Australian Unity A-REIT Fund

Fund Update
31 December 2023

The Fund invests in a portfolio of select Australian Real Estate Investment Trusts (A-REITs), aiming to deliver a total return, consisting of income and capital growth, above the S&P/ASX300 A-REIT Accumulation Index over the medium to long term.

Performance as at 31 December 2023

	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Since inception % p.a.
Distribution return	1.39	5.93	7.53	9.63	11.61	11.21	11.34
Growth return	11.33	2.30	(3.90)	(6.00)	(7.88)	(3.59)	(1.75)
Total return	12.72	8.23	3.63	3.63	3.73	7.62	9.59
S&P/ASX300 A-REIT Accumulation Index	16.50	16.90	5.88	6.39	5.95	9.42	10.79

Inception date for performance calculations is 31 July 2011.
Returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance.

How the listed property market performed

While 2023 has seen a notable slowdown to prior economic growth, the Australian economy has proved resilient against the many local and overseas challenges faced over the year. The impacts of stubbornly high inflation and interest rates reaching their highest levels since 2011 has seen annual economic growth shrink from 3.8% over 2022 to a 12-month rate to September 2023 of 2.1%.

Economic growth in Australia has been supported by a strong rebound in both overseas migration and tourism levels together with ongoing low unemployment which have helped to partially offset falling consumer demand in times of challenging cost of living pressures. However conversely, such economic resilience together with services price growth and housing supply issues has led inflation in Australia to remain markedly above the RBA's desired target 2% - 3% range. While this has moderated from prior peaks, it remains above several of Australia's developed world counterparts. As a result, at its November 2023 meeting, the RBA raised the cash rate by a further 0.25%, bringing the total cash rate to 4.35% where it was held in December 2023. Positively, recent inflation data in the USA and parts of Europe has demonstrated a material reduction in inflation and while declines in Australia have lagged, the downward trend would imply we are at or near to peak interest rates. Following recent projections from the USA's Federal Reserve that they anticipate a cut in interest rates in 2024, market sentiment has pivoted somewhat to bring forward expectations of interest rate cuts, both overseas and within Australia, leading to significant equity market enthusiasm in the latter stages of 2023.

Notwithstanding the recent optimism regarding the possible end to escalating interest rates, volatility risk and market uncertainty remains. Over the short term, Australia's economic growth is forecast to remain subdued as businesses and consumers work through the current constrained growth environment. However, continued population growth and strong employment levels should act as a backstop.

Overall, 2023 has been a testing year for commercial real estate, with interest rates continuing to rise, inflation levels remaining elevated and structural shifts in office worker patterns creating pricing pressures and a dislocation between buyers and sellers. Somewhat inevitably, property values have come under pressure, however, despite such tribulations, real estate markets have been resilient, most notably within the living, industrial and alternative property sectors. More prudent debt management together with flexibility from lenders has to date, resulted in minimal distressed asset sales driving a softer market landing in Australia. Looking forward macro-economic uncertainty remains, however the 2023 Institutional Real Estate Allocations Monitor notes Asia Pacific based Institutional investors expect to increase allocations to real estate in 2024. To this end, Australia is likely to remain attractive given ongoing migration levels and a relatively positive forecast economy, while potential interest rate cuts will also likely support transactional activity towards the second half of 2024.

For the quarter ending 31 December 2023, the Australian listed property sector, as measured by the S&P/ASX 300 A-REIT Accumulation Index (A-REIT Index), returned positive 16.5% outperforming the broader equities market as measured by the S&P/ASX 300 Accumulation Index which returned positive 8.4%. Over the year to 31 December 2023, A-REITs returned positive 16.9% compared to the broader equities market return of positive 12.1%, albeit this was somewhat skewed by the strong performance

Contact us
australianunity.com.au/wealth
australianunitywealth@unitregistry.com.au

Damian Diamantopoulos
Portfolio Manager
T +61 3 8682 7423
E DDiamantopoulos@australianunity.com.au

Andrew McLeod
Senior Portfolio Analyst
T +61 3 8682 4558
E AMcLeod@australianunity.com.au

of Goodman Group (GMG) which has returned 47.7% over 2023.

