating a price return of 13.4 per cent over the FY19. This result is in-line with the 2018 financial year (FY18), which delivered a 13.2 per cent return.

The industrial category continues to be the best performing in FY19, with an overall return of 55.8 per cent - more than double that of the previous year.

The growth of Ecommerce and its reliance on quick dispatch and delivery, has been a huge driver for the appeal of the category for investors.

Industrial REIT returns were driven by the strength of their portfolios, with high quality assets in urban corridors commanding strong rents.

Retail was the poorest performing A-REIT category in FY19, with an overall return of negative 13.0 per cent. Affected by shifting consumption trends, retail REITs strive to remain competitive through diversifying their tenancy mix and integrating online shopping into their bricks and mortar business models.

Office REITs returned 28.5 per cent in FY19. Blue-chip corporate and government tenants, high occupancy rates and strong rental growth has contributed to this result.

Debt and equity capital markets remained active in FY19, with $10.0 billion raised in support of earnings accretive acquisitions and the consequential impact on gearing profiles.

Average sector gearing continues to sit at c30 per cent, with the weighted average cost of debt decreasing from 3.8 per cent in FY18 to 2.1 per cent in FY19 off the back of all-time low bond yields and interest rates. This was an additional factor contributing to the strengthened earnings performance for A-REITs in FY19.

BDO has consulted with the senior management of this year's top performing A-REITs as they reflect on the previous 12 months, and the challenges they foresee going forward.

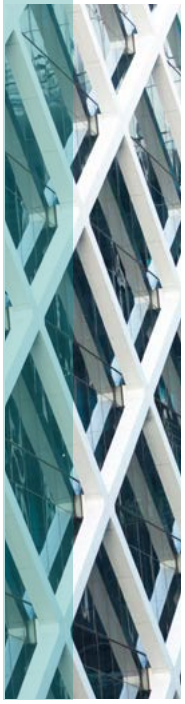
We thank all those trusts who engaged with us to complete this year's survey and especially those who shared their insights into their performance and the outlook for the A-REIT sector.

SEBASTIAN STEVENS
National Leader, Real Estate and Construction

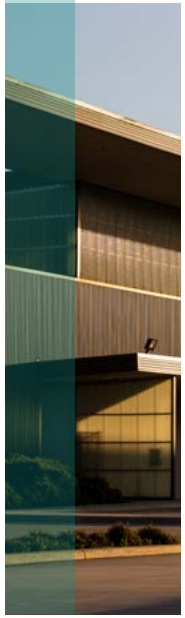
2019 A-REIT RANKINGS

01 GOODMAN GROUP

02 CHARTER HALL GROUP

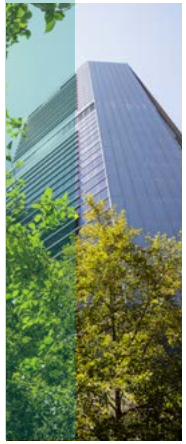


03 NATIONAL STORAGE REIT



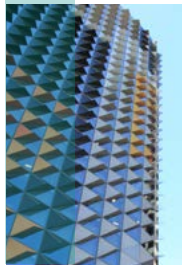
04 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP

