Dexus Wholesale Australian Property Fund

APIR code: NML0001AU

30 September 2024

Summary

- The total return over the quarter was 1.99%, which equates to an annualised return of 8.21%. The quarterly return was comprised of a 1.48% distribution and growth of 0.52%.
- Property valuations increased by 1.6% over the quarter with the retail sector again performing best. Importantly, this result consolidated the uplift in values from June 2024.
- The Fund's occupancy was increased to 97.1% and the weighted average lease expiry was maintained at 4.5 years.
- The Fund's gearing was 30.6% as of 30 September 2024.
- Binding contracts were entered to sell 425 Collins St, Melbourne at a contract price of $40 million. This is expected to settle in Q1/2025. This sale continues a theme of disposing of older properties in the portfolio in favour of new properties such as the Crossbank logistics portfolio.
- Construction at Crossbank 141 in Brisbane continued and upon completion, will be the fifth modern facility to be added to the portfolio in the last 12 months.
- Redemptions are currently being paid within 12 months of a withdrawal request being made. Units in the Fund can also now be bought or sold on the PrimaryMarkets platform and a new PDS was released which increased the liquidity options available to estates.

Key Objective

To provide income and long-term capital growth by investing in a diversified portfolio of Australian commercial properties and Real Estate Investment Trusts (AREITs).

Fund Facts	
Fund size (gross assets)	$1,912.3 million
Debt (% of gross assets)	30.6%
No. of Properties	24
Portfolio Occupancy	97.1%
Inception date	31 March 1985
Minimum investment	$10,000
Minimum suggested time frame	5 years
Management costs	1.01%
Buy/sell spread	Nil
Distribution frequency	Quarterly
Distribution cents per unit	1.54
Withdrawal payment time	12 months*

* While the Fund is liquid, the Responsible Entity aims to pay redemptions within 12 months of the applicable window. This may be extended in certain circumstances. Please refer the PDS for the Fund's withdrawal terms.

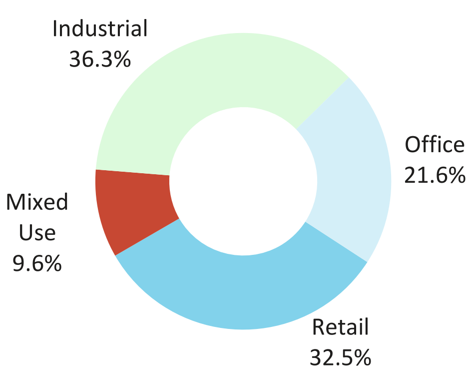
Fund Performance

	3 months %	1 year %	3 years %	5 years %	10 years %	Since inception %
Distribution return	1.48	6.01	5.60	5.68	5.92	7.78
Growth return	0.52	-12.48	-8.28	-4.97	-1.53	0.16
Total return (after fees)	**1.99**	**-6.48**	**-2.68**	**0.71**	**4.38**	**7.94**

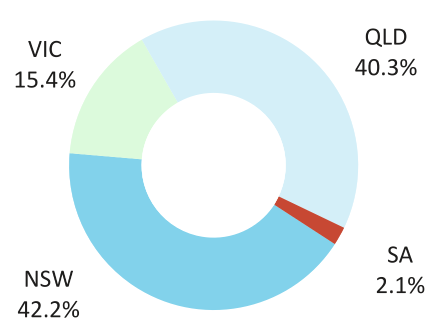
Past performance is not a reliable indicator of future performance.

Performance is annualised for periods greater than one year. Performance figures are calculated using exit prices, are net of management fees, ongoing fees and expenses, assume tax is not deducted. The Distribution return reflects total distributions paid from the Fund, while the Growth return reflects changes in the capital value of units.

Asset Allocation – by state



Asset Allocation – by sector



Fund Commentary

The total return was 1.99%, which equates to an annualised return of 8.21%. The quarterly return was comprised of a 1.48% distribution and growth of 0.52%. The tax-deferred component of the distribution was 68%.

At an operational level, the Fund continued to perform well, with the occupancy rate increased to 97.1%; the weighted average lease term expiry maintained at 4.5 years; and a low level of income arrears. Rental escalation provisions contained within the leases resulted in contracted income increasing.

Property revaluations and sales resulted in a 1.6% increase in the portfolio's value during the quarter. This consolidated the 0.7% uplift that was came through in the June quarter.

The average cap rate across the portfolio was broadly maintained at 6.49% (up 131 basis points from the peak of 5.18% in June 2022). The retail portfolio increased by 1.7%, supported by an increase in market rents. The office portfolio increased by 2.6% - which was partly offset by capital expenditure and transaction costs associated with the sale of 425 Collins St, Melbourne - and the industrial portfolio rose 1.2%. With the exception of Gasworks Workspace and 2 Second Ave, Mawson Lakes, all properties were either flat or rose in value over the quarter.

