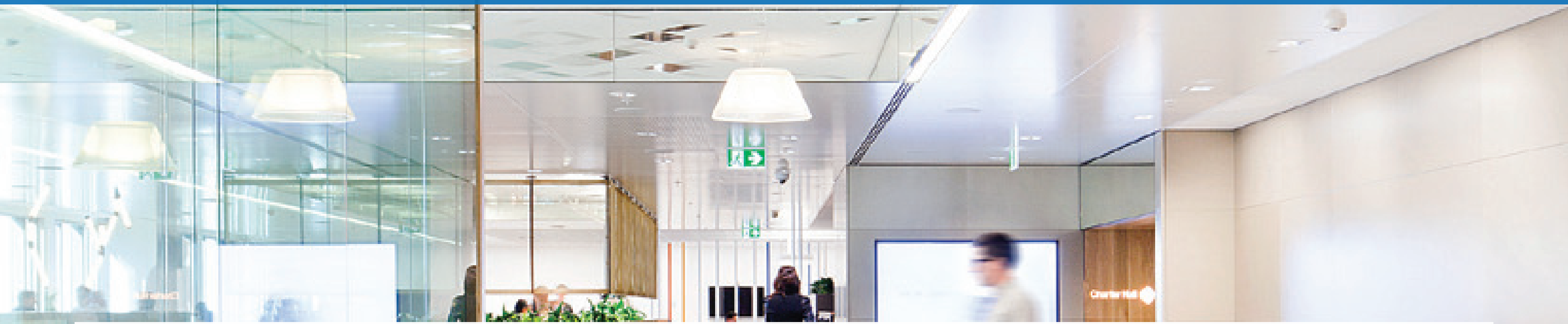
Charter Hall Group

Charter Hall

Investor Focus

Issue 9, July 2014



We are pleased to have ended the 2014 financial year with a full year distribution of 22.3 cents per security, a 10.4% increase over the prior year.

This follows another active year for Charter Hall and our managed funds where we have delivered on our strategy to access, deploy, manage and invest capital across our core property sectors of Office, Retail and Industrial.

In the last six months we have taken advantage of the ongoing demand for secure property investments to raise significant equity across our wholesale and retail fund platforms and acquire $1.8 billion of new assets. With Australian superannuation fund assets rising $264 billion in value over the 12 months to March 2014 and property yields remaining highly compelling in the current interest rate environment, we expect this demand to continue over FY15.

However, as we highlighted in prior updates, given the transitioning Australian economy we have broadly focused on de-risking our portfolios and focusing on assets with strong leasing covenants that provide superior income security. Labour force data to June has justified this approach, with employment growth averaging a soft 1.1% p.a. over the past three years and 61% of new jobs created being for part-time employment.

While there are now clear signs of improvement in tenancy markets - such as improved leasing take-up in office markets, a notable improvement in business confidence over the past 12 months and the strongest corporate revenue growth for three years - providing reliable income streams to investors remains the key focus for Charter Hall's funds.

Specifically we identified the logistics sector as a key growth area for the group and have subsequently emerged as the country's most active purchaser of major industrial assets over the past two years. This has seen our exposure to the sector increase by approximately 50% to around $2 billion with a weighted average lease term of 10 years across the assets.

We have also been actively managing our portfolios, selectively commencing a number of new redevelopments and achieving strong leasing transactions across our three core property sectors. Charter Hall's head office was one of the office leasing deals, with our Sydney office moving into No.1 Martin Place earlier this year. As a property group, we understand the impact of the work environment has on business efficiency, idea generation, employee satisfaction and results, and over the past two years have created a new way of working that is manifested in our new office space at No.1 Martin Place.

Our new way of working represents our commitment to our employees and ensures they are given the support to achieve the best possible outcome for themselves and the business. It brings our people together in an environment that supports the way they want to work – instead of telling them how to work – which allows us to extract the best possible result for our people, our customers and our investors.

We are excited about our new way of working and how it has been embraced by our people. We have already seen a positive lift in energy, enthusiasm, engagement and collaboration and we look forward to inviting our investors into our environment as part of our investor meetings and results over the coming year.

