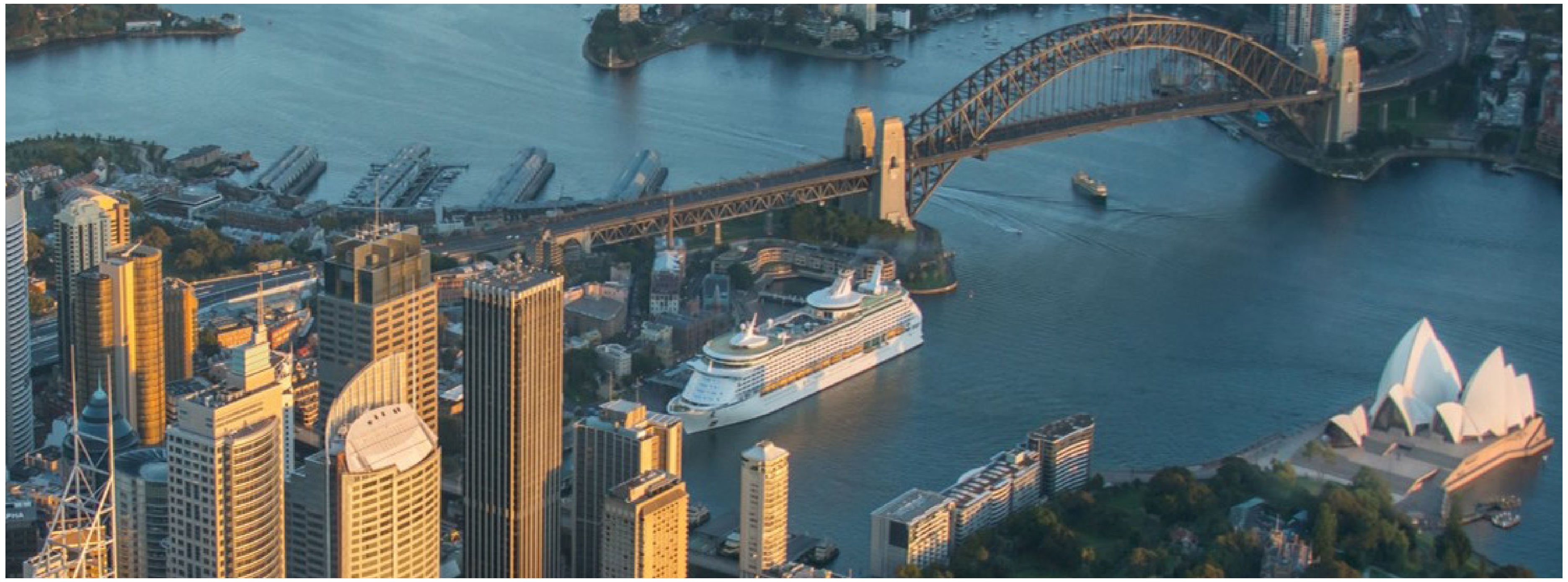
David Harrison



Managing Director & Group CEO Message

Dear Investor

Resilience and relationships continue to drive Charter Hall's record fund growth and equity across the business, delivering strong results for investor and tenant customers, and communities in the first half year alone.

Our real estate funds under management (FUM) grew by 17.2% or $9 billion to $61.3 billion in the six months to 31 December 2021. Our overall funds management grew to $79.5 billion after we entered a new partnership with the 50% acquisition of the $18.2 billion listed equities fund manager Paradice Investment Management (PIM), which invests on behalf of wholesale and retail investors across domestic and global listed entities.

The current period has drawn strong inflows across the Group, with $2.8 billion of gross equity allotted. We've also successfully deployed $5.4 billion in acquisitions across 18 funds and partnerships.

Importantly, our development pipeline continues to grow and now stands at $13.2 billion, providing valuable opportunities to create modern investment grade assets for our funds and partnerships.

Our capacity to access cash and undrawn debt stands at $6.7 billion, providing opportunities for Charter Hall to deploy capital alongside our investors creating a strong alignment of interest.

We've curated a high quality and diverse portfolio of 1,516 properties across our core sectors – Office, Industrial & Logistics, Retail and Social Infrastructure.