Binding contracts were entered to sell 425 Collins St, Melbourne at a contract price of $40 million. This is expected to settle in Q1/2025. This transaction is not subject to the purchaser raising capital and continues a theme of well-capitalised private investors seeing value in the current market.

The Fund's drawn debt was $585.9 million or 30.6% of gross assets as of 30 September 2024. Maintaining the Fund as a 'low-debt' option for investors remains a priority.

Commercial agreement was reached to extend the major Leases to the major tenants at both 33 Park Road, Milton and 200 Greens Road, Dandenong, increasing the value of each property and the cashflow security of the portfolio.

Construction of the Fund's facility at Crossbank 141, Brisbane remains on track for a Q4/2024 completion. This is fully leased to logistics tenant, Freight Specialists for a 10-year term. This property will be one of the five brand new buildings added to the portfolio since 30 June 2023. Paired with the sale of some of the fund's older assets, the overall quality of the portfolio, depreciation benefits and income security has been improved.

All redemptions submitted in the prior 12 months were paid in full over the quarter.

Units in the Fund may also now be bought or sold on the PrimaryMarkets platform and a new PDS was released which increased the liquidity options available to estates.

The Fund was added to the approved product list for the AMP Advice network. The Fund has also seen increased investment from offshore investors which has been encouraging.

There is increasing optimism that both inflation and interest rates have peaked and values have recalibrated to a higher interest rate environment. The priorities from here are to maintain the reliable and highly diversified rental base that underpins the quarterly distribution; to strengthen the balance sheet; and to look for opportunities to capture the income growth and translate this to capital uplift.

Market Commentary

Australia's headline monthly inflation rate fell to 3.4% in August 2024, a slower than expected decline has reduced market expectations of an interest rate cut in the short term and may extend the cycle into 2025. The 10-year bond yield fell below 4% for an extended period in August although it has since lifted to 4.2%, the apparent peaking of the global interest rate cycle is providing investors with greater confidence that headwinds facing valuations of real assets are alleviating.

The demand outlook for real asset sectors will be supported by population growth, which has been strong at circa 2.1% p.a. However, population growth is expected to normalise to about 1.3% p.a. by 2025 as the net migration surge wanes.

The labour market has softened only mildly with the unemployment rate currently at 4.2%. GDP growth slowed to just 1.0% p.a. Q2 2024. Growth is forecast to improve to 2.0% p.a. in FY25, with consumer indicators, infrastructure projects and exports helping to offset weak residential construction activity.

Commercial real estate transaction markets have been quiet over the last 1-2 years, but there are now clear signs of strengthening.

Transaction volumes were up 18% in the past 6 months compared to the same period last year. On a pro-rata estimate for Q4 2024, the value of transactions in 2024 is expected to be $44bn, around 11% above the level of 2023. These estimates exclude the pending $9.8bn AirTrunk data centre transaction - so can be considered conservative. Other signs that the transaction market is becoming stronger are that a) the average size of transactions in calendar 2024 year to date is up 60% on 2023, and b) the proportion of institutional buyers has increased from 34% in 2023 to 64%. While improving, transaction volumes still below average so there is a way to go before the market gets back to previous levels of activity. Nevertheless, improving volumes means buyers are seeing value at current pricing levels.

The office sector has experienced a quarter of mixed signals. Demand remains varied across the CBD markets, with the Sydney and Perth CBDs recording positive net absorption while Brisbane and Melbourne were mildly negative. In markets with sustained demand and decreasing vacancy rates, there are subtle indications that prime incentives are beginning to trend downwards.

The supply pipeline in office has significantly contracted, with forecast commencements for FY24-27 down 33% compared to the five-year average. This reduction in the forward supply pipeline will help protect existing stock from additional supply risk and support rent growth through the cycle. Rising construction costs, interest rates, and vacancy rates have put pressure on the feasibility of uncommitted developments.

The industrial sector has boomed in the past two years, seeing unprecedented rent growth and incredibly low vacancies. This growth has been slowly easing over the past few quarters as demand for space tapers in line with economic indicators.

The retail sector fundamentals are generally positive. Vacancies across shopping centre types have held relatively steady despite the weak sales environment. Lower occupancy costs than before the pandemic will help preserve occupancy levels and provide room for future growth in rents. A lack of new supply being held back by construction costs and planning constraints is another positive, particularly given population growth is adding to aggregate demand.