05 DEXUS



06 GARDA DIVERSIFIED PROPERTY FUND

07 CROMWELL PROPERTY GROUP



08 MIRVAC GROUP

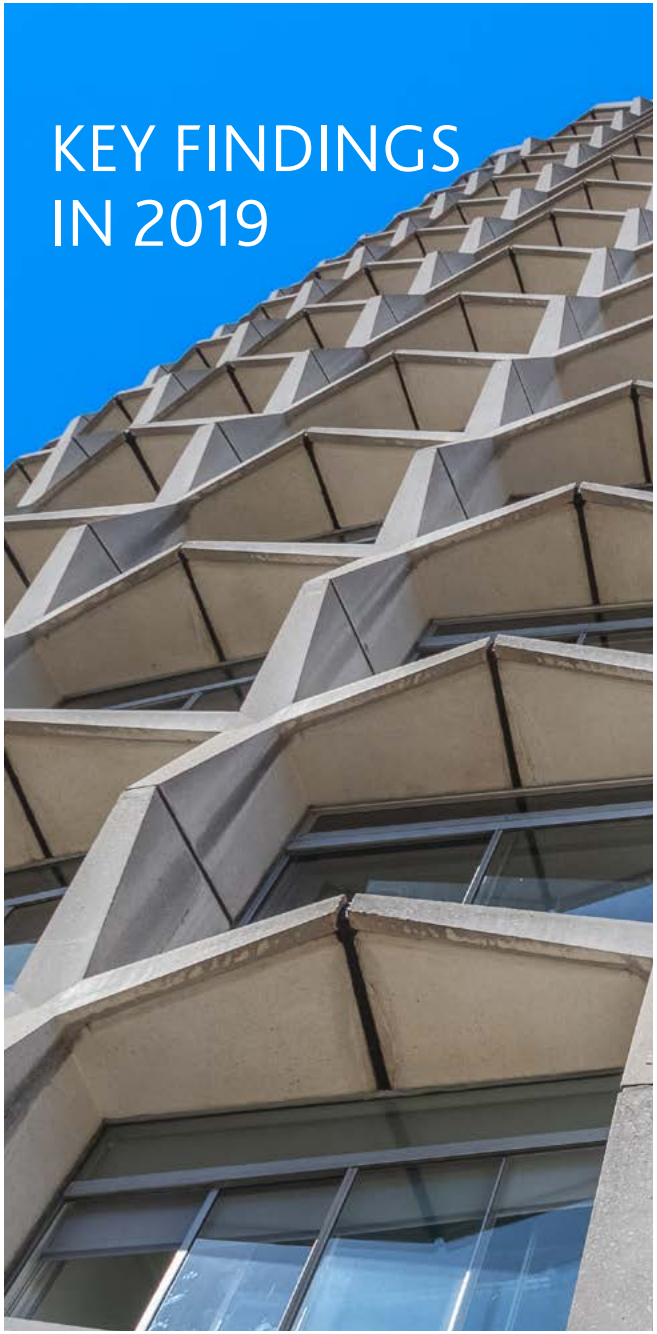
09 RURAL FUNDS GROUP

10 CENTURIA INDUSTRIAL REIT

2019 A-REIT RANKINGS

11	GROWTHPOINT PROPERTIES AUSTRALIA
12	ARENA REIT
13	GPT GROUP
14	AUSTRALIAN UNITY OFFICE FUND
15	CHARTER HALL RETAIL REIT
16	CENTURIA METROPOLITAN REIT
17	VICINITY CENTRES
18	STOCKLAND
19	ALE PROPERTY GROUP
20	INGENIA COMMUNITIES GROUP
21	SCENTRE GROUP
22	GDI PROPERTY GROUP
23	CHARTER HALL EDUCATION TRUST
24	APN CONVENIENCE RETAIL REIT
25	APN INDUSTRIA REIT
26	VIVA ENERGY REIT
27	ABACUS PROPERTY GROUP
28	ELANOR RETAIL PROPERTY FUND
29	BWP TRUST
30	CHARTER HALL LONG WALE REIT
31	HOTEL PROPERTY INVESTMENTS
32	AVENTUS RETAIL PROPERTY FUND
33	CARINDALE PROPERTY TRUST
34	US MASTERS RESIDENTIAL PROPERTY FUND
35	ASPEN GROUP
36	BLACKWALL PROPERTY FUND
37	BLACKWALL PROPERTY TRUST
38	QUATTRO PLUS
39	UNIBAIL-RODAMCO-WESTFIELD

Note: Total number of A-REITs ranked in the BDO A-REIT 2019 Survey has decreased from 41 in FY18 to 39 in FY19 following a number of de-listings in the year.

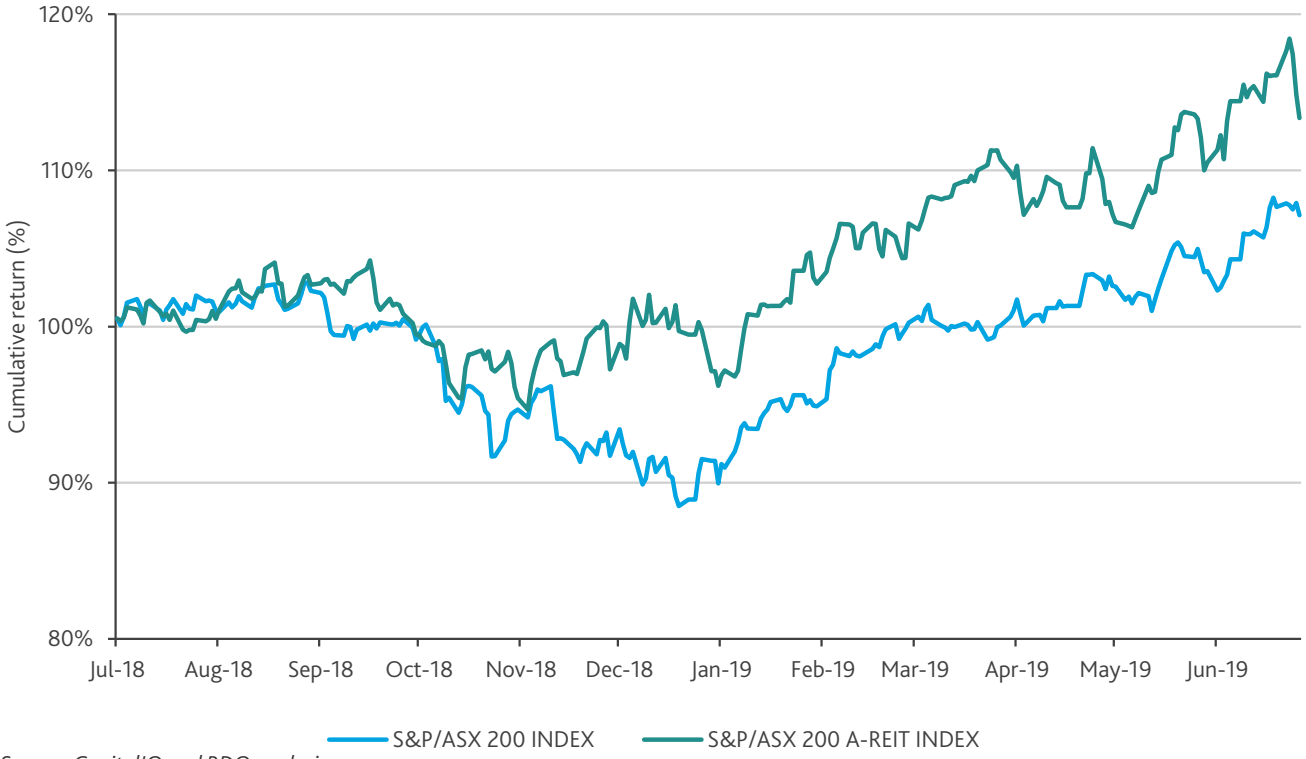


KEY FINDINGS IN 2019

A-REIT SECTOR RETURN

The S&P/ASX A-REIT 200 Index returned 13.4 per cent in FY19, outperforming the broader market index (S&P/ASX 200 Index) by 6.2 per cent. The broader market experienced a correction in December 2018 following the ongoing US-China trade tensions and the correction in the Technology, Media and Telecommunication sector.

