Fund Research

Qualitas Real Estate Income Fund (ASX: QRI)

Overview

The Qualitas Real Estate Income Fund ("QRI" or "Trust") is an ASX-listed Mortgage Real Estate Investment Trust (M-REIT) managed by Qualitas Limited, providing exposure to the domestic commercial real estate (CRE) debt market predominantly through direct loan investments. Qualitas is a pioneer in the Australian CRE alternative asset management space and has established a strong track record over the past 16 years, with zero losses of investor capital. QRI invests in Qualitas Wholesale Real Estate Income Fund ("Sub-Trust"), which holds both direct loan exposure, as well as indirect loan exposure via wholesale funds managed by Qualitas. As at 31 December 2024, Qualitas had ~$9.2 billion in funds under management (FUM) across all asset classes.

As at 28 February 2025, the market capitalisation of the Fund was $760 million ($755 million NAV), with $677 million in invested capital. Since inception, the Trust has completed a number of capital raises, with the latest being $218 million raised (including a wholesale placement) and settled in March 2025, following an additional wholesale placement totalling $36.9 million in June 2024 and a $40 million placement in December 2024. These capital raises have seen the fund NAV increase to $973 million as at 12 March 2025.

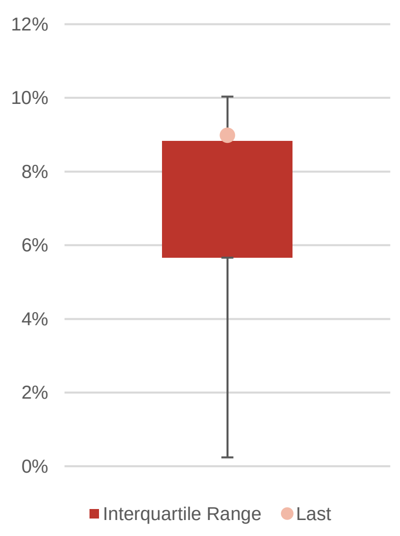
QRI is a closed-ended fund **targeting a net return of the RBA Cash Rate plus 5.0 - 6.5% p.a. after fees and expenses**, with distributions payable monthly. Fees comprise a 1.5375% p.a. (incl. GST) management fee based on NAV, and a 20.5% performance fee payable on outperformance above an 8.00% p.a. (net) hurdle rate.

Figure 2. Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2025	0.72	0.64											**1.36**
2024	0.72	0.71	0.72	0.68	0.76	0.71	0.77	0.71	0.70	0.74	0.70	0.78	**8.70**
2023	0.67	0.60	0.70	0.66	0.75	0.80	0.76	0.80	0.72	0.78	0.71	0.80	**8.75**
2022	0.36	0.42	0.45	0.45	0.50	0.49	0.53	0.54	0.60	0.60	0.57	0.72	**6.23**
2021	0.44	0.46	0.55	0.51	0.55	0.46	0.44	0.63	0.44	0.46	0.40	0.38	**5.72**
2020	0.51	0.49	0.45	0.55	0.49	0.51	0.50	0.59	0.48	0.51	0.51	0.60	**6.19**
2019	0.12	0.15	0.25	0.41	0.44	0.49	0.53	0.45	0.66	0.49	0.49	0.61	**5.09**
2018											0.02	0.08	**0.10**

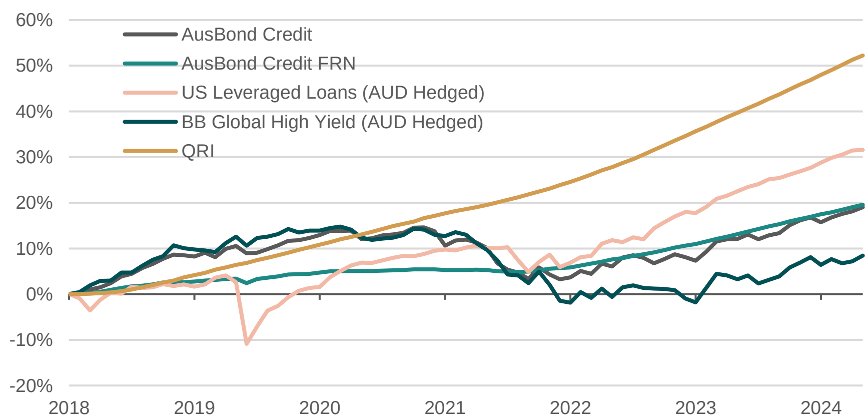
*Source: BondAdviser, Qualitas. As at 28 February 2025. *Return is monthly net total return based on daily weighted NTA plus dividends **and does not assume reinvestment of distributions**.*

Figure 1. Net Returns Distribution**



*Source: BondAdviser, Qualitas. As at 28 February 2025 ****Annualised monthly returns** based on daily weighted NTA since inception.*

Figure 3. Relative Cumulative Performance (NTA)



Source: BondAdviser, Qualitas, Bloomberg. As at 28 February 2025. QRI performance is based on daily weighted NTA and assumes all distributions are reinvested.

