Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Report data as at 28 Feb 2019
Rating issued on 15 Apr 2019

Charter Hall Direct Office Fund - Wholesale A Units

VIEWPOINT

The Fund, managed Sydney based Charter Hall Holdings (Charter Hall), is an unlisted property fund providing exposure to a portfolio of commercial office assets. Formerly known as the Charter Hall Direct Property Fund, the repositioned mandate and portfolio aims to provide stable, tax-advantaged income with the potential for capital growth over the medium to long-term. Zenith has a solid level of conviction in the abilities of Charter Hall to execute the strategy of the Fund throughout the market cycle, given their extensive operational expertise in this asset class.

Charter Hall is a subsidiary of ASX listed Real Estate Investment Trust (REIT), Charter Hall Group (CHC). CHC is a fully integrated property group, with over $28.4 billion of property across the office, retail, industrial and social infrastructure sectors. As at 31 December 2018, CHC held $A 28.4 billion in real estate under management.

Charter Hall focuses on targeting assets with strong tenant covenants on long-term leases. Charter Hall seeks to invest for the medium to long-term and actively manages assets to maximise value and income generation. While typically favouring long duration assets, properties of a more opportunistic nature may be considered where Charter Hall sees value from repositioning an asset. While able to operate along the full risk spectrum, this is only pursued in accordance with the investment mandate.

The Fund currently comprises a pool of 14 assets with a moderate level of gearing at 35%, against a target of 25% to 45%. Portfolio metrics continue to be robust with a Weighted Average Lease Expiry (WALE) profile of 8.7 years by income and occupancy of 100% as at 28 February 2019.

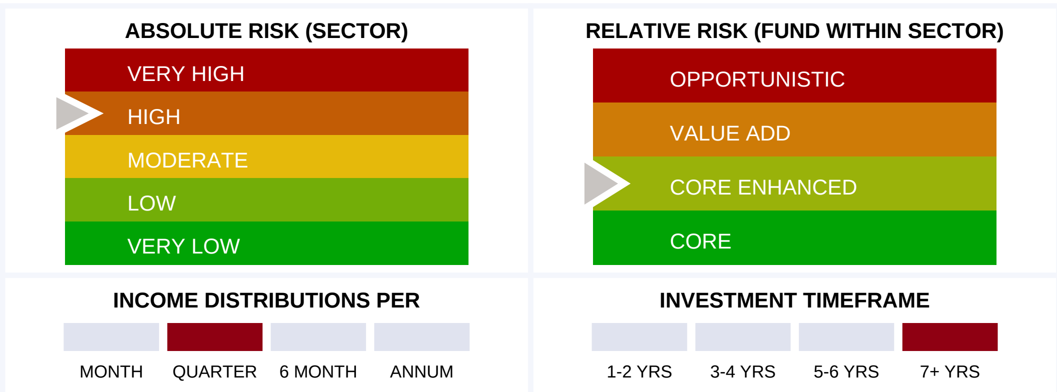
The Fund operates for a fixed term ending December 2019 whereby a full liquidity event will be offered to all investors. At this point, management will seek to engage with unitholders and determine if the Fund will be extended or wound up. In the case of extension, full liquidity events will be offered every five years. In the interim, withdrawal offers will be made six monthly subject to available liquidity and capped at $15 million p.a. At these liquidity events, unitholders will be given the option of staying in the Fund or exiting.

The portfolio is designed to comprise a diversified pool of quality office assets. Zenith sees the Fund's willingness to co-invest in assets with institutional investors in Charter Hall's wholesale pooled funds as a competitive advantage. This has given the Fund access to several high quality real estate opportunities which have typically remained out of reach for most retail investor funds.

Zenith has a solid conviction in the Fund over the proposed term as a generator of reasonably low volatility income returns with modest capital appreciation.

FUND FACTS

- Unlisted property fund holding a diverse portfolio of commercial office real estate
- Experienced and well-resourced Investment Manager with a long track record in commercial real estate asset and funds management
- WALE of 8.7 years by income, 100% occupied
- No buy spread makes an attractive entry point with minimal upfront cost drag to investor Net Tangible Assets per unit
- Compliant with Australian Government SIV guidelines



APIR Code
MAQ0842AU

Asset / Sub-Asset Class
Property
Direct

Investment Style
Core Enhanced

Investment Objective
To provide investors with a stable, tax advantaged income with the potential for capital growth over the medium to long term.

Zenith Assigned Benchmark
S&P/ASX 300 AREIT

Net Returns (% p.a.)

	3 yrs	2 yrs	1 yr
Fund	15.40	15.16	12.72
Benchmark	8.94	9.32	18.87
Median	11.36	11.45	10.13

Income (% p.a.)

	Income	Total
FY to 30 Jun 2017	7.17	18.06
FY to 30 Jun 2016	7.30	20.20

Fees (% p.a., Incl. GST)
Management Cost: 0.68%
Performance Fee: 15% of outperformance over IRR of 10%

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Unlisted direct real estate investments encompass a range of risk/return profiles depending on the portfolio assets and fund strategy. Typically investment into unlisted real estate exhibits lower volatility than other asset classes and weak returns correlation. This is largely driven by the low liquidity of such assets with either limited opportunities to exit for open ended funds or nil liquidity for closed ended funds. This is in contrast to listed property funds (A-REITs/G-REITs) which in Zenith's view represent a real estate proxy as returns can often be generated by sources other than rent and property values and whose liquid nature exposes them to market trading sentiment thus heightening their correlation to equities.