David Harrison
Joint Managing Director

David Southon
Joint Managing Director

Charter Hall head office, No.1 Martin Place, Sydney NSW

Office

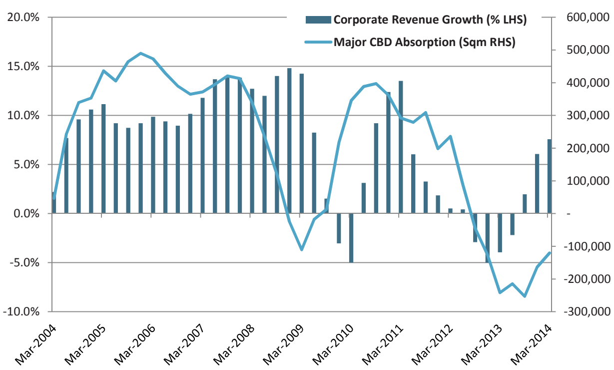
No.1 Martin Place, Sydney NSW

Our $6.5 billion office portfolio makes us one of the largest managers of CBD office properties in Australia. We manage 1,016,544sqm of office space accommodating approximately 647 tenants including Telstra, Macquarie Group, Commonwealth Bank, Westpac, BHP Billiton and State and Federal Government departments and agencies.

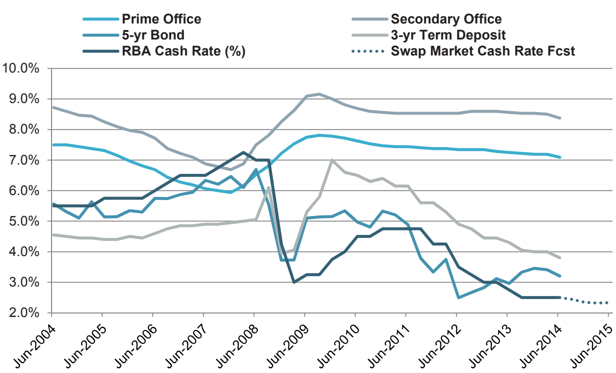
Our strategy is focused on providing smart, long-term accommodation solutions for our tenants and income and capital returns for our investors.

Market update

Major CBD Absorption vs Corporate Revenues



Office Yields vs Fixed Interest



Tenancy conditions in office markets remain challenging at the end of FY14, although a broad improvement in tenant demand is apparent over the same period last year. With national employment growth soft at 0.9% over the past 12 months, and predominantly driven by part-time employment, net office space take up among the major CBD's remained negative at -120,331sqm. However, this is less than half the reduction evident over FY13 and Sydney and Melbourne have now both seen positive take up. This looks likely to continue given a number of bellwether tenants with pending relocations have required more space than originally budgeted.

This demand improvement coincides with a strong uplift in revenues among Australian businesses, with gross corporate profits rising 7.6% over the 12 months to March 2014 (latest available). Business confidence has also notably improved over the same period in 2013, highlighting that drivers for a continued turnaround are apparent. However, with Sydney now the only market under a 10% vacancy rate (due largely to withdrawals of secondary stock) a meaningful uplift in tenant demand is required to offset further vacancy weakness as significant tranches on new supply come online through to 2016.

In Sydney, confirmed supply additions now total 310,605sqm, however this represents 6.2% of Sydney's total stock base and will be partially offset by a number of mooted withdrawals. Supply under construction across Brisbane and Perth is substantially higher at 8.7% and 10.3% of market stock respectively. Although CBD tenants in these markets have continued to contract as mining companies rationalise, employment growth across the broader Queensland and Western Australian economies recovered over the year to stand at an impressive 2.8% and 2.9% respectively. This is well above the national average and a sign these markets are likely to start gradually improving.

Despite the elevated vacancy levels investment demand has increased markedly over the past year, particularly for securely leased assets, with the margin between property yields and returns on fixed interest remaining compelling.