Product Assessment

Recommended

QRI offers investors exposure to a diversified portfolio of commercial real estate loans, and is suitable for retail fixed income investors with a higher risk appetite seeking to add exposure to the private CRE debt space.

QRI offers investors exposure to a diversified portfolio of commercial real estate loans, and is suitable for retail investors with a higher risk appetite seeking to add exposure to the private CRE debt space. This is achieved through the origination and management of a diversified portfolio of bilateral real estate loans, which has historically been inaccessible to retail investors. Appropriately, QRI provides investors with illiquidity and complexity premia given the private nature of the underlying assets (although the Fund itself offers daily liquidity on the ASX).

The Australian CRE debt market has become increasingly accessible as banks have progressively retreated from this segment as a result of greater regulatory capital requirements. That said, investing in such a highly specialised area of the private debt market also brings unique risks, and so specialist expertise is required to operate successfully in this market. **Consequently, manager selection is an important consideration for investors**. In this regard, **Qualitas has built a strong track record with no loss of investor capital spanning its 16-year history, through the full credit cycle.** Further, QRI has seen zero loans fall into arrears 90+ days reflecting the conservative nature of the strategy.

As at 28 February 2025, the portfolio is tilted to residential real estate, with 63% exposure, followed by commercial and industrial real estate exposure at 29% and 8%, respectively. The Fund has recently tilted towards providing accommodation/hotel loans, making up 17.1% of loan exposure. We note this marks a shift in diversification from our last update whereby 88% of the portfolio was weighted to residential as of 31 January 2024 and has primarily been a function of unfavourable market pricing for new residual stock loans. While the accommodation/hotel exposure is relatively concentrated (~8.0% and ~9.4% weights excluding cash and manager loan), we take comfort in the fact that both exposures represent investment loans on operational hotels with relatively conservative LVRs and no construction risk. We also note that one is personally guaranteed, and the underlying assets are supported by reputable hotel brands located within the central business districts of two Australian capital cities.

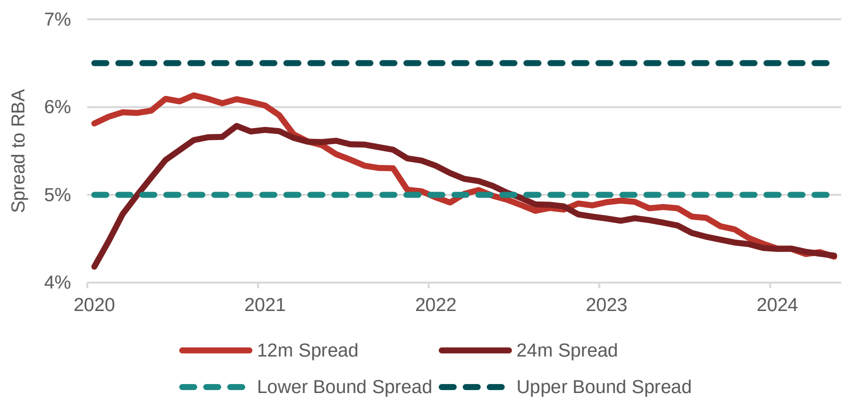
The Manager's strong risk management processes are evident by zero capital losses incurred across the broader QAL credit platform and zero loans reaching 90+ days arrears within QRI since inception.

The real estate and construction sectors have faced significant headwinds of late due to rising input costs and elevated borrowing costs. With costs being pushed onto builders and subcontractors, this has caused a significant rise in insolvencies across the sector, adding to strain experienced by developers (the borrowers) which may face higher project delays and added costs. Whilst developers may still be susceptible to hardships in the current environment, our comfort comes from the many layers of structural protections built into loan documents and effective risk management practices. This includes the level of equity buffer in projects (64% weighted average LVR), personal guarantees (~72% of deal value ex cash), as well as cushioning in the developer margin and the benefit of bank guarantees in the event a third party builder contracted by the developer becomes insolvent. In our view these tail risks are less relevant to QRI relative to other commercial real estate loan funds given the currently low level of construction lending and mezzanine exposure at 12% and 9% of the portfolio respectively (as at 28 February 2025).