Real estate strategies can range from stabilised assets to opportunistic real estate development. Stabilised portfolios have existing, tenanted assets and tend to produce low volatility income streams with small to moderate capital growth. Value-add and opportunistic strategies are higher risk, often involving real estate development or assets with delayed or impaired cash flows. It should be appreciated that even within stabilised strategies a wide range of risk/reward scenarios can be manifested. When taking into account portfolio construction issues and asset class classification, unlisted direct property funds are generally considered by Zenith to share the characteristics of direct property ownership while being open to different levels of risk. The asset class is considered to pose moderate to high risk characteristics. Investors should also be aware of the consequences of an allocation to what is an inherently illiquid asset class in their investment portfolio.

PRODUCT FEATURES

Key Features [1]	Description
Property sector	Office
Entry Price	$1.4766
Exit Price	$1.4766
Current Distribution/Yield [2]	8.25 CPU / 5.59%
Minimum Investment	$20,000
Fund commenced	2014 [2]
No. of properties	14
Total assets ($m)	1,981.5
Fund debt ($m)	718.6
Fund gearing	34.68%
Fund LVR	36.27%
Investment term	Open ended

[1] All as at 1/3/19 unless otherwise stated. [2] For Wholesale A Units.

PORTFOLIO APPLICATIONS

In Zenith's opinion, the Fund may be suitable for investors seeking long-term, stable income with a capital growth component and who can accept the risks of gearing and potentially low liquidity. Zenith believes that direct property should only be utilised in well-diversified portfolios in order to reduce the potential impact of illiquidity risk.

Zenith continues to be a strong believer in the merits of judicious exposure to unlisted property as an asset class within a well-diversified portfolio owing to its low correlation to most other asset classes; including listed property, making it a useful diversifier.

Significant Investor Visa

As at the date this rating is issued, the Fund has been classed as compliant with the Australian Government's Significant Investor Visa (SIV) guidelines. SIV is designed to attract overseas investment and provide a pathway for investors and entrepreneurs to acquire permanent residence in Australia. The SIV has other eligibility criteria which must be assessed by the Australian Government and met before it can be granted. Clients should seek their own taxation, legal and professional advice to assess whether or not they qualify to apply for the SIV and before making any investment decisions regarding the SIV. Information about the other criteria of the SIV is available on the Department of Immigration and Citizenship and Victorian Department of Business and Innovation websites.

Liquidity

The Fund has an initial five-year term ending in December 2019, whereby a full liquidity event will be offered to all investors in the event of an extension. The Fund will have rolling five-year terms with a full liquidity event at the end of each term. In the interim, withdrawal offers will be made six monthly subject to available liquidity and capped at $15 million p.a. While Zenith sees this structure as workable in normal operating conditions, the fixed dollar nature of the mechanism will be less effective as the Fund grows in size.

Capacity to facilitate full liquidity events is intended to be funded by either asset sales, equity raisings, debt or a combination of these. Unitholders do not have to vote on whether or not the Fund should be extended beyond the full liquidity events. Management has indicated that if redemptions during full liquidity events were to exceed a certain threshold, they will wind up the Fund. Ideally, Zenith would prefer to see greater clarity regarding minimum thresholds for the Fund remaining viable with regard to its objectives.

Potential investors need to be aware that unlisted property funds do not traditionally offer the same level of liquidity as listed real estate securities (although with lower volatility) and the implications of investing in asset classes which are fundamentally illiquid and long-term should be appreciated. That said, Zenith accepts this as a generally unavoidable feature of unlisted property funds.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the "Direct Property" sector are exposed to the following broad risks:

MARKET & ECONOMIC RISK: A significant risk to performance is a sustained downturn in the real estate markets. Supply and demand balances of assets (and leasing opportunities) will also impact outcomes. In addition, changes in economic, social, technological or political conditions, as well as market sentiment could also lead to negative fund performance.

VACANCY RISK: The risk of a tenant vacating a property, failing to meet their rental obligations or failing to renew a lease can have a detrimental impact on rental returns.

VALUE RISK: Property values are influenced by location, supply and demand, rental agreements, occupancy levels, obsolescence, tenant covenants, environmental issues and government or planning regulations. Changes to these drivers may affect the end value of the property.

LEVERAGE RISK: Investors should be aware that the effects of gearing can magnify gains as well as losses. In a loss scenario this may result in potential impairment of values and forced disposal at a time when markets may not be ideally placed to recoup the equity position.

STRATEGY RISK: Real estate strategies can vary from stabilised 'core' strategies which are generally low risk to opportunistic plays on development or distressed assets which can have complex and severe risks associated with them. Potential investors should have a clear understanding of the individual strategies posed by real estate investments.

MANAGEMENT RISK: Management risks encompass a wide range of factors relating to personnel (key person risk), counterparty risk (risk of management not being able to fulfil their duties due to insolvency) and skillset (ability to effectively and efficiently carry out strategies).

ILLIQUIDITY RISK: Investment in direct real estate investment funds can be prone to liquidity dislocations owing to the fundamentally illiquid nature of the underlying assets. Long duration illiquid assets means investors typically have limited ability to react to any changing conditions by reducing or redeeming their investments. Regardless of any liquidity mechanisms present, investors may face circumstances where available liquidity dries up.

