5 Highly Recommended Lonsec Research

Direct Assets Review
Charter Hall Direct Office Fund

ISSUE DATE: 12-09-2019

September 2019

Fund financial position[1]	June 2019
TOTAL ASSETS	$2,086M
GEARING – LVR	30.0% (COVENANT 60%)
GEARING – DEBT/TTL ASSETS	29.7% (TARGET 25%-45%)
NET ASSETS PER UNIT	$1.46
UNIT PRICE (WHOLESALE A)[2]	$1.48

Portfolio summary[3]	
NO. OF PROPERTIES	DIRECT 14; INDIRECT 26
PROPERTY TYPE	OFFICE 100%
PROPERTY LOCATION	NSW 44%, VIC 24%, QLD 23%, SA 7%, WA 2%
WTD AVG LEASE EXPIRY	8.6 YRS (BY INCOME)
OCCUPANCY (BY INCOME)	99%

Fund returns	Lonsec estimates*
EST. FUND 10 YR IRR PRE-TAX	8.64% P.A. (HURDLE 7.00% P.A.)
IRR AFTER TAX (@ 47%/15%)	6.48% P.A. / 7.96% P.A.

Year end June	FY20e	FY21e
DISTRIBUTION PER UNIT	8.50C	8.75C
PRE-TAX YIELD @ $1.48	5.74%	5.91%
TAX DEFERRED	60%	60%

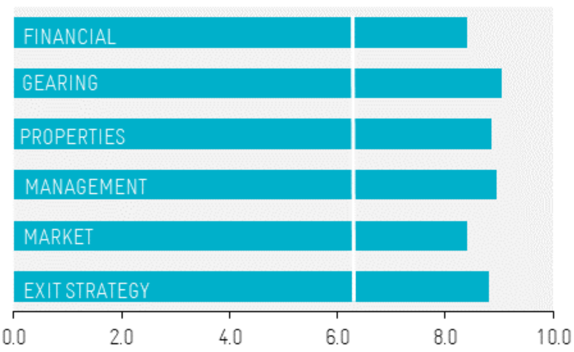
* Lonsec estimates of 10-year internal rate of return and distributions.

Other Fund details	
APIR CODE	MAQ0842AU
DISTRIBUTION PAID	QUARTERLY
MIN. INVESTMENT DIRECT MIN. VIA PLATFORM	$20,000 (THEREAFTER $1,000 LOTS) NO MINIMUM
INVESTMENT TERM	ROLLING FIVE YEAR TERMS FULL LIQUIDITY EVENT DEC 2019
REDEMPTIONS	SEMI ANNUAL
RESPONSIBLE ENTITY / MANAGER	CHARTER HALL DIRECT PROPERTY MANAGEMENT LTD (CHDPML)/ CH HOLDINGS (CHH)
MANAGER FUND HOLDING	NIL

Manager fees and expenses	
ESTAB. FEES & COSTS	1.50% ASSETS / 2.50% EQUITY
ANNUAL FEES & EXPENSES	0.68% ASSETS / 1.16% EQUITY
PERFORMANCE FEE	15% OF EXCESS ABOVE 10% IRR
DISPOSAL FEE	UP TO 1.5% OF DIRECT OR INDIRECT INTEREST IN PROPERTY

1: 30 June 2019 financial position.
2: Wholesale A unit price ex-distribution as at 30 June 2019.
3: DOF has an interest in the Charter Hall Prime Office Fund, which holds 26 office properties across Australia worth $5.6bn.

Lonsec ratings of critical determinants



Conclusion and Rating Rationale

Lonsec has assigned a **'Highly Recommended'** rating on the Charter Hall Direct Office Fund ('DOF' or 'the Fund') based on the following key factors:

- The Fund's mandate is to acquire and grow a portfolio of high quality **Australian office properties** located in the CBD and established markets of major Australian capital cities, with an emphasis on the east coast, and leased to high profile or well-regarded tenants. Investments can also be made in high quality office funds that meet the criteria. The Manager has discretion to dispose of properties when suitable and in the best interests of Fund investors.
- The Fund seeks to benefit from **strong office rental growth** which is supported by solid fundamentals: a growing local economy, strong employment and population growth, limited supply, and high government infrastructure spending.
- The portfolio consists of **good quality A-Grade office assets**, with over two-thirds of the portfolio invested in Sydney and Melbourne as both markets have the strongest fundamentals and highest liquidity. The portfolio has a mix of high-quality newly constructed properties and older (but recently refurbished) established assets.
- The properties are leased to **high-quality tenants** and are currently **99% occupied**. The portfolio is well positioned from a rental review perspective, increasing by ~3.5% p.a., which helps provide a **natural inflation hedge**. Additionally, the majority of direct properties are leased on a **net basis**, whereby the tenant is responsible for outgoings. The Fund's property portfolio is **reasonably diversified** from geographic, property type and tenant perspectives.
- The Fund has a weighted average lease expiry **(WALE) of 8.6 years**, which is higher than the Lonsec peer group average of 8.3 years and provides good long term income certainty for investors.
- The Wholesale A units offer a **distribution yield** in FY20 of 5.74% p.a. pre-tax (or 8.50c per unit), which is

below Lonsec' peer group average of unlisted property funds.

- Lonsec's estimate of **total return is 8.64% p.a.** which has reduced slightly compared to the previous review, in part due to unit price appreciation, however is still marginally above peer average and a good premium to Lonsec' hurdle rate.
- While this is an open-end fund with an initial five-year investment term, there is limited liquidity during this period. As such, liquidity is towards the **lower end of the Lonsec peer group**. However, the Fund has an initial liquidity event in December 2019, when all investors can redeem part or all of their investment (see Section 5 for details). After this, the Fund will have rolling five-year terms.
- **Charter Hall's high-quality management team** has a track record of delivering solid returns on direct property trusts, with a demonstrable ability to grow the portfolio in line with the current mandate.
- The Fund has a conservative gearing target of 25% to 45%, with current **LVR of 30%**. There is **comfortable headroom** to the LVR bank covenant of 60%.
- Overall **management fees and expenses** are in line with the Lonsec peer group average for open-end funds, but lower for closed-end funds.
- Current NTA of $1.46 is less than the unit price of $1.48, which itself is **marginally higher** than the average for open-end funds but significantly better than newly created closed-end funds.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- **Charter Hall Direct Office Fund** is an unlisted open-end property fund which invests in a portfolio of Australian office property assets and holds a small cash component.
- The Fund's objective is to provide investors with:
  - exposure to a diversified and growing quality Australian office property portfolio with a focus on CBD and established property markets; and
  - sustainable and stable tax-advantaged income returns with the potential for capital growth.
- DOF has an initial five year investment term ending in December 2019, at which time the Fund will have a **liquidity event** whereby all investors will be offered an opportunity to redeem part or all their investment. After this, the Fund will have rolling five-year terms with subsequent liquidity events.
- The Fund offers **limited liquidity during the initial investment term**, with the Manager making available $10m every half-year under the withdrawal offer. The regular withdrawal is subject to the Fund having available liquid assets (i.e. cash), is at the RE's discretion, and is on a pro-rata basis.
- While the returns of the Fund are expected to be less volatile than equities and listed property securities investments, investors should be aware that the Fund **may experience periods of negative returns** and that there is a **risk of incurring capital loss** on the Fund.
- As such, Lonsec considers the Fund suitable for medium to high-risk profile investors with a five+ year investment time horizon. The Fund will generally sit within the **growth component of a balanced portfolio.**
- Due to the Fund's significant exposure to illiquid assets (direct property) and because redemption opportunities during each five-year term are at the discretion of the RE, liquidity risk in the Fund is deemed to be high compared with other asset classes.
- Forward looking estimates of returns are either sourced from the Manager's forecasts or Lonsec estimates based on data supplied by the Manager, external valuation reports or other third party data sources deemed to be reliable, but are not a guarantee of future performance.
- The Manager applies a strict investment mandate to progressively acquire a portfolio of well-located office properties with income underpinned by quality anchor tenants.
- The **Investment Mandate** for property selection is:

Criteria	Description
PROPERTY TYPES	A-GRADE AUSTRALIAN OFFICE PROPERTY
LOCATION	CBD AND ESTABLISHED OFFICE MARKETS, EMPHASIS ON EAST COAST
TENANTS	HIGH PROFILE OR WELL REGARDED TENANTS ON LONG LEASES WITH STRUCTURED RENTAL INCREASES
FUND WALE	MINIMUM 5YR WEIGHTED AVERAGE LEASE EXPIRY (BY INCOME)
OCCUPANCY	100% TARGET OCCUPANCY (AND/OR COMMITMENT TO OCCUPY)
DEVELOPMENT RISK	FULLY MITIGATED VIA LEGALLY BINDING AGREEMENTS
DEBT FINANCE	COMMITMENT TO PROVIDE DEBT TO FINANCE EACH ACQUISITION (ON TERMS ACCEPTABLE TO THE RE)
CO-INVESTMENTS	HIGH QUALITY OFFICE ASSETS ALONGSIDE OTHER MAJOR INVESTORS INCLUDING LOCAL/INTERNATIONAL INSTITUTIONAL FUNDS OR PARTNERSHIPS

- Properties are regularly assessed for their income outlook and strategic value. The Manager may buy and sell properties prior to the conclusion of the initial term of the Fund.