Over the longer-term, the Fund has produced strong risk-adjusted performance, returning 7.15% p.a. since inception in November 2018 relative to a target of 6.91%-8.41% (albeit noting the target return was changed in June 2020) with limited volatility in net returns on a net tangible asset (NTA) basis. This has result in solid outperformance compared to public market fixed income indices since inception as seen in Figure 3.

However, since the beginning of 2024, **QRI has underperformed its RBA Cash Rate +5.0-6.5% net return target as shown in Figure 4.** This has been driven by the Manager's increasingly conservative investment strategy, opting to not move up the risk curve in a more challenging macroeconomic environment for borrowers. Whilst we appreciate the cautious approach to risk management at this point of the cycle, this has put pressure on QRI meeting its target return from a NAV perspective.

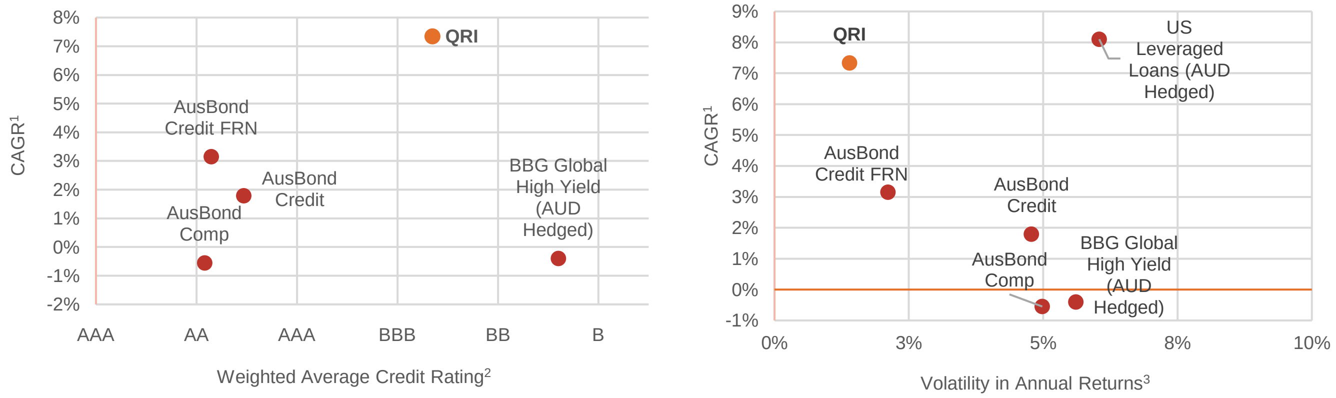
Figure 4. QRI & Target Return – Spread Measure[1]



Source: BondAdviser, Qualitas. As at 28 February 2025. Net 12m rolling returns. Monthly returns are not assumed to be reinvested. [1]Spread to RBA return across relevant time period; not annual return.

Whilst we are comfortable with the risk management processes, experience and track record of Qualitas over the course of our six years of continued coverage, performance of late has lagged the target return band. In our opinion, based on the level of risk taken in the Fund, market pricing of loans in the current competitive environment and level of fees charged on the product, we have doubts that the Fund can achieve its relatively punitive RBA +500-650bps target over the next 12 months. In line with criteria consistent with the BondAdviser Alternative Investment Fund Research Methodology, we therefore assign a **Deteriorating** Outlook to the Fund and maintain our **Recommended** Product Assessment, and we will continue to monitor fund performance over the near-term. **We note that this assessment does not reflect the credit quality of the Fund; we are fundamentally comfortable with the underlying assets held in the portfolio**, **and the robust risk management processes of the Manager.**

Figure 5. Estimated Risk-Adjusted Return Comparison



*Source: BondAdviser. Bloomberg, as at 28 February 2025. [1]All returns for indices are calculated using the compounded annual growth rate over 5 years. **QRI return based on NTA, not unit price.** [2]Calculated as at 31 January 2025 and may not reflect credit rating over the 5-year period. **QRI credit rating based on BondAdviser Estimates**. [3]Calculated based on the standard deviation of LTM returns over the past 5 years.*