While I don't want to dwell on the unprecedented difficulties that we all know only too well, it's important to acknowledge that the mutual success our investors, partners, tenant customers and our people have experienced is most definitely, unique.

This success is underpinned by our expertise, our ongoing relationships with tenant and investor customers, access to off-market opportunities in tightly held estates and growing sale and leaseback transactions. Our team of dedicated, customer centric property specialists maintain a razor-sharp focus to actively accrue high quality and resilient portfolios while driving performance via our strong develop-to-core pipeline.

For over 30 years, we have continued this momentum, picking up strategies and sectors that will outperform the return benchmarks expected by our investors.

At the same time, we are deepening our partnerships with our tenant customers and attracting new, high quality national and global customers, with high-yield and long WALE leasing and pre-leasing arrangements across all sectors. More than 80% of our tenants who had a lease expiring in the previous financial year are now re-leasing with Charter Hall, underpinning the income resilience of our assets.

Our focus on investors and tenant customers, and strong performance across our funds and partnerships, was recently recognised with Charter Hall being awarded Firm of the Year: Australia and a finalist in three other categories, including ESG Firm of the Year in the Private Equity Real Estate (PERE) 2021 Global Awards – the industry's most prestigious honours. This award is not just a win for Charter Hall, it's a win for our valued tenant customers, investors and partners who have all contributed to the mutual success that we share and are recognised for, today.

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PERE AWARDS 2021

Firm of the Year: Australia

Economic outlook

The significance of the world events, from the pandemic to the devastating war in Ukraine, present challenges to economic stability. While Australia is not immune, most indicators point to a strong economic outlook for the year ahead.

Our labour market has outperformed, with the unemployment rate finishing the year at 4.2% – the lowest rate in 13 years. Further, household and business balance sheets are in good shape with conditions supportive of wages growth. Australia's economy is expected to have grown by 5% over the year despite the impact of COVID-19 and a series of lockdowns hitting our two largest states – NSW and Victoria.

The Reserve Bank of Australia (RBA) expects GDP growth of around 4.25% over 2022 and 2% over 2023, although the war in Ukraine has created uncertainty about the global outlook. With job vacancies and other indicators of labour demand remaining strong, the RBA expects further improvement in the labour market over the next two years. Their central forecast is for the unemployment rate to fall below 4% in late 2022; this would result in the lowest unemployment rate in more than 50 years.

Australia is exposed to growing inflation pressures resulting from COVID-related disruptions, especially to global and domestic supply chains and Russia's recent invasion of Ukraine which has seen a surge in energy prices. As a result, inflation expectations have been revised up. It should be noted that we continue to expect that Australia's relatively rigid wage setting mechanisms mean that wage growth feeding into inflation is likely to be more gradual than in the US.

With the cash rate at 0.1%, the RBA has flagged they don't expect to raise the cash rate until well into 2023. The market has a different view; most economists expect the RBA to start raising rates in late 2022. The 10-year bond yield has risen to around 2.6% and is expected to remain elevated due to the global uncertainty and higher inflation expectations.

Woolworths Distribution Centre
Dandenong Vic.

Wesley Place
130 Lonsdale Street
Melbourne Vic.

Property market stabilising but divergence in returns

Australia's commercial property market has remained buoyant, however the rolling 12-month total returns have significantly diverged by sector.

According to the MSCI Mercer Wholesale Core Property Fund Index, the best performing sector in the 12 months to December 2021 was industrial (28.8%) followed by office (12.5%) and retail (7.8%). It's a similar story over 3 years – industrial (17.8% CAGR), office (9.0% CAGR) and retail (-4.0% CAGR). We expect this divergence in performance to continue in the year ahead.

Office – flight to quality

Our high-quality, centrally-located premium office assets continue to attract domestic and global corporate customers, as well as government tenants.

Despite concerns about the future of office arising during the pandemic, the office sector performed significantly better than many had predicted at the start of 2021. The MSCI Mercer Australian Core Office Fund Index generated a total return in 2021 of 12.5%. Our flagship office fund, the Charter Hall Prime Office Fund (CPOF), generated a return of 16.1%, making it the best performing multi-asset office fund over 1, 3, 5 and 10 years. CPOF's high-quality portfolio, with a sector leading WALE of 6.8 years, high credit quality tenant covenants, strong 95.6% occupancy, 3.6% weighted average rent reviews and its $2.4 billion develop to core pipeline continues to underpin the resilience of CPOF's future investment performance.

