Lonsec

Recommended

Product Review
Centuria Diversified Property Fund

ISSUE DATE: 14-11-2023

Fund financial position

TOTAL ASSETS	$239M
INVESTMENTS (TARGET)	DIRECT PROPERTY/SYNDICATES 90-100%; A-REITS/CASH 0-10%
DEBT	$86.5M
GEARING (LVR – DIRECT PROPERTIES)	40.0%

Portfolio summary

NO. OF PROPERTIES	8 DIRECT
PROPERTY TYPE	OFFICE 62.9%; INDUSTRIAL 22.2%; SOCIAL INFRA 5.6%; CENTURIA UNLISTED PROPERTY FUNDS 6.7%, A-REITS/CASH 2.6%
PROPERTY LOCATION	QLD 41.4%; SA 20.8%; VIC 14.5%, ACT 14.4%; WA 8.4%; NSW 0.5%
WTD AVG LEASE EXPIRY (WALE)	5.40 YEARS
OCCUPANCY	96.2%

Other Fund details

RESPONSIBLE ENTIY & MANAGER	CENTURIA PROPERTY FUNDS LTD
APIR CODE	CNT9370AU
MINIMUM INVESTMENT	$10,000 (THEREAFTER $1,000 LOTS)
DISTRIBUTION PAID	MONTHLY
REDEMPTIONS	CAPPED QUARTERLY (2.50% OF NET ASSETS); FULL LIQUIDITY EVENT EVERY 5 YRS, DECEMBER 2025
% OF FUND HELD BY MANAGER	21.7%

Manager fees and expenses

MANAGEMENT FEES AND COSTS	MANAGEMENT FEE 0.8% P.A. OF GROSS ASSET VALUE. EXPENSES CAPPED AT 0.35% P.A. ABNORMAL EXPENSES EST 0.52% P.A., INDIRECT COSTS 0.15% P.A.
PERFORMANCE FEE	20% OF EXCESS ABOVE 8% P.A. OF GAV. AVERAGE OVER THE 5 YEAR PERIOD TO 30 JUNE 2022 WAS 0.24% P.A.
TRANSACTION COSTS	0.78% P.A. OF GROSS ASSET VALUE FOR YEAR ENDED 30 JUNE 2022
BUY / SELL SPREAD	0% OF INVESTMENT

What this Rating means

The **'Recommended'** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- Good quality management team with significant experience across all Australian property sectors.
- Active portfolio construction and management of LVR.
- Co-investment in the Fund of 21.7% from the Manager provides strong alignment with investors.

Weaknesses

- Portfolio is not as diversified, both geographically and number of direct properties, as some peers.
- Fund metrics including, distribution per unit, and occupancy have deteriorated marginally since Lonsec's last review of the Fund, though gearing, asset allocation, financing terms and hedging has improved. Distribution yield remains at similar levels since last review.
- The Fund has a high exposure to the office sector where the longer-term impact of the 'working from home' trend still to fully play out.

Lonsec Opinion of this Fund

- Lonsec has assigned a 'Recommended' rating to the **Centuria Diversified Property Fund** following the latest review. The portfolio's exposure is still heavily exposed to the office sector at 63% albeit this has been actively reduced since last review, with industrial now 22%, social infrastructure 6%, other Centuria property funds 7% and AREITs / Cash 3%.
- The Fund has an interest in 8 direct properties, with the majority relatively new or have been recently refurbished (the average age 18.5 years). The portfolio also now has an average 5.0 star NABERS Energy rating. The Fund's office exposures are mostly in suburban/regional locations.
- The Fund is managed by a good quality investment team with a high level of experience and good co-tenure. The team has demonstrated an ability to pro-actively manage the portfolio via acquisitions and disposals to maximise investor returns.
- The Fund's income stream is spread across 90+ tenants, with the top 12 contributors being a mix of Australian and international listed and private entities as well as government. Since the last review, the Fund's WALE has improved from 4.9 to 5.4 years.