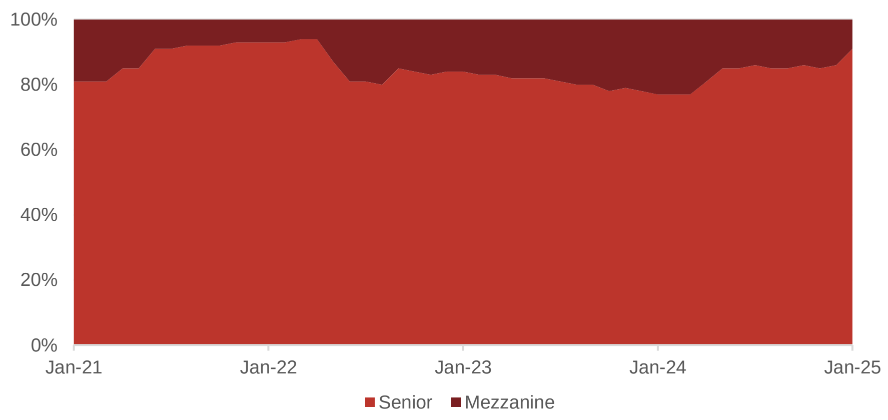
Construction and Investment Process

There have been **no material changes** to QRI's Construction and Investment process.

Portfolio Risk Management

Previously we highlighted the increase in mezzanine exposures within the portfolio, underscoring the risks associated with their subordinated nature. Since then, senior exposures have increased toward their January 2022 peak. Investors should note that whilst mezzanine investments are higher risk (and commensurate with higher returns), personal guarantees account for c.87% of these exposures. Given the reduction in mezzanine exposure combined with the personal guarantees, we view QRI's current portfolio as relatively lower risk in the context of CRE lending.

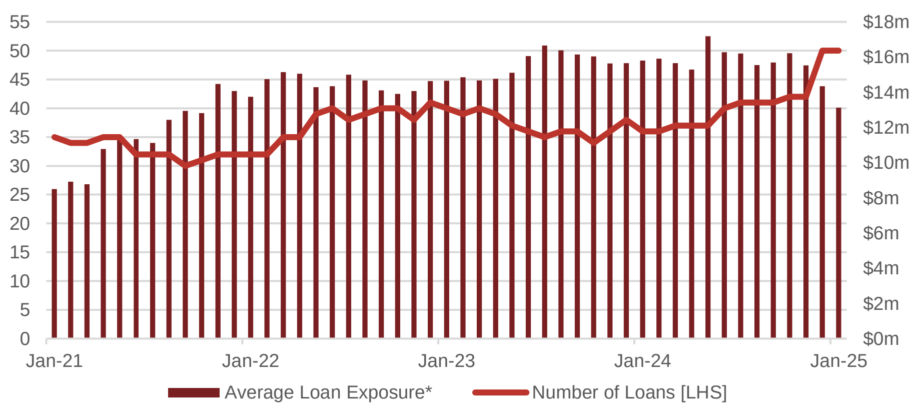
Figure 6. Portfolio Loan Composition – Seniority



Source: BondAdviser, Qualitas. As at 31 January 2025.

As the trust grows in size through capital raises, QRI continues to improve counterparty diversification. Over the past 12-months, the number of loans has increased to 50 and the average loan exposure has fallen to $13.1mn (or 1.2% vs 1.7% as of October 2023). This improvement is positive from a credit perspective given the negative skew of fixed income returns. The increase in fund size also delivers cost efficiency benefits to all Unitholders.

Figure 7. Counterparty Exposure

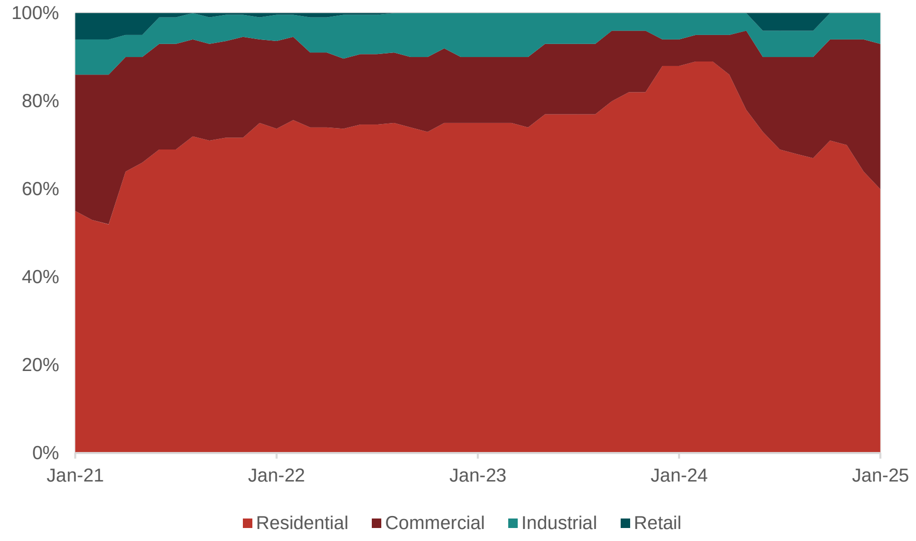


*Source: BondAdviser, Qualitas. As at 31 January 2025. *Arithmetic average based on invested capital from fund reports.* ***Does not reflect weighted average loan****.*