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

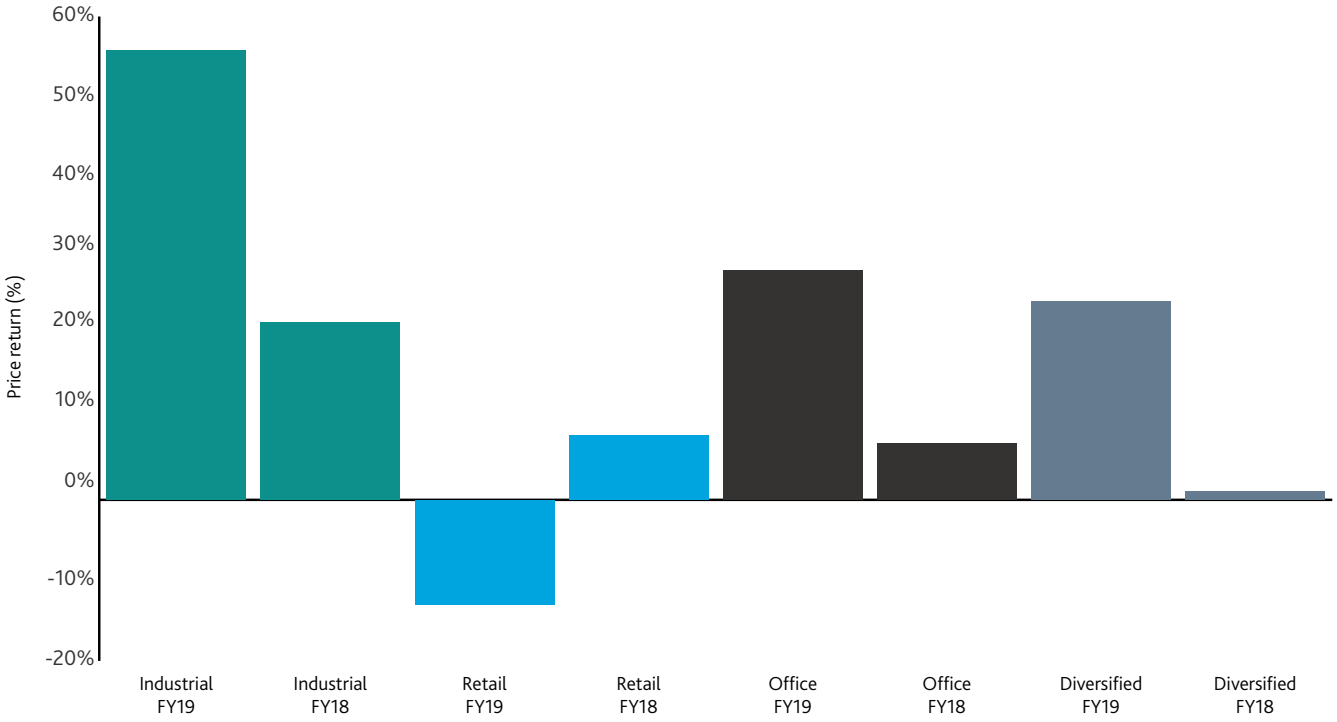


Source: CapitalIQ and BDO analysis

INDIVIDUAL CATEGORY PERFORMANCE

The industrial category delivered a 55.8 per cent price return over the 12 months to 30 June 2019, more than double the price return for the same period last year. The retail category was the poorest performing, delivering a negative 13.0 per cent return.

2019 A-REIT SECTOR PRICE RETURNS



INDUSTRIAL

The industrial category was the strongest performing and fastest growing in FY19. Industrial property demand was driven by the e-commerce boom, which has transformed logistics assets across Australia. Industrial REITs are forecasting this demand to continue and are adjusting their portfolios accordingly. Stockland, a diversified REIT saw the potential for earnings growth in the industrial category and increased their capital allocation to logistic and office assets.

A number of investors are increasing their exposure, with a surge in speculative industrial development along the Australian east coast.

Others seized opportunities created by the falling retail category. In an unprecedented move, Dexus (ranked 5th in this year's BDO A-REIT Survey) acquired retail centre space in Sydney, with plans to convert it for industrial use. This is a trend led by the United States, whereby demand for logistics and warehouse space is achieved by taking advantage of retail's prime position in the middle-rings of capital cities.

Goodman, which has a pure industrial play and total assets under management of $48 billion topped the 2019 Survey.

RETAIL

This year the retail category performed poorly, relative to others. Favourable conditions presented for industrial REITs, are adversely affecting retail tenants, who are burdened by the ongoing shift towards the convenience of online shopping. Those worst affected have shopping centres in low populated regional areas. However some REITs, namely those well-positioned in urban areas are taking an innovative approach by reconfiguring store fronts to be smaller, allowing the remaining space to act in a warehouse/distribution capacity.

With sluggish sales and changing delivery demands, retailers are looking to reconfigure stores to reduce the size of the shop front, and reuse the space for processing and dispatching orders for fast local delivery. There is also a continued trend for shopping centres and larger format retail sites to become 'experience/living centres' which incorporate activities such as gyms and fitness centres, healthcare, co-working areas, fine dining options and accommodation.

OFFICE

Australia's vulnerability to a tense global economy has not impacted office REITs overall returns as the office market continues to benefit from high occupancy rates, secured by high quality corporate and government tenants. Demographic shifts with an ageing population are seeing a growing number of health and aged-care providers requiring commercial office space.

The rise of co-working and agile workspaces has had an impact on the office market as traditional corporate tenants reconfigure their floor plans.

With changing needs affecting the types of spaces in demand, REITs are searching for investments that offer long-term value, such as those where rental income is sustained over a long period – or those that will secure yields from overseas investors. As a consequence, REITs are leveraging off a strong change towards social infrastructure, particularly in the education category and other private institutions who require commercial office space. This is creating the need for specialised, high quality commercial office space such as data centres and research labs.

Premium/discount to Net Tangible Assets (NTA)

The median premium to NTA for A-REITs in FY19 was c13%. Driven by the strong returns delivered from the industrial A-REITs.

