Navigating the Road Ahead – Real Estate Outlook
June 2016

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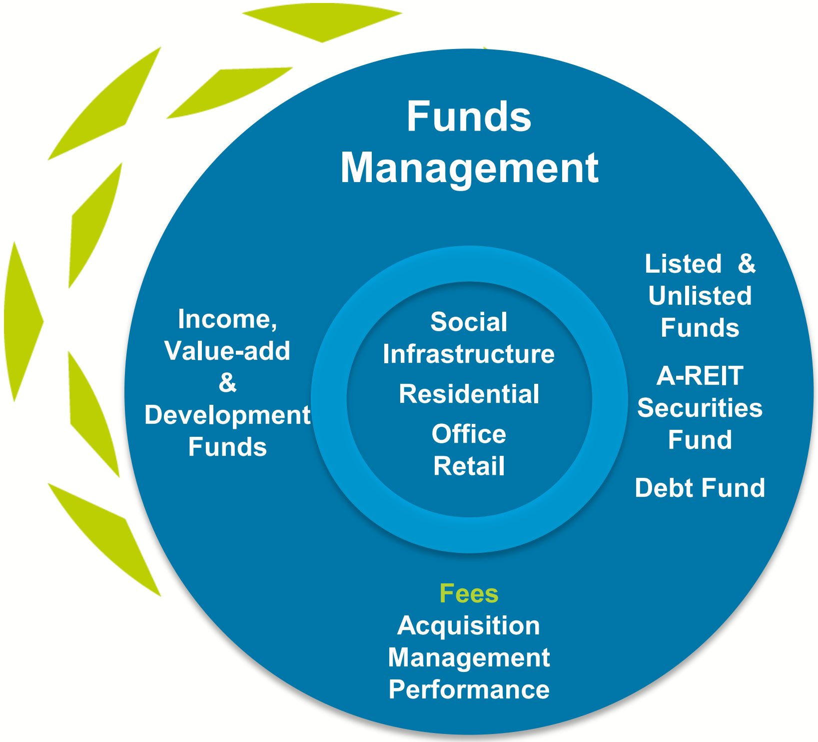
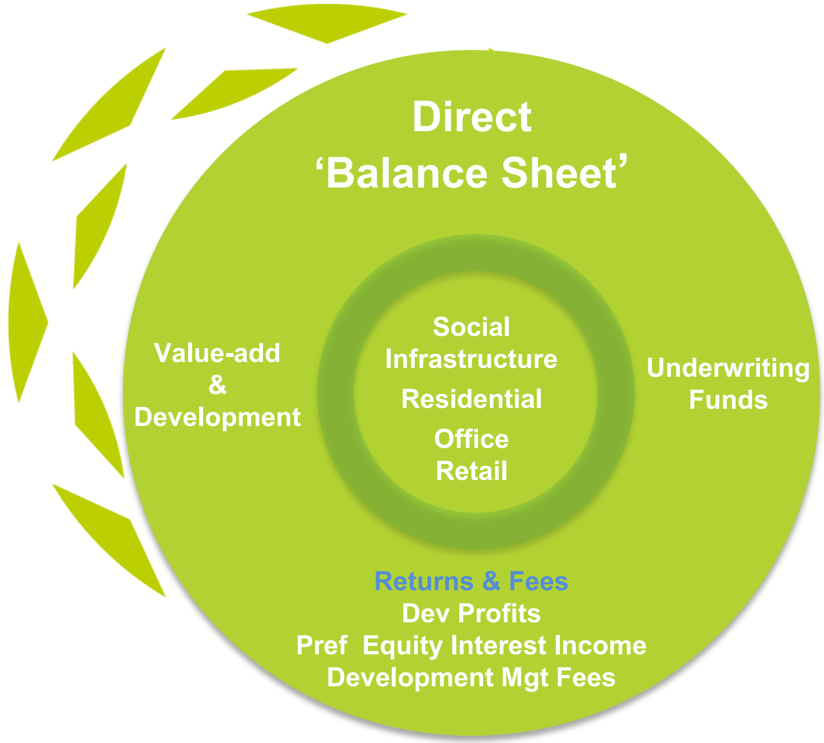
FOLKESTONE'S BUSINESS STREAMS

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. $964 million in funds under management[1]

On balance sheet activities focus on value-add and opportunistic (development) investments. Market capitalisation of $141 million[1]

