RESOLUTION CAPITAL

QUARTERLY INVESTMENT REPORT

RESOLUTION CAPITAL CORE PLUS PROPERTY SECURITIES FUND

SEPTEMBER 2018

Australian Real Estate Securities

Fund Investment Performance

The Resolution Capital Core Plus Property Securities Fund (the 'Fund') underperformed the S&P/ASX 300 AREIT Accumulation Index by 12 basis points for the quarter ending 30 September 2018.

Period Ending 30 September 2018*	Quarter %	1 Year %	3 Years % p.a.	5 Years % p.a.	7 Years % p.a.	10 Years % p.a	Since Inception[#] % p.a.
Fund (after fees)	1.86	12.93	11.46	13.18	15.81	7.81	7.81
Benchmark[+]	1.98	13.25	10.29	12.58	15.32	6.45	6.45
Difference	*-0.12*	*-0.32*	*1.17*	*0.60*	*0.49*	*1.36*	*1.36*

* Net returns are expressed after deducting investment management costs. Past performance is not a reliable indicator of future performance.
[#] 30 September 2008.
[+] S&P/ASX 300 AREIT Accumulation Index.

Resolution Capital Core Plus Property Securities Fund Unit Price	Net Entry	Net Exit
30 September 2018	$0.6483	$0.6457
30 June 2018^	$0.6364	$0.6339

^ Ex distribution of 14.0064 cents per unit as at 30 June 2018.

A-REIT Market Commentary

Market Overview	**30-Sep-18**	**30-Jun-18**	**Quarterly Total Returns**
FTSE EPRA/NAREIT Developed Index (unhedged in AUD Net TR)	4,118	4,045	1.8%
FTSE EPRA/NAREIT Developed Index (hedged in AUD Net TR)	2,600	2,592	0.3%
S&P/ASX 300 (GICS) Property (Accum)	49,352	48,392	2.0%
S&P/ASX 300 Index (Accum)	63,210	62,275	1.5%
U.S 10 Year Bonds	3.05%	2.85%	
AU 10 Year Bonds	2.67%	2.64%	
A$/U.S$	0.72	0.74	-2.1%

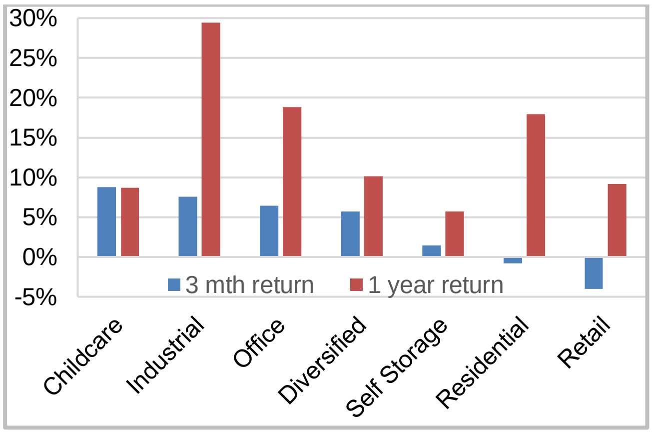
Source: Factset

A-REIT Commentary

The S&P/ASX 300 Property Accumulation Index produced a total return of 2.0% for the quarter ended 30 September 2018, outperforming the broader Australian equities market, which delivered a total return of 1.5%. On a net basis, the portfolio delivered 1.9%, underperforming the benchmark.

Within the A-REIT sector, performance for the quarter was consistent with the one-year total returns: retail REITs continue to lag their office and industrial peers.

ASX 300 A-REIT Sector Performance



Source: Factset, RCL

Investor demand for office and industrial property is reflected in heightened M&A activity. This quarter another party bid for Investa Office Fund (IOF) and a convoluted three-way tussle in the small cap industrial sector is underway between Propertylink (PLG), Centuria Industrial REIT (CIP) and Centuria Capital Group (CNI).

This quarter Australia also saw in another Prime Minister after Malcolm Turnbull was ousted due to party infighting and former Treasurer Scott Morrison was elected leader of the Liberal Party.