Fund Manager

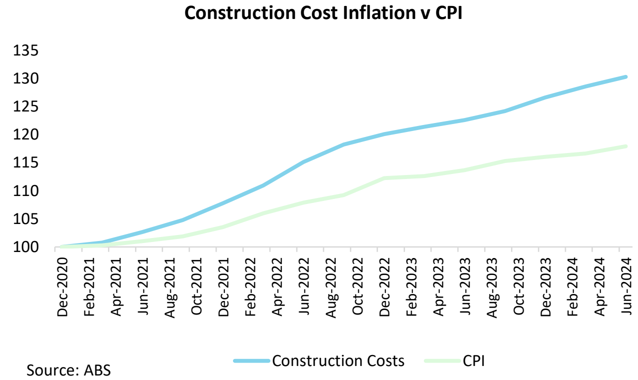
Christopher Davitt

Christopher is the Fund Manager for the Dexus Wholesale Australian Property Fund and has overarching responsibility for setting and executing the Fund's investment strategy and capital management plan.

Christopher works with Dexus's specialist teams to formulate asset plans for the properties, source and evaluate acquisitions and manage the portfolio's debt and equity. He joined the business in March 2010 having previously held research, transaction and funds management roles in Australia and Europe.

Replacement Costs Explained

Construction cost inflation has been nearly 70% higher than consumer inflation over the last 4.5 years. This has sparked increasing commentary around 'replacement costs'. Below we examine what this means and the opportunity it presents investors.



Source: ABS

Replacement cost vs Market value

The market value and replacement cost of a building are not the same thing. They are distinctly different concepts that are estimated using different criteria.

Replacement cost is the estimated cost to construct, at current prices, the same property. The major components of replacement cost are:

- Land value
- Construction costs – which includes both materials and labour
- Professional fees
- Financing costs
- Leasing costs
- Development profit

Market value is the estimated price at which a property would be sold on the open market between a willing buyer and seller in the prevailing market. The major drivers are:

- Rents
- Capitalisation rate – which works the same way as bond yields with a lower cap rate equating to a higher price, and vice versa

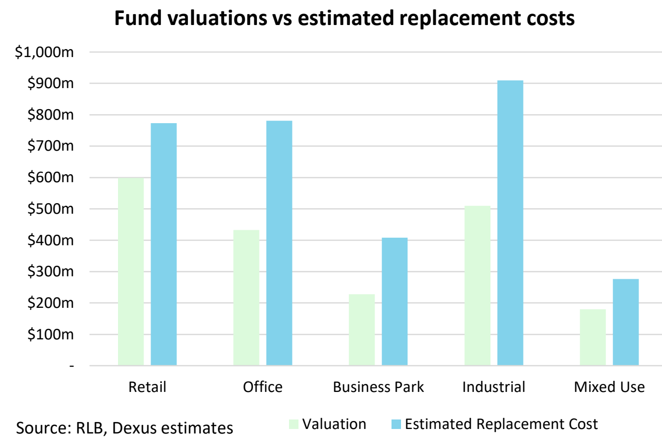
Real estate has a reputation as a hedge against inflation because its intrinsic value is linked to construction costs. If market values fall behind replacement costs, then new development will be curtailed. The resulting undersupply triggers a spurt of rental growth sufficient to bring market values back in line with replacement costs.

Over the last 18 months a substantial mismatch has emerged. Rising interest rates have triggered a correction in real estate values. Simultaneously, construction costs have risen due to supply chain disruption, higher land costs, higher material costs, higher labour costs, higher financing costs, the difficulty of finding a builder, competition from infrastructure projects and a repricing of development margins to reflect the risks above.

CBRE Research have published a paper on this topic which states:

> *there's a sizeable gap between current average value/rent and replacement costs across almost every aspect of Australian real estate. In most cases, the gap is around 30-40%.*[1]

This is corroborated by our analysis of the Fund's properties which indicated that all portfolios are valued below replacement cost. With demand for commercial real estate supported by a 1.65 million increase in the population since December 2021, we see the potential for strong rental growth as undersupply emerges in markets such as the Sydney CBD (where no buildings are forecast to complete in FY2026, sought after industrial markets and subregional retail assets in markets with strong income growth.



Source: RLB, Dexus estimates

Fund Features

The Dexus Wholesale Australian Property Fund (DWAPF) was started back in 1985 and has continued to improve the design of the fund while delivering an average return to investors of 7.9%. The Fund is widely available and offers market leading features, some of which have been recently introduced. Here is a summary:

Availability – the Fund is available for direct investment or via leading platforms including North, Panorama, Asgard, Macquarie Wrap, Expand Extra, FirstWrap, Netwealth, Xplore, Hub24, Dash, Praemium, FNZ and Mason Stevens.

Deceased estates / Legal disability – a legal disability withdrawal mechanism has been introduced that may facilitate monthly redemptions for investors that have passed away or have suffered other forms of 'legal disability' and meet the conditions. This is available up to $500,000 subject to conditions.