[1] *As at 31 December 2015.*

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PROPERTY MARKET OUTLOOK

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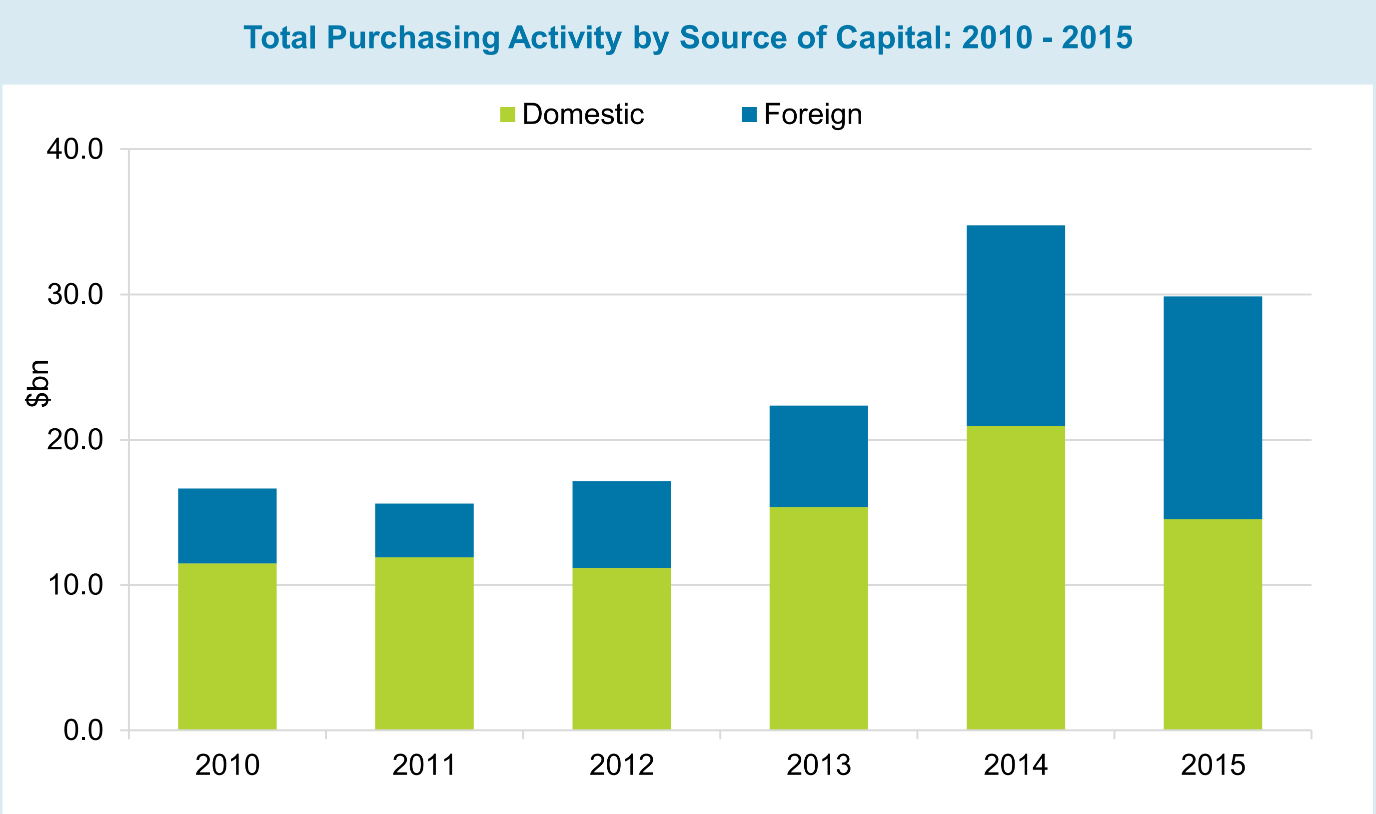
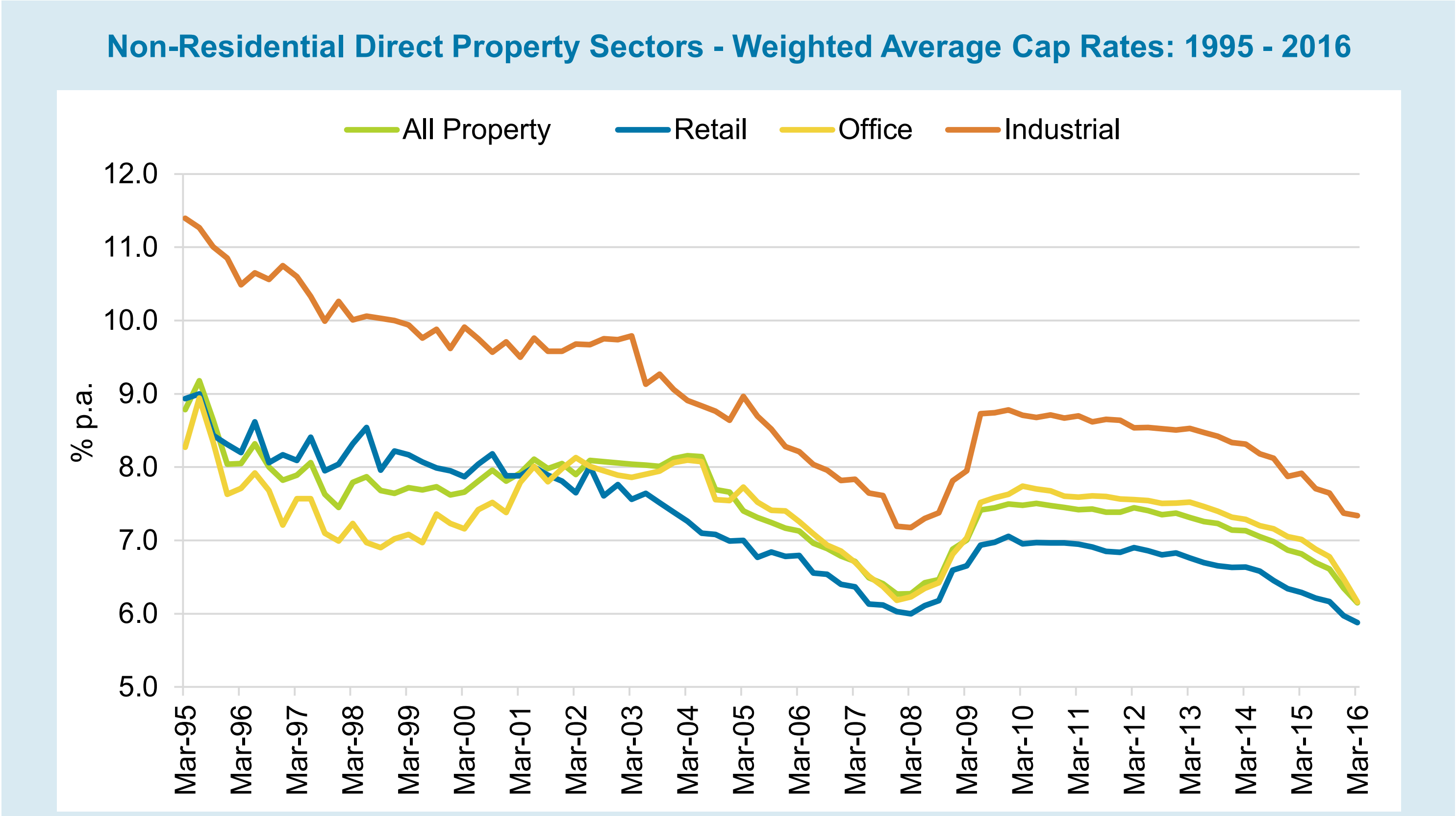
AUSTRALIAN MARKET CONDITIONS – TRANSACTIONS



Source: Cushman & Wakefield

- Foreign investors accounted for a record 51% of transaction value in the past year - well above historic levels
- Following the $13.8bn invested by foreign entities into Australia in 2014, a further $15.4bn was invested in 2015 accounting for 40% and 51% of the total volume respectively
- Singaporean-based investors accounted for the majority of overseas capital into Australia at $4.5bn in 2015 while Chinese investors increased their volume by 28% year-on-year to $3.7bn
- International investors (those with global platforms) were significantly more active in 2015 than in 2014, committing $2.6bn compared to $1.3bn

AUSTRALIAN MARKET CONDITIONS – CAP RATES (YIELDS)



Source: MSCI / IPD

- Cap rates (yields) now heading to pre-GFC lows
- Driven by 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