Chart Sources: JLL, ABS, APRA, RBA, Westpac, Charter Hall

Key business highlights

- We have continued to focus on the active management of our office properties with over 109 leasing agreements achieved across 171,429sqm of space.
- Topping off an active three years of leasing activity at 2 Park Street Sydney, which has seen 63,000sqm of space or more than 85% of the building leased or renewed, Charter Hall Office Trust (CHOT) and a joint venture partner secured a new lease with QBE's Australian & New Zealand division (QBE ANZO). New leases have also been negotiated with Metlife and Unilever.
- CHOT's No.1 Martin Place, Sydney asset has also attracted several new tenants, including law firm DLA Piper with nearly 30,000sqm being leased in the last 12 months. No.1 Martin Place is also now home to the Charter Hall Sydney office.
- Charter Hall's Core Plus Office Fund (CPOF) has commenced a number of redevelopments, including the $250 million 333 George Street redevelopment (case study below) and the $336 million redevelopment of 570 Bourke Street, in Melbourne. On completion, 570 Bourke Street will feature a glass atrium cutting through all 10 levels to create the largest vertically connected floor plates available in the Melbourne CBD.
- CPOF has also continued to build on its portfolio, acquiring a 50% equity interest in the Franklin Street Property Trust (FSPT) from Aspen for approximately $30 million. The 37,313sqm A-grade Adelaide building is fully leased to the ATO and Australia Post. As part of the agreement FSPT has acquired the adjoining Adelaide GPO and surrounding development land. Charter Hall has taken on the role as development management for the GPO and surrounding development.
- Charter Hall's PFA Diversified Property Trust (PFA) has continued to deliver on its strategy to sell down its non core mixed use and retail assets and reweight to a 100% office portfolio. The trust sold Homeworld Centre in Tuggeranong for $31 million in July and its 50% interest in Civic Tower, Sydney for $136 million (100% interest). Sale proceeds will be used to provide liquidity for investors wishing to redeem units. The remaining funds will be recycled into new office opportunities to improve and complement the trust's remaining office portfolio and to drive investor returns.
- We are continuing to see strong investment for direct property investments into syndicates. The Charter Hall Direct VA Trust is now closed to investment, having raised $43.3 million of equity from investors to complete the acquisition of the Virgin Australia's Brisbane-based headquarters at 56 Edmonstone Road. The property is leased on a 12 year term to Virgin Australia and has an initial forecast distribution of 8.6% per annum and 8.8% per annum for the years to 31 March 2015 and 31 March 2016.
- Charter Hall Direct Property Fund (CHDPF) continues to be managed in accordance with its investment objectives. The fund's liquidity event will occur in December 2014 with requests to be funded by asset sales. Further to this, CHDPF will be relaunched in upcoming months. The fund will be open for investment as a quality diversified office property fund targeting a 7.5% distribution yield.
- A key component of Charter Hall's strategy for its managed funds is the recycling of assets. In February, Charter Hall sold 130 Stirling Street in Perth for $90 million, representing a market cap rate of approximately 8%. The 12,350sqm 5 Star Green Star office building was designed and developed by Charter Hall in 2009 with the property syndicated in 2010. The sale is a great outcome for our investors, who received a return of greater than 16% p.a. over approximately four years since the fund was launched.
- Other divestments managed by the Group include the sale of CHOT's Charter Grove, St Leonards and 59 Goulburn St, Sydney properties to take advantage of opportunistic pricing and in line with the fund's strategy for ownership of core CBD located office buildings.
- As a testament to Charter Hall's development capabilities and commitment to sustainability, 171 Collins Street, Melbourne (50% owned by CHOT), was recently awarded the 'Best Commercial High Rise Development Australia' and was highly commended in the 'Office Development Australia' category at the Asia Pacific Property Awards. The building was also awarded the 'Hanson's Green Building' award at the United Nations Association of Australia World Environment Day Awards.

333 George Street, Sydney NSW

In March we started construction on 333 George Street - a contemporary new workspace that will offer 15 floors of office space and three levels of prime retail on one of the city's most prominent corners of George Street and Martin Place.

Owned by CPOF, the A-grade building will showcase a striking design with five levels of cascading rooftop terraces providing a unique outdoor workspace with natural light, fresh air and views over the CBD. Visually transparent, the building's floor to ceiling windows will engage with the city, while its boutique floorplates offer a vertically connected and flexible environment.