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- The weighted average gearing (LVR) of the Fund's direct property investments only is 40% and leaves a comfortable margin to the bank covenant of 60%. A strong income stream services debt payments (interest cover 3.65x), with 99% of debt hedged.
- Distributions have the capacity to grow in line with rental increases, with a weighted average rent review of 3.4%, although the rate of further equity raisings and deployment of capital to direct property investments (including capital expenditure) or A-REIT/cash holdings will impact on this growth
- Recent increases in interest rates are expected to have an impact on funding costs in the property sector generally. At this point c**apital values** of Australian direct property are holding up due to high occupancy supporting solid income streams and continued investor demand for quality property. Nevertheless, investor expectations for capital growth in the near term should be moderated given the elongation of this property cycle and uncertainty in global investment markets.
- Centuria is an ASX-listed diversified funds management business that has demonstrated a successful 20+ year track record operating in both the listed and unlisted property sectors. The Group's FUM was approximately $21b in June 2023 and follows the successful acquisition and integration of several small property groups.
- The Fund's PDS dated 30 September 2022 disclosed Annual Fees and Costs ('AFC') totalling 2.84% p.a. This value comprises (1) management fees and costs of 1.82% p.a. (2) performance fee estimate of 0.24% p.a. and; (3) transaction costs of 0.78% p.a. In line with RG97, some fees and costs have been estimated by the issuer on a reasonable basis. Actual fees and costs may vary to these estimates, with performance fees having the potential to vary significantly based on the Fund's realised performance and the fee's calculation requirements. Management fees and costs are at the high end the peer group, while the performance fee of 20% above a hurdle of 8.0% p.a. (net of tax and fees) is reasonably in-line with other property funds that have a performance fee.
- The Fund has a **quarterly regular liquidity facility**, with an indicative amount equivalent to 10% p.a. of net assets. The Fund has a **five yearly full Liquidity Event**, with the next being December 2025. However, investors are reminded that liquidity of direct and unlisted property may be restricted due to market conditions and redemptions are at the discretion of the RE.

Changes since Lonsec's previous review

The table below summarises the major changes to the portfolio and Fund since Lonsec's last review.

	PREVOUS REVIEW	THIS REVIEW
ASSET VALUE	$262M	$239M (▼)
NO. OF ASSETS - DIRECT	10	8 (▼)
WALE DIRECT (by inc)	4.9 YRS	5.4 YRS (▲)
OCCUPANCY	97%	96% (▼)
NO. OF DIRECT TENANTS	90+	90+ (--)
INCOME YIELD PORTFOLIO	6.0%	6.0% (--)
CAP'N RATE	5.99%	6.24% (▲)
DEBT	$99M	86.5M (▼)
GEARING - LVR	43.8%	40.0% (▼)
INTEREST COVER	4.6x	3.7x (▼)
UNIT PRICE	$1.10	$1.02 (▼)

What is this Fund?

- **Centuria Diversified Property Fund ('CDPF' or 'the Fund')** is a multi-asset, open-ended unlisted property fund investing in real property, unlisted property schemes, ASX-listed A-REITs, and cash deposits.
- CDPF is an open-end fund with rolling five year investment terms (next December 2025). The Fund offers limited liquidity outside of this investment term at the RE's discretion and the Fund's assets should be considered illiquid.
- The Fund's investment objective is to provide investors with stable income returns and the potential for capital growth by investing (directly or indirectly) in a diversified property portfolio.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure, and Warning on the final page.

- Lonsec notes that the Manager has produced a Target Market Determination (TMD) which forms part of the Responsible Entity's Design and Distribution Obligations for the Fund. Lonsec has sighted the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.
- While the returns of the Fund are expected to be less volatile than equities and listed property securities investments, investors should be aware that the Fund **may experience periods of negative returns** and that there is a **risk of incurring capital loss** on the Fund.
- The limited liquidity offered by the regular withdrawal offer, which is at the discretion of the RE, means potential investors should take a long-term view of their investment.
- As such, Lonsec considers the Fund suitable for **medium risk profile** investors with a **5+ year** investment time horizon. The Fund will generally sit within the **growth component of a balanced portfolio**.

Centuria Diversified Property Fund

Risk Assessment

Lonsec assesses the Fund's **key risk factors** in the overall context of both competing unlisted property funds and relative to other asset classes.

Level of assessed risk	Low	Med	High
OPERATIONAL EARNINGS			
BUSINESS	●		
LEASING		●	
CAPITAL GAIN VS. INCOME		●	
DIVERSIFICATION	●		
MARKET VOLATILITY		●	
FINANCIAL			
LEVERAGE (GEARING)		●	
REFINANCING	●		
INTEREST COST / HEDGING		●	
CURRENCY	●		
COUNTERPARTY	●		
SUPPORT TO DISTRIBUTIONS	●		
MANAGEMENT & OTHERS			
EXPERIENCE	●		
INDEPENDENCE	●		
RELATED PARTY TRANSACTIONS		●	
LIQUIDITY			●

- **Leasing Risk** is considered medium due to the higher weighting to the office property sector, where the outlook is more uncertain. However, the Fund's exposure is spread across 8 direct properties and multiple tenants. Lease expiries are well spread.
- **Interest Costs / Hedging risk** is moderate with 99% of the direct property with an average debt expiry of 2.9 years.
- **Management experience** is assessed to be low risk due to the relatively large team and their experience in establishing and managing single asset property syndicates. The risk is further mitigated by Centuria's long track-record in the office sector.
- The risk of **Related Party Transactions** is deemed medium as some of the Fund's investments were purchased from related parties. The RE will also utilise Centuria's internal resources. That said, the Manager has clearly defined protocols for managing conflicts of interest, and any such transactions must be approved by the independent Compliance Committee and the Compliance Officer.
- **Liquidity risk** is deemed high due to the possibility that the majority of unlisted assets may not be able to be sold and that other liquidity options (cash, property securities, debt or equity inflows) may be limited. The provision of a full liquidity event every five years may still be subject to the same potential restricted liquidity of the unlisted assets at this time.
- Overall, Lonsec considers the risk assessment for CDPF to be "**Medium**".

