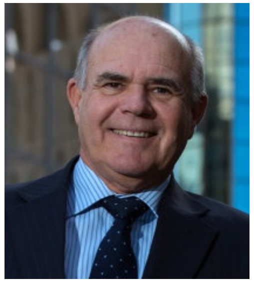

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AIA Conference – August 2014

Things To Consider Before Investing In Commercial Property

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What Is Considered Commercial Property?

- Office buildings
- Shopping centres
- Industrial sheds
- Specialised property
  - Hotels
  - Hospitals

Why Commercial Property?

- Commercial property can provide investors with:
  - → Great yields (6.5%-9%+ per annum)
  - → Capital growth over time
  - → Tax efficiencies
  - → Less volatility than shares
  - → Diversification away from residential property – most Australians have a significant exposure to the residential asset class by owning their own home

How Can I Invest?

- There are three main ways in which someone can invest into this asset class:
  - → Buying direct commercial asset yourself
  - → Buying units in an unlisted property fund
  - → A-REITs (listed property trusts)
- A-REITs trade more like equities and may not meet your diversification requirements

Why Should You Own Non-Residential Property

- If you want low volatility (i.e. to limit bad years) you must diversify
- Diversification does not just mean different
  - → Try to invest in asset classes that behave differently in various market conditions
- Example of highly correlated assets:
  - → Australian and International Shares
- Example of lower correlated assets:
  - → Australian Shares vs. Direct Property
- Example of diversification
  - → Permanent Portfolio
- Most investors spend almost no time on portfolio construction and way too much time picking shares
- Quality non-residential property can significantly lower portfolio volatility

Why Not Buy Commercial Property Myself?

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- The process is arduous and requires a lot of management on behalf of the owner
- Do you have the time/ability to:
  - → Complete careful 3-6month due diligence periods on the asset
  - → Undertake site inspections and meet with property managers regarding building issues
  - → Do thorough financial analysis on the asset (cap rates, demographics and profitability analysis)
  - → Negotiate new leases throughout the property in a tough leasing market and successfully market vacant spaces
  - → Cater to tenant needs on a weekly or daily basis
  - → Complete maintenance on the asset (not just mowing the lawn once a fortnight)
  - → Organise and manage contractors for any works needing to be done on the property
  - → General annual accounting/reporting responsibilities for the asset
- Remember: no tenant in your asset = no income
- A commercial property/fund manager will do all this above on a daily/weekly/monthly basis for an annual management fee of approximately 0.6%
- A direct unlisted property trust is one of the better ways to gain exposure to direct commercial property without all the above issues

Benefits and Risks of Direct Property Trusts

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Benefits:

- High level of tax deferred income generally paid monthly or quarterly
- Diversification! Allows investors to invest as little as $10,000 and spread their funds over several trusts
- Returns have a low correlation from other asset classes such as shares, bonds and residential property
- Longer investment timeframe
- No time involvement from investors. Manager looks after leasing, debt, repairs, capital expenditure etc.

Risks:

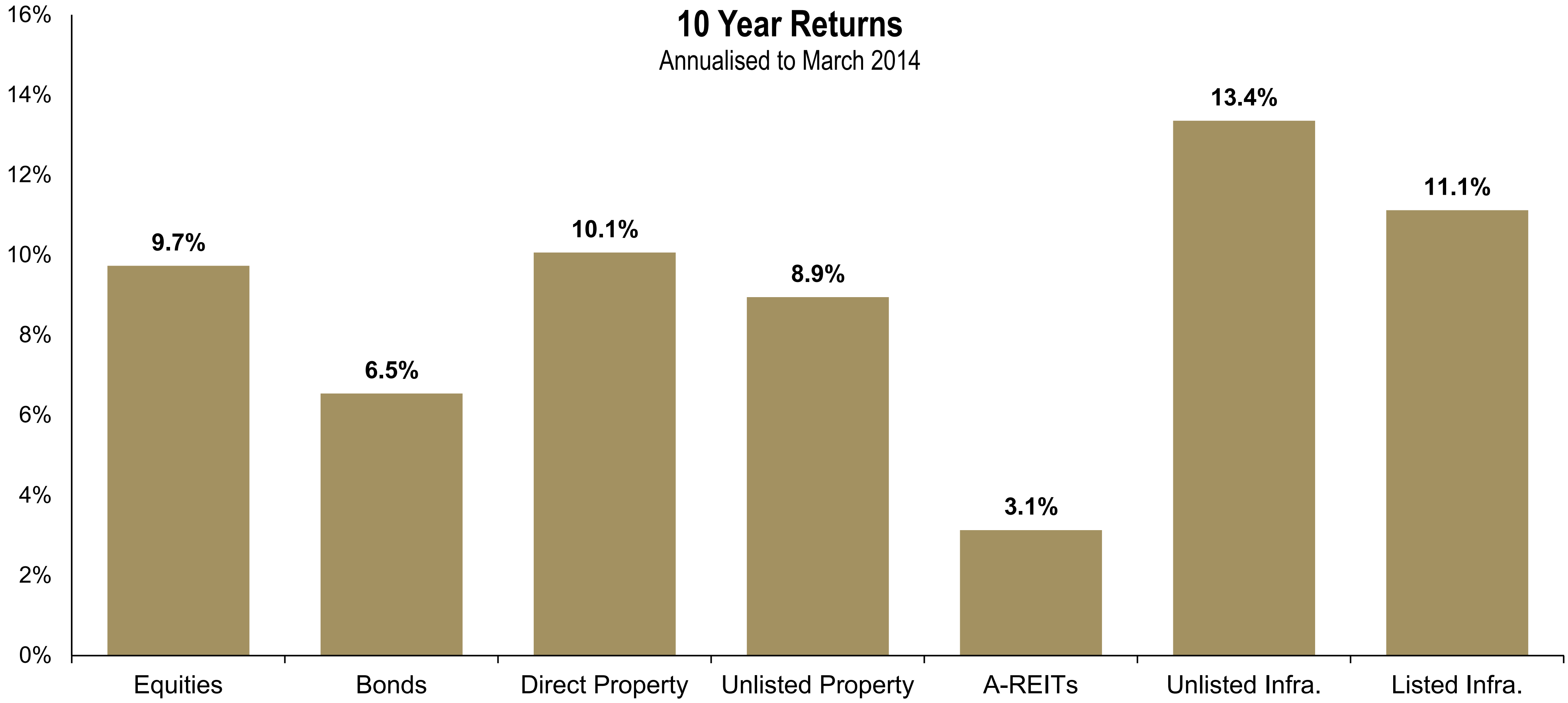
- Typically illiquid (5-7years) although transfers can be processed
- Like most "growth investments", it lost value during GFC
- Lose control unlike direct residential ownership

Consider the following:

- Reputation and track record of manager
- Initial net tangible asset (NTA) per unit. Due to stamp duty, rarely is a "real" NTA above $0.90
- Like any investment, quality of the underlying asset is important
- Don't trade quality for yield
- Long term leases that extend beyond the term of the trust are preferred
- Gearing – think lease term and security of cash flow. Good quality assets with long term leases support a higher level of gearing than short term leases with expiry risk.

Returns On Different Asset Classes

- Unlisted property and unlisted infrastructure have significantly outperformed their listed peers over 10 years



Source: IPD Research

Cromwell's Property Outlook

Office Property Outlook

- Key drivers for office tenant demand
  - White collar employment
  - Economic growth
- Our view
  - Office property offers the best value, in yield terms
  - Tenant demand is terrible, but has stopped getting worse
  - Market fundamentals in Sydney and Melbourne are best, but still not flash
  - Brisbane and Perth experiencing demand weakening due to resource sector
  - High levels of oversupply in Canberra are beginning to dissipate