CPOF has commenced the development without a tenant pre-commitment, highlighting its confidence in the building design and prime location as well as in Sydney's leasing market.

333 George Street is expected to be completed by the second quarter of 2016 and is targeting a 5 Star Green Star Office Design and As Built rating and a 5-star NABERS Energy rating.

Retail

South Hedland Square, South Hedland WA

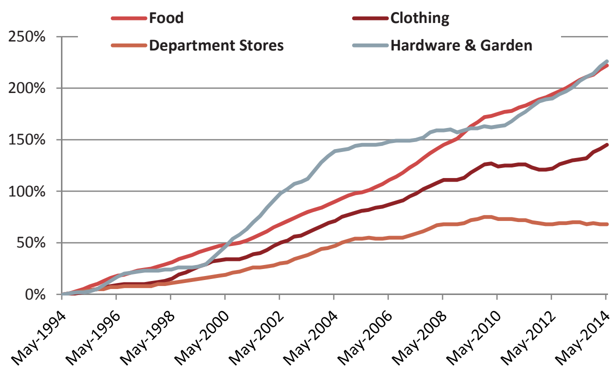
We manage a $3.0 billion portfolio of over 80 retail properties, making us one of Australia's largest managers of supermarket anchored retail centres.

We optimise returns for our investors, and create enjoyable environments for the 100 million shopper visitations to our centres each year, by providing end-to-end property services for each centre. These services include everything from leasing negotiation through to asset management.

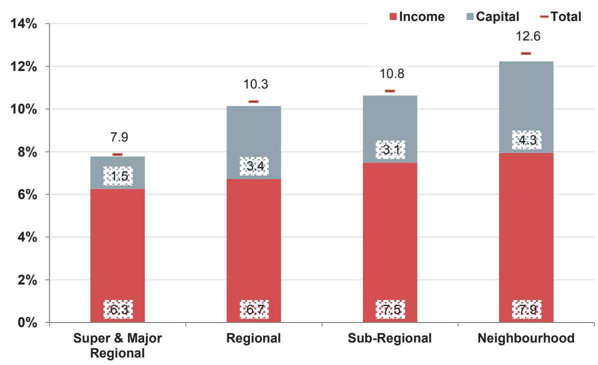
We have a team of 150 retail property professionals and are always focused on opportunities to enhance our existing properties through management initiatives and redevelopments.

Market update

20yr Compound Retail Trade Growth by Sector



Total Return by Retail Asset Class[1]



While business confidence has lifted over the past year the same cannot be said for the Australian consumer, with Westpac's consumer confidence index falling 7.1% and ending July in negative territory. The Federal budget has notably impacted sentiment, with many concerned over its impost on family finances and the broader economy during the year ahead.

Nevertheless while some components of discretionary trade have contracted others have proven resilient, with overall retail trade in Australia rising 4.2%. This is the strongest result since 2010, so the extent to which budget concerns continue to impact the broader market remain to be seen. Food sales remained a stable performer growing by 4.6%.

Notwithstanding the downturn in consumer sentiment, the transition in the economy from being led by mining infrastructure to domestic expenditure can be seen in retail figures. NSW has led the major states posting a 5.6% gain in retail trade as low interest rates spur double digit house price gains and a 49% rise in dwelling approvals over the past two years.

Chart Sources: ABS, IPD, Charter Hall
Retail trade quoted on a rolling annual basis
Note 1: 12 Months to Q1 2014

Hardware and Garden retailing has benefited from this trend with trade increasing 6.2% over the year (continuing its long term outperformance) which reinforces it as one of Charter Hall's preferred retail exposures together with supermarket anchored shopping centres.

The strong performance of food retailing, lower weighting to discretionary spending and positive re-leasing spreads over recent years has seen a significant uplift in demand for neighbourhood and sub-regional centres during 2014. These factors have resulted in yields on high quality assets tightening sharply over the past six months and are likely to see neighbourhood and sub-regional centres continue to perform strongly over the 2015 financial year.

During the current financial year neighbourhood shopping centres provided a total return of 12.6% to March 2014.