Income distributions/reinvestment

- Fund **distributions are paid Quarterly** in arrears, generally within 30 days of the end of September, December, March and June.
- The Fund has established a **distribution reinvestment plan** (DRP), whereby investors in the Fund can reinvest part or all their distribution for additional newly created units in the Fund. Investors are entitled to a **2.5% discount** to the latest entry price as part of the DRP.
- Lonsec highlights that this discount will likely encourage investors to participate in the DRP scheme which does improve the Fund's capital position, however, will be marginally dilutionary to investors within the Fund who do not participate.
- Distribution payments may contain some **proportion of tax-advantaged income**, diminishing over the life of the Fund. This is due to the capital allowances available for expenditure on structures; plant and equipment; and writing-off borrowing costs.

Charter Hall Direct Office Fund

- The Manager supports a sustainable distribution policy and distributions are generally in line with, or less, than the Fund's cash from operations (excluding borrowings). However, during the acquisition and development of assets, distributions may include a coupon payment from a developer reflecting DOF's funding costs.

Risk assessment

Lonsec rates the **key risk factors** associated with the CHDOF in the following table, which are assessed in the overall context of both competing unlisted property funds and relative to other asset classes.

- **Capital gain vs income risk** is deemed medium given that property funds have a higher element of capital risk than some asset classes (e.g. cash or bonds) but lower risk than others (e.g. equities).
- **Leverage (Gearing) risk** is deemed medium in comparison with other investment classes (including listed property trusts), where there is lower or no gearing (some wholesale property funds).
- **Refinancing risk** is low as Charter Hall has a good record of being able to refinance its debt facilities. Nonetheless, there is an inherent risk that property funds in some circumstances may not be able to obtain debt finance.
- **Interest Cost / Hedging:** The Manager is targeting to maintain hedging contracts in respect of at least 50% of the Fund's exposure to underlying borrowings.
- **Currency**: No part of the portfolio is directly exposed to foreign exchange movements.
- **Related Party Transactions:** Fund assets may be acquired from a related party. However, the Manager has clearly defined protocols for related party transactions / potential conflicts of interest.
- **Liquidity risk** is deemed high, as there are minimal liquidity provisions available during the five-year term of the Fund (property assets are relatively illiquid, the DOF units are not traded on an exchange, and the periodic offers are subject to a cap and the Manager's discretion). While there is a scheduled Liquidity Event in December 2019, sale of assets or other liquidity options may not be possible due to market circumstances.
- **Independence:** The risk is deemed as low given the relatively small position of the Fund's investment in the Charter Hall Prime Office Fund (CPOF) units rather than directly held assets.
- Overall, Lonsec considers the risk assessment for the Fund as **low to medium**.

Level of assessed risk	Low	Med	High
OPERATIONAL EARNINGS			
BUSINESS	●		
LEASING	●		
CAPITAL GAIN VS. INCOME		●	
DIVERSIFICATION	●		
MARKET VOLATILITY	●		
FINANCIAL			
LEVERAGE (GEARING)		●	
REFINANCING	●		
INTEREST COST / HEDGING		●	
CURRENCY	●		
COUNTERPARTY	●		
SUPPORT TO DISTRIBUTIONS	●		
MANAGEMENT & OTHERS			
EXPERIENCE	●		
INDEPENDENCE	●		
RELATED PARTY TRANSACTIONS		●	
LIQUIDITY			●

Charter Hall Direct Office Fund

1 Property Portfolio

1.1 Portfolio overview

- The portfolio consists of 14 direct properties (98% of the portfolio) including one 'under development' and due for completion in 2021. The Fund holds indirect ownership of another 26 properties via the Charter Hall Prime Office Fund (2% of portfolio). The assets are a mix of high-quality newly constructed properties and older (but recently refurbished) established assets. All assets in the DOF portfolio appear to be in good condition.
- The portfolio is well diversified from a geographic perspective, with the greatest concentration in the economically stronger and more liquid markets of NSW (44%) and Victoria (24%), and to a lesser extent Queensland (23%). All properties are located either in the CBD or established suburban business centres of major Australian capital cities. While the latter are considered secondary locations relative to the former, Lonsec believes them to be fit for purpose.
- The Fund is also well diversified from a tenant perspective, with the tenants of both the direct and indirect properties being highly-regarded businesses from a variety of fields including government, education, law, banking and consumer staples. The portfolio has a high occupancy rate of 99%, a long WALE and a low proportion of lease expiries over the short term. While the portfolio has a large number of tenancies that require intensive lease renewal management, Charter Hall has a well-resourced property management team that effectively manage this.

Acquisitions

PROPERTY	OWNERSHIP (%)	PURCHASE[1] (A$M)
61 MARY ST, BRISBANE QLD	100%	275.000
10 SHELLEY ST, SYDNEY NSW	50%	262.500
26 FRANKLIN ST, ADELAIDE SA	50%	135.000
6 HASSALL ST, PARRAMATTA NSW[2]	50%	25.200

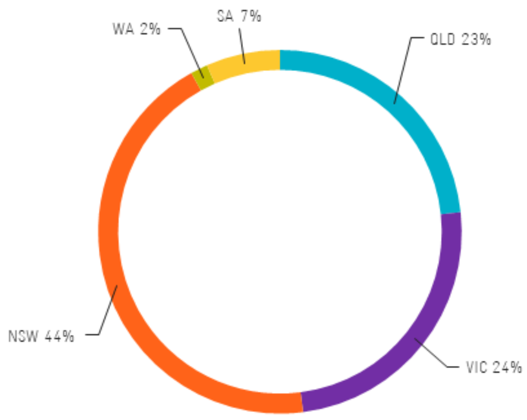
1: DOF share.
2: Under development. Completion expected 2021.

Divestments

PROPERTY	OWNERSHIP (%)	SALE[1] (A$M)
100 SKYRING TCE, NEWSTEAD QLD[2]	50%	125.000

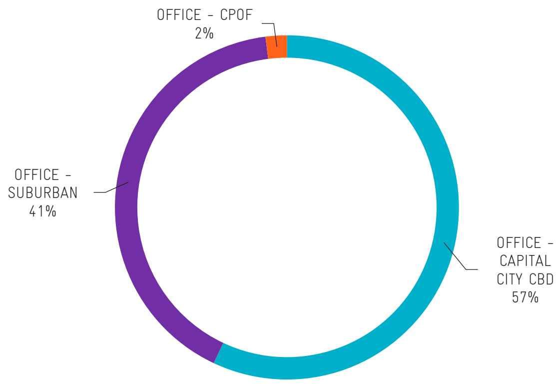
1: DOF share.
2: The purchaser made an offer for the entire building, which represented good value for DOF and the co-owner CPOF. The Fund recycled the proceeds into the purchase of 61 Mary Street which represented a superior value proposition being located in the Brisbane CBD market and fully leased to the QLD State Government.

DOF geographic allocation



Note: Includes the geographic distribution of CPOF assets.

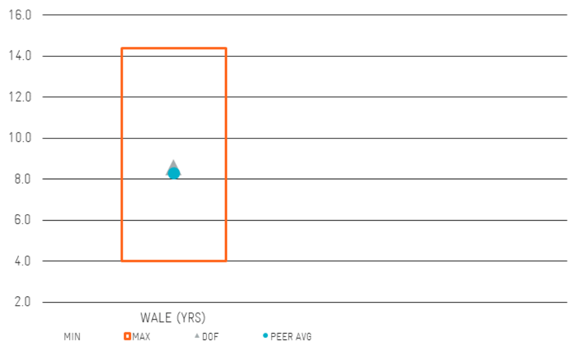
DOF sector allocation



1.2 Major Tenants / Leases

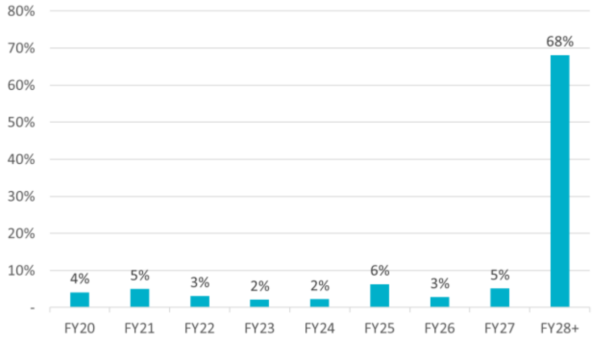
- The Fund has a weighted average lease expiry (WALE) of 8.6 years, which is marginally higher than the peer group average of 8.3 years. DOF's long WALE provides greater income certainty for investors.