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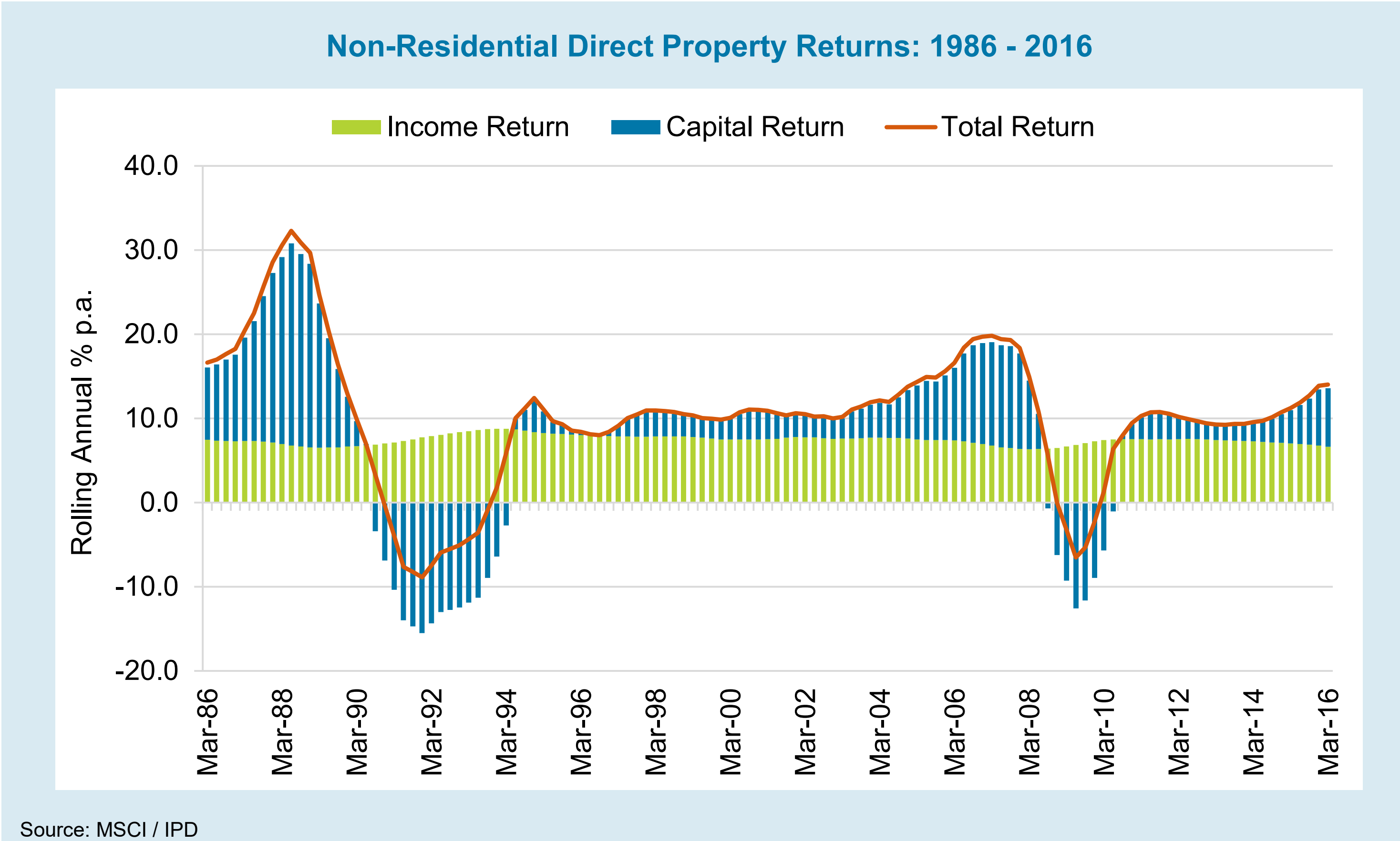
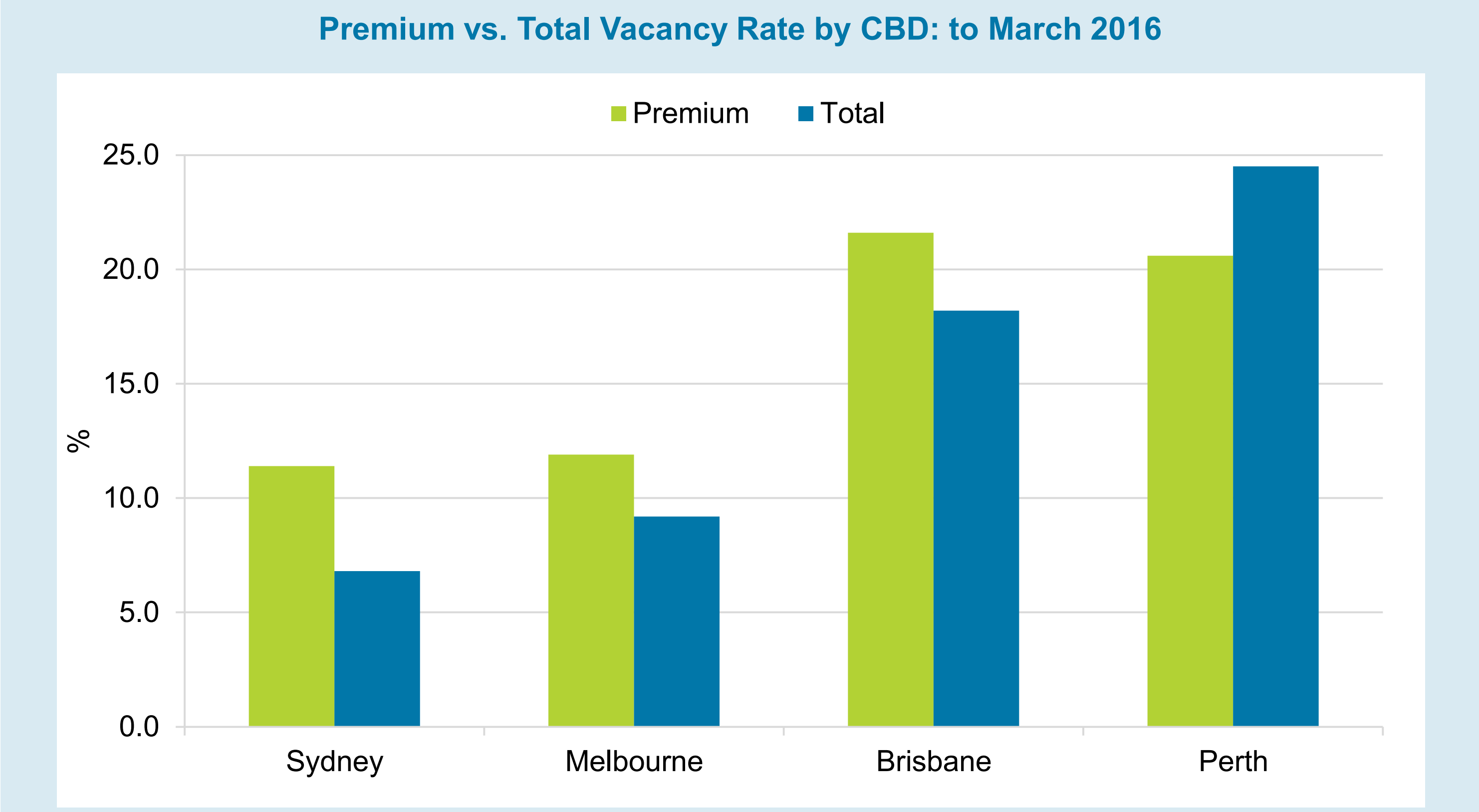
NON-RESIDENTIAL REAL ESTATE RETURNS



- Non-residential real estate has delivered
  - relatively stable income returns over the past 25 years
  - a total return of 14% in the year to March 2016
  - a capital return of 7.0% year to March 2016 – the highest since 2008

AUSTRALIAN MARKET CONDITIONS – OFFICE



Source: Credit Suisse

- Vacancy rates reflect divergent economic growth prospects of the major markets
- Sydney and Melbourne are the only CBD markets to record single digit vacancies
- Tenant demand was subdued in most markets except Sydney and Melbourne CBD's - we expect this to be the case again in 2016

