



Stockland

# Stockland Direct Retail Trust No.1 (SDRT1 or the Trust)

## Investment Report at 31 December 2017

NTA PER UNIT AT 31 DECEMBER 2017	AGGREGATE PROPERTY VALUATIONS	LOAN TO VALUATION RATIO	OCCUPANCY	TOTAL RETURN SINCE INCEPTION
\$1.06 <sup>1</sup>	\$88.3m	47.8%	96.6%	8.2% p.a. <sup>2</sup>

### Highlights

- Woolworths launched its newly refurbished store at Pacific Pines in November 2017 and shade sails have been installed over a third of the centre's car spaces.
- The Trust's Weighted Average Lease Expiry by rental income (WALE) has increased to 4.2 years from 3.3 years at 30 June 2017, largely as a result of Woolworths exercising an option to extend its lease by a further five years at Pacific Pines.
- Across the portfolio, a total of three new specialty leases commenced and 10 specialty leases were renewed or extended during the six-month period ended 31 December 2017 representing 22.5 per cent of the Trust's specialty income.
- The leasing activity over this period has resulted in the Trust's occupancy by rental income increasing to 96.6 per cent from 95.1 per cent at 30 June 2017.
- The aggregate valuation of the Trust's properties has increased by \$1.5 million or 1.7 per cent to \$88.3 million from \$86.8 million at 30 June 2017.
- As a result of the increase in the valuations of Benowa Gardens Shopping Centre (Benowa Gardens) and Pacific Pines, the Trust has provisioned for a performance fee pursuant to the Trust's Product Disclosure Statement (PDS)<sup>3</sup> and constitution. This has resulted in a decrease in the Trust's Net Tangible Assets (NTA) to 106.2 cents per unit from 111.0 cents per unit at 30 June 2017.
- The outcome of the last meeting of Members in June 2014 was that a further meeting must be convened before 30 June 2019 to consider the future of the Trust. Accordingly, we have been undertaking a review of the Trust and its properties and whilst we are not yet in a position to make a recommendation on the future of the Trust, we will confirm the date of this meeting in due course.

### Performance fee

Pursuant to the Trust's PDS and constitution, Stockland Capital Partners Limited, as responsible entity of the Trust, is entitled to a performance fee if specified performance criteria are met, including that unitholders receive at least the return of their subscribed equity. The fee is payable on the earliest of the date on which the responsible entity retires or is removed, the winding up of the Trust and the next reporting date following settlement of the sale of the property (or properties).

For the first time since inception of the Trust, the responsible entity would be entitled to a performance fee if Benowa Gardens and Pacific Pines were sold today at their latest independent valuations and accordingly, accounting standards require the Trust to provision for a fee. The provision is calculated to be \$3.34 million (8.4 cents per unit) and whilst the provision is reflected in the Trust's interim financial report at 31 December 2017, it is not payable until one of the above dates is achieved.

Whether a performance fee is paid in the future will depend on the selling prices achieved for the properties or the value of the assets if the responsible entity retires or is removed. The provision is reviewed at the time of preparation of the Trust's financial report and may vary depending on future changes in the valuations of the properties.

### Trust performance

The increase in property valuations has contributed to an increase in the Trust's NTA, however, this increase has been reduced by the performance fee provision. Accordingly, the total return of the Trust was -1.0 per cent<sup>2</sup> for the six-month period ended 31 December 2017. This return takes into account distributions totalling 3.7 cents per unit paid during the period and a 4.3 per cent decrease in the Trust's NTA to \$1.06 per unit as a result of the performance fee provision.

The total return of the Trust since inception has decreased to 8.2 per cent per annum from 8.7 per cent per annum at 30 June 2017, which is also a consequence of the performance fee provision.

#### TRUST PERFORMANCE AT 31 DECEMBER 2017

	6 MTHS	12 MTHS	SINCE INCEPTION
Total return <sup>2</sup>	-1.0%	3.2%	8.2% p.a.

### Debt update

The Trust's borrowings increased to \$42.2 million from \$41.4 million at 30 June 2017 following the drawing down of \$800,000 on 19 December 2017 to finance the installation of shade sails at Pacific Pines and leasing capital, including lessor works and fitout contributions, resulting from the letting up of vacant premises at Benowa Gardens and Pacific Pines.