WALE Comparison



Note: Lonsec peer group average includes sector specific funds.

DOF Lease Expiry Profile – as at June 2019



Source: Charter Hall

- Leases generally have built-in fixed rental increases of 2.5-4.0% p.a. (average 3.5% p.a.). Generally, there are provisions for market reviews upon lease expiry.
- Occupancy has been greater than 97% over the last 5-7 years. Over the last three years, the Fund's occupancy has increased to 99%, with major tenants extending leases on improved rentals as refurbishments have been implemented.
- As the following graph illustrates, tenant lease expiries are quite low over the next seven years. While most expiries are FY28 and beyond, given the high quality and well-located nature of the assets, it is anticipated that major tenants will either re-sign, or the Manager will be able to source replacement tenants well in advance.

1.3 Valuation policy

- Before a Property is acquired, the Responsible Entity is required to obtain an external valuation on an 'as is' or on an 'as if complete' and 'as is' basis for development properties.
- The properties are externally valued on an annual basis, or as required under the Fund's loan facility. This is in accordance with most funds covered by Lonsec and strikes a reasonable balance between the costs incurred for valuation services and maintaining a portfolio which is reflective of fair value.
- Valuations may occur more frequently than annually if it is believed there has been a material change in a property's value (+/- 5%). In such cases, an external valuation will be sourced using a prescribed standard valuation brief.
- External Valuers will be rotated so that a property is not externally valued by the same valuation firm for three consecutive years.

Charter Hall Direct Office Fund

1.4 Overview of Fund investments

PROPERTY	STATE	PROPERTY TYPE	VALUE A$M	VALUE % PORT	NET INCOME A$M	INCOME YIELD FY20	GLA SQM	SITE SQM	OCCUP.	CAP'N RATE	DISC. RATE	WALE (INC.) YRS	MAJOR TENANTS
61 MARY ST, BRISBANE	QLD	OFFICE - CAPITAL CITY CBD	280.000	13.4%	15.377	5.49%	28,750	3,646	100%	5.50%	7.25%	9.8	QLD GOVERNMENT
10 SHELLEY ST, SYDNEY*	NSW	OFFICE - CAPITAL CITY CBD	262.500	12.6%	12.076	4.60%	27,717	2,364	100%	4.60%	6.58%	8.6	SUNCORP, IRESS
68 PITT ST, SYDNEY	NSW	OFFICE - CAPITAL CITY CBD	222.000	10.6%	9.919	4.47%	14,283	1,372	96%	5.25%	6.38%	2.6	ADECCO, CITIGROUP, PACIFIC SMILES
200 QUEEN ST, MELBOURNE	VIC	OFFICE - CAPITAL CITY CBD	214.850	10.3%	10.963	5.10%	19,736	2,818	100%	5.25%	6.75%	5.7	BARRISTERS CHAMBERS, OPUS
169 MACQUARIE ST, PARRAMATTA*	NSW	OFFICE - SUBURBAN	150.500	7.2%	7.6105	5.06%	26,500	2,943	100%	5.13%	6.75%	12.6	WESTERN SYDNEY UNIVERSITY
800 TOORAK RD, HAWTHORN EAST*	VIC	OFFICE - SUBURBAN	145.000	6.9%	8.3575	5.76%	39,399	34,002	100%	5.50%	6.75%	10.7	COLES GROUP
1 NICHOLSON ST, MELBOURNE	VIC	OFFICE - CAPITAL CITY CBD	142.000	6.8%	7.592	5.35%	16,964	2,345	100%	5.35%	6.58%	7.6	ORICA, DCC, HUB PARLIAMENT
26 FRANKLIN ST, ADELAIDE*	SA	OFFICE - CAPITAL CITY CBD	136.250	6.5%	8.111	5.95%	36,807	3,621	100%	6.00%	7.25%	7.9	ATO, AUST. POST, SA GOVERNMENT
105 PHILLIP ST, PARRAMATTA*	NSW	OFFICE - SUBURBAN	128.000	6.1%	6.291	4.91%	25,191	3,470	100%	5.25%	7.00%	10.8	NSW GOVERNMENT
4-16 MONTGOMERY ST, KOGARAH*	NSW	OFFICE - SUBURBAN	105.500	5.1%	5.818	5.51%	31,715	13,010	100%	5.50%	6.96%	15.0	WESTPAC
69 ANN ST, BRISBANE*	QLD	OFFICE - CAPITAL CITY CBD	101.750	4.9%	6.751	6.63%	26,669	3,419	96%	6.63%	7.00%	4.9	TELSTRA, QLD GOVERNMENT
900 ANN ST, FORTITUDE VALLEY*	QLD	OFFICE - SUBURBAN	98.125	4.7%	5.522	5.63%	19,029	2,461	100%	5.63%	6.75%	10.7	AURIZON
CHARTER HALL PRIME OFFICE FUND^	VARIOUS	OFFICE - CH POF	48.166	2.3%	2.207	4.58%			99%	5.14%	6.60%	7.1	VARIOUS
181 ST. GEORGES TCE, PERTH	WA	OFFICE - CAPITAL CITY CBD	26.900	1.3%	2.341	8.70%	3,590	696	100%	6.75%	7.25%	6.8	DOF SUBSEA, EMIRATES
6 HASSALL ST, PARRAMATTA*~	NSW	OFFICE - SUBURBAN	25.200	1.2%			28,800		100%	5.50%		11.6	WESTERN SYDNEY UNIVERSITY
TOTAL / WTD AVG			2086.741	100%	108.936	5.22%	345,150	76,167	99%	5.38%	6.74%	8.6	

* Value reflects DOFs 50% ownership share.
^ Value of units as of 30 June 2019. Income has been annualised.
~ Development completion 2021. Completion value (50% share) = $140.5m. Property is 50% owned by and 50% pre-leased to, Western Sydney University (WSU), with the remainder benefiting from a 5-year rental guarantee from Charter Hall Group.

Charter Hall Direct Office Fund

1.5 DOF Direct Property Asset Assessment

Property	Key Strengths	Key Weaknesses
61 Mary St, Brisbane QLD	• Prominent CBD location near transport and amenities. • Long WALE of 9.8 years and 100% occupied. Excellent anchor tenant in **QLD Government**. • Major refurbishments over past four years with quality fitouts. NABERS Energy (5.5 star) rating.	• Building is almost 35 years old with a dated façade, albeit the internals have been recently refurbished. • Passing rent is below market with no reversion for four years, although 4% p.a. rent reviews are higher than expected market rent growth and expected to partially bridge this gap.
10 Shelley St, Sydney NSW **(50% DOF; 50% CPOF)**	• Located in close proximity to Barangaroo precinct. Very large and functional floor plates. • Long lease to excellent anchor tenant **Suncorp**. Occupancy of 100%, long WALE of 8.6 years. • A-grade building with NABERS Energy (5 star) rating.	• Suncorp does not pay rental for signage rights. • Limited 'make-good' requirement at lease expiry. • Disruption from ongoing Barangaroo construction.
68 Pitt St, Sydney NSW	• Prominent CBD corner location within the financial core precinct, and good access to public transport. • Mix of whole floor and part floor tenancies, with excellent retail exposure for ground floor tenancy (**Citigroup**). • Well-placed to benefit from rising rents as 80% of NLA expires within next three years.	• B-grade building over 50 years old, albeit steadily being refurbished. Short WALE of 2.6 years spread across 24 tenancies, and occupancy of 96%. • Small and irregular floor plates, and limited end-of-trip facilities not attractive to large tenants. • Relatively low NABERS Energy (3.5 star) and Water (3 star) ratings.
200 Queen St, Melbourne VIC	• Prominent CBD location within legal precinct, with three street frontages. Large public carpark on site. • Good-quality tenants (predominantly legal). WALE of 5.7 years (by NLA), occupancy of 100% and rent reviews of 3.5-4% p.a. • Periodically refurbished, most recently in 2016 with completion of modern end-of-trip facilities.	• Small (<1,000sqm) and irregular floor plates may not attract corporate occupiers. • Relatively intensive management required due to 17 different tenancies. • **Barristers Chambers** renting over 55% of NLA poses a significant re-leasing risk if they were to depart.
169 Macquarie St, Parramatta NSW **(50% DOF; 50% CPOF)**	• New A-grade building located within the Parramatta Square Masterplan, and next to major amenities. • Occupied 100% by strong institutional tenant **Western Sydney University**. • Very long WALE of 12.6 years, strong 3.75% p.a. rent reviews. Basement parking in a parking-starved area.	• Competition from future developments within Parramatta CBD area. • Building is of a slightly specialised nature and would lose NLA if it became a multi-occupant asset.