Additionally, diversification has improved across the portfolio through lower exposure to residential real estate. This has come from an increased exposure to the commercial sector, with 17.1% reflecting accommodation hotel loans. Whilst greater diversified loan exposure is positive, these new loans are relatively concentrated with two hotel loans which make up 8.0% and 9.4% of the portfolio (excluding cash and manager loan), which is negative from a credit risk perspective in our view.

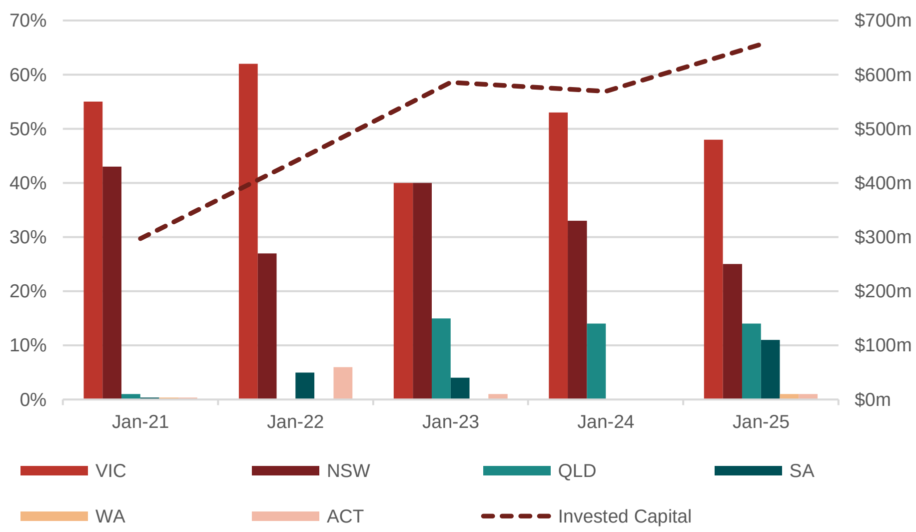
Geographical exposure has become less concentrated to Victoria over recent years. This is positive from a risk management perspective given the state has faced material idiosyncratic issues of late (e.g., fiscal balance sheet and increased taxes). Exposure to both QLD and SA has grown over the past 5-years, now representing 14% and 11% of the portfolio respectively.

Figure 8. Portfolio Composition – Property Sector



Source: BondAdviser, Qualitas. As at 31 January 2025.

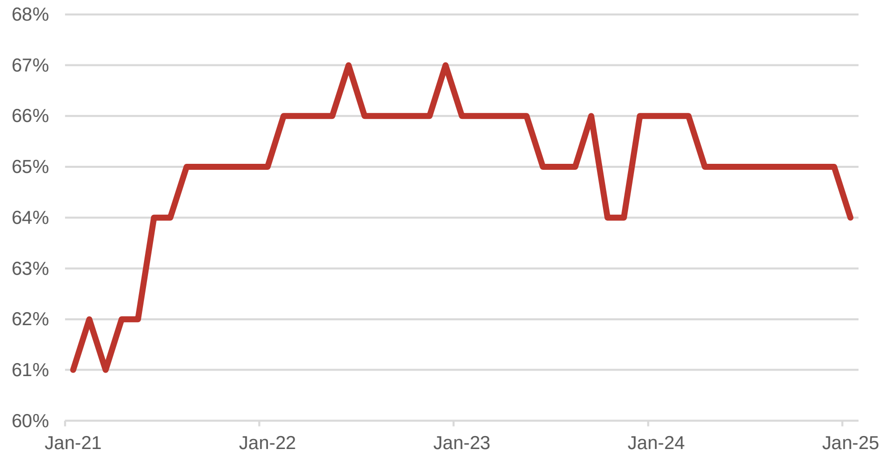
Figure 9. Portfolio Composition – Geography (LHS) & Invested Capital (RHS)



Source: BondAdviser, Qualitas. As at 31 January 2025.