Industrial Property Outlook

- Key drivers for industrial tenant demand
  - → Increased interest from institutional investors
  - → Move to online sales is generating additional demand from logistics tenants
- Cromwell's view
  - → Limited scope for further reduction in yields / capital gain
  - → Industrial property is becoming more specialised – this needs to be taken into account
  - → Cromwell likes industrial assets where there is a long term lease, a solid tenant and an attractive yield
  - → There may also be opportunities in older properties with high yields, but not for the faint-hearted

Retail Property Outlook

- Key drivers for retail tenant demand are weak
  - → Sector remains at the mercy of weak consumer spending
  - → Any recovery requires a more broad-based economic recovery
  - → Continued pressure from established and emerging online retailers
- Cromwell's view
  - → Downward pressure on rents will continue
  - → More value likely in smaller centres where adjustment has already taken place

Residential Property Outlook

- Key drivers for residential property values
  - → Interest rates
  - → Employment
- Our main concern for investors is lack of diversification
  - → Most Australians own their own homes and are therefore already overweight towards residential property
  - → Majority of SMSFs are not large enough to own direct property and maintain a diversified investment portfolio

Cromwell Case Studies

Our Performance

Cromwell Property Group (ASX:CMW)[1]

	3 Years (Annualised)	5 Years (Annualised)	10 Years[2] (Annualised)
CMW Performance After fees & costs	21.1%	20.7%	35.3%
Benchmark S&P/ASX 300 A-REIT Accumulation Index	11.7%	15.7%	1.9%
Excess Returns After fees & costs	9.4%	5.0%	33.4%

Property Portfolio Returns[1]

	3 Years (Annualised)	5 Years (Annualised)	10 Years (Annualised)
CMW Performance After fees & costs	9.8%	9.1%	10.5%
Benchmark IPD Benchmark	9.5%	7.9%	9.5%
Excess Returns After fees & costs	0.3%	1.2%	1.0%

Cromwell Direct Property Fund[1]

	3 Months	6 Months	Since Inception (August 2013)
Fund Performance After fees & costs	6.2%	9.1%	10.8%
Benchmark PCA/IPD Australian Pooled Property Fund Index – Unlisted Retail	1.4%	3.7%	5.6%
Excess Returns After fees & costs	4.8%	5.4%	5.2%

Cromwell Phoenix Property Securities Fund[1]

	3 Years (Annualised)	5 Years (Annualised)	Since Inception (April 2008)
Fund Performance After fees & costs	20.1%	27.3%	5.5%
Benchmark S&P/ASX 300 A-REIT Accumulation Index	11.7%	15.7%	(2.2%)
Excess Returns After fees & costs	8.4%	11.6%	7.7%

1) As at 31 March 2014. Past performance is no indication of future performance.
2) 10 year CMW returns includes period prior to stapling in 2006.

