Dexus AREIT Fund

Quarterly Report

30 June 2023

Investment Objective

The primary investment return objectives of the Fund are to:

- Provide a gross annual income yield (before management fees and expenses) that equates to at least 110% of the average yield of the S&P/ASX 300 AREIT Index Dividend Yield
- Provide a level of capital growth which at least matches increases in CPI over a 5-7 year time horizon
- Provide lower than market volatility[1]

Benefits

- Focus on generating sustainable, regular and relatively high income returns through investing in listed property securities
- Access to an underlying diversified portfolio of thousands of quality commercial real estate assets predominantly located in Australia
- Has paid monthly distributions[2]
- Actively managed (non-index aware) portfolio, applying a highly disciplined and proven strategy designed to deliver on the Fund's income and risk objectives
- Liquid – daily applications and withdrawals (under normal market conditions but withdrawals can take longer in certain cases as set out in the PDS)

Fund Facts	
Fund type	Property securities fund
Commencement date	19 January 2009
Fund size	$654.44m as at 30 June 2023
Investment timeframe	5-7 years
Minimum investment	$1000
Minimum additional amount	$500 ($100 per month with regular savings plan)
Income distribution	Monthly generally payable within 10 business days[2]
Unit pricing	Daily
Management fees and costs	0.85% pa of NAV (see section 6 of the PDS for details)
Buy/sell spread	0.15% buy and 0.15% sell

Performance – Dexus AREIT Fund

	1 year %	3 year %	5 years %	10 years %	Since inception %
Income[3]	6.40	5.42	5.87	6.55	7.55
Total return (after fees)[4]	**4.73**	**6.02**	**0.22**	**5.95**	**9.26**

1. The Dexus AREIT Fund aims to provide lower than market volatility compared with the S&P/ASX 300 AREIT Index over a 5-7 year time horizon.
2. Past performance is not an indicator of future performance.
3. Distributions may include a capital gains component.
4. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Returns and values may rise and fall from one period to another. Past performance is not an indicator of future performance. Fund's inception date used to determine return: 19 January 2009.

Fund Commentary

Dexus AREIT Fund

The Dexus AREIT Fund returned 2.19%[5] over the quarter, underperforming the S&P/ASX 300 A-REIT Index by 96bps over this period. Contributors to performance over the quarter were positions in Centuria Industrial, Abacus, and Dexus, while detractors were positions in Goodman Group, Mirvac and Scentre Group.

According to UBS the AREIT sector is priced on a 12m forward dividend yield of 4.6%, which represents 60bps spread to the 10-year bond rate of 4.0% at the end of June 2023. While the sector yield remains attractive, the sector's yield spread and discount to valuation have narrowed in the last quarter due to the positive returns. The sector is trading at a 9.4%[2] discount to the UBS blended NAV/DCF at FYE23.

Higher interest rates for longer remain a key risk to the sector in FY24, with higher debt costs a drag on A-REIT earnings. Higher inflation can also have a positive impact on rental growth for landlords such as Arena and Scentre Group who have leases that have CPI linked rent increase clauses which will underpin significantly higher than normal rental growth.

Another factor will be cap rates which are expected to soften further in the next 12-18 months, indicating a risk to asset capital values. According to JPMorgan, excluding fund managers the average AREIT discount to NTA is 23%[2]. With the majority of AREITs trading at significant discounts future declines in asset values appear to be more than priced into the market.

As an income focused manager our preference remains AREITs with resilient income streams and solid balance sheets. Industrial remains our preferred real estate asset class, given its favourable structural dynamics with a number of alternative sectors (child/healthcare, self-storage and service stations) also offering attractive attributes at discounted prices.

As at 30 Jun 2023, the Dexus AREIT Fund provided a 6.6%[5] distribution yield based on its ex-buy price.

Market commentary[2]

Over the quarter, the S&P/ASX 300 A-REIT Index returned 3.2%, outperforming the broader equities market (ASX 300[8]) by 220bps. Primarily thanks to Goodman (GMG), the industrial asset class has provided the strongest returns, outperforming the other asset classes over both the quarter and FY23, while moderating consumer sentiment and RBA cash rate increase fears has seen retail underperform markedly in the June quarter, after providing solid returns over prior quarters.

The AREIT sub-sector returns over the June quarter and past year[2], were as follows:

- Diversified: 4.1% / 10.9%
- Retail: -1.7% / 4.9%
- Office: 5.3% / -8.7%
- Industrial: 7.3% / 14.2%
- Specialised: -0.6% / 1.1%

As the implications of higher interest rates are starting to be felt across the broader economy, investors are looking at sectors that led the market down in early 2022, that should benefit after the rate cycle peaks. Clearly, AREITs are in this bucket as reflected by the sectors June quarter performance which was 2.2% ahead of the broader equities market, the impact of higher rates and a slowing economy.

It is worth noting that since the end of September 2022, the S&P/ASX 300 A-REIT sector returned a solid 15.4% over the nine months to 30 June 2023. This is an impressive result not only because it was 1.5% ahead of the broader equities market[1], but it also occurred through a period when the RBA increased cash rates by a staggering 1.75%.

Generating this level of return highlights how significant the markets overreaction to rising inflation and higher rates was through much of 2022. Investors abandoned interest rate sensitive sectors, with REITs globally at the forefront of the sell-off. Clearly some investors took advantage of this opportunity and have benefitted from a strong recovery in AREITs from its low and have been rewarded with strong returns through what was a volatile period.

Over the June quarter stocks that outperformed were HMC Capital (+40.9%), Centuria Capital (+13.0%) and Mirvac (11.2%). Meanwhile, the underperformers were Rural Funds Group (-10.3%), GDI (-7.0%) and Vicinity (-5.1%). Over FY23 residential names, Mirvac (+19.9%) and Stockland (+19.4%) led the top performers. While the residential sector faces interest rate headwinds, supply shortages and immigration provide a strong platform for future growth. Service station landlord Waypoint (+18.9%) was also a performance leader, it's income security, predictable growth and a strong balance sheet remaining attractive to investors in volatile times. Rural Funds Group (-25.7%) lead the performance laggards, followed by office landlords GDI (-23.8%) and Cromwell (-22.4%)

5. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Returns and values may rise and fall from one period to another. Past performance is not an indicator of future performance.
6. Source: UBS Research as at 30 June 2023. Distributions may include a capital gains component. Past performance is not an indicator of future performance.
7. S&P/ASX 300 Australian Equities Index.

Fund Manager

Pete Morrissey

Pete joined Dexus Real Estate Securities (formerly APN) in 2006. Pete has been the Head of Real Estate Securities since 2019 and is responsible for the management of the Dexus suite of real estate securities funds and the dedicated Fund Manager of the Dexus AREIT Fund.

With more than 20 years financial markets experience, Pete brings a unique knowledge set having completed Masters level academic research papers on both commercial real estate cycles and global property securities.

Prior to joining Dexus, Pete was a senior analyst at research house Lonsec and managed an internationally focused private investment fund. Pete also spent several years as an analyst in the UK for Nomura, ING Barings and Lloyds Banking Group.