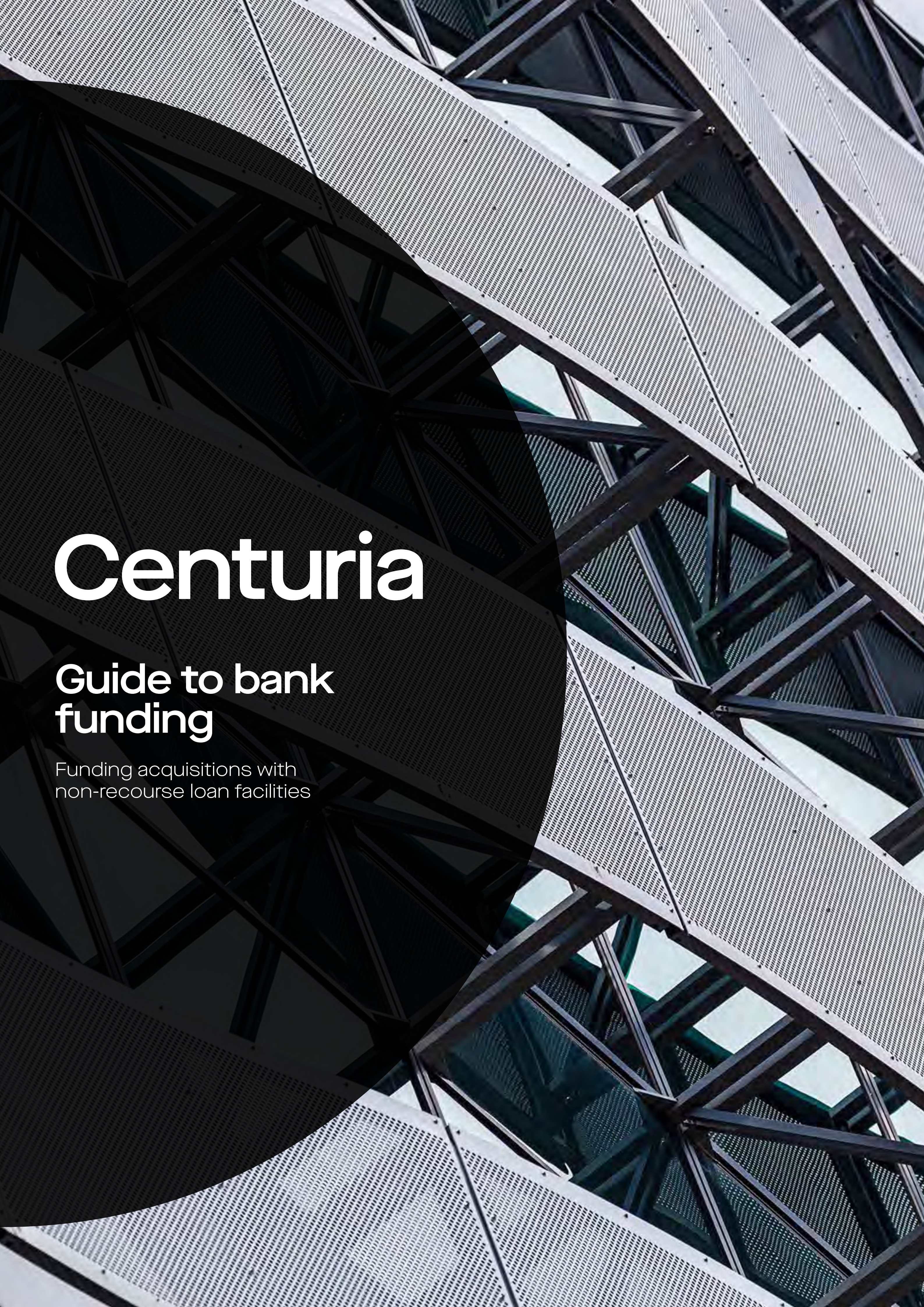

Centuria

Guide to bank funding

Funding acquisitions with non-recourse loan facilities

Understanding bank funding

Every Centuria fund takes out a non-recourse loan facility with a major bank, which is designed to help fund acquisitions, and use leverage to improve the income and capital returns to investors.

There are a few key aspects of a Loan Facility which investors should be aware of, particularly in terms of the risk which the loan adds to an investment.

> "Investors are not required to personally provide security for a loan."

- Facility limits and LVRs
- Interest Cover Ratio
- Facility terms
- Interest costs
- Loan security

Facility limits and LVRs

The facility limit refers to the total amount of debt the bank is willing to lend under a given facility. It is expressed as a dollar amount, and is related to the value of the underlying assets (the Fund Property). The relationship between the level of debt and the value of the assets is called the Loan to Valuation Ratio (LVR).

The LVR is calculated by dividing the value of the loan by the value of the property.