Charter Hall Direct Office Fund

Property	Key Strengths	Key Weaknesses
800 Toorak Rd, Hawthorn East VIC **(50% DOF; 50% EPC Pacific Group)**	• Strong high-quality tenant in the form of **Coles Group**. • Prominent inner suburban location supported by good amenity including retail, education, medical, roads and public transport. • Long WALE of 10.7 years, 100% occupied with rent reviews of 3.25% p.a. • High underlying land value with future mixed-use redevelopment potential.	• Unusual modular design with large irregular floor plates and a single service core may be difficult to sub-divide/lease. If Coles were to depart and sub-division pursued, this would result in loss of net lettable area. • B-grade building that despite periodic refurbishments is over 30 years old. By end of lease - 44 years old. • Lease requires substantial capex (est. $4-5m) by DOF during FY2021-22.
1 Nicholson St, Melbourne VIC	• Iconic and well-known building with a CBD-edge location next to public transport and amenities. • WALE of 7.6 years, occupancy of 100% and solid 3.5% p.a. rent reviews. Anchor tenant **Orica** recently extended its lease by 10 years. • Functional floor plates with good natural light.	• Building is over 60 years old, has a dated façade and may face additional maintenance costs. Heritage status restricts re-development potential. • Poor NABERS Water (2.5 star) rating. • Melbourne CBD grid remains the preferred commercial location for many tenants.
26 Franklin St, Adelaide SA **(50% DOF; 50% Charter Hall Long WALE)**	• Central CBD location with secure on-site parking • Fully leased with WALE of 7.9 years to tenants such as **ATO**, **SA Government** and **Australia Post**. • Excellent NABERS Energy (5.5 star) rating.	• 'Gross' leases for all tenants which means the Fund is responsible for the payment of all outgoings. • High price point for a single asset in Adelaide, which is a more illiquid market than Sydney or Melbourne.
105 Phillip St, Parramatta NSW **(50% DOF; 50% CPOF)**	• Brand-new and award-winning A-grade building with very high-quality fittings. Located within the Parramatta Square Masterplan close to all amenities. • Excellent tenant in the form of the **NSW Government**. Very long WALE of 10.8 years, with strong annual rent reviews of 3.75%. • Good off-street parking. Excellent NABERS Energy (5.5 star) and Water (5 star) ratings.	• Competition from future developments within Parramatta CBD area. • Passing rental is considered under-market, however the lease provides a market review in the seventh year, subject to a 10% cap and collar.
4-16 Montgomery St, Kogarah NSW **(50% DOF; 50% Charter Hall Long WALE)**	• Occupied 100% by St. George Bank (**Westpac**) as their corporate headquarters. Located near all amenities. • Very long WALE of 15.0 years. • Extensive refurbishment in 2015 to modernise facility.	• Rent reviews of 2.5% p.a. considered below market. • Kogarah is considered a secondary commercial market compared to Sydney CBD.

Charter Hall Direct Office Fund

Property	Key Strengths	Key Weaknesses
69 Ann St, Brisbane QLD **(50% DOF; 50% CPOF)**	• A-grade building in central CBD location near public transport and amenities. • Anchored by excellent tenants in the form of **Telstra** and the **QLD Government**. • Adaptable floor plates with central services core.	• Relatively short WALE of 4.9 years. • Relatively intensive management required due to 17 different tenancies. • Brisbane CBD vacancy rate for A-grade office accommodation sits at 13%.
900 Ann St, Fortitude Valley QLD **(50% DOF; 50% CPOF)**	• New A-grade building occupying a prominent corner location just under 1km from the Brisbane CBD and in close proximity to the James Street precinct. • Very long WALE of 10.7 years to strong anchor tenant ASX-listed **Aurizon** on a net lease basis.	• Aurizon is sub-letting a number of floors which may impact the market's perception of the asset. • Leasehold tenure (albeit for 110 years) may impact investor or prospective purchaser demand.
Charter Hall Prime Office Fund	• Prime assets (26) located in a variety of CBD and established suburban markets in major capital cities. • WALE of 7.1 years, 99% occupied by 286 tenants, with strong 3.80% annual rent reviews.	• Lonsec does not have detailed data on individual CPOF properties and has not made any site visits, thus is unable to comment on the weaknesses of individual properties.
181 St. Georges Tce, Perth WA	• Well-located Perth CBD building close to transport links and amenities. • Occupancy is 100%, with a reasonably long WALE of 6.8 years, supported by strong 3.50% annual rent reviews. Major tenant **DOF Subsea** is on a lease through to 2026 paying above-market rentals. • Strong NABERS Water (5 star) rating.	• Relatively small and narrow floor plates with low natural light, and a low car-parking to office NLA ratio. • Perth office market is heavily influenced by commodity prices, resulting in substantial adjustments in spatial requirements at short notice. • High volume of competing stock may depress market rents.
6 Hassall St, Parramatta NSW **(50% DOF; 50% Western Sydney University). Under development**	• Prominent Parramatta CBD location with links to public transport and all amenities. • A-grade building with excellent environmental credentials: NABERS Energy (5 star) and Water (4 star) ratings, Green Star (6 star) rating. • Excellent anchor tenant in **Western Sydney University** (50% NLA pre-lease commitment for 15 years) with remaining 50% benefiting from 5-year rental guarantee from the developer (Charter Hall Group). • 50% co-owned by Western Sydney University which ties them to the property.	• Does not currently have development approval (DA), however DOF has the right to require the developer to sell DOF's interest in the property if DA is not obtained by the sunset date, including coverage of any shortfalls.

Charter Hall Direct Office Fund

1.6 Lonsec DOF Direct Property Asset Assessment

Lonsec summary assessment of DOF property portfolio

	LOCATION / INFRASTRUCTURE	BUILDING CONDITION / FACILITIES	TENANTS / LEASES	MARKET / POTENTIAL
61 MARY ST, BRISBANE	EXCELLENT	VERY GOOD	EXCELLENT	VERY GOOD
10 SHELLEY ST, SYDNEY	EXCELLENT	EXCELLENT	EXCELLENT	EXCELLENT
68 PITT ST, SYDNEY	EXCELLENT	VERY GOOD	GOOD	EXCELLENT
200 QUEEN ST, MELBOURNE	VERY GOOD	VERY GOOD	GOOD	EXCELLENT
169 MACQUARIE ST, PARRAMATTA	VERY GOOD	EXCELLENT	EXCELLENT	EXCELLENT
800 TOORAK RD, HAWTHORN EAST	VERY GOOD	GOOD	EXCELLENT	GOOD
1 NICHOLSON ST, MELBOURNE	VERY GOOD	GOOD	EXCELLENT	EXCELLENT
26 FRANKLIN ST, ADELAIDE	EXCELLENT	EXCELLENT	EXCELLENT	GOOD
105 PHILLIP ST, PARRAMATA	VERY GOOD	EXCELLENT	EXCELLENT	EXCELLENT
4-16 MONTGOMERY ST, KOGARAH	VERY GOOD	EXCELLENT	EXCELLENT	EXCELLENT
69 ANN ST, BRISBANE	EXCELLENT	VERY GOOD	VERY GOOD	VERY GOOD
900 ANN ST, FORTITUDE VALLEY	VERY GOOD	EXCELLENT	EXCELLENT	VERY GOOD
CHARTER HALL PRIME OFFICE FUND^	-	-	-	-
181 ST. GEORGES TCE, PERTH	VERY GOOD	GOOD	AVERAGE	GOOD
6 HASSALL ST, PARRAMATTA*	VERY GOOD	EXCELLENT	EXCELLENT	EXCELLENT

^ Lonsec does not have detailed data on the 26 properties within the CHPOF, so is unable to make an exact assessment of the portfolio's characteristics.
* Under development with expected completion 2021. Property is 50% pre-leased to Western Sydney University, with remainder benefiting from a 5-year rental guarantee from developer Charter Hall Group.
Lonsec Property Ratings Scale (descending): Excellent, Very Good, Good, Average, Fair, Poor, Very Poor.