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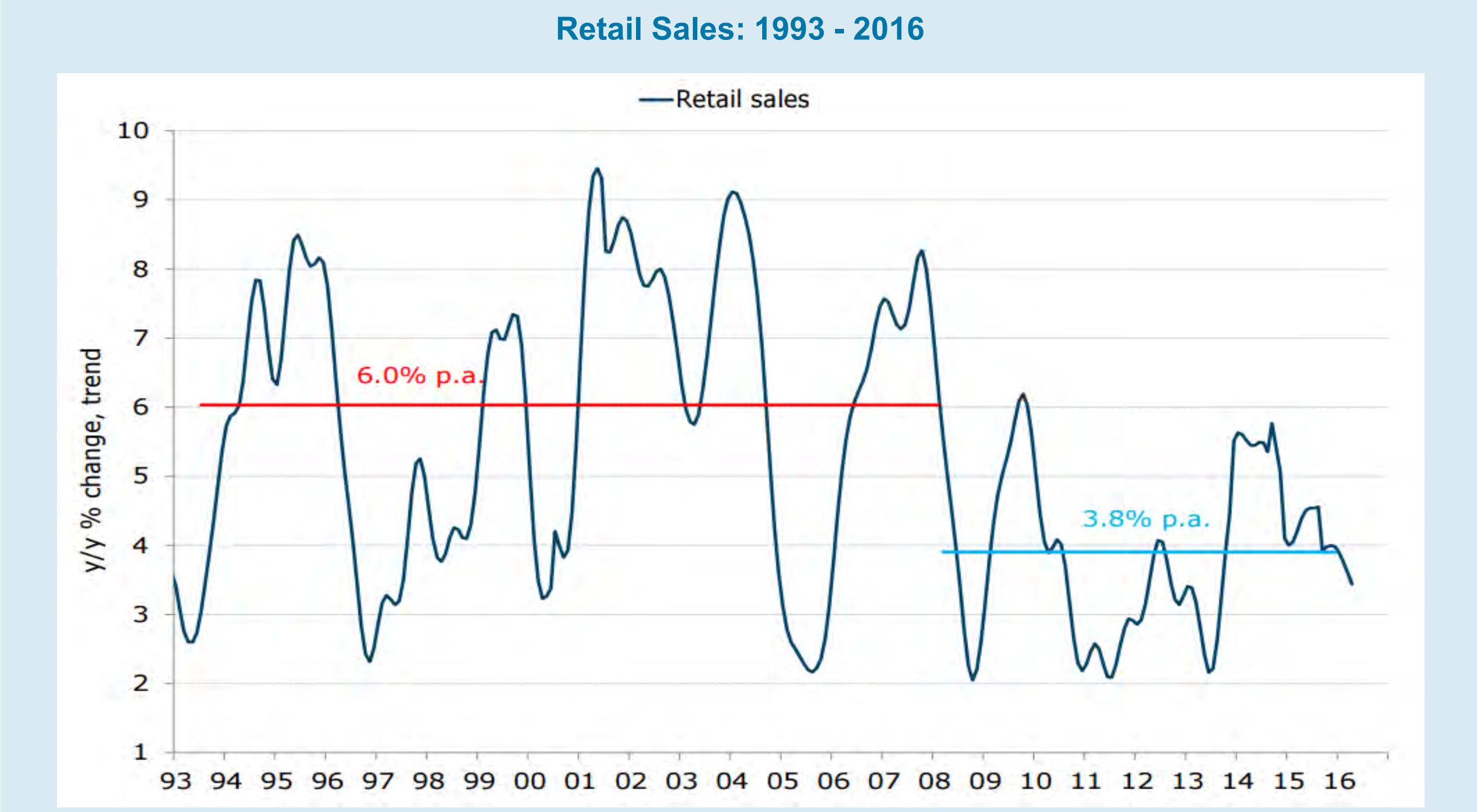
AUSTRALIAN MARKET CONDITIONS – RETAIL



Source: ABS / ANZ 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)
- The evolution of retail centres to include more non-retail uses such as gyms, childcare, entertainment, community services and restaurants as well as the growth of mini-major stores (stores in excess of 400 sq.m.) will continue to be a theme played out in the next few years
- Traditional anchor tenants (department stores/discount department stores) are losing their appeal – no longer key drivers of traffic to centres