REGULATORY RISK: The ASIC Regulatory Guide 97 'Disclosing Fees and Costs in PDSs and Periodic Statements' came into effect on 1 October 2017, and seeks to establish a common framework for disclosing fees with respect to registered managed investment schemes issued to retail investors. The guide is currently under review by ASIC, with final recommendations expected to be made before the end of 2018.

In its current form, RG97 is not expected to impact the actual costs (or net returns) on existing investments. Rather, the guide is focused on providing increased transparency with respect to the costs of management. Given this, it is feasible that under RG97, investors become more sensitive to the costs charged and seek lower cost alternatives, potentially leading to fund outflows.

FUND RISKS

Zenith has identified the following key risk associated with the Fund; this is not intended to highlight all possible risks:

KEY PERSON RISK: Zenith believes Fund Manager Steven Bennett is integral to the success of this Fund. We do however acknowledge the integrated nature of Charter Hall's operations lessens key man risk as operations are sourced across the business. The continued presence of key individuals within Charter Hall is essential and any material departures of Bennett or other key team members would result in Zenith re-assessing its rating on the Fund.

FINANCE RISK: The Fund's finance facilities mature in December 2022 and December 2023. There is no guarantee that refinancing will be available or on similar terms.

RETURNS DILUTION RISK: Funds dealing with real assets that have low liquidity are generally unable to deploy capital as rapidly as investment strategies operating in liquid markets. Accordingly, rapid inflows of equity into a fund or significant delays in acquiring assets may result in dilution of returns (i.e. cash drag) to existing investors until capital is deployed.

CONFLICT OF INTERESTS RISKS: The Fund may purchase assets from related parties within the Charter Hall Group. Related party transactions increase the risk of outcomes which can be less transparent and potentially inequitable. Zenith notes that Charter Hall has robust guidelines for related party transactions with only independent board members permitted to vote on such issues.

STRATEGY EXECUTION RISK: The Fund has a mandate to acquire assets, some of which are yet to be identified. Although the portfolio has reached a high level of deployment, the successful acquisition of new properties is subject to availability. As a result, a greater reliance is placed upon the skills of the investment team. The ultimate robustness of assets and cashflows in the portfolio is unknown until the Fund is fully invested.

DEVELOPMENT RISK: Some of the assets are potentially exposed to risks around the completion of construction, including risks of completion delays. While these risks should be adequately catered for due to the structuring of development agreements, development risk cannot be mitigated entirely.

INTEGRATION RISK: Given the expected 2019 integration of Folkestone Limited into Charter Hall team, there is a risk of increased staff turnover and disruption to operations. Such outcomes could ultimately be to the detriment of Fund performance.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Charter Hall Direct Property Management Limited (Charter Hall), is a wholly owned subsidiary of listed REIT, Charter Hall Group (ASX:CHC). CHC is a fully integrated property group, with over $28.4 billion of property across the office, retail, industrial and social infrastructure sectors. As at 31 December 2018, CHC held $A 28.4 billion in real estate under management.

CHC has over 27 years' experience managing and investing in high quality property on behalf of institutional, wholesale and retail clients. CHC has significant expertise and resources and maintains an internalised business model, operating not only as a fund manager but also as a full service asset manager.

CHC has a substantial national property portfolio via the stapled structure of the REIT, institutional pooled funds, partnerships and mandates as well as a retail investor channel.

As CHC (and its subsidiaries) invest in real estate across a wide spectrum of values and strategies, the underlying business divisions operate as centralised service providers to the assets spread out across the various holding funds. With over 480 staff deployed nationally, CHC has considerable local resources to manage assets.

In February 2016, former Joint Managing Director David Southern stepped down from the role leading to a restructure of CHC's Board. David Harrison (former Joint MD) has assumed the CEO and sole Managing Director role. As part of the transition, CHC has moved to a sector based model, appointing dedicated Heads of Office (Adrian Taylor), Retail (Greg Chubb) and Industrial (Richard Stacker) which all report to Harrison.

The Board's credentials and experience in real estate and funds management are robust, for both the Executives and Non-Executives. Zenith believes this remains an important consideration given that in the event any related party actions take place within its funds, Executive Directors are not permitted to cast a vote.

As at 31 December 2018, CHC had co-invested $A 1.8 billion across its fund platform. This co-investment generates a material level of CHC's revenue with the remainder coming from funds management operations. The fact that CHC maintains co-investment across the majority of its unlisted funds and not just within the listed REIT, is seen as a positive as it tends to create a high level of alignment.

As at 28 February 2019, the Fund has assets under management of $A 2.03 billion.

INVESTMENT PERSONNEL

Name	Title	Tenure
Steven Bennett	Fund Manager / Head of Direct	9 Yr(s)
Christopher Choi	Assistant Fund Manager	7 Yr(s)
James Duffy	Fund Analyst	5 Yr(s)

CHC's Sydney based funds management operations are split between the listed REIT, institutional unlisted funds and partnerships and retail investor funds. Charter Hall operates as its own silo, and also acts as the Responsible Entity of the Fund. Investment management services are provided by Charter Hall Holdings (CHH), including asset management, property management, transactions, finance, market research, accounting and legal services.