Fund Manager A-REITs led the sector with Charter Hall Group (CHC), HMC Capital (HMC) and Centuria Capital (CNI) all posting quarterly returns in excess of 29% as investors responded positively to potential for future interest rates cuts, while HMC is also expected to benefit from the merger of Sigma Healthcare and Chemist Warehouse via one of its managed funds. Outside of this, performance was widely strong with several diversified groups and large retail mall owners achieving returns of between 15.2% (RGN) and 22.2% (GPT). Performance was slightly more muted for several specialised focused AREITs, while industrial focussed stocks led by Goodman Group (GMG) returned 18.1% over the quarter (UBS, 2023). The laggards for the period were diversified group Mirvac (MGR) which returned positive 0.2%, healthcare focused HealthCo Healthcare & Wellness REIT (HCW) returning 2.7% and development focussed Lendlease and Qualitas Real Estate Income Fund (QAL) which returned positive 4.0% and 4.2% respectively.

The strong performance by the A-REIT market over 2023 was heavily influenced by the strong returns achieved in the final quarter of 2023, as softer inflation data saw a sharp adjustment in market expectations for future interest rate cuts which was received positively by listed property market participants. Yields on Australian 10-year Government bonds finished the year at 3.95% having hit an annual peak as recently as late October 2023 of 4.94%. Such volatility is symbolic of bond markets over the year with the Australian 10-year Government bond yields starting and ending the year at similar levels despite demonstrating a near 180bps peak to trough differential.

The erratic performance exhibited by Australian 10-year bonds (commonly used as a proxy for comparing and valuing asset classes) has subsequently impacted direct property purchaser pricing considerations and limited purchaser confidence. As a result, transactional property market activity in 2023 has declined substantially versus prior years, particularly for larger value assets, with a bid ask spread remaining between buyers and sellers. This is likely to continue until such time as the volatility within debt markets stabilises, providing purchasers with greater certainty in their asset appraisal process. Against this limited transactional evidence backdrop, December 2023 saw several A-REITs provide updated property revaluations for their portfolios. In line with the trend of the prior 12 months, valuers continue to soften capitalisation rates, albeit the associated impact on underlying asset values varies by sector. Reported valuations for the Industrial and Retail property sectors have largely held, with continuing rental growth and consumer resilience, particularly for non-discretionary retail focussed assets, largely offsetting capitalisation rate expansion. In the face of continued demand side headwinds, property values within the listed office sector remain under pressure with declines averaging 6% to December 2023 for those office A-REITs which had pre-reported as at 31 December 2023.

For the most part, corporate activity was muted over 2023 as A-REITs struggled with rising costs of capital, however the end of 2023 saw a modest pickup in activity. In December 2023, Stockland (SGP) acquired 12 master planned community sites from Lendlease (LLC) for c.$1.1bn while earlier in the quarter Mirvac Group (MGR) acquired a 47.5% stake in the Serenitas Land Lease business as it looks to prosecute on its strategy to expand into the manufactured housing estate business and capitalise on the ageing demographic.

The recent decline in 10-year bond yields and improved sentiment regarding future interest rate levels has provided a welcome fillip to the A-REIT market. While this is unquestionably positive for the listed real estate market, investors remain highly sensitive to macro-economic conditions and associated data, which is likely to continue to create some volatility in the short term. As of 31 December 2023, the A-REIT sector is trading at a c.4.3% FY24 estimated dividend per share yield and a substantial c.-17% discount to last stated Net Tangible Assets (NTA) which excludes Charter Hall Group (CHC), Centuria Capital Group (CNI), HMC Capital (HMC) and Goodman Group (GMG) from the equation as these have a large portion of non-rental earnings/assets (i.e. development and funds management businesses) and their market pricing can deviate substantially from NTA backing. Gearing across the sector (S&P/ASX 300 A-REIT Accumulation Index) is currently a manageable c.24%, with most individual stocks operating within target rages.

Outlook

In general terms, returns over the past few years have been strongly influenced by substantial property yield compression and a low interest rate environment. Listed market volatility is likely to continue in the short term, while returns moving forward are likely to be increasingly guided by underlying property fundamentals.

Top 10 A-REIT holdings

Stock	Portfolio %
Scentre Group Limited	10.71
Goodman Group	7.27
Dexus	6.94
Stockland	6.90
Vicinity Centres	5.71
Mirvac Group	5.29
GPT Group	4.64
Region Group	4.49
HomeCo Daily Needs REIT	3.71
Centuria Industrial REIT	3.22

Asset Allocation

Asset class	Portfolio %
Listed Property	97.76
Cash	2.24