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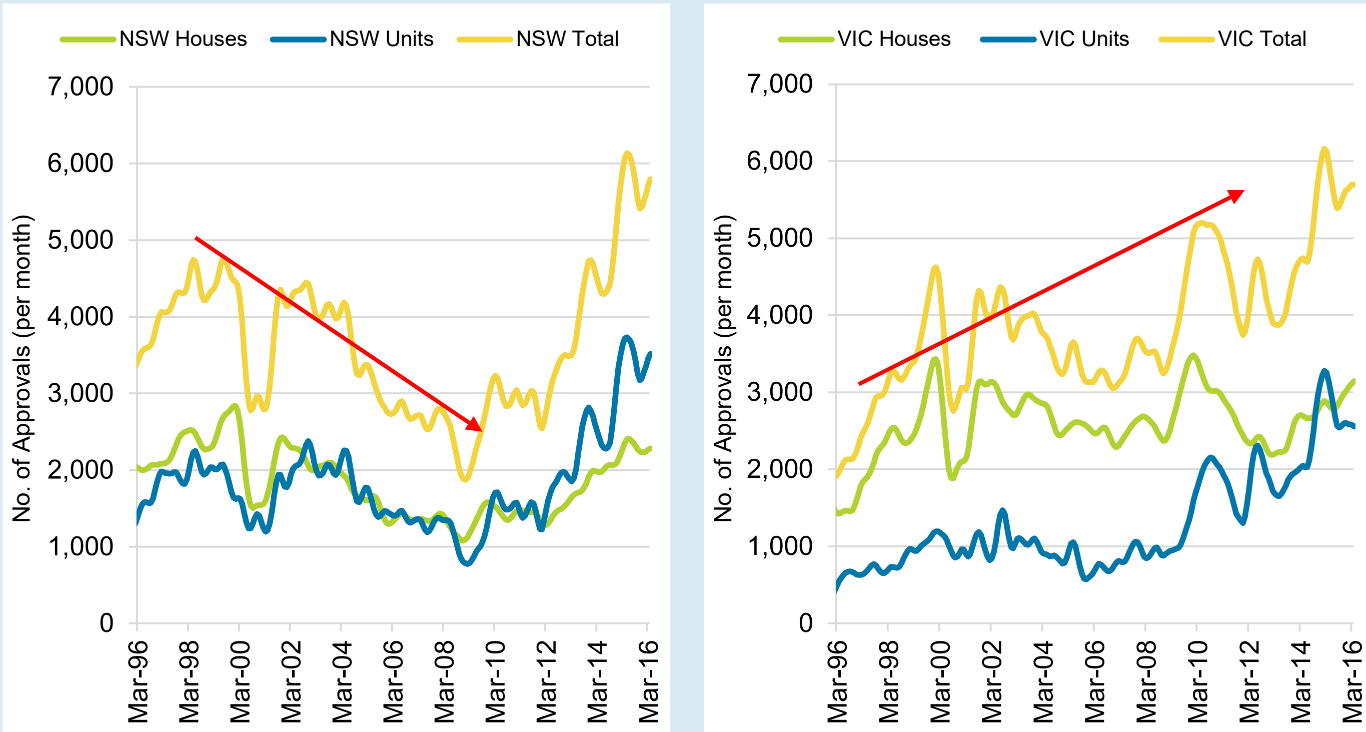
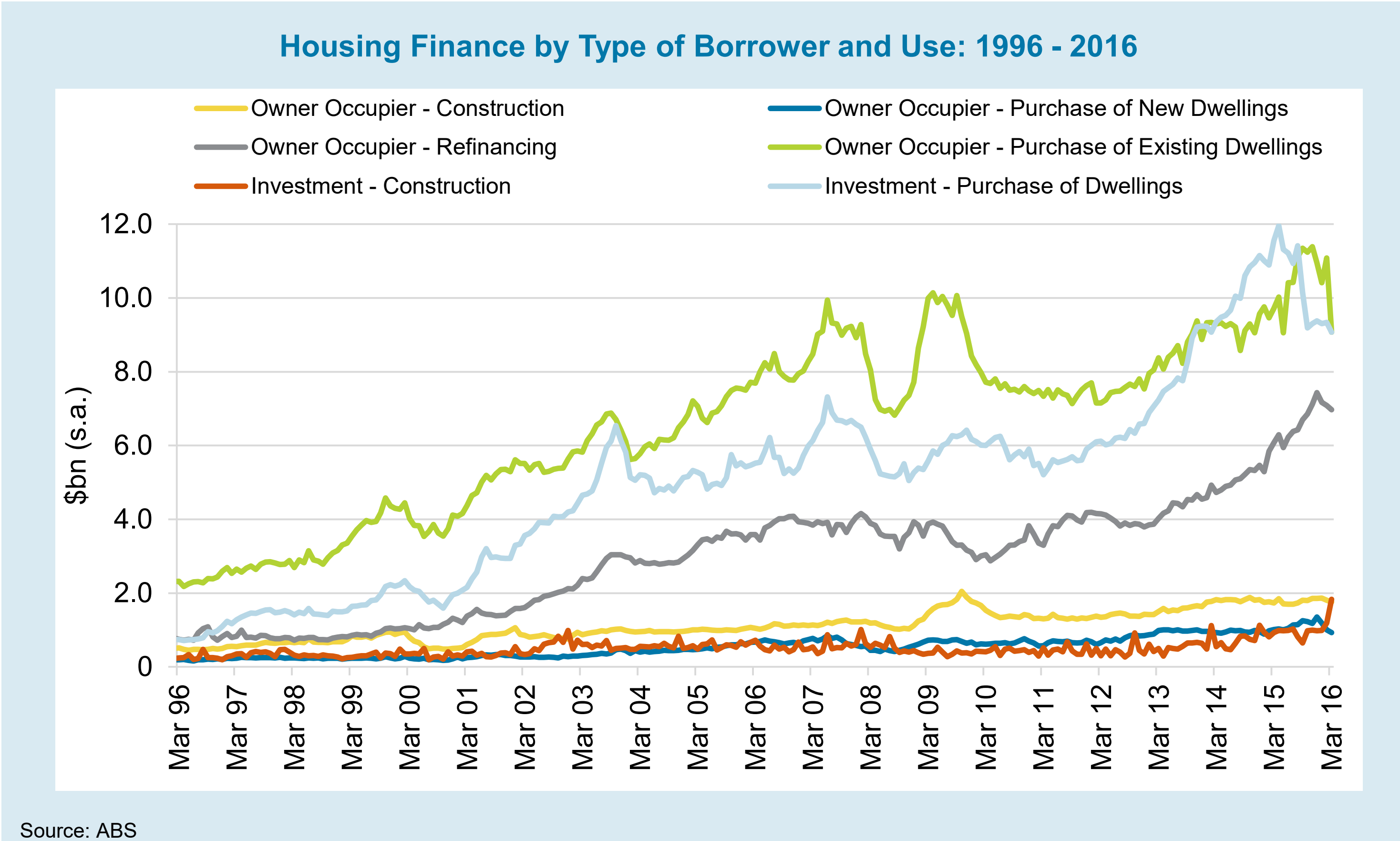
AUSTRALIAN MARKET CONDITIONS – RESIDENTIAL



Source: ABS

- 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 in 2016
- More even split between houses and apartments in Victoria vs NSW which continues to be slow in releasing land for houses

AUSTRALIAN MARKET CONDITIONS – RESIDENTIAL



- Investor activity drove the residential market between 2012 - early 2015
- APRA macro-prudential controls on bank lending now having an impact on the investor market
- Lending to borrowers purchasing existing dwellings now back on top
- As finance has contracted so too has apartment dwelling approvals which was a key target segment for investors

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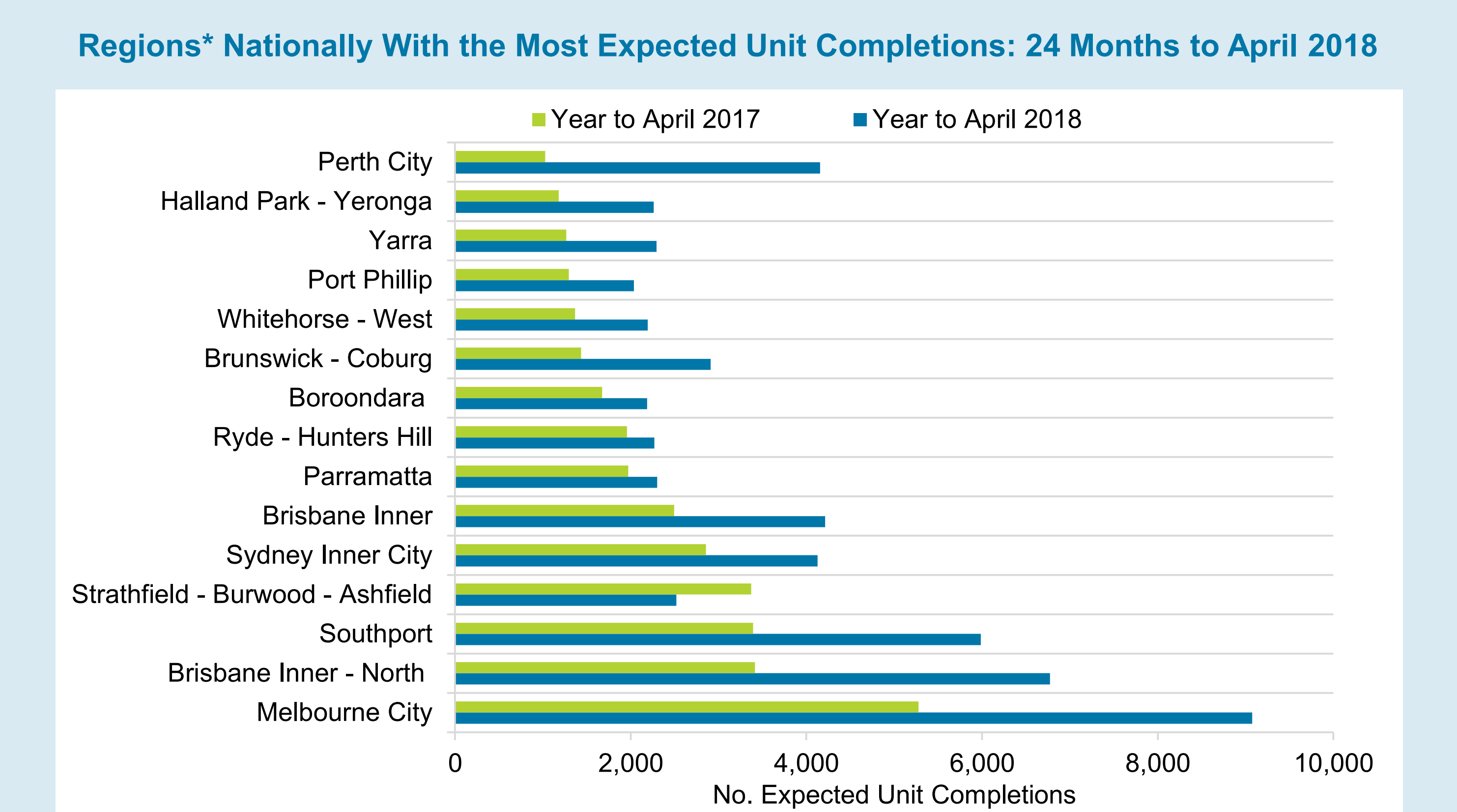
AUSTRALIAN MARKET CONDITIONS – RESIDENTIAL