2 Financial Analysis

2.1 Income/Expenses analysis

	Jun-20[1] $m	Jun-21[1] $m
PROPERTY INCOME	117.116	122.676
INTEREST INCOME	0.165	0.248
TOTAL INCOME	117.116	122.676
MANAGEMENT FEE	(10.993)	(11.811)
OTHER EXPENSES	(1.684)	(1.721)
INTEREST EXPENSE	(20.285)	(23.477)
TOTAL OPERATING EXPENSES	(32.962)	(37.010)
NET OPERATING INCOME	84.154	85.666
PROPORTION OF W/SALE A UNITS	85.12%	85.12%
NET INCOME (**W/SALE A UNITS**)	71.632	72.919
INCOME SUPPORT / (RETAINED EARNINGS)	(1.578)	(0.753)
NET DIST. (W/SALE A UNITS)	70.054	72.166
AVG UNITS ISSUED - W/SALE A (M)	824.410	824.410
DISTRIBUTION PER UNIT (CPU)	8.50C	8.75C
YIELD (ANNUALISED)	5.74%	5.91%
% TAX DEFERRED	60%	60%

1: Lonsec estimates.

Assumptions underlying income

- The income section of the above table details Lonsec's estimates (based on data supplied by the Manager) of income and expenses over a projected two-year period for DOF. Considering the Manager has a mandate to acquire further properties, the above figures will change, however, the **newly acquired properties will likely have a similar income profile** and they are not expected to materially change the Fund's yield.
- Debt establishment costs, stamp duty costs, legal fees and expenses incurred in the acquisition of the investments are **capitalised and then amortised through expenses** in the profit and loss.
- The above estimates are based on the Manager's model and include **adequate allowances for potential vacancies and leasing costs**, and **significant allowances for capital expenditure and incentives** where deemed necessary on the older buildings.

2.2 Distribution / Tax deferred

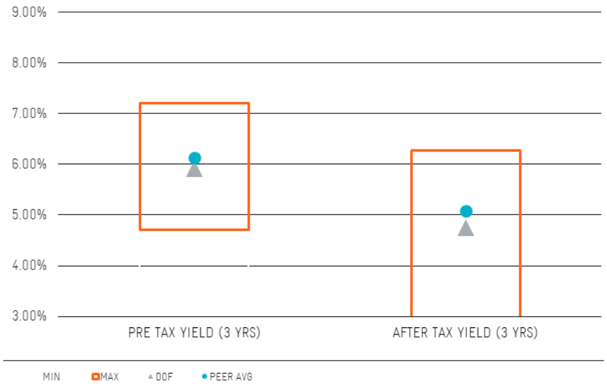
DOF estimated distribution yields

Ordinary units	FY20E[1]	FY21E[1]
DISTRIBUTION/UNIT	8.50C	8.75C
PRE-TAX YIELD (@$1.00)	5.74%	5.91%
TAX DEFERRED	60%	60%
YIELD AFTER 47% TAX	4.66%	4.80%
GROSSED-UP YIELD	8.80%	9.06%
YIELD AFTER 15% TAX	5.40%	5.56%
GROSSED-UP YIELD	6.35%	6.54%

1: Lonsec estimates.

Lonsec has compared the DOF distribution yields with a sample of open-end unlisted property trusts over the last 12-18 months.

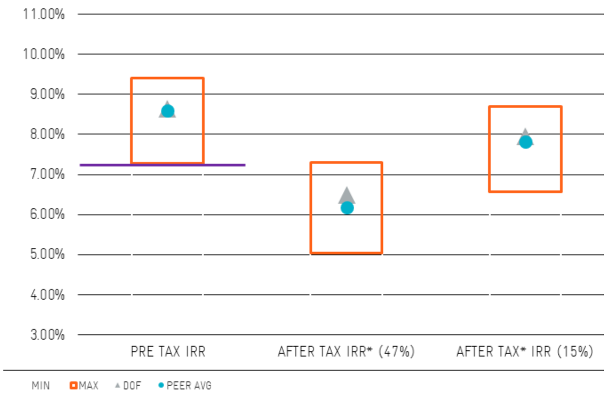
Distribution yields peer comparison



- The estimated DOF distribution yield for the initial three years is lower than the Lonsec peer group average on a pre-tax basis.
- While the Fund's tax-deferred portion is higher than average, the DOF after-tax distribution is lower than the peer group average.

2.3 Total Returns (IRR net after fees)

Estimated total return peer comparison



*Also net of capital gains tax. Rolling 12-18 months.

- For comparative purposes, Lonsec estimates the total internal rate of return (IRR) over a 10-year period for the Fund by adopting the long-term assumptions from the latest valuations for vacancy, leasing fees/ incentives, and capital expenditure (deducted from net rentals).
- The actual cash flows may differ from the assumptions and the returns may be higher or lower than estimated. In particular, Lonsec assumes that the growth in capital value of the portfolio increases in line with the **average market rental growth** of the properties (+3.5% pa).
- There is an allowance in the tenth year for a deterioration in terminal capitalisation reflecting the ageing of the assets (notwithstanding the capital expenditure undertaken during this period).
- The estimates assume interest costs (all-up including costs of hedging) of 3.0% p.a. over FY20-29.

Charter Hall Direct Office Fund

- The Performance Fee is calculated on achieving a total return in excess of 10% p.a. over the five-year initial term of the Fund. Lonsec has estimated an average return of 10.1% p.a. over a ten-year cycle and therefore given Lonsec's estimate is greater than the hurdle rate, a small fee is assumed to be payable.

2.4 Debt position / interest costs

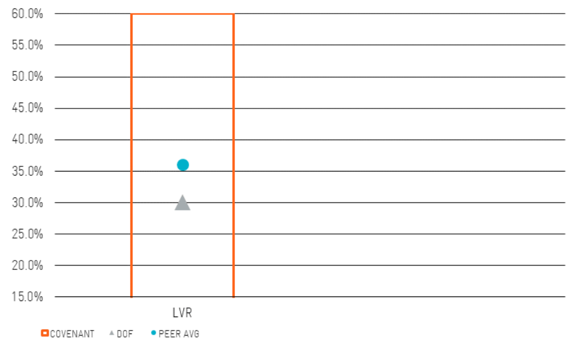
- The Manager has entered into a loan agreement with NAB, CBA and the ANZ. The loan is spread over two tranches, one with a limit of $500m expiring in December 2023 and another with a limit of $500m expiring in December 2024.

Debt Facility – June 2019	Total
FACILITY LIMIT ($M)	1,000
DRAWN-DOWN ($M)	627
EXPIRY*	DEC 23/DEC 24
COST OF DEBT	3.0% P.A.
HEDGED	80.5%
LVR	30%
LVR COVENANT	60%
ICR	5.1X
ICR COVENANT	1.5X

* $500m matures December 2023; $500m matures December 2024.

- The Manager has a target gearing ratio (debt to total assets) of 25-45%, however gearing may be temporarily higher in order to settle property acquisitions. Subsequent equity capital raised will be used to reduce gearing in line with the target.

Gearing peer comparison



- The Fund's gearing (loan to value ratio or 'LVR') position is low compared to the peer group average and in relation to the bank covenant of 60%.

Sensitivity analysis – gearing covenants

- The Fund's LVR is sensitive to changes in capitalisation rates for properties - as determined by market transactions and valuations.

Cap'n rate	Portfolio valuation	Value chg	LVR	H'room to covenant
BASECASE 5.38%	$2,086M	0%	30%	30%
+1.79%	$1,565M	-25%	40%	20%
+5.36%	$1,045M	-50%	60%	0%

- The DOF has good coverage above the bank LVR covenant, with the portfolio able to **withstand a 50% reduction in the value of the property** before reaching its 60% covenant. A rise in income or property value will improve the headroom.
- **Interest Cover Ratio** (as calculated in accordance with the bank covenant) of **5.1x is strong**, with the property net income having to reduce by 71% before the bank covenant of 1.5x is breached.

Sensitivity analysis – interest costs

- All-up interest cost is 3.0% p.a. with 80% of this fixed over the term of the Fund's facility, implying that the majority of interest costs will be stable over FY20-24.