Due to political turmoil within the Liberal Party the odds increased that the opposition Labor Party will win next year's federal election. This has potential ramifications for the real estate investment landscape, most notably for residential property. The Labor Party currently proposes to limit negative gearing (for future purchases) to new housing and halve the Capital Gains Tax (CGT) concession to 25%. We will discuss the implications later in the report.

FY 2018 reporting season

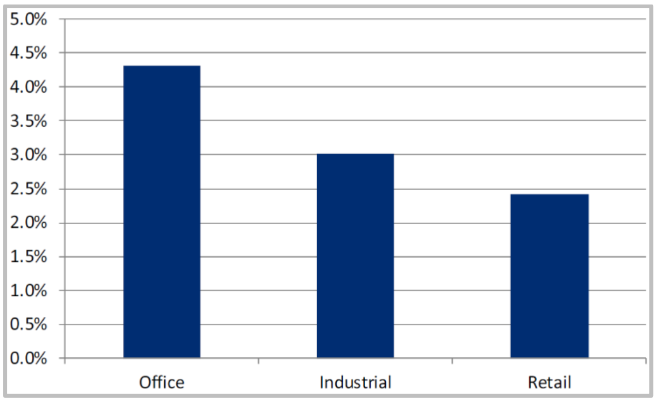
A-REITs delivered results broadly in-line with both our and consensus expectations. The A-REIT sector delivered FY2018 Earnings Per Share (EPS) growth of 4.8% and guidance for FY2019 is for 4.0% EPS growth.

Industrial REIT Goodman Group (GMG) continues to experience strong operating tailwinds, which are increasingly being captured in performance fees from its fund and development management activities.

Office REIT portfolios are enjoying low vacancy rates and there is limited new building supply in the next few years in the office markets of Sydney and Melbourne. Interestingly, both Dexus (DXS) and Mirvac (MGR) bought future development sites in Melbourne this quarter.

Meanwhile, tenant retail sales are typically growing less than 2% for most listed retail landlords. Whilst Net Operating Income (NOI) of retail REITs is still respectable at ~2.5%, it is below that of office and industrial peers.

FY 2018 Like for Like NOI Growth



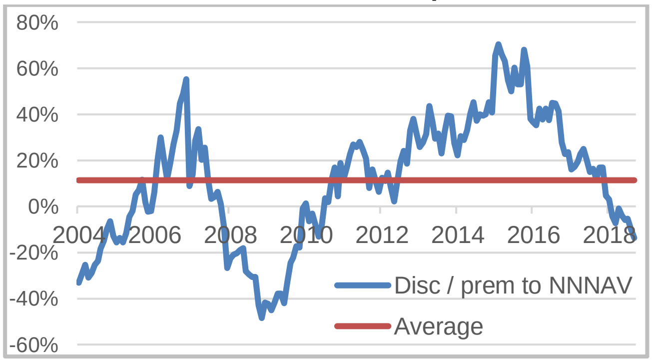
Source: Citi

Unibail-Rodamco-Westfield's (URW) maiden result post-merger provided, at best, a mixed picture. On the positive side, URW's Continental European retail portfolio continues to perform well with 4.3% like-for-like rental growth. In contrast, the former Westfield U.S. portfolio produced soft numbers and is underperforming U.S. peers. It seems that during the merger management took their eye of the ball in terms of leasing.

The market also seems to have taken a dim view of management not upgrading full year earnings guidance. Previously, the merger was not included in guidance set in February this year and with higher leverage post-merger market participants had expected an earnings upgrade. Also, the company's previously stated medium-term EPS growth forecasts of 6 to 8% p.a. looks overly ambitious and it's unclear how the merger is additive to the EPS outlook.

Whilst we have respect for the quality of URW's malls and management's operating prowess, we believe the balance sheet leverage is too high. Recently URW has de-rated significantly and its high premium to NNNAV[1] per share has turned into a discount.