A six person investment team is responsible for the full suite of Charter Hall's unlisted property funds which are managed for retail investors (10 funds). The investment team is also supported by dedicated teams in Distribution, Market/Investor Relations, Registry and Research Services.

The team is headed by Steven Bennett. In 2016, former Head of Direct, Richard Stacker exchanged roles with the Head of Investor Relations, Nick Kelly. as part of part of an executive rotation. In January 2017, Kelly resigned from the business and subsequently, Bennett was promoted to Head of Direct alongside his responsibilities for the Fund.

Bennett has 16 years experience in property funds management and was formerly the Portfolio Manager of the Fund prior to its acquisition by CHC from Macquarie Bank. Bennett is supported by Assistant Fund Manager Christopher Choi, who has 11 years experience in unlisted property with former roles at Investa Property Group. James Duffy (Fund Analyst) supports Bennett and Choi and has been with the firm for five years and comes from an accounting background.

Zenith has developed a solid level of conviction in the abilities of Bennett and Choi to manage the fund, viewing them as experienced, astute individuals.

Two additional team members were added in 2016 with the internal appointment of Duffy to his current role and Shrabastee Mallik (Research Analyst) who was an external hire. Mallik however subsequently departed in mid 2017. While Zenith believes that the addition of Duffy is a positive given the increasing workload of additional funds and assets being added to the team's responsibilities, we remain cautious on resourcing constraints. Charter Hall has noted this as a potential issue given growth in the businesses retail unlisted funds. They appointed a new Graduate Analyst, Angus Pulver, to the team in February 2018.

Overall, Zenith remains comfortable with these changes and we acknowledge the presence of strong embedded skills on Charter Hall’s Board and Investment Committee. However, Zenith will maintain a heightened watch on any further staff movements. The significant breadth and scope of CHC's property related resources provide significant support to the funds management arm.

CHC maintains the majority of property management capabilities in-house, including development, tenant relations and leasing. Facilities management is outsourced to preferred providers. This is also supplemented by dedicated teams who undertake project management, property transactions, capital management and environmental management. This arrangement typically allows for a closer relationship with tenants and creates greater efficiencies in asset management.

Given the depth of operations, the potential for related party conflicts is evident. Zenith has reviewed CHC's Acquisition and Transaction check-lists as well as the Conflict of Interests and Related Party Transaction Policy. These guidelines are detailed and should provide a robust conflict management framework. Should any related party transaction be entered into, each party must obtain independent valuations of the asset(s) and has individual negotiating teams. In addition, only the Independent Directors of each party's Board may cast a vote on the transaction.

Staff remuneration is structured with a combination of fixed and performance-based incentives. Performance takes into account the personal achievements of the individual, the investment returns of Charter Hall’s funds and the profitability of the business. The investment performance of an individual fund is a key input in driving the performance-based incentives that a fund manager is eligible to receive. Performance rights over CHC stock is also available for senior management with vesting arrangements in place to retain high performing members of the team.

In August 2018, CHC announced it would acquire Folkestone Limited (FLK). FLK is a property fund manager and developer, operating listed, unlisted and private funds, with FUM of $1.6bn as at the announcement date. The acquisition of Folkestone expands Charter Hall's investable universe into the social infrastructure and early learning sector. Zenith notes that initially, FLK's unlisted funds will continue to be run as a dedicated silo by FLK staff. Over time, it is expected that these staff and operations will be integrated into Charter Hall's operations. While Zenith notes that CHC underwent a similar strategy in acquiring and assimilating the Macquarie unlisted property platform in 2010, a period of consolidation will be required to bed down this new acquisition.

Zenith views CHC and Charter Hall favourably given the organisation's extensive experience, resources and skill set. While we view co-investment positively and note that CHC has held positions in the Fund previously, CHC currently holds no position in the Fund.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

The objective of the Fund is to provide a sustainable and stable tax advantaged income stream and potential for long-term capital growth. The Fund aims to progressively acquire a diversified portfolio of high quality Australian office assets.

In the office segment, Charter Hall focusses on CBD and CBD fringe markets, targeting assets with strong tenant covenants on long-term leases. Management seeks to invest for the medium to long-term and actively manages the assets to maximise value and income generation. While typically favouring long duration assets, properties of a more opportunistic nature may be considered where the team sees value from repositioning an asset. While able to operate along the full risk spectrum, this is only pursued in accordance with individual investment mandates.

The Fund has progressively transitioned from a broadly diversified real estate vehicle into a targeted owner of Australian direct commercial office assets. Management has also worked to enhance the quality of the portfolio by recycling capital from non-core assets into longer leased quality properties (which has been a thematic across much of the CHC portfolio in recent years).

SECURITY SELECTION

Potential acquisitions are sourced via the Group's investment pipeline, joint venture partnerships and other market opportunities. Acquisitions are assessed by the property transactions team, which operates on a group-wide basis. This allows the flexibility to source assets and then determine which of CHC's funds it will be most suited to in terms of size, attributes and investor type.

Asset identification and selection may be derived from a range of sources. As such, the process is not strictly driven by bottom-up or top-down processes. However, a potential acquisition must undergo a detailed due diligence process from the property transactions team which is then followed up with a formal due diligence review by the Board of the relevant fund. Once an acquisition is made, the Board will continue monthly high level asset reviews with full reviews done every quarter to determine if the holding remains appropriate.