The total borrowing cost of the Trust, which includes the margin, line fee and establishment fee payable under its loan facility and the fixed interest payable under the Trust's interest rate swap, decreased slightly to 4.1 per cent per annum from 4.2 per cent at 30 June 2017.

#### DEBT AT 31 DECEMBER 2017

LOAN FACILITY LIMIT	\$43.0m
DRAWINGS	\$42.2m
TOTAL INTEREST RATE	4.1% p.a.
YEARS TO MATURITY	2.0

### Investor market overview

The neighbourhood centre and, more recently, large format retail centre categories have experienced strong demand from private investors and syndicates seeking higher yields in the current low interest rate environment. This demand has resulted in significant capital growth for assets in these categories, particularly high quality centres in metropolitan locations, as evidenced by recent sales at capitalisation rates approaching historical lows.

Recent favourable market conditions have been reflected in increases in the valuations of the Trust's properties with the aggregate value growing by 34.8 per cent over the five-year period ended December 2017 which equates to compound annual growth of 6.2 per cent.

Whilst investor demand for large format retail centres has improved recently, the investment market for non-metropolitan centres such as Tamworth Homespace is not as deep as metropolitan markets because of their perceived vulnerability to potential economic downturns and weak market conditions.

It is also apparent that the current cycle of capitalisation rate compression that has driven the recent increase in the Trust's property valuations has slowed.

### Meeting of Members

Pursuant to the PDS, the responsible entity of the Trust convened a meeting of Members on 27 June 2014 to consider the termination of the Trust. The outcome of this meeting was to continue the Trust and convene another meeting by 30 June 2019 to consider the future of the Trust.

1. The Trust NTA does not allow for costs associated with any potential sale of the properties and winding up of the Trust.

2. Calculated in accordance with Financial Services Council Standard No. 6 which assumes distributions are re-invested in the Trust.

3. Refer to Section 7 of the Trust's Product Disclosure Statement dated 16 October 2006.

Accordingly, we are undertaking a review of the Trust and its properties and the markets in which they operate. Whilst we have received initial feedback from Members both for and against a sale of the properties, we are as a minimum, considering the following scenarios:

1. a sale of all three of the Trust's properties and a winding up of the Trust;
2. a sale of Tamworth Homespace only, whilst retaining Benowa Gardens and Pacific Pines, and a continuation of the Trust; and
3. a continuation of the Trust whilst retaining all three of the Trust's properties.

As part of this review, we are investigating opportunities for further improving the saleability and potential selling prices of the properties, for example, the negotiation of certain leases to further extend the centres' WALE and continued modernisation of the centres' appearance and amenity.

Any opportunities identified may affect the timing of the next meeting of Members, however, we will confirm a date in due course following the completion of our review.

## Governance update

We would like to take this opportunity to recognise the service of Mr Anthony Sherlock who sadly passed away in December 2017. Mr Sherlock was appointed as an independent Director of Stockland Capital Partners Limited in 2004 and served on both the Stockland Capital Partners Audit Committee and the Stockland Audit Committee during his tenure.

Mr Stephen Newton joined the Board of Stockland Capital Partners on 18 December 2017, having already been in the role of the Chair of the Audit Committee since October 2016. Mr Newton has been a Director of Stockland since June 2016.

In line with the Trust's corporate governance arrangements, Mr Terry Williamson was appointed as an independent Director of the Board of Stockland Capital Partners in April 2018. Mr Williamson was previously a Director of Stockland Capital Partners and a Director of Stockland during the periods 2004 to 2007 and 2003 to 2015 respectively. During his tenure, Mr Williamson also served as the Chair of the Audit Committees of both Stockland Capital Partners and Stockland.