URW's Premium / Discount To Triple Net NAV



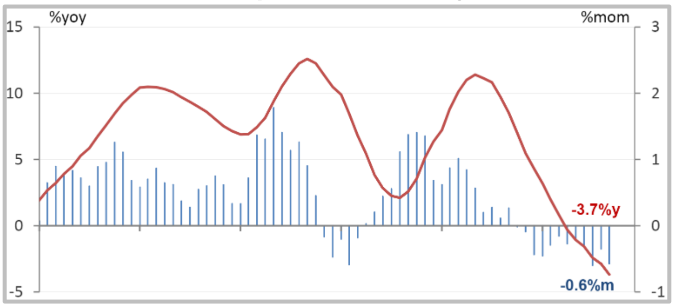
Source: Unibail-Rodamco, Factset, RCL (pre-merger is Unibail Rodamco data)

[1] NNNAV (Triple Net Asset Value) = NAV + fair value of deferred tax liabilities, debt & financial instruments

Returning to the Australian residential market. Labor's proposed changes to negative gearing and the halving of CGT for residential investors is likely to be on balance negative for stocks with residential development activity, such as Mirvac (MGR) and Stockland (SGP). Meanwhile, the residential market is already slowing.

Residential price declines are notable in Sydney and more recently Melbourne. However, these two cities enjoyed very strong price gains in previous years, therefore some moderation was due.

National residential prices are falling



Source: Corelogic, Morgan Stanley

The pull-back appears to be the result of a number of factors, including increasing building supply together with reduced demand from offshore buyers, most notably the Chinese. However, more significantly, the Australian Prudential Regulation Authority (APRA) restrictions on investor loan growth and interest only lending and The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry are having an impact by restricting credit to the residential sector.

The Royal Commission uncovered many poor practices and consequently lenders are stepping up their efforts to lend responsibly, including stricter verification of customer's finances.

Despite a weakening residential market diversified REITs Mirvac and Stockland continue to report strong profits from their residential businesses. The outlook for the year is also solid due to sufficient pre-sold product at healthy margins.

However, as mentioned, clouds are forming for future years due to falling residential prices and volumes. Given these concerns, the portfolio is underweight both stocks.

Staying with the residential theme. It is noteworthy that Mirvac launched its first 'Build-to-Rent' project this quarter. The seed asset is a project in Sydney's Olympic park, an area were residential sales have slowed significantly of late.

The institutional rental model is not common in Australia. We attribute this to a number of factors, particularly the negative gearing tax regime and, to a lesser extent, capital gains tax concessions. Land tax and other indirect taxes, particularly for foreign institutions, adds to the hurdles. Bottom line, it is simply more economic for developers to sell to individuals and self-managed super funds than to institutional investors. That Mirvac is launching this product now has a lot to do with long-term strategic positioning and the slowdown in the residential market. It is better to generate a low cash return than sit on excess land sites and have its labour force lay idle. By Mirvac's own admission, the project's economics are marginal.

Hence, unless we see a major change in the tax system, a distinct possibility if the Shorten led Labor Party were to win government, it is unlikely that Australia will witness a massive increase in the institutional residential rental model in the foreseeable future.

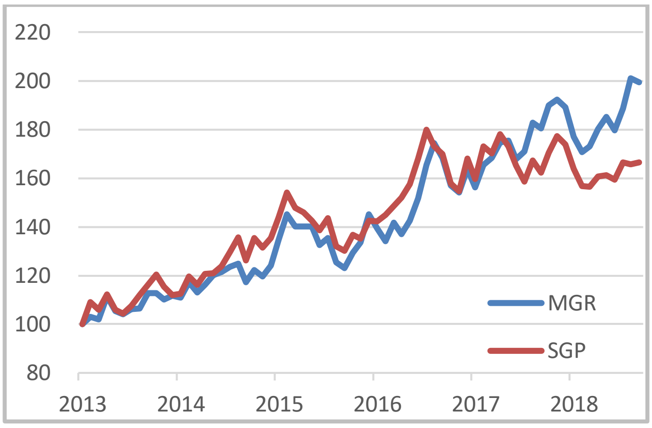
It is interesting that both Mirvac and Stockland's current CEO's joined their respective company's around the same time. Susan Lloyd-Hurwitz joined MGR in November 2012 and Mark Steinert joined Stockland two months later.