2.5 Fee Structure

Establishment fee

- The RE/Manager will charge an Acquisition Fee for new direct or indirect interests in a property purchased (or developed) by the Fund of up to 1.5% of the total consideration (including the purchase price and all development and related costs). The amount charged to Wholesale A units is in proportion to the total number of DOF units.
- Where the Fund invests in another fund or trust managed by an entity within Charter Hall Group, the RE/Manager will only charge an acquisition fee in respect of that investment such that in total the RE and the Manager of the other Charter Hall fund receive a maximum acquisition fee of 1.5%. Therefore, no double charging of acquisition fees by entities in the Charter Hall Group will occur.

Total Establishment Cost Comparison

	% Prop.	% Invested[1]
DOF[2]	1.50%	2.50%
LONSEC AVG (OPEN-END)	1.73%	2.84%
LONSEC AVG (CLOSED-END)	2.95%	5.01%

1: Based on gearing ratio of 40%.
2: No Acquisition Fee was payable on the initial CHDOF portfolio. The 1.5% Acquisition Fee is applied only to property assets acquired after the establishment of the initial portfolio of five properties (originally valued $358m, now worth $606m). Therefore, the total Acquisition Fee paid by investors for the overall portfolio is 1.1% of the total direct property assets in the Fund. Lonsec would need to adjust all existing funds to make a fair comparison on this basis.

- Based on the initial capital (equity and debt) being raised, the DOF's upfront fees/costs are lower than Lonsec's unlisted property sample average for both existing (open-end) funds and new (mostly closed-end) funds.

Annual management fees and expenses

- The annual management fee (0.50% p.a.) is slightly below the unlisted property sector average, and expenses are estimated to be another 0.18% p.a. of gross assets. Assuming a target gearing ratio of 40%, this translates to an overall Indirect Cost Ratio of 1.16% p.a. The Indirect Cost Ratio is below Lonsec's peer group average for similar non-wholesale investment vehicles due to the Fund's lower level of gearing.

Charter Hall Direct Office Fund

Comparison of management expense ratios

	M/ment Fee	Other Exp	Total MER
DOF	**0.50%**	**0.18%**	**0.68%**
LONSEC AVG (OPEN-END)	0.63%	0.19%	0.82%
LONSEC AVG (CLOSED-END)	0.61%	0.16%	0.77%

Comparison of indirect cost ratios

	M/ment Fee	Other Exp	Total ICR
DOF	**0.83%**	**0.33%**	**1.16%**
LONSEC AVG (OPEN-END)	1.03%	0.32%	1.35%
LONSEC AVG (CLOSED-END)	1.13%	0.31%	1.44%

Performance fee

- The RE/Manager is entitled to a **15% share** of excess total return (Internal Rate of Return) above 10% p.a.
- The DOF performance fee hurdle rate of 10% is **similar to its peer group**, although Lonsec has observed that recently some managers are reducing this hurdle to 8-9% p.a. The fee entitlement (15%) above this hurdle rate is **in line** with the incentive structure (mid-point 15%) adopted by its peer group**.** This fee will only be paid (if applicable) upon sale of the property and distribution of net proceeds to investors.

Other fees

- **Disposal Fee**: Up to 1.5% of the gross sale price of any property, held directly or indirectly by the Fund. Disposal fees will still be payable if the Manager is removed as the RE or in other circumstances (e.g. if the Fund is listed on the ASX).
- If the Fund's Responsible Entity or Investment Manager are removed by a Unit-holder vote, then no additional **Removal Fee** is payable and neither will they be compensated above what is due.
- **Buy/Sell Spread:** While the Buy spread is Nil, the Sell spread is 2.5% of the investment. This is an additional cost to the investor but held in the Fund and not passed through to the RE or Manager.

Total fees comparison

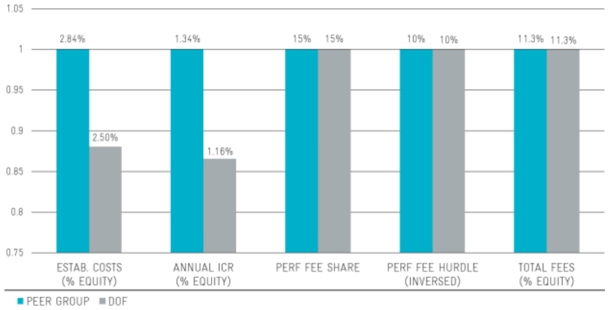
- For comparative purposes with our sample of unlisted funds, Lonsec has estimated the present value of total fees and expenses paid to the RE/Manager by the DOF over a ten-year period. This takes into consideration the differences in timing of initial establishment costs, on-going expenses and back-end performance/disposal fees and varying investment terms. In order to calculate performance fees, Lonsec has assumed a 30% increase in the gross asset value over ten years.

Comparison of PV of total fees and expenses

	% Total Assets	% Net Assets
DOF	**7.6%**	**11.3%**
LONSEC AVG (OPEN-END)	7.5%	11.3%
LONSEC AVG (CLOSED-END)	8.1%	14.2%

- The Fund's fees are on par with the Lonsec peer group average for open-end funds, and lower than closed-end funds, on both a total assets and net assets basis.

Fee and expense comparison

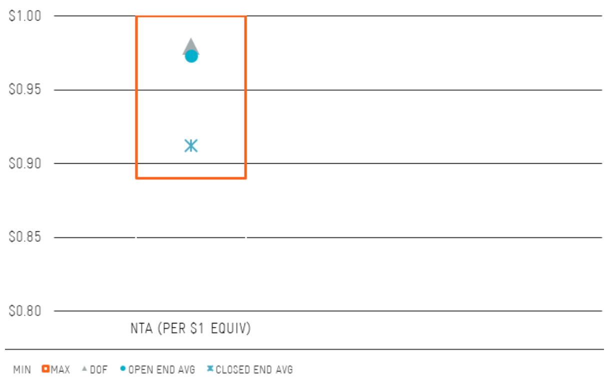


2.6 Balance Sheet / Net Asset Backing

	June 2019 ($M)
CASH	9.5
PROPERTIES	2,093.7
CAPEX & OTHER ASSETS	10.6
TOTAL ASSETS	**2,113.8**
CURRENT LIABILITIES	(31.6)
NON-CURRENT LIABILITIES	
INTEREST BEARING LOAN	(627.0)
OTHER NON CURRENT LIABILITIES	(13.2)
TOTAL LIABILITIES	**(671.8)**
NET ASSETS	**1,442.0**
NET ASSETS (W/SALE A UNITS)	**1,227.5**
NO. OF W/SALE A UNITS (MILL)	846.3
NTA PER UNIT	**$1.46**

- Lonsec's estimate of DOF's NTA per unit on an equivalent $1.00 invested basis is $0.98 per unit. The adjusted NTA of recent unlisted property trusts has ranged from $0.89 to $1.00 on an equivalent $1.00 invested basis. A number of funds either purchase properties within existing trust structures or construct new buildings, which saves on stamp duty.
- The average is lower for closed-end funds ($0.91) than open-end funds ($0.97) as the latter have already absorbed most of the costs for establishing the fund. However, there are often buy-spreads (1%-3%) to equalise costs for existing and new investors.

Net Asset Backing Comparison



Charter Hall Direct Office Fund

3 Management

An assessment of Management is another key performance measure and is largely qualitative, focusing on the ownership, operating and reporting structure, property investment policy, and selection criteria. Capable and experienced management is vital to the success of the Fund. Previous performance is evaluated, but is not necessarily a guide to future returns.

3.1 The Responsible Entity (RE)

- The Responsible Entity of the Fund is Charter Hall Direct Property Management Limited (CHDPML or 'the RE'), which holds AFSL No. 226849. CHDPML is licensed by the Australian Securities and Investment Commission (ASIC) to act as the responsible entity for managed investment schemes (MIS).
- CHDPML is a wholly-owned subsidiary of the ASX-listed **Charter Hall Group** (Charter Hall or 'the Group'). Charter Hall is a specialist property funds management group with in-house development and property services capabilities. Founded in 1991, the Group is listed on the ASX as a stapled security and is currently included in the S&P/ASX A-REIT 200 Index.
- As at June 2019, Charter Hall had funds under management (FUM) of around $30.4bn across listed A-REITs and a number of wholesale and retail investor unlisted property funds. Lonsec notes the following about the Group's financial results:
  - Charter Hall Group's performance over FY19 was positive with operating earnings of $221m (up 25%), distributions of 33.7cps (up 6%), and net tangible assets increasing by 11.1%.
  - FUM grew by $7.2bn, driven predominately by acquisitions (incl. the $1.6bn acquisition of Folkestone), positive asset revaluations and Charter Hall's ongoing capital expenditure program. The portfolio has grown to 844 properties (+155%) with 3,419 tenants (+40%).
  - The Group has a development pipeline of $6.5bn, roughly half of which are committed projects.