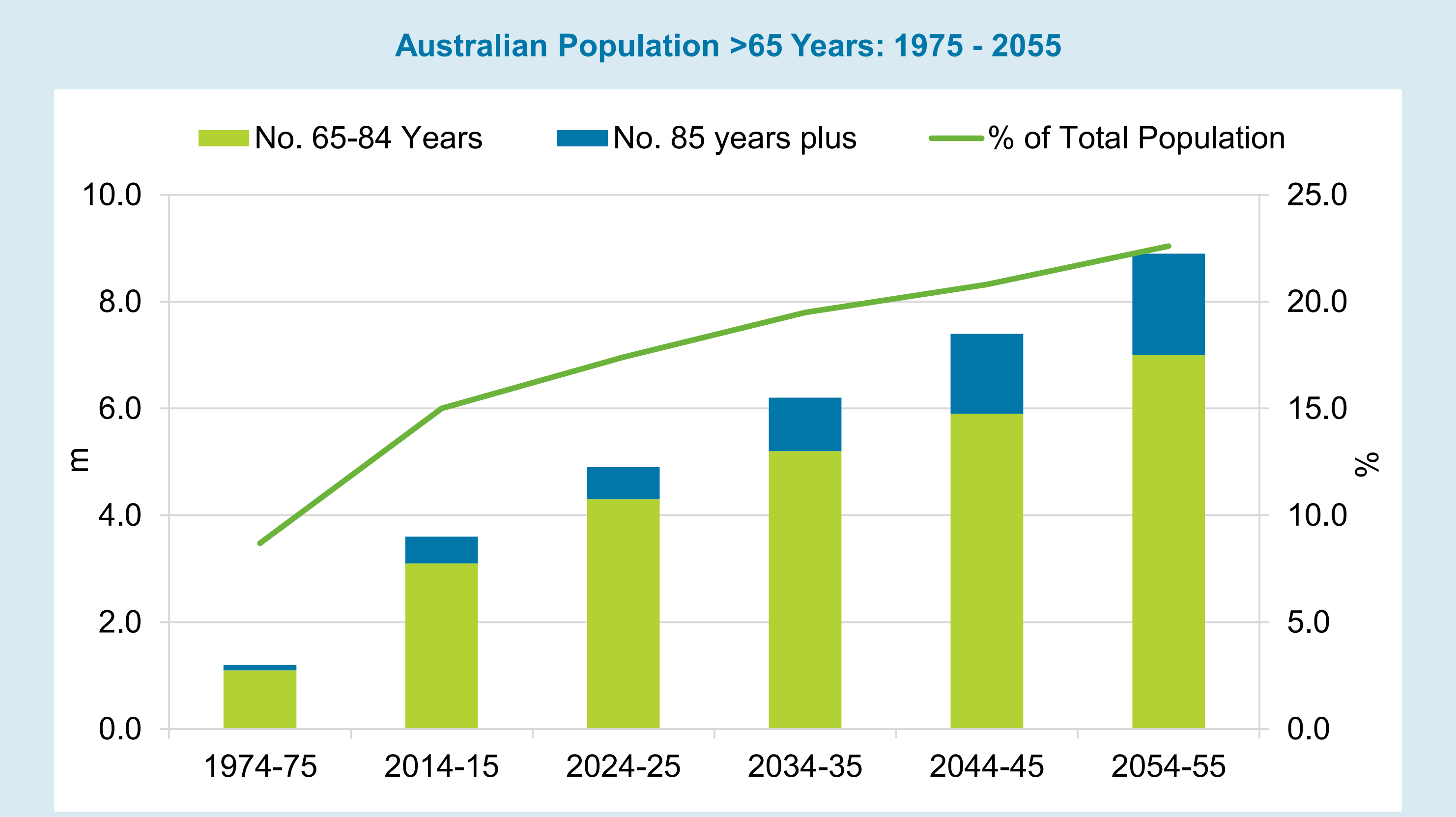


Source: CoreLogic *SA3 Regions

- Melbourne City sub-market followed by Brisbane- Inner North have the largest supply pipeline
- Of the top 15 locales, over the next 24 months:
  - Sydney metro represents approx. 48% and Melbourne metro 39% of the apartments to come online
  - Melbourne City represents 26% of total whereas Sydney-Inner City is 17% as the supply is more geographically spread across the Sydney area