During Mrs. Lloyd-Hurwitz tenure Mirvac has divested secondary assets and invested the proceeds in higher quality office and industrial developments, mainly located in Sydney and Melbourne. This transformation was of course enabled by the company's development capability. Nevertheless, even in its retail portfolio its move towards urban centres seems – largely – well executed.

Meanwhile, Stockland has seen less change. It sold most of their office assets, but its retail portfolio remains dominated by sub-regional shopping centres, in outer urban areas subject to greater competition. Whilst SGP's retirement business has improved its return on assets, it is still below target. More positively, the residential business has increased its 'speed to market' and improved the location and margin of its product.

Of note, since mid-2017 MGR and SGP's fortunes on the stock exchange have started to divert. Retail being out of favour did not do SGP any favour. SGP's investment portfolio has a 71% retail weighting. Furthermore, SGP's retail portfolio actually decreased in value in FY 2018. The valuation decline was concentrated in central and north Queensland assets, which were impacted by weaker economic conditions and tenant remixing. In contrast, retail REITs are still reporting valuation uplifts.

MGR vs SGP Total Return



Source: Factset, RCL

In the light of the above, it is probably not surprising that SGP has made some management changes. Earlier this year they changed their head of commercial property and this quarter they combined their retirement and residential businesses, making the head of retirement redundant. Finally, in response to management's perception that the market does not appreciate the stock value this quarter Stockland announced a share buyback of up to $350m worth of shares.

During the quarter, PM Morrison announced a new Royal Commission, this time into the age care sector. Retirement living was ruled out as it is covered by state regulation which have recently been reviewed, but retirement living and aged care provider Aveo (AOG) sold off significantly in the quarter (-16.9% total return).

Collateral damage from the Royal Commission might stymie Stockland's efforts to sell part of their low-yielding retirement business.

Perhaps one of the more interesting earnings results came from Abacus Property Group (ABP) where recently appointed Managing Director Steven Sewell announced a change in strategy. This will entail reducing the company's exposure to retail and residential and increase exposure to self-storage and office. ABP will continue to buy assets that need repositioning, but now for long-term hold rather than selling and crystallising gains.

This change in strategy is expected to reduce earnings per share materially, though the quality of the earnings will improve. More recurring income should lead to a higher multiple.

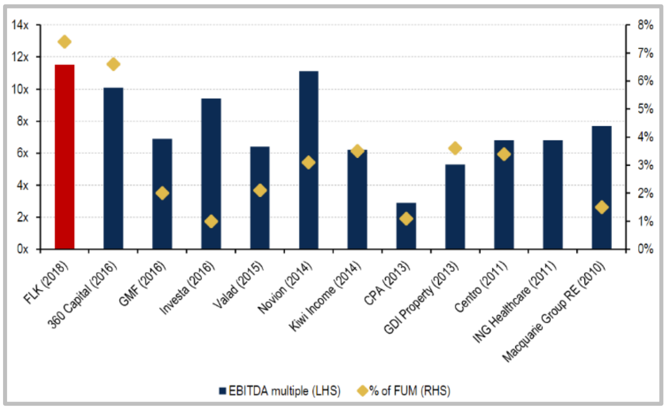
More More Paramor

Charter Hall Group (CHC) further increased its assets under management (AUM) by acquiring listed funds manager Folkestone Limited (FLK) for $205m.

Folkestone is led by Managing Director Greg Paramor who has a track record of building funds management platforms and selling them to larger institutions and listed rivals.

Stripping out non-recurring performance fees and the value for FLK's 12.1% stake in the listed childcare REIT Folkestone Education Trust (FET) the price equates to 11.5x recurring EBITDA, or 7.4% of FLK's $1.6bn FUM.