Going forward, we expect steady office demand, underpinned by healthy employment growth and strong underlying investment fundamentals.

Our customers are telling us that the office environment will remain essential in attracting talent, stimulating productivity, driving innovation, maintaining culture and managing risk.

It is clear there is a "flight to quality". Net-absorption in the December quarter increased by 185,700 sqm q/q with prime space recording growth of 228,000 sqm, the highest quarterly growth in demand since December 2007, while secondary space contracted by 42,300 sqm. In 2021, the occupied space across the prime stock increased by 500,000 sqm, while secondary stock reduced by 74,000 sqm. We expect this bifurcation to continue.

End-of-trip amenities, dedicated wellness areas and strong ESG credentials are increasingly critical for firms seeking space that is both attractive to their staff and reflects the quality of their brand, values and purpose.

Domestic and offshore investors remain active, with recent office transactions exhibiting pricing bifurcation reflecting the increased divergence by asset quality and income profile. Quality assets with resilient tenant bases are in demand with cap rates firming and several recent transactions trading at premiums to book value, while those assets with risks to free cashflow (i.e. short WALEs, weak covenants, higher vacancies and poor amenity) are trading at discounts.

Office transaction volumes have picked up; $15.7 billion was transacted in 2021 – marginally below the 10-year average of $16 billion. 2022 has kicked off strongly with Allianz Real Estate and the National Pension Service of Korea acquiring a 50% interest in Commonwealth Bank Place in Sydney's Darling Harbour for $634 million on a sub 4% yield. On a year-on-year basis, indicative cap rates have firmed across most office markets with prime yields falling 12.5bps in both the Sydney and Melbourne CBDs to 4.57% and 4.76% respectively. We expect both domestic and offshore capital to continue to chase quality office assets in 2022.

Industrial & logistics – tailwinds to continue

Demand for industrial space remains strong supported by both secular tailwinds, including the ongoing growth in online retailing, the continued quest for efficiencies in supply chains, and the rebound in the Australian economy.

Despite COVID-19 related interruptions impacting supply chains, annual national leasing volumes reached 4.2 million sqm of floorspace, up from 2020's benchmark of ~3.3 million sqm, and almost double the 10-year historic average of 2.4 million sqm. The national vacancy rate hit a record low of 1.3%.

Prime rents in Melbourne and Sydney have increased at the fastest pace since 2008 with the Melbourne West (13.4%) and Sydney Inner West (10.8%) sub-markets leading the way.

Given the continued near-record level of occupier demand, low levels of speculative development, and expectations the economic rebound will gain further momentum, low vacancies and robust rental growth should continue through at least the medium term.

Melbourne continues to outperform on the national stage in terms of absorption, whilst pricing relativity to Sydney continues to attract occupier volume growth and solid rental growth.

Investor demand for industrial & logistics assets is as strong as we have ever seen. Investment volumes over the past 12-months totalled $18.2 billion – three times 10-year historical average. Both domestic and global investors were active.

Investor demand is set to remain elevated; institutions generally remain underweight to the sector and are recognising the attractive long-term, resilient returns that are available.

Given the competition for assets, sale and leasebacks continue to be an effective mechanism in unlocking assets with long term leases to quality covenants. In the past year, we secured more than $1.5 billion in assets through sale and leaseback, particularly in the consumer staples and food logistics sector. Our investors consistently tell us that they value our ability to secure assets off-market and are appreciative of the defensive and stable cashflows these properties generate over the long term.

Our $19 billion industrial & logistics portfolio with more than 200 tenants across 20 industries gives us a unique insight into how industries and companies are thinking about their business space, omnichannel and last-mile requirements. We are well placed to meet the demand from both our tenant customers and investors, through continuing to leverage our extensive market relationships to secure off-market transactions, undertaking sale and leasebacks with leading corporates, accelerating our $5.0 billion development pipeline and continuing to leverage our cross-sector relationships to provide optimal space solutions to our tenant customers.