While somewhat agnostic on the sourcing of deals, the Group is by nature a high conviction asset manager whose integrated business model allows it to maximise value extraction across all aspects of the process. The Group has its own internal research team which provides proprietary research on prevailing market conditions. Zenith believes the Group's structure and national presence provides the research team with timely and valuable on-the-ground intelligence from its property managers.

Quantitative and qualitative factors are utilised in the screening process to determine the relative value of each asset. Core quantitative factors will generally encompass analysing valuation criteria including; DCF analysis; capitalisation rates; capital value and comparable sales/valuations. Further analysis is also applied to additional factors including; supply/demand pipeline; lease structure and rent analysis; market incentives and capex programs.

PORTFOLIO CONSTRUCTION

The portfolio comprises a diversified pool of office assets. The portfolio is in keeping with the strategic aims of the Fund in favouring properties with long-term leases to strong covenant tenants.

The portfolio comprises a diversified pool of predominantly high quality office assets and is generally in keeping with the strategic aims of the Fund in favouring properties with long-term leases to strong covenant tenants. While some assets continue to bear exposure to development risks, these are largely mitigated by their structural arrangement, the presence of step in rights, fixed price building contracts and a generally short time to completion.

The current portfolio is as follows:

Direct Portfolio Details

Diversification	No.	Value ($m)	% by value	% by income
NSW	6	879.5	44%	41%
VIC	3	467.3	24%	24%
QLD	3	470.7	24%	25%
WA	1	26.9	1%	2%
SA	1	135.0	7%	7%
Total	**14**	**1,979.4**	**100%**	**100%**
Metrics - As at 31 December		**2016**	**2017**	**2018**
Weighted Average Lease Expiry (yrs)		9.2	9.1	8.7
Weighted Average Capitalisation Rate		6.47%	5.92%	5.50%
Occupancy		100%	100%	100%

[1] Taken from latest valuations as at 31/12/18

Portfolio [1]	% of Portfolio	Current Valuation ($m)	Valuation date	Cap Rate	Passing Yield	Lease expiry (yrs)
Direct Property Portfolio						
NSW						
10 Shelley St	13%	261.9	Dec-18	5.00%	4.58%	8.9
68 Pitt St, Sydney	11%	220.0	Dec-18	5.25%	5.27%	2.2
WSU, 1PSQ, Parramatta	7%	147.0	Dec-18	5.13%	4.99%	12.9
105 Phillip Street, Parramatta	6%	123.7	Sep-18	5.25%	4.94%	11.1
Westpac, Kogarah	5%	105.3	Dec-18	5.50%	5.51%	15.3
WSU, Hassall St, Parramatta	1%	21.7	Jun-18	5.50%	5.50%	10.3
VIC						
200 Queen St, Melbourne	10%	190.0	Dec-18	5.50%	5.57%	5.3
Coles HQ, Harwthorn East	7%	141.5	Dec-18	5.50%	5.77%	11
1 Nicholson St, Melbourne	7%	135.8	Dec-18	5.25%	5.51%	7.8
WA						
181 St George Terrace, Perth	1%	26.9	Dec-18	6.75%	8.77%	6.4
SA						
ATO Adelaide	7%	135.0	Jul-18	6.00%	5.95%	8.2
QLD						
61 Mary St, Brisbane	14%	274.7	Oct-18	6.00%	5.33%	10.1
69 Ann St, Brisbane	5%	98.4	Dec-18	6.00%	7.21%	5.1
Aurizon, Brisbane	5%	97.5	Dec-18	5.63%	5.56%	11
Total / Weighted Average	**100%**	**1,979.4**		**5.50%**	**5.45%**	**8.7**

[1] Taken from latest valuations as at 31/12/18

The Fund will also hold cash where it is deemed appropriate. Any residual cash holdings from asset sales will be utilised to reduce debt.

Zenith notes that from 2017 the Fund has held an interest in the Charter Hall Prime Office Fund (CPOF). While the Fund's investment mandate does not specifically preclude investments in other unlisted property funds, Zenith feels that best practice would be to include this in the mandate along with any exposure limits.

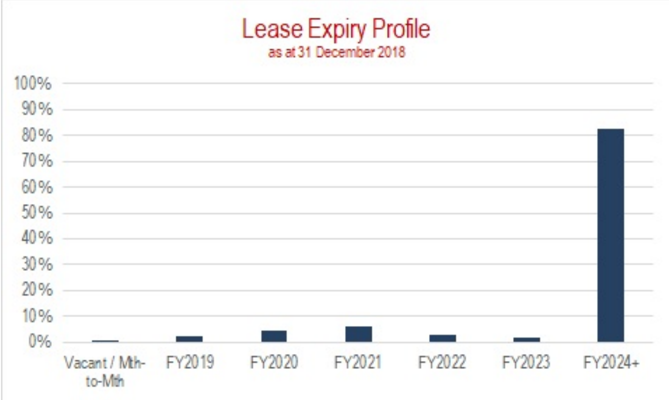
Charter Hall has indicated that currently, the expectation is that any investments in other unlisted funds would be limited to 5% of the portfolio and that only funds where Charter Hall is the investment manager would be considered.