Key business highlights

- Charter Hall established a second Bunnings Partnership Fund, BPF2, this year acquiring a $127 million portfolio from Bunnings. The transaction reflects a range of initial yields from 6.95% to 7.5%. The BPF2 portfolio comprises approximately 50% (by value) of metropolitan located stores in the Perth suburb of Armadale and the Gold Coast suburb of Burleigh Heads, with the balance of regionally located Bunnings stores at Gympie and Mackay in Queensland. All properties are leased to Bunnings on new 12 year leases and provide average 3% per annum rental increases. The acquisition increased Charter Hall's total Bunnings assets under management to $400 million.

Charter Hall Retail REIT: Investing in our Australian portfolio

Charter Hall Retail REIT (ASX:CQR) offers unitholders exposure to a portfolio of Australian supermarket anchored shopping centres that provide a secure and growing income stream. CQR's geographically diverse Australian portfolio benefits from exposure to key markets along the eastern seaboard and across a number of growth regions in Western Australia and Queensland.

During the financial year, CQR finalised the sale of its Polish and US assets and continued to focus on the management of its Australian portfolio, completing 92 new leases and 113 renewals for the nine months to March 2014. This delivered specialty rent growth of 2.7% and total occupancy of 98.2% with FY14 same property net operating income (NOI) growth expected to be 2.0%.

In April, CQR entered into a Put and Call option to acquire Coomera City Centre in Coomera, Queensland, for $59.2 million, building on its $2 billion portfolio. Located approximately 20 kilometres north of the Gold Coast, Coomera City Centre is a 9,431sqm neighbourhood shopping centre anchored by a strongly performing Woolworths supermarket and a Dan Murphy's liquor store with 33 specialty retailers. The centre is 97.8% leased and has an 8.8 year weighted average lease expiry, with the Woolworths and Dan Murphy's leases contributing 48% of annual base rent. The Put and Call was exercised on 2 July 2014 with settlement expected 22 July 2014.

CQR's $15.7 million South Hedland Square centre has performed in line with expectations, and was fully leased on completion in October 2013.

The REIT's redevelopments at Caboolture and Lansell are progressing well, with construction nearing completion at Caboolture and Stage 1 of Lansell on track to complete in October 2014.

Despite the softer retail trading environment, we were pleased to announce a distribution for the half year ending 30 June 2014 of 13.65 cents per unit, which together with the first half distribution provides unitholders with a full year distribution of 27.3 cents per units.

Lansell Square, Bendigo Vic.

In line with CQR's focus on enhancing its existing portfolio, Charter Hall commenced the $38 million redevelopment of Lansell Square in November 2013. The centre is undergoing a complete refurbishment which will include the addition of a new 650sqm Reject Shop, a new format 4,337sqm Coles supermarket and the full refurbishment and expansion of the existing Woolworths supermarket. A number of new specialty retailers will also join the centre as part of the redevelopment. Upon completion of the works in February 2015, Lansell Square will offer 22,611sqm of retail space in a refurbished and upgraded format.

Industrial

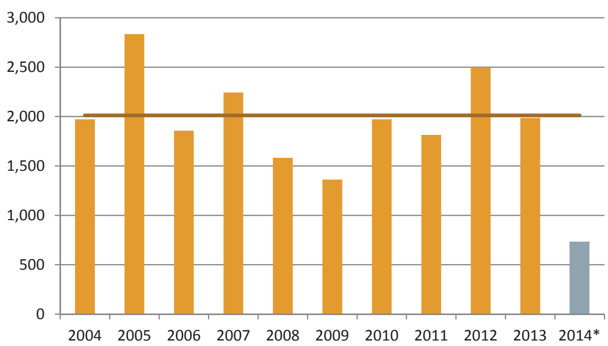
Coles Distribution Centre, Perth WA

We own and manage 56 long-leased industrial and logistics properties across Australia comprising 80 high calibre tenants including Coles, Woolworths, Toll, Metcash, Schenker, Australia Post and Chevron.