Retail – focus on non-discretionary retail

The acceleration of online retailing during COVID-19 has further disrupted the retail landscape. Online retailing in Australia surged during the pandemic, with Australia Post reporting online sales in December 2021 more than 35% higher than pre-COVID levels. Estimates put the pull-forward of online retail penetration between 3 to 5 years.

Sales reports from major retailers have highlighted the divergence in growth between online and brick-and-mortar retailing. Whilst online retailing sales volumes are still concentrated amongst the more established online retailing categories like discretionary goods retailing, it is clear the type of goods being purchased online is expanding.

Online grocery sales volumes are surging - reaching levels not expected until beyond 2023. Around 70% of the online grocery market is dominated by the two largest players – Coles and Woolworths. Both are investing significantly in their online capabilities and their extensive store and logistics networks are being integrated as part of their drive to create an efficient online grocery fulfilment network that complements their physical store network.

We are certainly seeing this across our convenience retail portfolio and are actively partnering with our grocery tenant customers to ensure our centres support their in-store shop, click-and-collect and stock fulfilment requirements which are critical for their last-mile deliveries.

While retailers and the larger discretionary retail centres were being challenged prior to the pandemic, this has been accentuated by the increase in penetration of online retailing and changing shopping patterns during COVID-19.

Over the next few years, larger centres will need to reposition their offer in a challenging environment. Given the elevated vacancies and softer demand, a rebasing of rents will be required.

The convenience, non-discretionary end of the retail spectrum has been exceptionally strong during COVID-19 driven by the essential role they played in providing non-discretionary items and consumers preferring to shop closer to home. Despite supermarket sales normalising post the pandemic spike, the outlook for convenience retail centres remains positive.

Long WALE retail centres leased to leading retailers like Bunnings will continue to be highly resilient.

Strong investor demand from both private and institutional investors should see a further re-rating of convenience centres and long WALE retail yields in the year ahead.

Right: Secret Harbour Square, Secret Harbour WA


Brisbane City Council Bus Network Terminal,
Eagle Farm Qld

Bunnings Warehouse
South Mackay Qld

Chullora Logistics Park (Australia Post)
Chullora NSW

Social infrastructure – in demand

COVID-19 highlighted the critical role that social infrastructure plays in our community. The growth in demand for social infrastructure assets will reflect the longer-term demographic and post-COVID structural changes underway.

Social infrastructure assets typically offer longer leases than traditional real estate assets (often 10 years or more), net or triple net leases, secure, often government-backed, cash flows and a low correlation and relative lower volatility to other real estate and non-real estate assets.

The combination of the pandemic and the attractive attributes of social infrastructure factors is driving increased investor interest in the sector. In the year ahead, we expect more capital to flow into social infrastructure sub-sectors such as health, education, build to rent and data centres.

ESG – a shift in perceptions

ESG has reached a critical inflection point. The COVID-19 crisis has clearly elevated the importance of how real estate owners and managers must operate and has accelerated the growing relevance of ESG considerations in long-term value creation and risk mitigation.

Stakeholders are demanding higher levels of transparency and disclosure when it comes to ESG reporting. We see this trend continuing.

As a leader in the Australian real estate market, we understand the important role we play in taking decisive action to support enhanced governance, social responsibility and environmental sustainability across our platform and the broader industry. In doing so, we are focussed on delivering tangible solutions and value to all our stakeholders – our tenant and investor customers, employees and communities.

Market outlook

Australia enters 2022 well-positioned. There will no doubt be challenges, particularly with the war in Ukraine, but we are optimistic this will be another positive year for Australia's commercial real estate markets.

We are certainly not complacent about the prospect of rising rates in 2022, but we expect bond yields to remain well below their long-term average and the yield gap to commercial property to remain positive.

As concerns about rising inflation occupy investor's minds, real estate offers an inflation hedge. Over the past 30 years, periods of higher inflation in Australia have tended to coincide with real estate generating higher annual returns. This is a reasonably consistent relationship regardless of the underlying property sector. The majority of real estate leases have an inbuilt inflation buffer with either a fixed percentage increase, CPI (or a fixed percentage plus CPI), while inflation typically increases against a backdrop of economic expansionary periods which is positive for the demand for space.