The RE has appointed Charter Hall Holdings Pty Ltd (CHH or 'the Manager'), a related party entity, to act as the Investment Manager for the Trust. CHH has been appointed under an 'Asset Management Agreement' (AMA) that specifies the asset management services CHH is to provide. Importantly for investors, the RE may at any time replace CHH. The services to be provided include:

- Managing the properties;
- Reporting on Fund performance to investors;
- Providing administrative support; and
- Arranging the disposal of properties or interests in properties.

All material decisions relating to the Trust must be ratified by the Independent Directors of the RE.

3.2 Management Team

Board of directors – Charter Hall Direct Property Management Limited

DIRECTOR	POSITION	JOINED GROUP*
PEEYUSH GUPTA	INDEP. CHAIRMAN	2010
RICHARD HIGGINS	INDEP. DIRECTOR	2008
IAN PRATT	INDEP. DIRECTOR	1998
DAVID HARRISON	EXEC. DIRECTOR	2004
RICHARD STACKER	EXEC. DIRECTOR	2004

*Joined either Charter Hall or Macquarie

- Lonsec notes that the CHDPML Board currently comprises three external directors (including the Chairman) accounting for 60% of the representatives.
- Biographies of all the Directors and Senior Executives are detailed in the Product Disclosure Statement.

Executive team and other resources

- The Fund has access to the experienced Charter Hall senior executive team, including a dedicated Fund Manager, Steven Bennett (Direct CEO).
- Charter Hall Group has total staff of over 550 across property (development, leasing, and transaction services), funds management and finance/back office. The Charter Hall funds management team currently consists of over 30 people, with direct support available from 135 'full-time equivalent' staff.

3.3 Investment Style / Process

- Charter Hall is a high conviction real estate manager that places emphasis on active management, both in its individual asset holdings and portfolio allocations (relative to peer-group and market benchmarks). Being vertically integrated, significant resources are allocated to all aspects of the property funds management process.
- As an investment manager, Charter Hall forms a clear view on the property markets it believes will offer the highest prospective rental growth over a three to seven-year term. The Group uses its own proprietary research and market intelligence gained from its national presence. The Group also places significant importance on its relationships with tenants in order to maximise tenant retention.
- On average, the Group favours long-lease duration assets and aims to retain high weighted average lease expiries relative to its peer-group in both listed and unlisted markets. Where short-lease durations are considered, they are typically the result of an arbitrage opportunity where assets are materially under-rented or where there is a re-positioning opportunity.
- The team is performance focused, with all Charter Hall funds retaining a significant performance component to their respective fee structures, aligning the interests of Management with that of investors.
- This does result from time-to-time in the Group taking a contrary view to consensus market opinion and forecasts, where it believes a mispricing event has occurred during a property market cycle.

Charter Hall Direct Office Fund

On-going property management

- CHDPML has appointed CHH to provide the Fund with asset management, leasing services, rent reviews, ensuring that the properties are well-maintained and that there is regular reporting. The two parties have entered into a Property Management Agreement which details the terms and conditions of the service agreement. The Property Management Agreement is compliant with Charter Hall's related party transactions policy.

Potential conflict of interest / related party issues

- The RE may from time to time engage related parties to provide property services to the Fund. In addition, Charter hall-related vehicles can at times hold equity in the Fund.
- Initial financial analysis is undertaken by Charter Hall to see if the property meets all its acquisition check-list criteria. A proposal and Heads of Agreement is put before the board of CHDPML for approval to proceed to due diligence.

Lonsec notes that the Group has developed its **'Charter Hall Managed Funds Conflict Protocols'** to manage conflicts of interests that may arise during acquisitions by implementing the following procedures:

- Asset transaction prices must be supported by independent valuations;
- All acquisition terms must reflect normal commercial terms; and
- All executive directors of the RE will be required to abstain from voting on proposed acquisitions/ divestments.

Conflicts of interest will be assessed by the **Charter Hall Compliance Manager** and if necessary, referred to the RE's board. Under the policy, the RE may be required to disclose conflicts of interest to investors.

When the property is fully owned by another Charter Hall fund, **each party has their own negotiating team, with separate due diligence undertaken, including independent valuations obtained**.

3.4 Previous fund / trust performance

Non-wholesale ('retail investor') funds

The table on the next page provides a summary of the performance history of Charter Hall funds for mostly 'non-wholesale' or 'retail' investors.

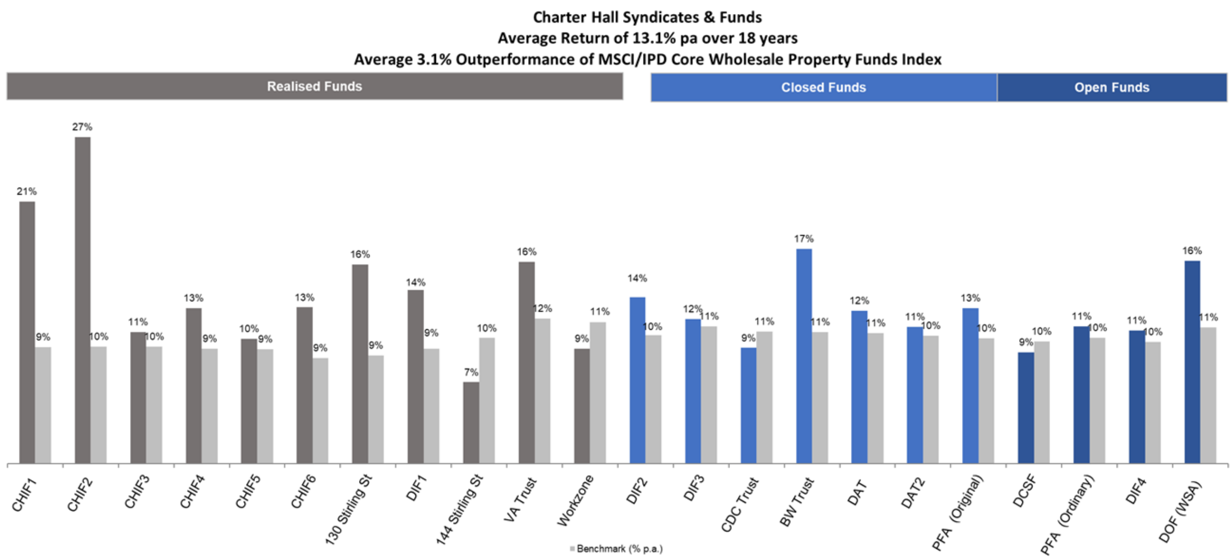
- Charter Hall has achieved strong performances from its CH Direct series of funds over various periods during the last 10-15 years, with an average return of 13.1% p.a. over the 18 years to June 2019.
- All funds have delivered consistent attractive income yields in line with their focus towards 'retail' investors.

Charter Hall Group – Total Returns vs Index

RETURNS % TO 30 JUNE 2019	1 YR	3 YRS P.A.	5 YRS P.A.
CHARTER HALL GROUP (ASX CODE: CHC)	72.41%	35.25%	26.74%
S&P/ASX200 A-REIT ACCUMULATION INDEX	19.32%	8.13%	13.63%
OUT (UNDER) PERFORMANCE	53.09%	27.12%	13.11%

(Source: IRESS)

Charter Hall Fund/Trust Performance



Source: Charter Hall. All data to 30 June 2019.

Investors are reminded that past performance is not a guarantee of future returns

4 Market Analysis

- In mid-2019, the Reserve Bank of Australia (RBA) cut interest rates twice in quick succession to provide support and bolster business confidence in the face of an Australian economy facing stronger economic headwinds than anticipated: persistently low inflation, weak wages growth, disappointing retail sales and a declining housing market.