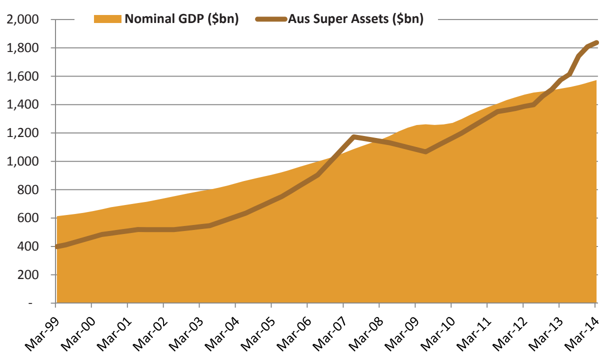
Given the sector's strong property fundamentals and the increasing interest from both wholesale and retail investors, Charter Hall has been actively growing its industrial portfolio over the past number of years. The Group's total industrial portfolio now totals over $2 billion and provides a development pipeline of approximately 285,000sqm, with an end value in excess of $365 million.

Market update

Major Industrial Leasing Activity ('000sqm)



Australian GDP vs Super Fund Asset Value



The industrial sector emerged as the top performing asset class according to Investment Property Databank, with an average total return of 11.3% over the year to March 2014. The sector saw a notable increase in purchaser demand for prime long leased assets given the appeal of fixed reviews amid the lacklustre employment market and low interest rate environment.

Major leasing activity looks to be relatively in line with long term averages this year with 730,000 major deals recorded. Prime rents were broadly stable across the country with minor growth recorded in Sydney and Melbourne, while slight declines were evident in Perth and Brisbane as growth from mining construction eased. The preference for larger tenants to commit to new development remained apparent with 57% of major leasing activity stemming from pre-lease and design and construct activity. However, this trend was heavily orientated toward Melbourne - where new developments represented 80% of major leases tracked - with demand for existing stock in other states notably more active.

There is presently just over 1.26 million sqms of industrial stock under construction across the major capitals of which 69% is already committed by incoming tenants. Relative to market size, Brisbane has the largest level of supply under development, with Melbourne also being relatively active. Development activity in Sydney, Perth and Adelaide remains restrained with developers reluctant to proceed without significant tenant commitments.

While specific value-add assets have been acquired by Charter Hall's CPIF, we broadly continue to favour long leased industrial assets with income security in the present lower growth environment. This is apparent when looking at the average lease expiry across our managed funds of 10.0 years, while this figure stands at 4.8 years on a weighted basis among peers. JLL recorded a strong 41 basis points of yield compression on average for prime assets across Sydney over FY14, with the average prime yield now standing at 7.80% nationally. Given the $264 billion increase in super fund assets over the past year, this figure appears likely to tighten further as more investors seek exposure to the sector.