Recent Management Platform Transaction Multiples



Source: BAML

The relatively "full" price paid by CHC was justified by the attractive growth prospective in the highly fragmented childcare market, which provides growth opportunities in an asset class with high-quality covenants and long leases.

A fair price for management alignment?

Regular readers know may know that we have a strong preference for internally versus externally managed REITs. Whilst both structures have 'agency problems' we find the former typically better aligned with shareholders, which leads to better long-term returns for shareholders.

As an industry participant we believe Aventus Retail Property Fund's (AVN) internalisation proposal was excessively priced as it came with a $143m price tag. This represents 9.3x FY19 EBIT for a management agreement with only seven years remaining, or 7.5% of assets under management.

A 9.3x multiple for a contract with only 7 years remaining suggest management has aggressive growth ambitions. Of note, AVN has increased its asset base by over 50% since its listing late 2015. This higher asset base leads of course to a higher price tag!

Whilst we acknowledge that fund managers are currently highly valued (see CHC prior), there should be talented managers who were willing to manage these centres for a significantly lower sum.

The internalisation is marginally EPS accretive, but by increasing balance sheet gearing from 36% to 39%. Meanwhile, NTA per share reduces by almost 12%.

Disappointingly, all three proxy advisors were in favour of the proposal and it was subsequently approved in the shareholder meeting.

With Investa Office Fund (IOF) likely to be taken private soon, see below, the top 10 A-REIT index constituents are pleasingly all internally managed. These ten stocks represent ~86% of the ASX 300 index.

Last minute IOF suitor spoils BX party

Last quarter Blackstone Group (BX) made a bid for IOF. Initially the Board of IOF seemed supportive, but during this quarter IOF's manager, Investa Commercial Property Fund (ICPF), sold a 9.99% stake in IOF to Oxford Properties Group, which is part of the Ontario Municipal Employees Retirement System (OMERS) pension fund.

Just before the unitholder vote Oxford announced a superior offer to acquire the whole of IOF. In the subsequent bidding war both BX and Oxford increased their offers. Currently it seems that Oxford is in pole position to acquire IOF as its cash offer of $5.60 is superior to BX's $5.52 per unit. Of note, BX's first offer in June was $5.25.

Therefore, it seems highly likely that the long running saga to take IOF private will finally come to a conclusion. We must admit that corporate governance issues at IOF, including the part internalisation last year, have caused us plenty of headaches over the years.

At least the latest offer represents a premium to IOF's last stated NTA of $5.47, on valuations at or near cyclical peaks.

Of note, this is the second time this quarter that BX's efforts to take private a listed REIT were snuffed. In the U.S BX was unsuccessful in buying hotel REIT LaSalle (LHO-US) due to a superior offer by Pebblebrook (PEB-US), another listed U.S hotel REIT.

Increased M&A and bidding wars indicates to us that the real estate cycle is in its mature phase. As further evidenced by...

Industrial M&A tussle

A rather complicated scrimmage broke out between two small cap REITs. The fracas started when Propertylink Group (PLG) submitted a non-binding proposal to acquire all the outstanding shares in Centuria Industrial REIT (CIP) in a deal that valued CIP at approximately $755m.

Not surprisingly, CIP's external manager, Centuria Capital Group (CNI), was not enamoured by this proposal. To make matters more interesting CNI tried to buy PLG in 2017 and still owns a 10.9% stake in PLG.

Subsequently CNI announced that it had lost confidence in PLG's board given, among other things, the company's elevated gearing of 49% should they be successful in their takeover bid. Furthermore, CNI lodged requisition documents to replace PLG's Board, with a majority of the nominees being independent.

In another twist, PLG's largest shareholder, ESR Real Estate, launched a cash takeover bid for the shares they do not already own in PLG, with the condition that PLG does not bid for CIP.

This bidding war highlights the high demand for industrial property and that real estate is often cheaper, or "less expensive", on the ASX versus the direct market.