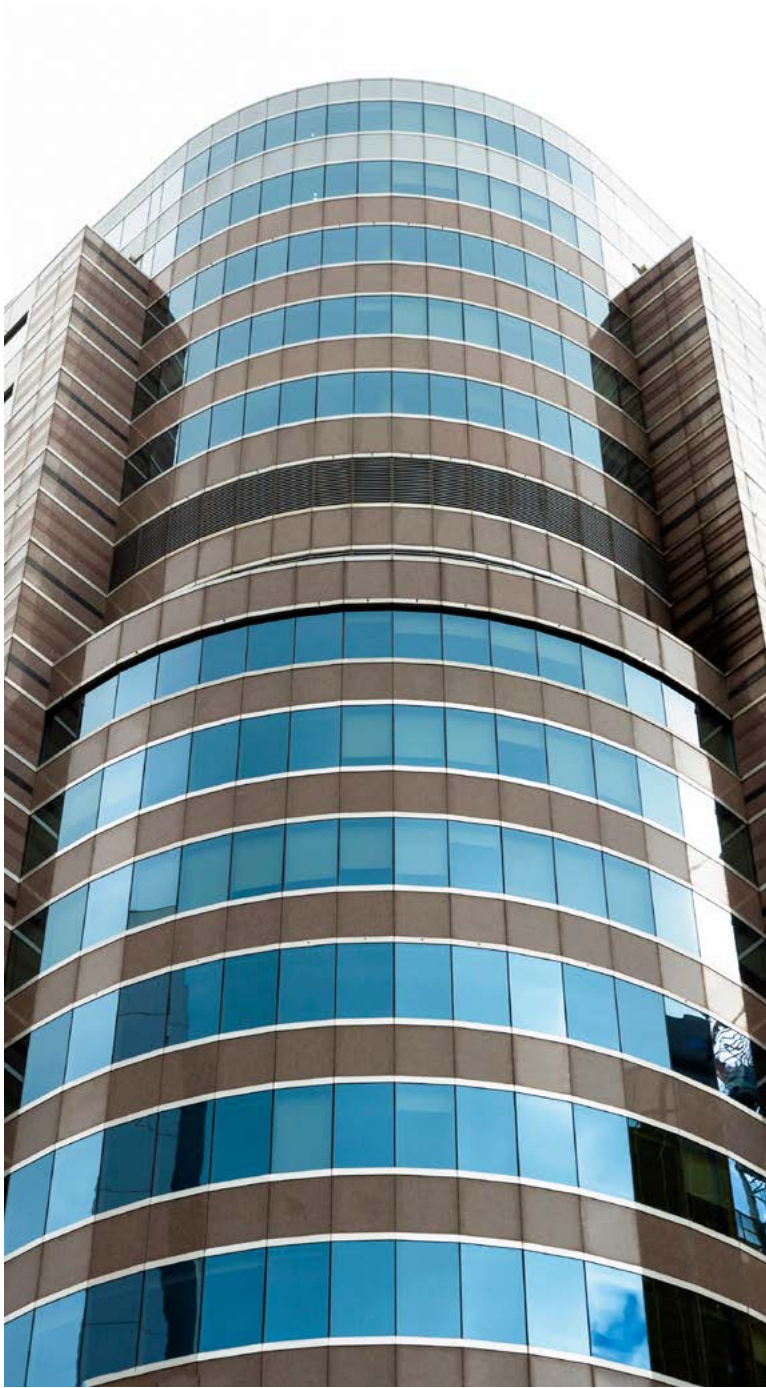
Gearing levels

A-REITs continue to maintain lower gearing levels, with an average c29% gearing in FY19. This remains in line with the sectors c30% gearing levels over the past 11 years.

The weighted average cost of debt has decreased from 3.8% in FY18 to 2.1% in FY19.

Capital raising

FY19 saw $10.0 billion raised in the secondary debt and equity markets, this is slightly down on the $10.8 billion raised in the previous year. The largest was Unibail-Rodamco-Westfield's raising of $5.0 billion in fixed-income offerings. Other considerable issues were the follow-on equity offerings by Dexus ($1.0 billion) and GPT Group ($0.9 billion). The use of funds represents a mix of extending debt-maturity profiles; funding earnings accretive acquisitions and adjusting gearing profiles.



TOP 10 A-REITs

01 GOODMAN GROUP

Highlights:

TOTAL SHAREHOLDER RETURN OF **59 PER CENT** OVER ONE YEAR

TOTAL SHAREHOLDER RETURN OF **123 PER CENT** OVER THREE YEARS

PREMIUM TO NTA OF **202 PER CENT**

15 PER CENT INCREASE IN NTA PER SECURITY TO $5.34

Goodman Group (GMG) is a global, commercial and industrial property group that owns, develops and manages real estate including warehouses, large scale logistics facilities, business parks and offices.

GMG achieved a total shareholder return of 59 per cent over one year and a total shareholder return of 123 per cent over three years.

Goodman Group's number one ranking this year is due to strategic investments in gateway city locations. On the back of the boom in e-commerce, Goodman bought and developed warehouses to cater for online shopping and subsequent distribution needs of retailers. Key clients include Amazon and Walmart.

02 CHARTER HALL GROUP

Highlights:

TOTAL SHAREHOLDER RETURN OF **71 PER CENT** OVER ONE YEAR

TOTAL SHAREHOLDER RETURN OF **133 PER CENT** OVER THREE YEARS

PREMIUM TO NTA OF **182 PER CENT**

Charter Hall Group (CHC) is a diversified property investment and funds management group. They manage and invest equity across core property sectors in office, industrial, retail and social infrastructure.

Charter Hall are focused on investing in high-quality, well-located assets with an emphasis on sustainability which are leased to corporate and government tenants.

03 NATIONAL STORAGE REIT

Highlights:

OPERATING CASH YIELD OF **9 PER CENT**

8 PER CENT INCREASE IN NTA PER SECURITY TO $1.63

77 PER CENT UNANNUALISED LIQUIDITY

National Storage REIT (NSR) is an internally managed and fully integrated owner and operator of commercial and residential self-storage. Specifically, their storage consists of self-storage, business storage, climate-controlled wine storage, vehicle storage, vehicle and trailer hire, packaging, insurance and other value-added services. They are placing an increased focus on sustainability by creating a solar network across their sites.