Chart Sources: JLL, ABS, APRA, Charter Hall

Key business highlights

- The industrial sector has continued to perform strongly over the past six months and the Group has maintained its focus on building on its portfolio, increasing this by approximately 50% in the last two years to over $2 billion.
- Our Core Plus Industrial Fund (CPIF) was very active securing a number of new properties.
  - CPIF acquired 103 Welshpool Road, Welshpool, WA for a total consideration of $17 million in June, increasing the fund's total portfolio to over $900 million. The property comprises a strategic 3.2ha site that is located on a major intersection with prominent exposure and frontage to the Leach Highway and Welshpool Road. The property has a new 10 year lease to Milne Feeds (part of the Milne Agrigroup) with fixed annual reviews of 3.5%.
  - CPIF also acquired 42 Airds Road in Minto, NSW in May 2014 for $12.6 million. This property comprises a generic 10,800sqm warehousing facility with a large concrete hardstand storage area and surplus land with expansion potential. The property is leased to VIP Plastic Packing on a 5.6 year remaining lease term and provides the fund with exposure to the growing South Western Sydney precinct.
  - Increasing its Queensland portfolio, CPIF acquired two industrial sites in Willawong, Brisbane. New logistics and warehousing facilities will be developed on both sites, with these facilities having pre-lease agreements with PrixCar and Akzo Nobel. The two property portfolio has a weighted average lease expiry of 21.8 years and a value on completion of $54.7 million.
  - CPIF also acquired a vacant industrial site in Dandenong South, Melbourne that will provide approximately 7ha of serviced land and enable the fund to grow its Victorian portfolio in an area that is benefitting from recent infrastructure upgrades.
- Our newest wholesale industrial fund, the Core Logistics Partnership, was also active during the last six months, acquiring the Peters Ice Cream industrial facility in Mulgrave, Melbourne for $62 million on a sale and leaseback agreement. The industrial property is leased to Peters Ice Cream on a 20 year initial term with annual reviews of 3.5% for the first 10 years and 3.25% reviews for the following 10 years. As part of the sale, CLP committed to developing a new 2,500sqm office building and car park leased to Peters Ice Cream. CLP has grown from inception in 2013 to a total portfolio exceeding $600 million, with funded capacity to grow to $800 million. The fund's weighted average lease expiry is 11.0 years and it has 98.2% occupancy.
- The Charter Hall Direct Industrial Fund No.2 (DIF2) acquired its seventh asset, with the acquisition of a quarter share of the $153 million Coles Regional Distribution Centre in South Australia. This landmark logistics facility is located in a strategic industrial location in Adelaide's northern suburbs and comprises a modern circa 68,000sqm distribution centre on a site of 24.4ha with a weighted average lease expiry to Coles of 13 years. The acquisition increased the fund's portfolio value to $176 million and lease expiry to 12.5 years. The acquisition meets DIF2's mandate to invest in prime-grade industrial property with long leases to investment-grade tenants. The property is jointly owned with other Charter Hall managed funds. Further opportunities are currently being considered which will see the final DIF2 portfolio total over $200 million.
- As the portfolio for DIF2 is finalised, we are developing the third in the successful industrial fund series and we expect to launch Direct Industrial Fund No.3 over the coming months.
- With significant support from our highly valued investors, a new industrial syndicate, the Charter Hall Direct CDC Trust was launched and closed oversubscribed with $45.5 million raised. The closure of the trust was ahead of expectations and once again demonstrates the overwhelming appetite by investors for quality direct property. The trust co-invests in the Coles Regional Distribution Centre mentioned above. The trust has a forecast distribution of 8.0% pa and 8.1% pa respectively for the years to 31 May 2015 and 31 May 2016.

Artists Impression

15 Long Street, Smithfield NSW

Core Plus Industrial Fund (CPIF) recently completed a $24 million development of a new 16,500sqm distribution centre in Smithfield NSW, delivering a yield on development cost of circa 9%.

The fund acquired 6.6ha of industrial-zoned land in late 2013, securing an eight year lease pre-commitment with national logistics operator Northline prior to the settlement of the acquisition of the land, which was a great result for investors and Northline in this competitive market.

In partnership with the national logistics developer CIP, CPIF developed the generic distribution centre for Northline within part of the fund's planned $90 million estate.

Office

200 Queen Street, Melbourne

Charter Hall

7.5%

target distribution yield[1]

Charter Hall will be launching a new investment opportunity for investors looking for sustainable income and the potential for capital growth.

This unlisted property fund will include:

- High quality CBD office portfolio
- Diversified across major office markets with over 75 tenants
- No stamp duty payable[2]
- Monthly distributions
- 5 year investment term on defined exit

The issuer of the units will be Charter Hall Direct Property Management Limited. A Product Disclosure Statement (PDS) for the trust will be available in early Q4 2014. Applications for units in the fund may only be made under the application form in the PDS. You should contact your financial adviser before making any investment decision.

To find out more information please contact your financial adviser or contact Charter Hall to register your interest for a PDS.

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Notes:
1. 12 months from early 1 October 2014 to 30 September 2015
2. Based on an existing portfolio

This information has been prepared by Charter Hall Direct Property Management Limited (CHDPML) (ABN 56 073 623 784, AFSL 226849) without taking account of any particular investor's objectives, financial situations or needs. A product disclosure statement (PDS) for units in the trust is likely to be made available in early Q4 2014. Investors should consider the PDS carefully in determining whether to acquire units in the trust. To the maximum extent permitted by law, CHDPML disclaims all liability for any loss or damage which may arise out of the provision to, or by, or use by, any person of the information set out above. This is not an offer to acquire any units or make any investment in the trust.

Contact us

Should you have any questions about your investment, please contact Charter Hall Investor Relations:

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To access information on your holding or to change your details contact the relevant registry.

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