Outlook

We remain relatively constructive on the A-REIT sector outlook. Whilst capital values are relatively high, tenant demand is robust and supply remains relatively measured. REIT management teams remain disciplined and focussed, and balance sheet leverage is relatively low. As it should be at this point of the cycle.

However, it is worth highlighting that sentiment for retail property is more subdued. Retail is not just of out of favour in the listed market. Direct property investor demand appears also relatively thin for all but the best retail assets.

Sub-regional shopping centres in particular are not popular because they are not neighbourhood centres, which appeal to convenience, and do not have enough critical mass to attract a best in class tenant roster of apparel retailers.

The continued struggle at discount department stores Big W and Target, important anchors for sub-regionals, does not help as well. Therefore, the portfolio remains underweight retail with a bias towards REITs with high quality retail portfolios.

Based on direct market transactions it seems to us that appraised book value for all property types, except retail, is relative conservative compared a buoyant direct market. Hence, it is notable that M&A is becoming more prominent as listed REITs are often trading at a discount to direct market pricing.

Higher levels of M&A typically occur in the later part of the cycle, which is consistent with our view of rents and cap rates. We expect to 'lose' a few more vehicles as demand for properties is strong, particularly from cashed up private equity funds which have been raising records amount of capital. This should provide somewhat of a floor underneath share-prices. At least near-term.

Most A-REITs are currently trading around or slightly above NTA. The exceptions are fund managers GMG and CHC, which trade at large premiums, and the large shopping centre owners Scentre Group (SCG) and Vicinity (VCX), which are trading at double-digit discounts to NTA.

Industry Funds & Investor Choice: property liquidity conundrum

After a strong run-up in property asset values over the past 6 to 8 years, Australia's largest industry super fund, AustralianSuper, has decided to make changes for its property option. To better manage the liquidity of its members accounts it is:

- Introducing a cap of 70% on the amount members can invest in the property option; and
- In exceptional circumstances, in response to a market stress event, AustralianSuper will have the ability to freeze switches, contributions and withdrawals into and out the property option for a maximum period of up to two years.

We have a long-held concern about the fundamental flaw of illiquid assets under the Australian Superannuation Investor Choice regime. Currently superannuation funds can request permission from the regulator, the Australian Prudential Regulation Authority (APRA), to halt redemptions. Whilst

AustralianSuper is at least publicly acknowledging the problem before it occurs, and curbing the exposure, they aren't really solving the fundamental issue – should illiquid investments with opaque pricing be permitted in a Fund Choice regime?

Australian industry super funds have been a significant investor in direct Australian real estate in recent years. Furthermore, according to our research, domestic super funds are developing or funding (via take-outs) at least 45% of office development projects currently underway in Sydney and Melbourne.

In our opinion, to allow investors to invest the majority of their savings in periodically illiquid assets in an open-end unit structure is a brave decision by trustee boards. In the wrong circumstances it could undermine confidence in the superannuation industry, albeit the current Royal Commission into the financial services industry leaves little room for surprises.

Furthermore, an issue that is often overlooked is the impact this situation can have on asset allocation and the broader investment market. When redemptions are suspended for a key area of a mixed asset portfolio, it forces sales of other typically more liquid investments, thereby compromising the overall asset allocation strategy. Furthermore, by forcing funds to sell the liquid components, e.g. listed REITs, it exacerbates the perceived volatility of these more liquid assets.

Imagine if we at that time suspended redemptions because we didn't like pricing of our investments on the basis that we considered it not in the best interest of our clients to sell. Rightly there would be an uproar because we have marketed the strategy as a liquid investment. However, it's a tempting thought!

It's also worth noting a recent warning by Mark Carney, Governor of the Bank of England: "the growth of open-ended funds that promise investors instant liquidity despite holding potentially illiquid assets represented a 'major new vulnerability' across the G20…in other words, they are built on the lie that markets always clear."

We would like to finish with a quote from Benjamin Graham who wrote in The Intelligent Investor in 1949: "It is self-deception to tell yourself that you have suffered no shrinkage in value merely because your securities have no quoted value."

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