Secondary sale of units – Dexus has partnered with PrimaryMarkets, enabling the Fund's investors the potential to list for sale their units and gain liquidity at a price nominated by them (if a buyer is available) through a facilitated secondary market at a 2.5% fee payable to PrimaryMarkets (note, the Fund does not charge a sell spread). This arrangement is designed to provide a potential alternative liquidity pathway if the primary way of exiting the Fund is not practical. Alternatively, eligible purchasers can potentially take advantage of an immediate uplift in the holding value of their investment if they complete a purchase of units through the PrimaryMarkets platform at a discount to the Fund's prevailing unit price.

Financial hardship – is available for investors that meet the ASIC hardship criteria. Investors can submit requests up to four times a year, capped at $100,000.

Recontributions – if investors need to technically redeem and re-invest in order to facilitate a recontribution strategy, this can be facilitated.

Switching – if investors need to transfer between platforms or onto/off platform or on a super-to-super basis or super-to-pension basis, this can be facilitated.

Bonus Units – direct investors who choose to activate the Distribution Reinvestment Plan are eligible for 2% bonus units.

SIV Compliant – the Fund is 'complying' for the purpose of meeting the Significant Investor Visa requirements.

Ratings – Lonsec and Zenith Investment Partners have currently both issued 'Recommended' ratings for the Fund.

The Fund continues to offer one of the most competitive liquidity and fee structures amongst comparable unlisted managed property funds. Currently, monthly withdrawal payments are being made based on redemptions lodged 12 months prior.

[1] CBRE Research, September 2024

Balance Sheet – Dexus Wholesale Australian Property Fund

Assets/Liabilities	Valuation / Contract Price	Valuation Date	Cap rate	Occupancy	No. of Tenants	WALE* (yrs)
Casula Mall	$200.0m	Sep-2024	6.00%	100.0%	63	2.7
Stud Park Shopping Centre	$140.0m	Sep-2024	6.50%	99.4%	60	5.4
Gasworks Plaza	$130.0m	Sep-2024	5.75%	99.4%	35	5.2
Brickworks	$138.5m	Sep-2024	6.00%	95.5%	50	2.5
The Mill, Alexandria	$180.5m	Sep-2024	5.63%	98.3%	19	4.0
Bond One, Walsh Bay	$113.0m	Sep-2024	6.88%	100.0%	4	3.0
636 St Kilda Rd, Melbourne	$63.0m	Sep-2024	8.00%	39.4%	26	1.1
199 Grey St, Brisbane	$85.5m	Sep-2024	7.50%	100.0%	17	2.9
Gasworks Workspace, Brisbane	$62.0m	Sep-2024	7.50%	95.5%	6	3.0
33 Park Rd, Brisbane	$49.0m	Sep-2024	7.75%	97.8%	12	2.6
Stanley House, South Brisbane	$30.9m	Sep-2024	6.00%	100.0%	2	7.0
Connect Corporate Centre B2, Mascot	$89.0m	Sep-2024	7.75%	98.8%	9	4.9
Connect Corporate Centre B3, Mascot	$142.5m	Sep-2024	7.75%	99.4%	15	4.7
Holbeche Industrial Estate, Arndell Park**	$65.0m	Sep-2024	5.38%	100.0%	3	3.8
384-394 South Gippsland Hwy, Dandenong	$24.3m	Sep-2024	6.00%	100.0%	1	3.1
2 Pound Rd West, Dandenong	$10.5m	Sep-2024	6.00%	100.0%	1	7.0
202-228 Greens Rd, Dandenong	$49.8m	Sep-2024	5.88%	100.0%	4	4.9
Crossbank 161, Trade Coast, Brisbane	$90.5m	Sep-2024	5.50%	100.0%	1	14.4
Crossbank 141, Trade Coast, Brisbane	$50.0m	Sep-2024	5.63%	100.0%	1	10.2
121 Evans Rd, Salisbury	$52.8m	Sep-2024	6.75%	100.0%	5	3.4
Acacia Gate Industrial Estate, Acacia Ridge	$37.0m	Sep-2024	6.50%	100.0%	11	2.6
7-9 French Ave, Brendale	$30.2m	Sep-2024	6.00%	100.0%	1	5.3
2 Second Ave, Mawson Lakes	$38.8m	Sep-2024	7.50%	100.0%	1	6.2
425 Collins St, Melbourne***	$40.0m					
Cash	$5.4m					
Total / Portfolio Average	**$1,918.0m**		**6.49%**	**97.1%**	**347**	**4.5 yrs**
Debt	$585.9m					
Other liabilities	$93.1m					
Total	**$679.0m**					
Net Assets	**$1,239.0m**					

* Weighted Average Lease Expiry ** 50% interest *** contracted price: settlement expected Q1/2025

www.dexus.com