Office

- **Office property fundamentals remain solid**, with Sydney and Melbourne in particular experiencing record low vacancy rates and solid real growth in rentals off the back of strong demand for office space. Combined with expected supply constraints over the next few years and a diminution in incentives, office properties are expected to continue delivering stable income. As a result, there continues to be healthy investment demand for well-located office assets, which have seen values increase strongly over the last couple of years and this is expected to continue over the next 12 months. While 'co-working spaces' offer their members (usually small businesses, entrepreneurs and start-ups) the benefit of a network of office locations with integrated amenities and low/zero rental commitment, the Fund targets A-grade buildings in high demand by well-regarded tenants such as large corporates and government departments, who are willing to rent large floor spaces on long-term leases. As such, the risk posed to the Fund is considered to be relatively low.
- The **Sydney** office market continues to experience strong tenant demand ('flight to quality') on the back of solid employment growth and record infrastructure spending of $90bn over four years to 2022-23.[1] However, supply of such quality assets has been limited by withdrawal of stock for residential/hotel conversion, accommodation for the Metrorail infrastructure project, and limited new office space until 2020-22. While new office space of ~300,000sqm is slated for delivery over 2019-22, close to 58% has already been pre-committed.[2] Sydney's already low vacancy rate of 4.1% is forecast to fall to 3.4% by January 2020.[3] As a result, rental growth has been solid amidst falling incentives, and in a low interest rate environment the sector's relatively high yields are attracting significant attention from investors.
- Increasingly referred to as Sydney's second CBD, **Parramatta** has emerged in recent years as a prime beneficiary of the strong tailwinds powering the office 'boom'. There is a shortage of quality A-grade assets which form only ~45% of total stock.[3] While Parramatta has one of the tightest prime office markets in the country with a 1.0% vacancy rate, Lonsec notes there are significant developments in the pipeline (~399,000sqm over seven projects by 2022) the majority of which are pre-committed.[4] Parramatta is expected to continue benefit from strong economic growth supported by the NSW Government's decentralisation program and major infrastructure projects in the area including the new Badgerys Creek airport, road and rail links.
- The **Melbourne** office market continues to benefit from several years of strong economic expansion driven in large part by significant population growth of ~460,000 people over the previous three year period.[5] Increasingly, suburban office tenants are migrating to the CBD for its greater amenities and transport links, which has resulted in greater tenant competition for A-grade office space. This has translated into very a low vacancy rate (3.2%), increasing market rents, decreasing incentives and yield compression. While new office supply of ~385,000sqm is anticipated over 2019-21, the vast majority (82%) is already pre-committed.[4]
- **Brisbane**'s office market is in a recovery phase after a challenging period following the end of the resources boom five years ago. The office vacancy rate has fallen from 14.7% to 13% over the previous 12 months.[2] Brisbane is starting to benefit from a significant number of major infrastructure projects either planned or under construction, strong net interstate migration of +49% on the prior 12 months, and the continued transition to a more balanced and services-led economy.[5] While demand remains steady, it is the supply side which is supporting a recovery in rents: withdrawal of obsolete stock from the market, and a lack of new supply for the next two years.
- The **Adelaide** office market has experienced significant investor interest in the wake of the South Australian government's 2018 decision to abolish stamp duty on commercial properties. With low interest rates looking set to continue, institutional investors are increasingly turning to Adelaide assets which offer higher yields (6.0-7.5%) relative to the eastern seaboard capital cities. Significant defence-related contracts and major infrastructure projects are beginning to provide stimulus to the SA economy. While the CBD vacancy rate of 13.5% is still high compared to Sydney (4.1%) and Melbourne (3.2%), the fundamentals are improving with future office supply low (~31,200sqm) and demand growing.[6]
- The **Perth** office market looks to be turning the corner after a very weak period following the end of the resources boom. While still early in the recovery cycle, there are positive signs emerging in labour market job growth (+20% over 12 months) and business sentiment off the back of the resources sector looking to make new project investments, and a number of Perth road and rail infrastructure projects which are providing support to the local economy. Investors are increasingly attracted to the higher yields on offer in the Perth market (5.90-6.25%), albeit for quality assets on long leases to high-quality tenants as part of a 'flight to quality' and centrality. While vacancy rates are still ~20% for A-grade assets, there is little supply in the new office pipeline, so rents are anticipated to remain stable in the short-term, albeit substantial incentives (40-50%) are still being offered to entice tenants to sign-up for long leases.[2]

1. NSW Budget (June 2019); 2. Colliers Research (June 2019); 3. PCA Office Market Report (January 2019); 4. CBRE Research (June 2019); 5. ABS data (2018); 6. JLL Research (June 2019)

Charter Hall Direct Office Fund

5 Exit Strategy/Liquidity

- The Fund is illiquid under ASIC guidelines and investors may only withdraw in response to a withdrawal offer made by the RE.
- Direct property assets are illiquid by nature, so the **Manager is only able to offer limited regular withdrawal offers**.
- The Manager aims to make available **$10m every six months** under the Withdrawal Offer. The regular withdrawal is subject to the level of liquid assets that the Fund holds (i.e. cash) and the RE has discretion to delay or suspend redemptions.
- The Fund has an initial term of 5 years ending in December 2019, at which time the Fund will have a **liquidity event** whereby all investors will be offered an opportunity to redeem part or all their investment. After this the Fund will have rolling five-year terms until the next liquidity event.
- Given the limited liquidity offered by the regular withdrawal offer, which is at the full discretion of the RE, potential investors should take a long-term view of their investment.
- The Manager will use its best endeavours to implement the liquidity strategy to redeem investors wanting to exit in December 2019. The liquidity strategy may include selling properties; raising new equity; arranging new debt financing; listing on the Australian Securities Exchange (ASX); winding up the Fund; or a combination of these. That said, liquidity events may be deferred in exceptional circumstances for so long as it is impracticable to offer liquidity, or it would not be in the best interests of the remaining investors for liquidity to be offered.
- The Constitution gives the RE the power to list the Fund on the ASX without unitholder approval. However, it is the Manager's expectation that ASX listing would go to a unitholder vote. In these circumstances, no Liquidity Event would apply as unitholders would be able to sell their units on the ASX. If listed, units may trade at, below, or above net tangible asset value. In short, this is another liquidity option for investors.

6 Lonsec Methodology

The research methodology includes a rating process designed to assess the qualitative and quantitative factors of the investment. The process is consistent for comparable investment products, enabling projects to be individually rated, comparatively ranked, and to establish a Lonsec Research recommendation status for use by financial planners.

The rating determinants are:

- Financial Analysis / Gearing
- Properties
- Management
- Market Analysis
- Exit Strategy

Lonsec Direct Assets research rating definitions

Highly Recommended	The **Highly Recommended** rating indicates that Lonsec has very strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered a preferred entry point to this asset class or strategy.
Recommended	The **Recommended** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.
Investment Grade	The **Investment Grade** rating indicates that Lonsec has conviction the financial product can generate risk adjusted returns in line with relevant objectives. However, if applicable, Lonsec believes the financial product has fewer competitive advantages than its peers.
Fund Watch	The **Fund Watch** rating indicates that no new investment into this financial product is recommended. A significant change has occurred with the financial product and a detailed assessment of the change is needed and / or series of rectifying actions required prior to this rating being changed.
Screened Out	The **Screened Out** rating indicates that Lonsec currently does not have conviction that the financial product can generate risk adjusted returns in line with relevant objectives. The financial product currently has insufficient competitive advantages relative to its review peer group (if applicable).
Redeem	The **Redeem** rating indicates the financial product is no longer considered worthy of investment for any time period and investors should immediately redeem units from the financial product, subject to seeking financial advice. An adverse development has taken place that is considered detrimental to the interests of investors.

Financial Products withdrawn from research process

Capital Raising Closed	As the Trust is closed to new investment, it is no longer included on the Lonsec Recommended List and existing Lonsec research reports and ratings have been withdrawn from the Lonsec website. Going forward, Advisers should not rely on prior research in respect of this product. Lonsec will only be providing further updates should circumstances require. The Trust manager will have to obtain a new Lonsec rating for any new capital raising. Lonsec may also make a recommendation if a roll-over of investor capital is proposed or a liquidity offer is made. An investment in the Trust can be retained.
Discontinued Review	The **Discontinued Review** status is applied where a fund manager that has approached Lonsec and agreed to tender a financial product for assessment, subsequently elects to discontinue participating in the Review prior to its completion for any reason, other than the financial product being closed or unavailable to retail investors. The Discontinued Review status will be published on the Lonsec website.
Cease Coverage	The **Cease Coverage** status is applied to financial products where fund managers withdraw from the Lonsec research process after the research process has been completed.
Closed / Wind Up	The **Closed / Wind Up** status is applied to a financial product when the fund manager advises Lonsec that the financial product is being wound up and the capital is to be returned to investors.

Charter Hall Direct Office Fund

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately-owned entity with a multi-brand strategy of providing leading financial services research and investment execution.

Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the rating outcome. The analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst(s) holdings may change during the life of this document. The analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the financial product(s) to which this document refers.

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Release authorised by

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