SOCIAL INFRASTRUCTURE

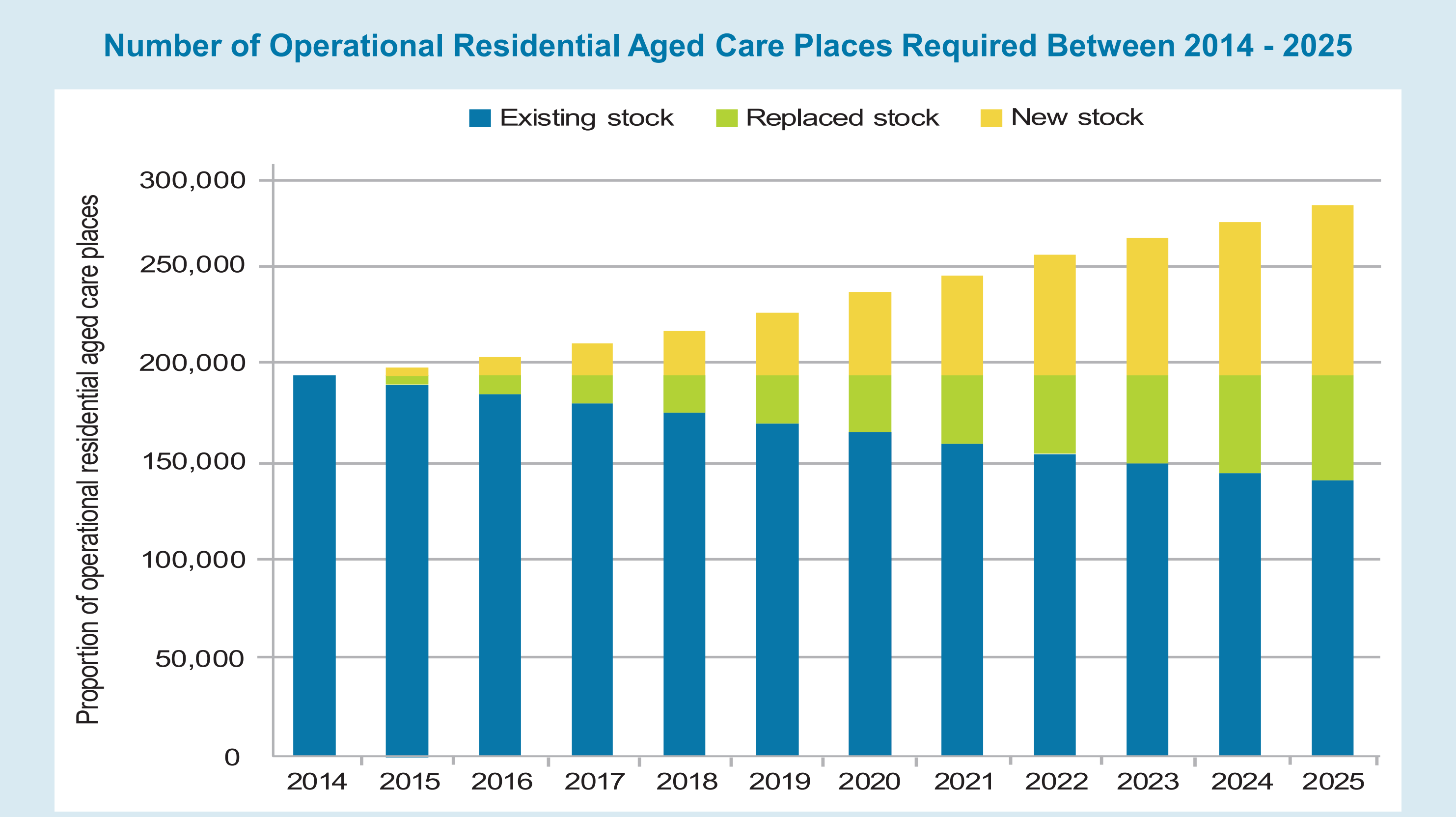
SOCIAL INFRASTRUCTURE – SENIORS LIVING



Source: ABS and Treasury Projections

- Seniors living (manufactured housing, retirement villages and aged care) 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

SOCIAL INFRASTRUCTURE – SENIORS LIVING AGED CARE



Source: Aged Care Financing Authority

- Australian government estimates a need to build 82,000 additional places over the next 10 years compared to 36,778 new places that came on-line over last 10 years
- Almost half of existing stock will need to be refurbished or rebuilt to meet new standards and consumer expectations

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A-REIT SECTOR OUTLOOK

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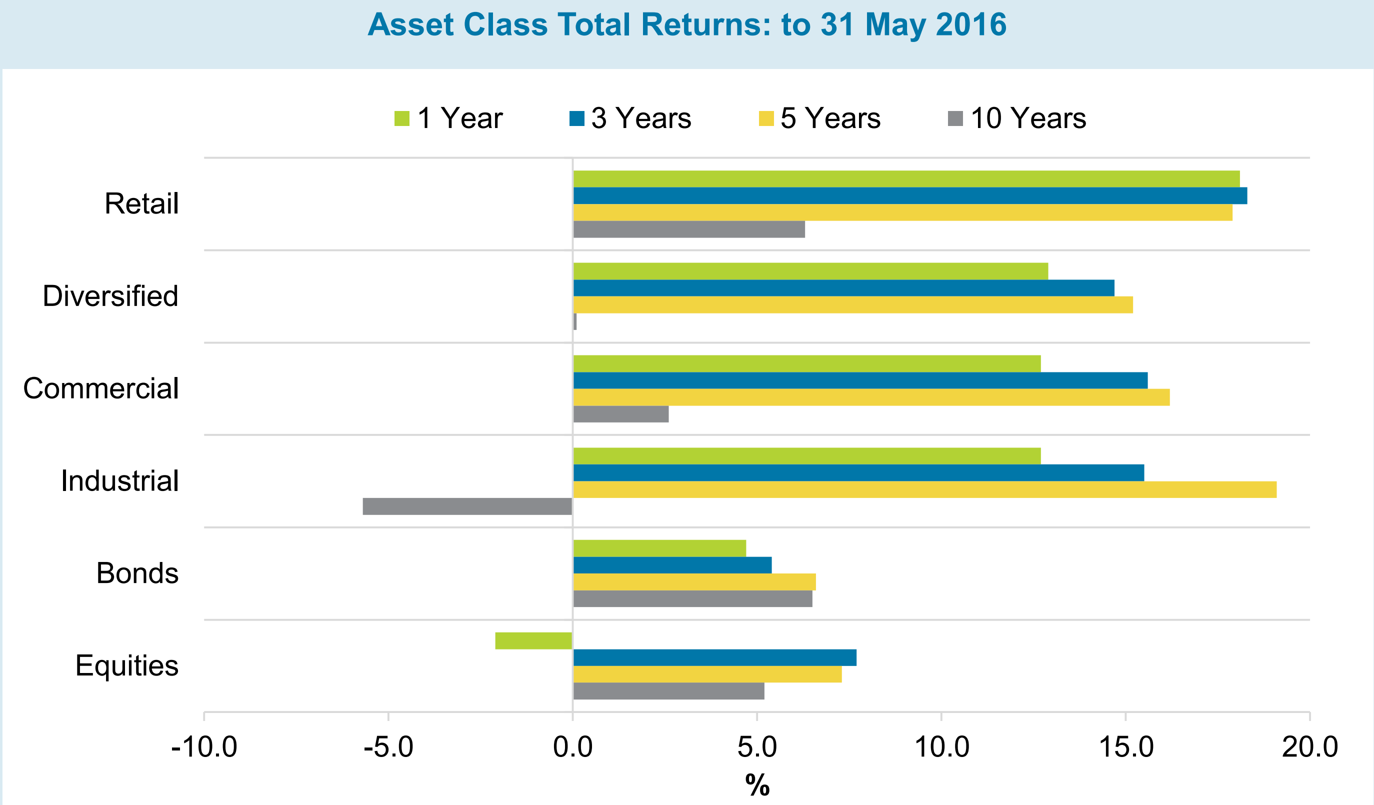
A-REIT SECTOR PERFORMANCE



Source: UBS

- A-REITs have performed strongly in recent years relative to equities and bonds
- 12 months to May 2016 – A-REITs generated 15.6% total return vs. -2.1% for equities and 4.7% for bonds
- Retail was the best performing sub-sector – 18.1% in the year to May 2016