04 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP

Highlights:

88 PER CENT UNANNUALISED LIQUIDITY

DISTRIBUTION RETURN OF **6 PER CENT**

Shopping Centres Australasia Property Group RE Limited (SCA Property Group) is an internally managed REIT with a portfolio of quality sub-regional and neighbourhood shopping centres and freestanding retail assets focused on convenience retailing across Australia.

SCA Property Group's performance is in contrast to the overall retail category which underperformed by 13.0 per cent in FY19. SCA Property Group's large distributions and liquidity offered to investors enabled them to rank in the top ten.

05 DEXUS

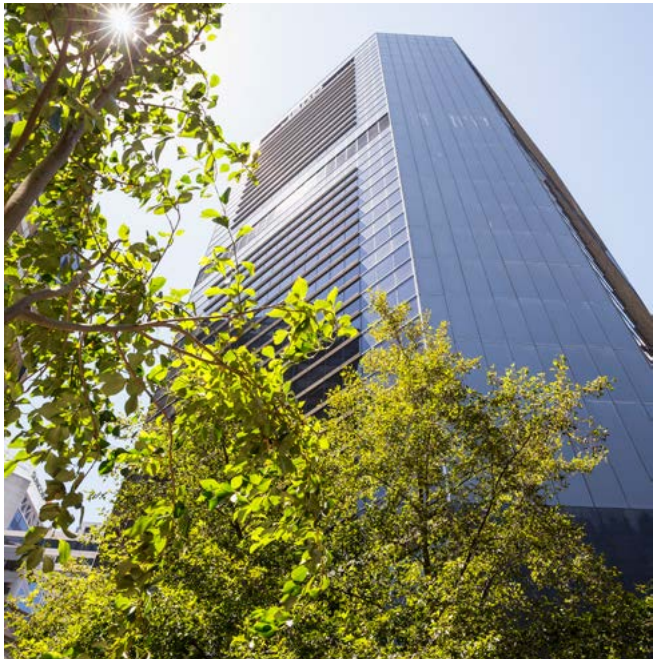
Highlights:

9 PER CENT INCREASE IN NTA PER SECURITY

TOTAL SHARE RETURN OF **39 PER CENT** OVER ONE YEAR

PREMIUM TO NTA OF **29 PER CENT**

Dexus (DXS), is an Australian REIT and funds manager that invests in, develops, manages and trades in quality Australian office and industrial property. In 2019, they were named as the Global Industry leader for sustainability in real estate by the Dow Jones Sustainability Index (DJSI).



06 GARDA DIVERSIFIED PROPERTY FUND

Highlights:

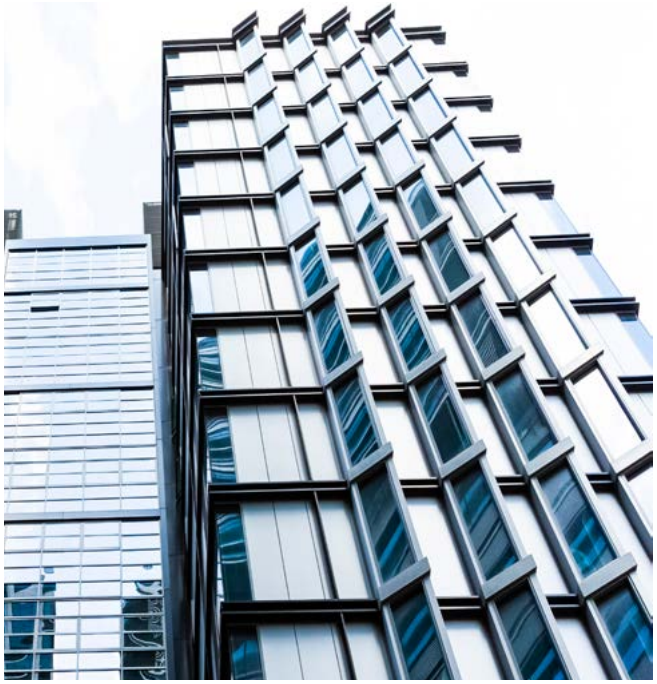
TOTAL SHAREHOLDER RETURN OF **28 PER CENT** OVER ONE YEAR

TOTAL SHAREHOLDER RETURN OF **63 PER CENT** OVER THREE YEARS

OPERATING CASH YIELD OF **10 PER CENT**

77 PER CENT TAX ADVANTAGED DISTRIBUTION

Garda Diversified Property Fund (GDF) invests in commercial offices in city and city-fringe markets, as well as industrial facilities along the eastern seaboard of Australia. The fund currently owns 17 assets consisting of established income producing assets and assets that offer development opportunity. This is the first time GDF has ranked in the top ten performing A-REITs as they benefited from a strengthening portfolio of commercial and industrial assets.



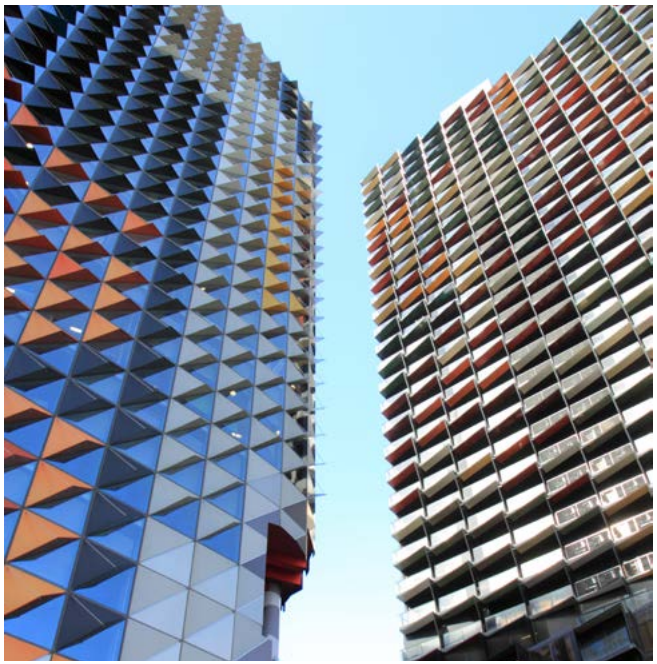
07 CROMWELL PROPERTY GROUP

Highlights:

DISTRIBUTION RETURN OF **6 PER CENT**

72 PER CENT TAX ADVANTAGED DISTRIBUTION

Cromwell Property Group (CMW) is a REIT and property fund manager of commercial properties throughout Australia. Gross property assets as at June 2019 were $2.5 billion with their portfolio consisting of more than 320 assets and 3,800 tenants.