Case Study 1 – Cromwell Riverpark Trust, Brisbane

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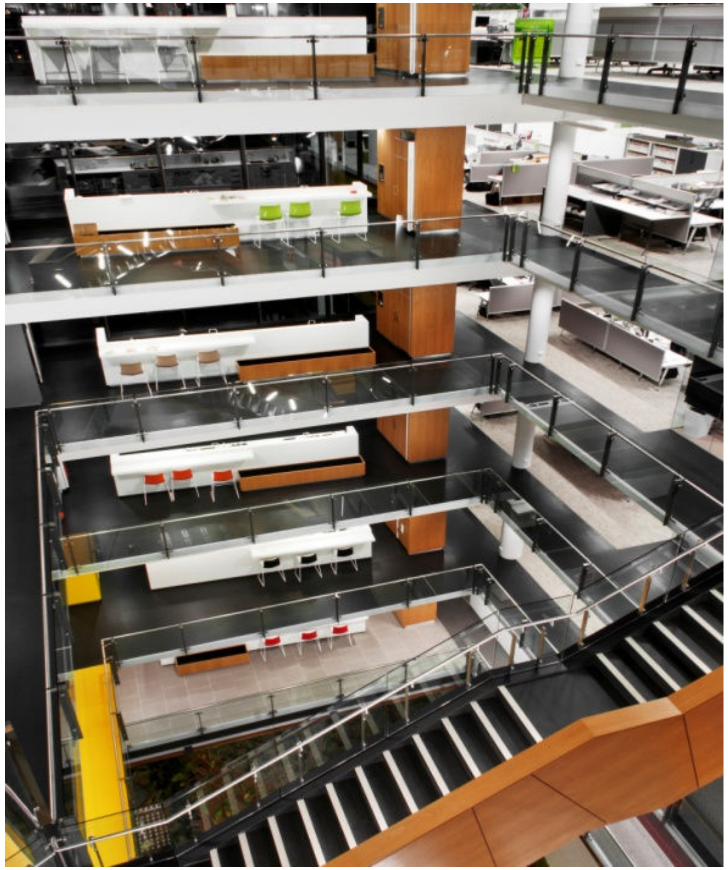
- Trust established 2009 – property originally purchased for $173m
- Commencing distributions 8.25% per annum (paid monthly)
- 93% leased Queensland Government (Energex Limited) with a 15 year lease
- Fixed 3.75% per annum rent reviews
- Currently valued at $199 million, distributing 9.25% per annum increasing to 9.50% per annum from July 2014
- NTA currently $1.12 – expected to grow before trust expiry
- Trust expires in June 2016 with over 9 years remaining on Energex lease
- $8.3m saved on stamp duty via original acquisition structure (purchase of land only not completed building)
- Annualised return since inception to 31 March 2014 – 11.5%[1]
- Six Star Green Star certified Rating awarded by the Green Building Council of Australia.

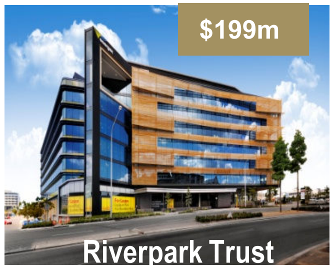


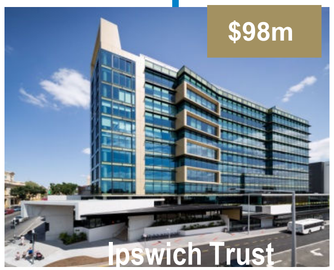
Performance Statistics[1] (to 31 March 2014)	1 Year	3 Years	Since Inception (June 2009)
Fund (After fees & costs)	16.5%	13.4%	11.5%
Benchmark (PCA/IPD Australian Pooled Property Fund Index – Unlisted Retail)	6.9%	8.1%	6.9%
Outperformance	**9.6%**	**5.3%**	**4.6%**

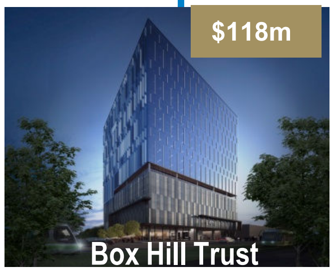
1) Past performance is no indication of future performance.

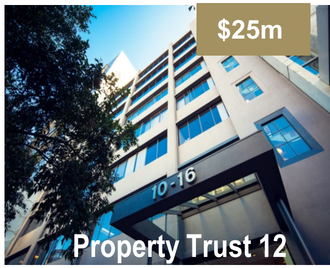
Case Study 2 – Cromwell Direct Property Fund

INITIALLY INVESTS IN CASH AND CROMWELL SYNDICATES[1]:

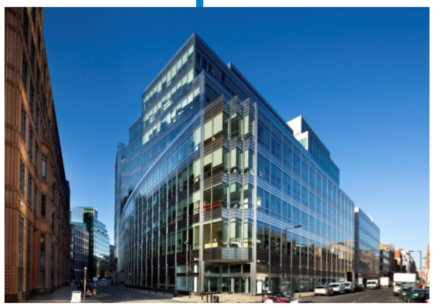








WILL ALSO PURCHASE DIRECT PROPERTIES WORTH $10M-$40M[2]



1) Asset values reflect 100% of underlying property syndicate values.
2) These properties are for illustration purposes only.

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Thank you for your time