Stronger diversification across the portfolio is being supported by a slight moderation in LVRs across the underlying assets within the portfolio. Since October 2023, QRI reduced its exposure to investments with a loan-to-value ratio (LVR) between 71-81%, shifting toward the more conservative 61-71% range (up 25.6ppts versus October 2023). That said, the portfolio's maximum LVR increased 202bps to 78.6% while the weighted average LVR increased 58bps to 63.7%.

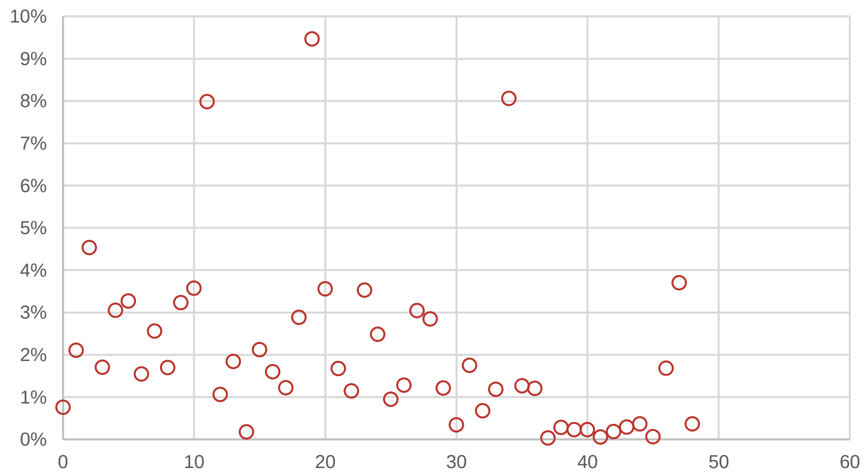
Figure 10. Weighted Average LVR Over Time[1]



Source: BondAdviser, Qualitas. As at 31 January 2025. [1]Excludes cash.

The chart below shows a breakdown of individual loan exposures held within the Fund (ex cash and manager loan). The portfolio is well diversified with approximately 50 loans (as at Jan-25 portfolio) and we expect further diversification post the recent $218mn capital raise - a further credit positive for the Fund.

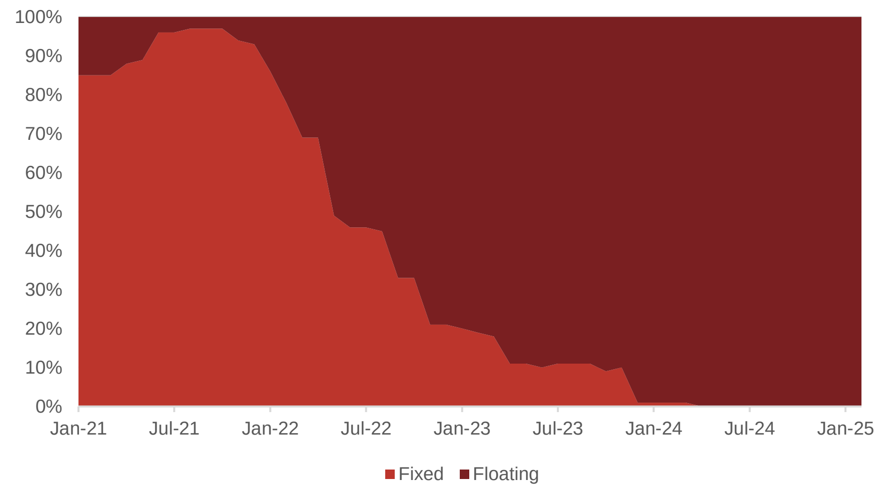
Figure 11. Individual Loan Exposures[1]



*Source: BondAdviser, Qualitas. As at 31 January 2025. [1]**Excludes cash and manager loan.***

In terms of fixed/floating exposure, the Fund is entirely floating-rate with no fixed rate exposure. This is primarily a function of the market being predominantly floating-rate loans. We do not anticipate that the Manager will speculate on rates by adding fixed-rate exposure during the current falling interest rate cycle, unless the opportunity screens as strong value from a risk/return perspective.

Figure 12. Fixed/Floating Exposure



Source: BondAdviser, Qualitas. As at 28 February 2025.

Fund Governance

There have been **no material changes** to QRI's fund governance.

Figure 13. Net Asset Value Against Unit Price

Source: BondAdviser, Bloomberg. As at 21 April 2025.

Positively, the unit price discount to NAV has closed after trading at a discount to NAV for an extended period of time. Given the gap has closed across a number of LITs we view this to be a function of the market supply/demand dynamics and broader positive risk sentiment. There has also been price support for QRI after being included in the ASX All Ordinaries Index as well as the ASX300 and ASX300 A-REIT indices in 2023, as a function of increased demand from institutional passive and active funds that track market indices.