08 MIRVAC GROUP

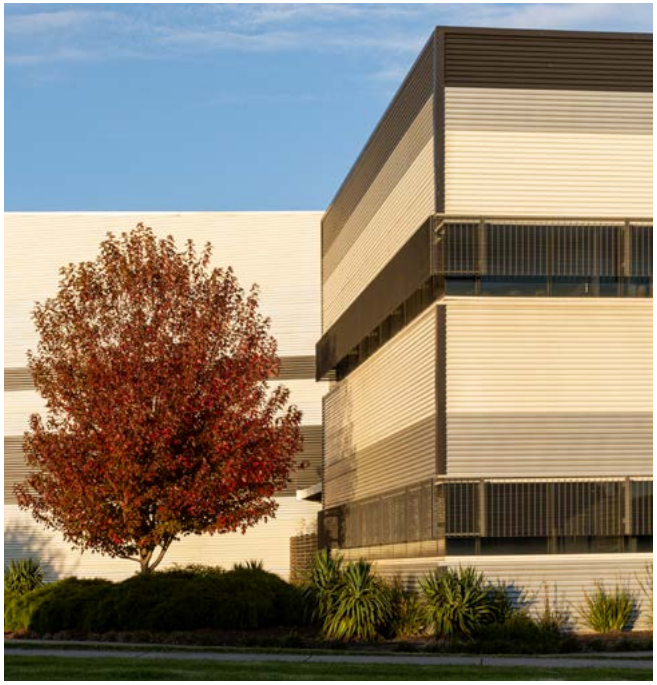
Highlights:

TOTAL SHAREHOLDER RETURN OF **49 PER CENT** OVER ONE YEAR

TOTAL SHAREHOLDER RETURN OF **71 PER CENT** OVER THREE YEARS

8 PER CENT INCREASE IN NTA PER SECURITY TO $2.50

Mirvac (MGR) is principally located in Australia's four key cities of Sydney, Melbourne, Brisbane and Perth. Mirvac owns and manages assets across the office, retail and industrial sectors, with over $18 billion of assets currently under management.



09 RURAL FUNDS GROUP

Highlights:

OPERATING CASH YIELD OF **10 PER CENT**

TOTAL SHAREHOLDER RETURN OF **65 PER CENT** OVER THREE YEARS

PREMIUM TO NTA OF **32 PER CENT**

Rural Funds Group (RFF) is a unique Australian REIT, engaged in the leasing of agricultural properties and equipment which produce almonds; macadamias and poultry.

Rural Funds Group assets include property and infrastructure, vineyards, agricultural plant and equipment and water rights leased to experienced tenants on long term leases. RFF dipped out of the top three rankings for the first time in four years, because of a below-average one year total shareholder return of 13 per cent in FY19.

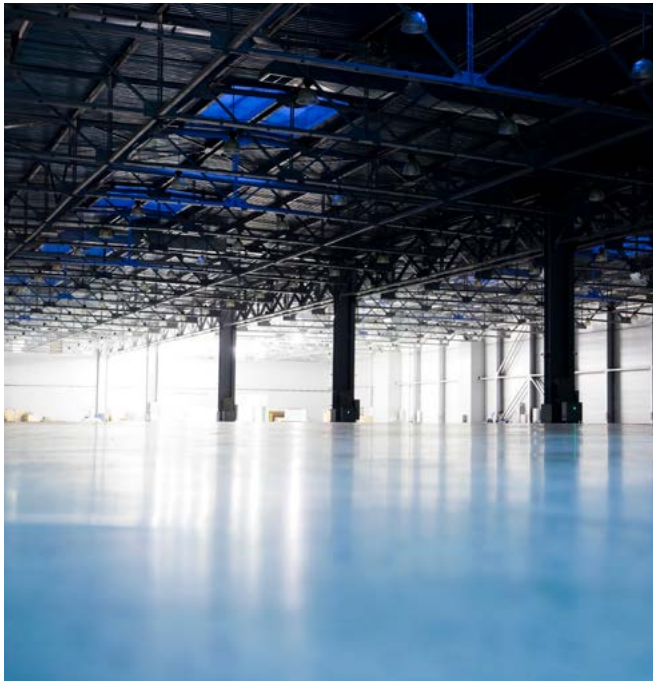
10 CENTURIA INDUSTRIAL REIT

Highlights:

OPERATING CASH YIELD OF **7 PER CENT**

DISTRIBUTION OF 17.6 CENTS **(6 PER CENT)**

Centuria Industrial REIT (CIP) is Australia's largest industrial property focused REIT. Their portfolio consists of 45 high-quality industrial property assets located in key metropolitan areas in Australia.



A-REIT INSIGHTS

GARDA DIVERSIFIED PROPERTY FUND (GDF)

Matthew Madsen, Executive Chairman

What do you see as the underlying strengths for the sector?