The Fund's allocation to CPOF was driven by the opportunity to access a portfolio of higher quality assets as well as enhanced opportunities to partner with CPOF should it seek a capital partner on its office development assets. CPOF is a $A 5.3 billion office portfolio providing institutional investors with exposure to high-quality office buildings located in Australia's major capital cities. At as 31 December 2018, CPOF held 26 assets with an occupancy level of approximately 99% and a WALE of 6.6 years.

While Zenith is not against small allocations to other quality unlisted investment vehicles, we would prefer that a more robust framework exists regarding allocation limits. This is to ensure that investors in the Fund are not unduly exposed to additional illiquidity risks.

Tenancy Profile

Despite being a sector-specific strategy, the Fund's portfolio is well diversified by number of tenants (90). Zenith believes that the long lease expiry across the portfolio is a positive feature of the Fund as it is relatively rare to be able to access a portfolio of office assets with such a long WALE (8.6 years as at 28 February 2019).



Rental uplifts for the underlying assets are solid over the short to medium-term (particularly when taking into account the long lease expiry profile) with the majority of the assets subject to fixed rent increases in excess of current Consumer Price Index. Given the minimal incidence of rent reviews in the interim, Zenith believes this should ensure effective rental growth remains robust across the majority of the portfolio.

DEBT ANALYSIS

Financing Details [1]	
Debt Facility ($m)	1,000.0
Maturity Date	Tranche 1 - 1/12/2022 Tranche 2 - 1/12/2023
Drawn ($m)	718.6
Hedged	70.3%
Weighted average interest rate	3.65%
Fixed/Variable Split	70.3%/29.7%
Average Debt expiry (Yrs)	4.3
Current LVR	36.3%
Facility LVR [2]	50.5%
LVR Covenant	60.0%
LVR sensitivity to covenant [3]	-39.6%
Gearing	34.7%
Interest Coverage Ratio	3.62
Interest Coverage Ratio Covenant	1.50x
Interest Coverage Ratio sensitivity to covenant [3]	-58.5%

[1] As at 14/3/19 unless stated otherwise. [2] If fully drawn. [3] Decline in asset value required to initiate a covenant breach on drawn debt

Management's use of leverage for the Fund is targeted at 25% to 45% Loan to Value Ratio (LVR) with a maximum of 50% LVR at the point of asset acquisition.

Current leverage is within target levels although this will fluctuate as additional assets are added to the portfolio.

Any required capital expenditure on assets is expected to be debt funded, which will add to drawn debt. However, the impact is expected to be relatively minor unless unforeseen, significant expenditure eventuates.

While Zenith is comfortable with the current level of leverage, any material rise from current levels would be a cause for concern. The appropriateness of Fund gearing will ultimately be dependent on the nature of the properties purchased.

Debt levels are expected to remain at least 50% hedged over the longer term. Zenith considers management allowances for future interest rate rises are appropriate.

RISK MANAGEMENT

The Fund has no formal risk constraints outside the investment mandate.

Zenith notes that as the Fund portfolio has grown in value, some parameters such as investment sizing have been revised to a more appropriate setting (previously Fund interest was stated as assets between $25 - $150 million).

Investment Mandate - Charter Hall Direct Office Fund	
Property type & location	Australian office property.
Property Grade	Prime, A-Grade, B-Grade.
Tenant quality	Must have high quality tenants.
Size	At acquisition, Fund interest must be <25% of the total portfolio value.
Weighted Average Lease Expiry (WALE)	At acquisition, asset must not reduce the property portfolio WALE below five years.
Development	Must have an approved development application; an agreement for lease; and other risk mitigants as deemed appropriate.
Co-Investment	All co-investments will be in high quality office investments alongside Charter Hall's institutional office funds or major Australian or international investors.

Risk management is centred around the due diligence process regarding asset selection and acquisition. These processes include the use of independent valuations, physical, technical, financial and legal due diligence and the experience of the investment team in asset selection.

Given the nature of the Fund and the objectives, Zenith believes that these constraints are broadly appropriate and that the risk management processes for the Fund are thorough and of high quality.

Zenith notes that there is no formal restriction on exposure to either cash or indirect investments in other funds and we believe that additional guidelines on these areas would reflect best practice. Regarding cash levels, we note that Charter Hall expects the Fund to be generally fully invested where possible except where cash holdings may rise prior to asset acquisitions.

Environmental, Social & Governance (ESG)

Zenith notes that while the Fund does not have any specific ESG exclusions in the traditional sense, ESG as a consideration forms part of Charter Hall's investment decision-making process across its funds. Where applicable, Charter Hall utilises measures such as the National Australian Built Environment Rating System (NABERS) to measure operational impacts across the Fund's properties on the environment. CHC has also adopted the Global Reporting Initiative (GRI) guidelines as the framework for reporting on the Group's wider ESG performance.

INVESTMENT FEES

The sector average management cost (in the table below) is based on the average management cost of all Property - Direct funds surveyed by Zenith. These include calculations for both Gross Asset Value (GAV) and Net Asset Value (NAV), which are principally influenced by a funds leverage.

The annual management cost is 0.68% of Gross Asset Value (GAV) p.a. Ongoing management fees (0.5%) and administration and expense recoveries (up to 0.2%) are charged as a proportion of the assets relevant to each unit class in the Fund rather than total assets.