## Portfolio update

Whilst the Trust properties have experienced capital growth in recent times, rental income growth has been limited due to challenging leasing conditions, partially as a result of slower retail sales growth and, as reported previously, increased competition in the trade areas of Benowa Gardens and Pacific Pines. These conditions may place downward pressure on the Trust's rental income in the short to medium term.

Our strategy of remixing the offering at Benowa Gardens and Pacific Pines towards food, casual dining, health and other non-discretionary services is expected to improve the resilience of these centres to increased competition and potential economic downturns, however, it is anticipated that additional leasing capital will be required as this remixing progresses.

## Benowa Gardens

Monthly sales at the centre are now growing at a modest rate following the decline in moving annual turnover as a result of the opening of the competing Benowa Village centre in 2016.

Following the letting up of three vacancies during the period, the centre's occupancy has increased to 98.4 per cent by rental income from 95.5 per cent at 30 June 2017. New leases and lease renewals have contributed to an increase in the centre's WALE to 3.5 years from 2.6 years at 30 June 2017.

The centre's valuation has increased to \$41.3 million from \$40.7 million at 30 June 2017 primarily due to the increase in occupancy.

The centre's fresh food and casual dining offer has been enhanced by the opening of Grand Asia Fresh Produce and Grocery and the introduction of a new, highly regarded operator of Highland Court Bistro and Bar. We continue to search for suitable tenants for the remaining two vacancies and are in discussions with Coles on an extension of its lease beyond its current lease expiry in April 2022.

Whilst sales have stabilised, the ageing nature of the centre may mean that significant capital works will be required to modernise the centre's appearance and amenity to maintain the centre's competitiveness and its appeal to shoppers and tenants.

## Pacific Pines

Whilst sales at Pacific Pines have declined significantly since the opening of nearby Coles Pacific Pines in November 2016, there is evidence that the impact on centre sales is beginning to stabilise.

The centre had three vacancies at 31 December 2017 resulting in centre occupancy of 90.8 per cent. The centre's casual dining and service offer has been boosted by the opening of Cut & Grind, a combined hairdressing and café business.

We are pleased to report that Woolworths has exercised an option early to extend its lease to October 2028 which has resulted in the centre's WALE increasing to 6.4 years from 4.8 years at 30 June 2017.

The centre's valuation has increased to \$28.5 million from \$28.0 million at 30 June 2017 largely due to a projected increase in turnover rent following the refurbishment of Woolworths.

## Tamworth Homespace

Tamworth Homespace continues to be 100 per cent occupied following the renewal or extension of four leases representing 18.3 per cent of total centre rental income during the period. The centre's valuation has increased by \$0.4 million or 2.2 per cent to \$18.5 million primarily due to fixed rent increases during the period. The centre's WALE has increased to 2.8 years from 2.6 years at 30 June 2017.

### KEY PROPERTY STATISTICS AT 31 DECEMBER 2017

	BENOWA GARDENS SHOPPING CENTRE	STOCKLAND PACIFIC PINES	TAMWORTH HOMESPACE
Independent valuation date	31 December 2017	31 December 2017	31 December 2017
Valuation	\$41,300,000	\$28,500,000	\$18,500,000
Valuation rate per square metre	\$7,150	\$5,157	\$1,417
Trust ownership	100%	100%	100%
Capitalisation rate <sup>1</sup>	7.00%	6.25%	8.25%
WALE by rental income <sup>2</sup>	3.5	6.4	2.8
Major tenant	Coles	Woolworths	The Good Guys
Major tenant GLA (% of centre GLA)	1,960 sqm (34%)	3,541 sqm (64%)	2,404 sqm (18%) <sup>3</sup>
Major tenant lease expiry	April 2022	October 2028	March 2022
Occupancy by rental income <sup>4</sup>	98.4%	90.8%	100.0%

1. The weighted average capitalisation rate for the portfolio is 7.1 per cent.

3. To be reduced to approximately 1,800 square metres once a suitable tenant is found.

2. The WALE by rental income for the portfolio is 4.2 years.

4. The Occupancy by rental income for the portfolio is 96.6 per cent.

### Unit Registry

Computershare Investor Services Pty Limited  
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### Responsible Entity

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