GDF is exposed to both the commercial and industrial property sectors. GDF develops to hold property as well as acquiring existing assets. Predominantly this is fringe office in Melbourne and Brisbane Industrial. Each of these have different drivers but both currently share very favourable investor sentiment. When we think about Melbourne office over the longer term we believe the population growth story in Melbourne will continue to benefit this sector while in the short term the very low vacancy across the market will sustain rents. Brisbane industrial is being driven by the positive economic impact of a ~$50bn infrastructure spend largely in SEQ and the strength of the resources sector more broadly combined with a depleting land supply.

What do you see as the key challenges for the sector in the next 12-months?

Economic activity across the board appears to be weak at best. Tenants, particularly those with offshore parents are deferring investment (leasing) decisions and the "stay put" option is the biggest challenge to new office leasing. Similarly, industrial users also have a very strong cost management focus – trying to deliver new buildings for old rent levels is only being supported by continued capitalisation rate compression.

What assets in your portfolio/sector are showing the best value?

Over the past we have experienced the strongest capital growth through our Melbourne commercial office properties however we expect this markets growth to moderate, but not plateau. Brisbane industrial is being keenly sought by investors generally and we anticipate continued positive asset value increases over the next few years as the current yield differential being offered by Brisbane compared to Melbourne and Sydney reduces and perhaps in time constrained land supply brings some positive rental pressure.

Are there any other themes or trends in your sector?

Although we believe capital values will continue to demonstrate growth, the clear risk to all sectors in our view is the weak economic activity and the impact this has on the confidence of tenants and their resultant decision making.

ARENA REIT

Rob De Vos, Managing Director.

What do you see as the underlying strengths for the sector?

Demand for high quality and well located early learning and healthcare property continues to be underpinned by growing community demand and supportive domestic macro-economic trends including:

- actual and projected population growth[1]
- record and growing female workplace participation rate[2]
- strong long day care participation rate[3]
- improved affordability for early learning from the federal government's Child Care Subsidy (CCS)[4]; and
- Aging population and increased prevalence of chronic health conditions[5].

What do you see as the key challenges for the sector in the next 12-months?

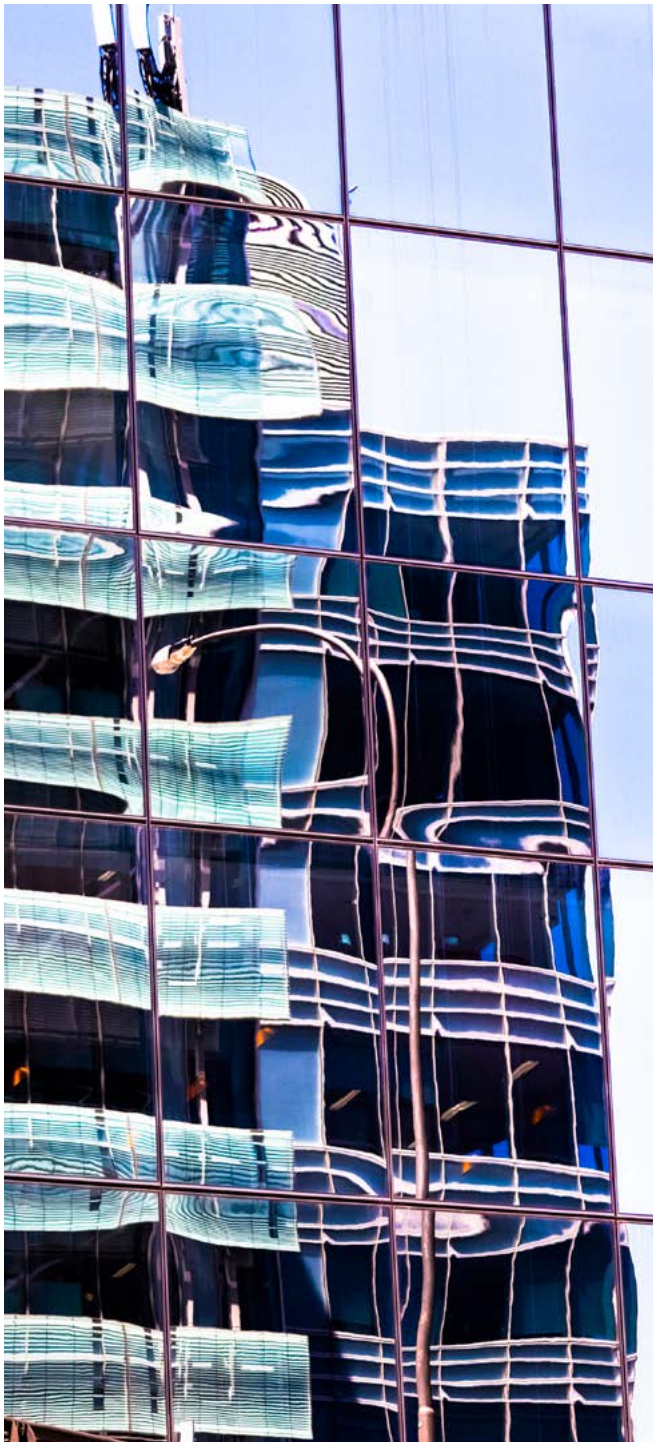
Rent sustainably is a key investment driver for Arena; outside of Arena's portfolio we expect the long term sustainability of headline rents to be a focus point for the social infrastructure category and the property market generally.

What assets in your portfolio / sector are showing the best value?

Arena remains focused on maximising the quality of its portfolio and sees opportunities to enhance and further develop its existing properties for increased return. The market is also conducive to opportunities to both acquire and develop, select, new high quality early learning and healthcare assets

Are there any other themes or trends in your sector?

There is increasing interest in the social infrastructure property category both domestically and offshore as investors better recognise the growing accommodation needs for services as a result of population growth and changing community needs; as well as investors seeking diversification from traditional property assets such as retail, office and industrial.