The performance fee is 15% of the Fund's excess return over an IRR of 10% p.a. The first performance fee calculation period is from the date of the first issue of Wholesale A Units through to the end of the Fund's initial term in 2019. If the Fund continues beyond 2019 as per the rolling five-year terms, the performance fee will be payable and the IRR calculation reset at the end of each term.

The Fund also applies a buy/sell spread of 0%/2.50% on all applications and redemptions.

Additional fees may apply as follows:

- Acquisition fees - Up to 1.5% of the property purchase price;
- Disposal fees - Up to 1.5% of the gross sale price

Zenith believes the Fund's fee structure is below peers, and appropriate given its stated objectives.

Fee Type	Fund	Sector Average
Management Costs p.a. (% of GAV)	0.68%	0.89%
Management Costs p.a. (% of NAV) [1]	1.09%	1.52%
	Description	
Performance Fee	15% over a 10% net IRR	
	Buy Spread	Sell Spread
Buy/Sell Spread	0.00%	2.50%

[1] *Based on midpoint target gearing of 38%.*

PERFORMANCE ANALYSIS

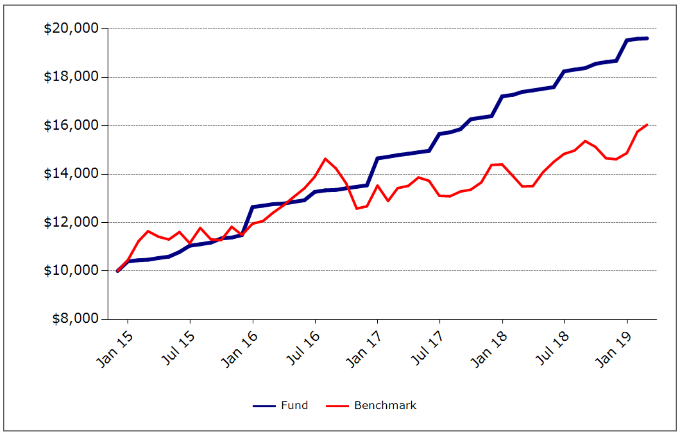
Report data: 28 Feb 2019, product inception: Dec 2014

Monthly Performance History (%, net of fees)

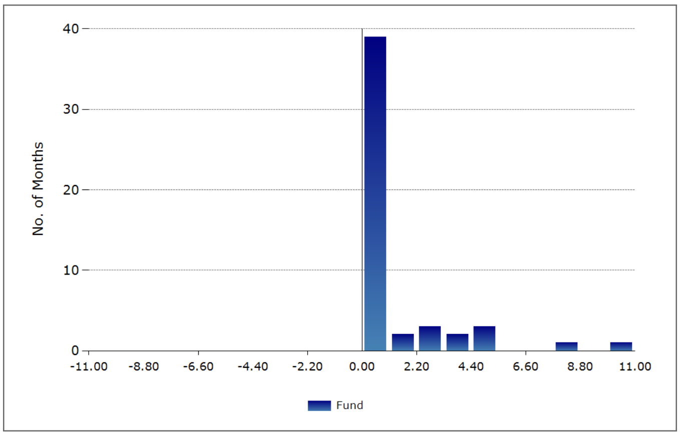
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	FUND YTD	BENCHMARK YTD
2019	0.32	0.09											0.41	7.87
2018	0.33	0.71	0.37	0.39	0.38	3.70	0.41	0.32	0.96	0.41	0.25	4.56	13.44	3.26
2017	0.45	0.47	0.38	0.41	0.41	4.66	0.42	0.84	2.58	0.41	0.38	5.00	17.51	6.45
2016	0.45	0.50	0.17	0.57	0.52	2.66	0.50	0.13	0.50	0.47	0.44	8.23	15.90	13.18
2015	0.48	0.19	0.68	0.52	1.82	2.41	0.56	0.60	1.53	0.34	0.90	10.08	21.61	14.38

Benchmark: S&P/ASX 300 AREIT

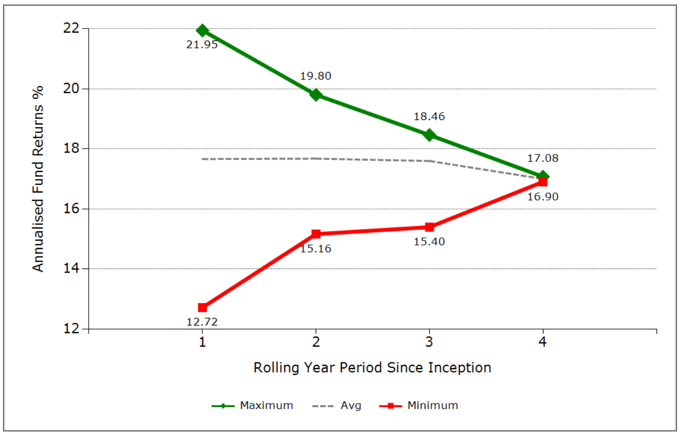
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	3 yr	2 yr	1 yr
Fund (% p.a.)	17.17	15.40	15.16	12.72
Benchmark (% p.a.)	11.76	8.94	9.32	18.87
Median (% p.a.)	17.04	11.36	11.45	10.13
Ranking within Sector	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund Ranking	6 / 13	7 / 29	6 / 31	10 / 33
Quartile	2nd	1st	1st	2nd
Standard Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund (% p.a.)	6.99	6.21	5.37	4.91
Benchmark (% p.a.)	11.72	11.40	9.06	8.23
Median (% p.a.)	6.56	4.66	4.05	3.32
Downside Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund (% p.a.)	0.00	0.00	0.00	0.00
Benchmark (% p.a.)	6.06	6.44	4.58	3.19
Median (% p.a.)	0.82	0.00	0.00	0.00
Risk/Return	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Sharpe Ratio - Fund	2.16	2.17	2.47	2.19

It should be recognised that Zenith's sector benchmark (S&P/ASX 300 A-REIT Index) is intended as a broad market indicator only. Returns characteristics of unlisted property funds should be expected to vary materially at different points in the investment cycle given their inherently lower correlation to liquid benchmarks.