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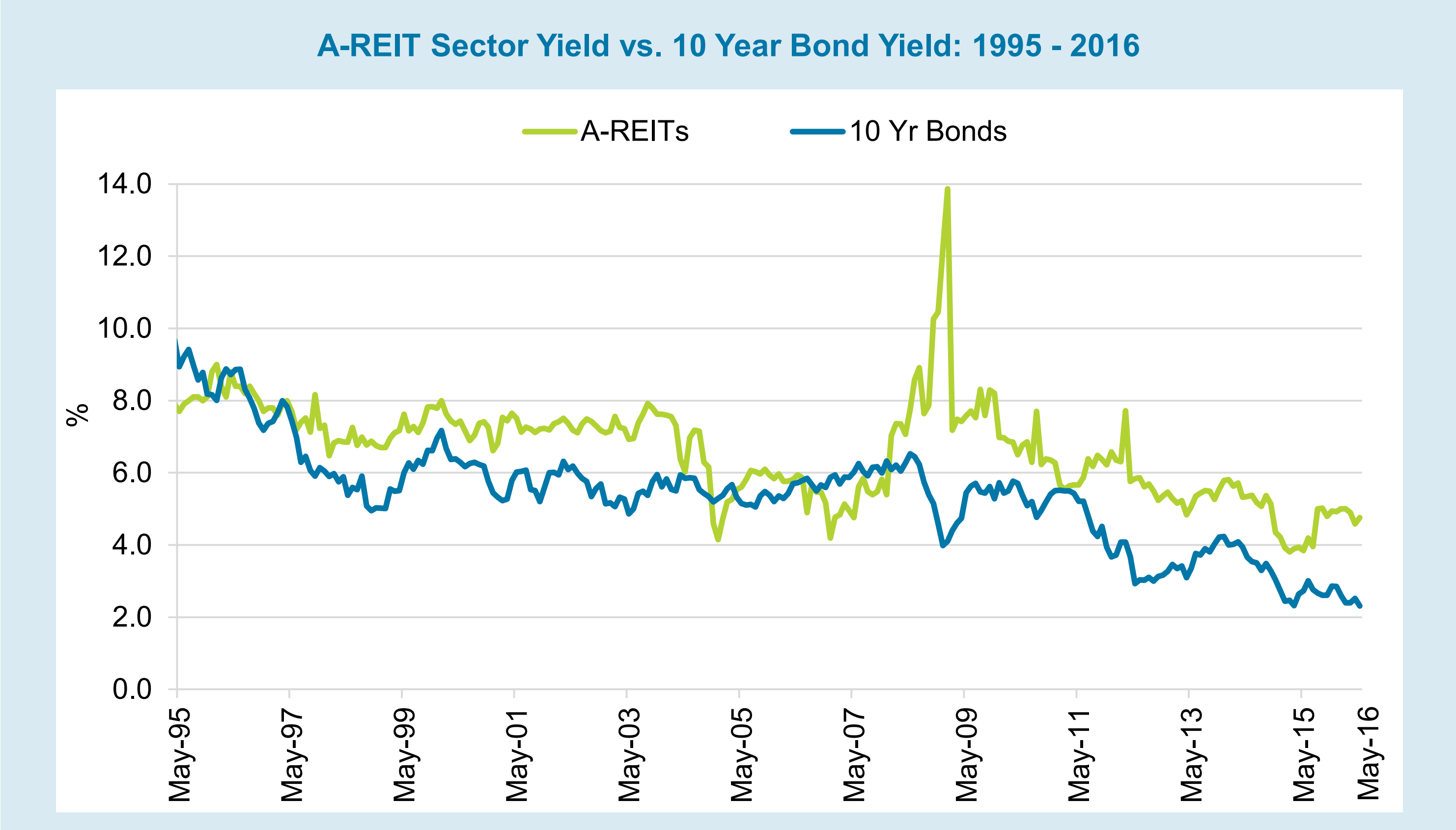
A-REIT SECTOR PERFORMANCE



Source: IRESS

- A-REITs currently trade on a 4.8% dividend yield, a 2.50% premium to 10 year bonds
- The dividend yield looks sustainable in our view given the average ~85% earnings pay-out and ~4% plus pa earning growth FY15-18
- A-REIT susceptible to short-term movements in bond markets – any sign of bond sell-off could see A-REITs underperform

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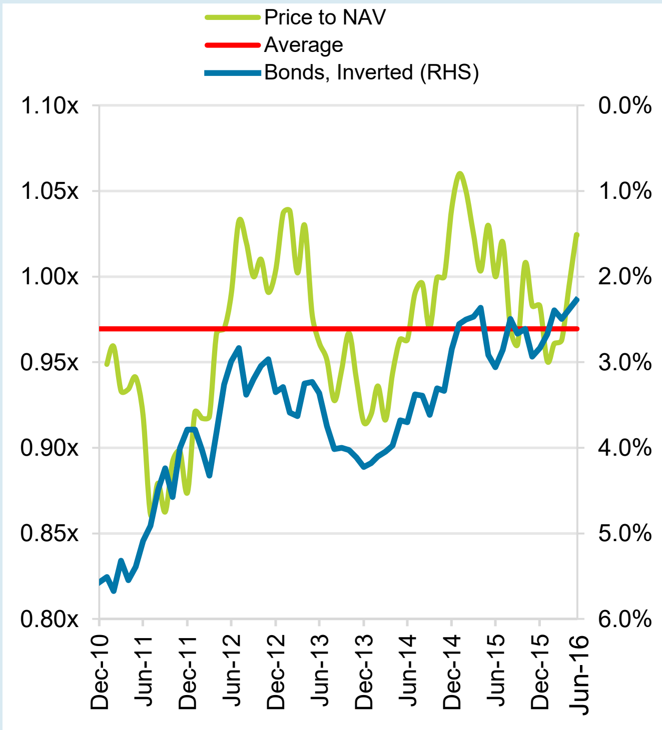
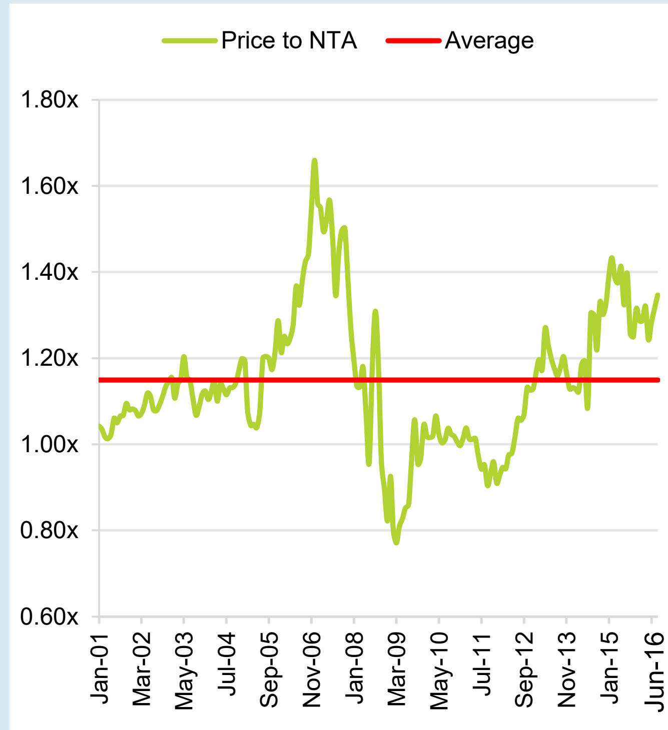
A-REIT SECTOR PERFORMANCE

A-REIT Price to NAV vs. 10yr Bonds: 2010 - 2016



Source: IRESS, RBA, Credit Suisse estimate

A-REIT Price to NTA: 2001 - 2016



Source: IRESS, Credit Suisse estimate

- A-REITs trading on a:
  - 35% premium to NTA
  - 2% premium to NAV
- Recent direct property sales suggest the A-REIT NAV is understated and the spread should close at June 30 when the A-REIT’s re-value the majority of their assets

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OUTLOOK

Millers Junction Home, Folkestone Real Estate Income Fund at Altona North

SUMMARY

- Divergence in performance between mining and non-mining states to widen which will impact on real estate markets
- 2016 is proving to be a challenging year to deploy capital – weight of money chasing yield
- 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

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