[1] *ABS Australian Demographic Statistics.*

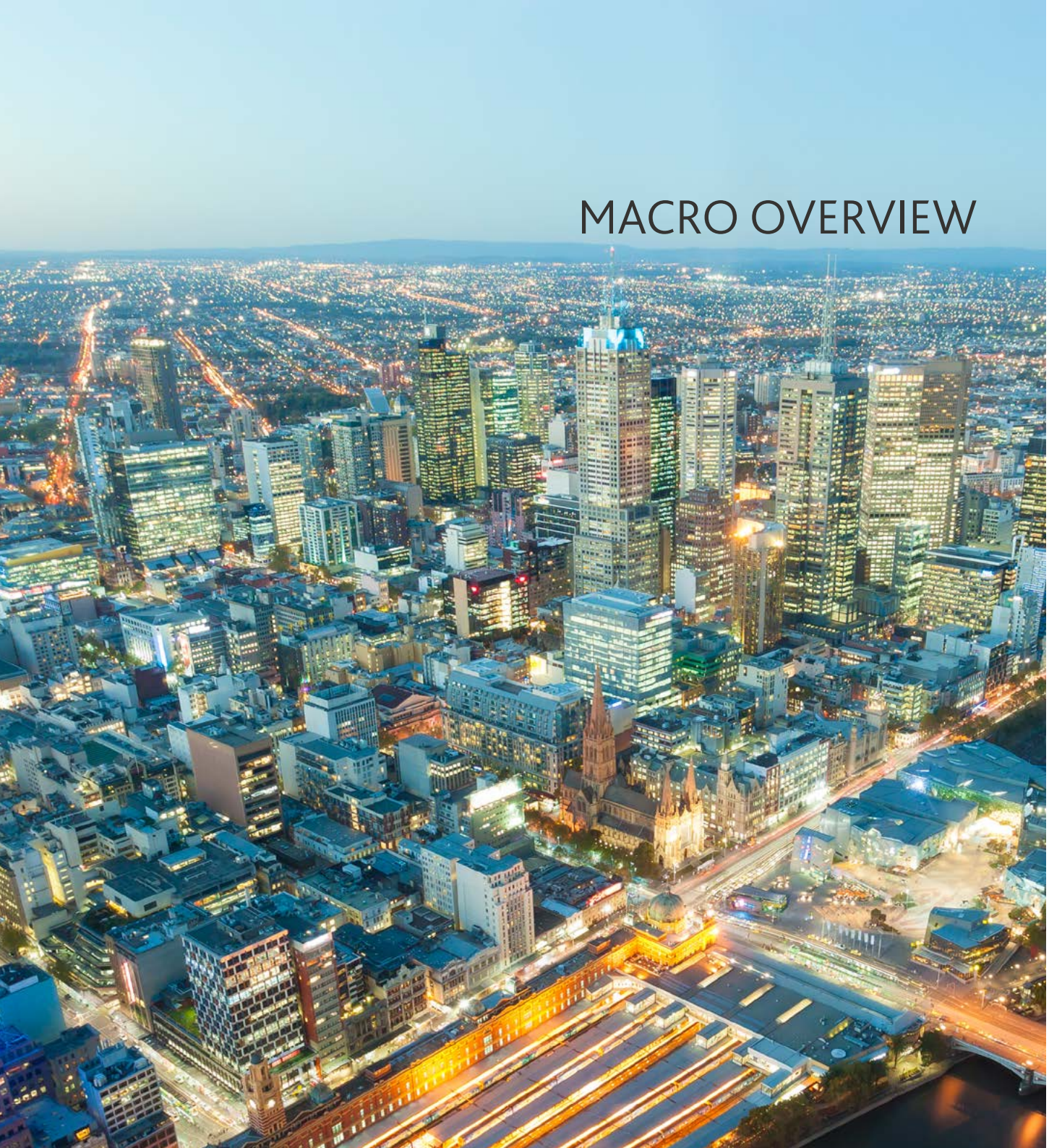
[2] *ABS Female Labour Force Participation Rate (aged 20-74 at least one dependent child of ELC age).*

[3] *Australian Government 'Early Childhood and Child Care in Summary' Reports 2012-2018.*

[4] *Arena analysis based on operating data provided by Arena's tenant partners as at 31 March 2019.*

[5] *ABS National Health Survey.*

MACRO OVERVIEW



In FY19, A-REITs benefited immensely from low interest rates when compared to other lower-risk asset classes, and it is predicted that bond yields and interest rates will remain low in the short-to medium term. Current 10-year bond yields are below cash rates set across the major world economies, ripening A-REITs for investment and potential M&A activity, as investors search for higher sustainable yields. However, investors must balance the deployment of capital with the potential impact of oversupplying asset's that can shock earnings across the sector.

Despite the low interest rate environment, favourable flow-on affects to consumer spending is yet to resonate for retails REITs. This trend was noted in FY19, as Australian consumers preferred to reduce household debts and accelerate mortgage payments.

Interest rates present the biggest threat to A-REITs as any future increases in bond yields will have adverse impacts on discount rates, cost of debt, and earnings. BDO's analysis indicates that A-REITs are somewhat protected from any unfavourable future increases to interest rates, as weighted average debt terms in FY19 continue to be greater than five years.

The ongoing trade wars scaled back activity in the global economy, as investors are willing to wait on the sideline for tensions to ease. Persistent economic uncertainty continues to cast doubt on future A-REIT performance. Despite tensions and the overall slowdown in economic growth, Australia's economy remained resilient to any major global shocks.

Looking forward, A-REITs continue to present themselves as attractive investments - through protection offered from their diversified asset portfolios, lengthy weighted average debt terms and current low bond yields.

METHOD OF RANKING

1 EXPLANATION OF CRITERIA AND RANKING

A brief explanation of each criterion used to rank REITs in the 2019 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 2019 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 Bloomberg.

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 2018 and 2019 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 criteria.

1.2 Investment Criteria

▶ Total Return

This measure, over both the one year and three years to 30 June 2019, 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 2019 by the weighted average total number of Securities on issue.

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

METHOD OF RANKING

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
	2019
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
	2019
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 taken into account. 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 criteria, 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.

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