Figure 14. Market Price Downside Risk – Unit Price Drawdown

Source: BondAdviser, Bloomberg. As at 21 April 2025. ***Drawdown based on daily periodicity***.

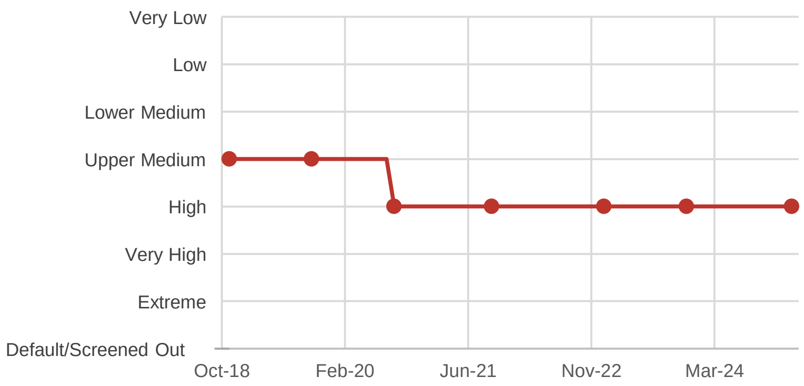
Quantitative Analysis

In this section, we model expected performance of the underlying portfolio, by simulating the portfolio under two scenarios: a benign economic environment (Scenario 1), and a stressed environment (Scenario 2). Each scenario utilises different recovery rates, credit migration rates, and yield curves based upon empirically observed data. It should be noted that our analysis uses shadow credit ratings we have assigned using the loan to value (LTV) ratios of the underlying assets. Whilst imperfect, this allows us to simulate the portfolio through varying conditions accounting for the probability of default, recovery and rating transitions.

The underlying portfolio performs well under our Baseline and Stressed scenario modelling. Under the Baseline scenario, the median modelled return outcome of the 10,000 simulations was 9.1%, weighed down by cash drag. When accounting for underlying loans on an ex cash basis, the median return is 9.8%. This analysis does not account for: management fees, origination fees passed onto the Fund, and it also incorporates expected credit losses occurring during the simulations. When accounting for management fees, this brings the median modelled return down to 7.6%, well below the Fund's target of RBA +500-650bps (9.1-10.6% after fees).

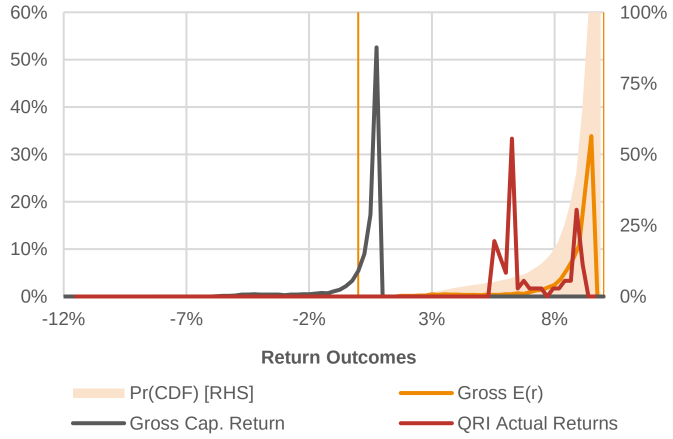
The portfolio also exhibits strong downside protection under our Stressed scenario modelling as a function of the collateral underlying the loans and equity cushioning across each project. In the event of default in a simulation, this makes recovery strong. The median return under our Stressed modelling is 8.37%, with a 99% and 95% VaR of 0.02% and 2.14%, respectively, implying that the top 99% of simulation outcomes did not result in a total return loss over a distressed environment. Given a lack of material movement in our shadow credit rating of the underlying loans, our Risk Score remains **'High'** or BB-equivalent.

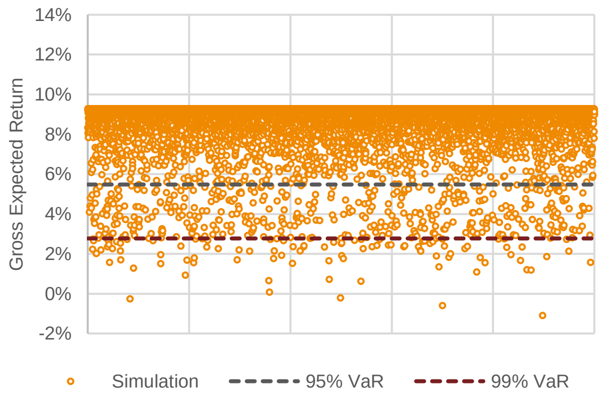
Figure 15. Risk Score



Source: BondAdviser Estimates as of 31 January 2025 portfolio.