With investors' desire for yield continuing, real estate will continue to be an attractive component of a diversified portfolio. We continue to see real assets, particularly real estate, as a surrogate for traditional fixed income, given the demand for income-producing assets against a backdrop of low global yields. Real estate's low correlation to equities will continue to see it play a valuable role in reducing a portfolio's volatility and overall risk profile.

For assets with long WALE, contracted income growth and resilient market growth prospects, we expect continued compression of both cap rates and discount rates.

Over the next year, we expect industrial and long WALE NNN sectors to continue to significantly outperform, followed by convenience-based retail centres and office, with discretionary retail malls dragging well behind.

We expect robust capital flows into real estate and Australia should be a beneficiary. The recently released ANREV INREV and PREA 2022 Investment Intentions Survey (a survey of 99 global and domestic institutions with more than USD$1.3 trillion in assets under management) revealed an average allocation to real estate of 8.9%, well under the target allocation of 10.1%. Not surprisingly, 61% expect their allocation to real estate to increase over the next two years, while 36% expect no change and just 3% expect to reduce their allocation.

Transaction volumes across the three major sectors reached $48.8 billion over 2021 – the highest level on record. We expect 2022 to be another strong year with Australia continuing to be an attractive destination for investors capital into real estate. Australia is still very much seen as a safe-haven for foreign investors and will continue to provide superior risk-adjusted returns on a relative basis to other key global markets where there is the potential for greater volatility.

The ANREV INREV PREA Survey revealed Tokyo, Sydney and Melbourne as the top three preferred investment destinations in the Asia-Pacific region for institutional investors in 2022. Tokyo and Sydney tied for the first spot, with 76% of investors intending to invest in the two cities, Melbourne ranked third (61%) well ahead of China Tier 1 cities, Seoul, Singapore and Hong Kong.

M&A activity is also set to hot-up in 2022. Global and domestic pensions funds (super funds in Australia) are increasingly looking at the listed market as another source of assets. The combination of pension fund capital and private capital, plus the availability of debt funding, will provide the firepower to support the public to private transactions. Charter Hall has recently teamed up with PGGM to make a $1.3 billion bid for the ASX listed Irongate Group.

As more global capital is deployed into Australia, and the competition for assets intensifies, investors will increasingly seek to partner with expert local managers of wholesale capital that hold strong track records in securing assets, on and off-market.

Charter Hall

Our total funds under management of $79.5 billion and our property funds under management of $61.3 billion[1] represents the largest sector diversified commercial property portfolio in Australia.

Our exposure to more than 2,500 tenant customers across multiple sectors, gives us insights into both corporate, government and not for profit customers within multiple industries. These insights allow Charter Hall to pivot its investor's capital toward the better performing and more resilient sectors.

One thing that COVID-19 highlighted, is the importance of resilient income streams. The long WALE thematic that Charter Hall has pursued over many years remains at the centre of our investment strategy. Valuations will continue to recognise long WALE assets as a key driver of lower capitalisation rates and discount rates, reflecting the lower risk of these types of assets.

Going forward, we continue to look to mitigate downside risks by focusing on the strength of our tenant covenants, underlying lease terms and in-built rent escalations. We remain discerning on pricing, especially with regards to the weight of capital chasing quality assets and the potential for mispricing of secondary assets in the current low-rate environment.

We are continuing to expand our "develop to core" strategies with high quality tenants secured on long-WALE pre-leases to create the highest quality spaces for our tenant customers and high performing assets for our funds and partnerships.

Looking ahead, we have access to over $6.7 billion in available investment capacity through existing cash balances, and available lines in our funds and on our balance sheet. This capacity provides resilience against any short-term volatility that may prevail in 2022 and gives us the ability to move quickly to capture opportunities for our funds and partnerships.

Finally, we trust Charter Hall will continue to provide relative outperformance for your investments and importantly strong total returns. We are proud of our track record in portfolio performance, innovation and agility for the benefit of our capital partners.

Thank you for the continued support for Charter Hall and our teams that manage your capital.

David Harrison
Managing Director & Group CEO

1. As at 31 December 2021.