All commentaries below are as at 28 February 2019.

The objective of the Fund is to provide a sustainable and stable income stream with the potential for long-term capital growth.

The Fund has generated robust absolute returns over all time periods and in excess of our sector benchmark. While we attribute part of this positive performance to Charter Hall's active repositioning and management of the portfolio, it should be noted that a portion of the excess returns are also likely attributable to higher leverage levels in a rising market versus the benchmark.

Looking forward, Zenith expects minimal impact from the effects of underlying lease expiries, capital expenditure programs or other extraneous fund costs to the existing portfolio in the short to medium-term. Zenith believes that this should result in a strongly stable income stream.

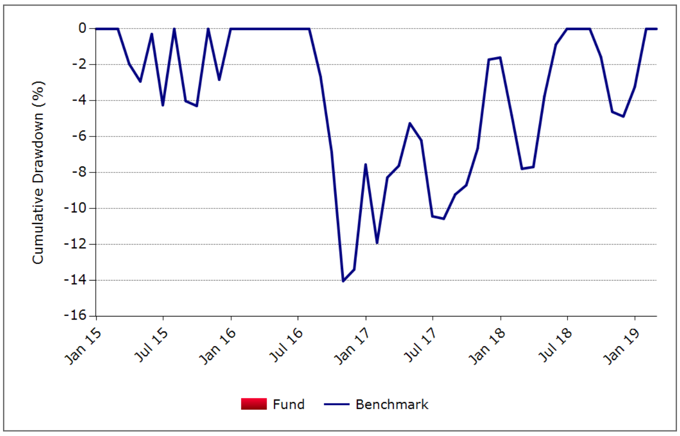
Performance of the Fund against the Zenith sector benchmark should be viewed in the context of the characteristics of the asset class. Unlisted property funds typically exhibit low correlations to more liquid assets such as A-REITs and also typically have higher levels of leverage. Accordingly, it should be expected that material short to medium term performance dispersion between the Fund and the benchmark at different points in the cycle.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	Fund	Benchmark
Max Drawdown (%)		-14.04
Months in Max Drawdown		3
Months to Recover		20

Worst Drawdowns	Fund	Benchmark
1		-14.04
2		-4.88
3		-4.29
4		-4.25
5		-2.83



All commentaries below are as at 28 February 2019.

Fund drawdowns to date have been zero given the combination of the short time-frame since inception and strong market conditions. It should be recognised that funds with exposure to direct real estate will not only react to valuations of physical assets but also to the mark-to-market valuations of financial instruments such as interest rate hedges.

Given Zenith's sector benchmark is highly liquid, it is expected that drawdowns by the benchmark will be more frequent and greater in scale than that of the Fund.

INCOME/GROWTH ANALYSIS

Income / Growth Returns	Income	Growth	Total
FY to 30 Jun 2017	7.17%	10.89%	18.06%
FY to 30 Jun 2016	7.30%	12.90%	20.20%

All commentaries below are as at 28 February 2019.

Investors should be aware the Fund does not target a specific income level. Distributions will be made quarterly where possible.

Distributions to date have been stable and in-line with forecasts. As at 1 March 2019, the Fund has a distribution yield of 5.59% based on a 8.25 Cents Per Unit distribution (annualised) for the December 2018 quarter and unit price of $1.4766.

As at the same date, the underlying passing yield on the direct portfolio assets is 5.45% (unlevered) which should largely underpin distributions over the short term. Looking forward, Zenith expects minimal impact from the effects of underlying lease expiries, capital expenditure programs or other extraneous fund costs to the existing portfolio in the short to medium-term. Zenith believes that this should result in a strongly stable income stream.

Zenith notes that the distribution policy does not restrict how distributions are funded and that the Investment Manager may elect to retain income for the purposes of capital management. Based on fund cost assumptions and having had regard to contracted rents, Zenith believes that Fund's earnings capacity is sufficient, however, additions and or deletions to the portfolio over time will impact this outlook.

REPORT CERTIFICATION

Date of issue: 15 Apr 2019

Role	Analyst	Title
Author	Dugald Higgins	Head of Property & Listed Strategies
Sector Lead	Dugald Higgins	Head of Property & Listed Strategies
Authoriser	Bronwen Moncrieff	Head of Research

RATING HISTORY

As At	Rating
15 Apr 2019	Highly Recommended
1 Feb 2018	Highly Recommended
22 Dec 2016	Highly Recommended
15 Dec 2015	Highly Recommended

As At	Rating
31 Oct 2014	Not Rated - Declined

Last 5 years only displayed. Longer histories available on request.

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