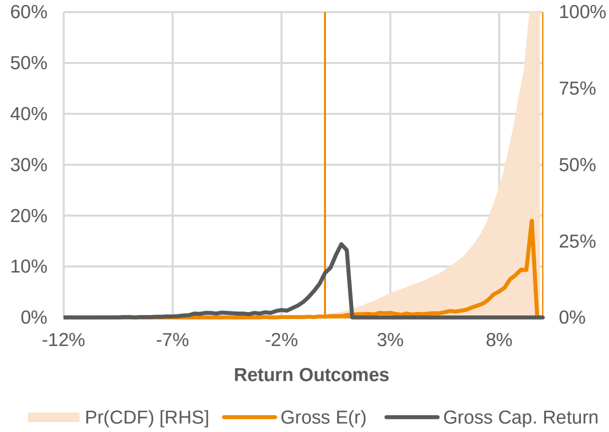
Scenario 1. Baseline Asset Assessment

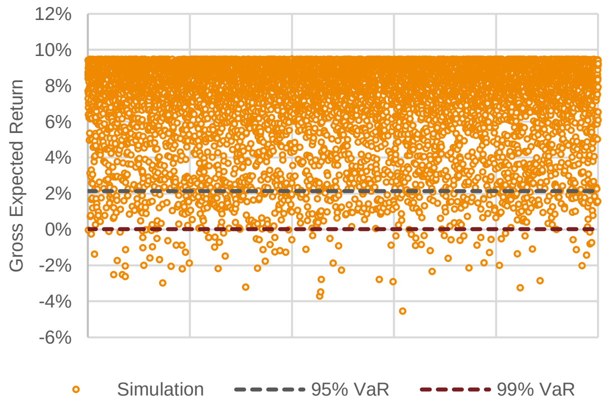




Source: BondAdviser Estimates as of 31 January 2025 portfolio. Excludes impact of management, performance and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated. For a more detailed explanation of the methodology, please contact BondAdviser. Actual returns reflect historical LTM returns for QRI over time based on NAV.

Scenario 2. Stressed Asset Assessment





Source: BondAdviser Estimates as of 31 January 2025 portfolio. Excludes impact of management, performance and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated.

Reporting History

QRI Report – 7 March 2024

QRI Report – 20 December 2022

QRI Report – 15 September 2021

QRI Report – 27 August 2020

QRI Entitlement Offer Report – 10 September 2019

QRI Report – 8 October 2018

Alternative Investment Fund Research Methodology

Click here to view

Important Information

BondAdviser has acted on information provided to it and our research is subject to change based on legal offering documents. This research is for informational purposes only. This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice.

The content of this report is not intended to provide financial product advice and must not be relied upon or construed as such. The statements and/or recommendations contained in this report are our opinions only. We do not express any opinion on the future or expected value of any Security and do not explicitly or implicitly recommend or suggest an investment strategy of any kind.

BondAdviser will receive a licensing fee from the Manager in relation to this research report. BondAdviser Asset Management or associate investment vehicles which it controls may also choose to hold units of the Fund as necessary.

This report has been prepared based on available data to which we have access. Neither the accuracy of that data nor the research methodology used to produce the report can be guaranteed or warranted. Some of the research used to create the content is based on past performance. Past performance is not an indicator of future performance. We have taken all reasonable steps to ensure that any opinion or recommendation contained in the report is based on reasonable grounds. The data generated by the research is based on methodology that has limitations; and some of the information in the reports is based on information from third parties.

We do not therefore guarantee the currency of the report. If you would like to assess the currency, you should compare the report with more recent characteristics and performance of the assets mentioned within it. You acknowledge that investment can give rise to substantial risk and a product mentioned in the reports may not be suitable to you.

You should obtain independent advice specific to your particular circumstances, make your own enquiries and satisfy yourself before you make any investment decisions or use the report for any purpose. This rep ort provides general information only. There has been no regard whatsoever to your own personal or business needs, your individual circumstances, your own financial position or investment objectives in preparing the information.

We do not accept responsibility for any loss or damage, howsoever caused (including through negligence), which you may directly or indirectly suffer in connection with your use of this report, nor do we accept any responsibility for any such loss arising out of your use of, or reliance on, information contained in or accessed through this report.

Report created on 23 April 2025.