For example:

LOAN FACILITY	$5,000,000
PROPERTY VALUATION	$10,000,000
LVR	50%

Every facility has a Loan to Valuation Ratio Covenant, which needs to be maintained as part of the facility agreement. The LVR Covenant requires that the loan is kept below a maximum LVR at all times. This LVR Covenant is normally between 45% and 65% depending on the type of asset. The Bank requires that the LVR covenant is tested at least every 12 months, which requires the Fund to get an external valuation of the property. Valuations are conducted by professional valuers who are approved by the Bank, and are included on the Bank's panel (panel valuers).

In the event that the LVR Covenant is breached (ie: the value of the property declines), the Bank will require that the loan is reduced in order to bring it back in line with the covenant. This is achieved either by raising further equity from Investors, committing free cashflow from the property to reducing debt (which results in a suspension of distributions), or a recovery in the property valuation.


ONE RICHMOND ROAD
R1
GREENHILL RD
ANZAC HWY
City Centre

Interest Cover Ratio

Facilities taken out by Centuria funds are "interest only" facilities. This means that the Fund is only required to pay the interest cost of the loan, with the principal being repaid when the facility ends (either by the sale of the property or refinancing with another Bank).

The Interest Cover Ratio ("ICR") defines the number of times the income from a property covers the annual interest payable on a facility. This is a critical measure for the financier, as it expresses the ability of the fund to meet its' interest payments. Every facility has a ICR Covenant, which requires that the income from the property not fall below a given ICR.

The covenants range from 1.15 to 2 times, depending on the facility and risk to income.

For example:

NET PROPERTY INCOME	$1,500,000
INTEREST COST	$750,000
ICR	2.0 times

A breach of the ICR Covenant can occur if, for example, a large number of tenants vacate a property at the same time, or if a property has a single tenant and this tenant leaves.

In the case of a breach of an ICR Covenant, the Bank will generally require that extra funds are placed on deposit to cover the difference between the actual income from the property and the ICR Covenant. It will also often result in the Bank requiring that the Fund cease paying distributions to investors until the income from the property is improved.

We are required to report on the LVR and ICR Covenant at least every 12 months, and in some cases every six months.

This is completed by submitting a Compliance Certificate, which is signed by the Directors of Centuria.

Facility terms

When we enter into a new Facility, we will normally seek to line up the term of the facility with the term of the trust. The term of the Facility is normally between 3-5 years. We will seek the maximum facility that the Bank will offer, as this prevents us having to refinance a facility which incurs re-finance costs to the Fund.

Interest costs

The interest payable by a Fund is determined by two factors – the base rate and the bank margin.

Base Rate – in simple terms the base rate is the "cost of money", and is derived using the inter-bank lending rate, known as "BBSY". This is a floating rate which re-prices daily.

In order to reduce the risk of this rate increasing, we will fix the base rate payable for a term, generally in line with the term of the loan or the term of the trust. This is known as "hedging".

Bank Margin – the bank margin is essentially the profit to the bank from lending to the Fund. The margin differs based on the risk of the underlying property. There has been significant movement in margins since 2007, with rates going from a range of 0.6-1.0% to a range of 2.5-3.0%. The financial crisis saw banks react by increasing margins, in line with the (perception of) increased risk of loans. The margin is fixed for the term of the loan, unless there is a facility review, triggered by a breach of covenant (LVR or ICR as discussed above).

It is our view that the "natural" margin for Centuria-style funds is a range of 1.25-1.5%, and we anticipate that as the market normalises, we will see margins return to these levels.

Loan security

We only enter into non-recourse facilities. A non-recourse facility means the loan is only secured by the assets of the Fund (i.e. the underlying property). Investors are not required to personally provide security for a loan.

Know your risks

As with any investment, there are risks to investing - and these should be understood. Some factors to consider when investing in listed and unlisted property funds include, but are not limited to, stock market volatility, the liquidity of the fund, the gearing of the properties in the fund and understanding the individual properties held by the fund and their characteristics (e.g. tenant demand, property valuation metrics, cash flow sustainability etc).

It's important that you have a manager who has experience managing and mitigating these risks where possible. A critical part of the success of property investment is the quality of the ongoing management of tenants and the physical aspects of the property, both of which we consider to be strengths within our business. In addition, capital gain potential is maximised by ensuring the most efficient use of space, conducting services upgrades, building refurbishment and assessing potential re-development. The majority of our portfolio is managed by our in-house property division. Our team is comprised of experienced property professionals with backgrounds in leasing, agency and valuation. Any property managed externally is managed by hand-picked experts in their locations and asset types.

Centuria

FURTHER INFORMATION

For further information on Centuria's property offerings and to aid your clients in their property investing decisions visit **centuria.com.au** or speak to a member of our property team on **02 8923 8923.**