Product

Structure

- The Fund is a registered managed investment scheme under the Corporations Act. The Manager employs high quality service providers as Custodian and valuers.
- Lonsec notes the Fund uses a related-party Responsible Entity ('RE') which may lead to potential conflicts of interest. While the use of external REs is Lonsec's preferred operating model, Lonsec notes the RE has built experience in operating and managing a number of registered managed investment schemes over an extended period and is expected to have a structured governance framework in place.

Liquidity

- The Fund has a full Liquidity Event for all unitholders **every five years**, with the first scheduled in December 2025. Under the Fund's Constitution, Centuria is allowed up to 365 days to accept a withdrawal request.
- The Manager also offers a **regular liquidity facility on a quarterly basis**. The amount available for redemptions will be at a maximum 2.5% of the Fund's net assets (equivalent to 10% per year, which is around the average for open-end unlisted funds). If the amount required to meet withdrawal requests in any one quarter exceeds the amount Centuria determines to be available, then withdrawal requests will carry forward and be met on a pro-rata basis. Lonsec notes this is currently the case.
- Notwithstanding the above, withdrawals may be suspended in certain circumstances. Lonsec stresses to investors that the **liquidity facility is limited and the acceptance of redemption requests is ultimately at the discretion of the R.E.**

Valuation policy

- All properties are subject to a minimum requirement to complete an independent valuation once every two years.
- CDPF currently exceeds the requirements of the Centuria Valuation Policy. CDPF has undertaken valuations on a quarterly basis since 2020. This exceeds market practice and ensures unit price is reflective of current valuations.
- External Valuers will be rotated so that a property is not externally valued by the same valuation firm for three consecutive years.

Fee Structure

- **Annual management cost** comprises management fee of 0.80% p.a. of the Fund's gross asset value (0.35% on liquid investments). For any investment in another fund managed by an entity within the Centuria Group, the management fee charged at the underlying fund level will be deducted from the management fee payable to this Fund (avoids 'double-charging' of fees by the RE). **Expenses**

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(excluding Abnormal Expenses) are capped at 0.35% p.a. of the Fund's gross assets and includes compliance costs, audit, accounting, and legal fees.

- **Transaction Costs - Acquisition and Disposal fee** of 2.0% and 1.0% respectively of the price of any property asset in which the Fund acquires or divests a **direct or indirect interest**.
- **Performance Fee**: The RE/Manager is entitled to a **20% share** of excess total return above 8.0% p.a. (pre-tax, net of fees). This is at the lower end of the range for the peer group (8%-9% p.a. hurdle). The Performance Fee is charged on a high-watermark basis, with any prior underperformance having to be recovered prior to an amount being paid.

Property Portfolio

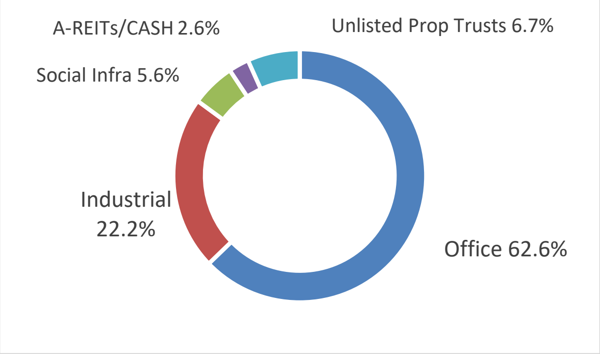
The Manager continues to evaluate further potential acquisitions of direct properties, with consideration given to the overall portfolio WALE, gearing, geographic and sector diversification. These will be balanced against the risks and opportunities presented by the proposed acquisitions. During FY23, there were $811m of acquisitions and $510m of divestments across the Centuria Group. Current portfolio characteristics:

- Eight **direct property** investments (100% owned)(90.64% of investment portfolio);
- Investments in six Centuria **unlisted property funds** (8 properties) (6.72% of investment portfolio);;
- Holding in the **Vanguard Australian Property Securities Index Fund** (0.59% of investment portfolio);;
- **Cash** – At bank(2.64% of investment portfolio);.

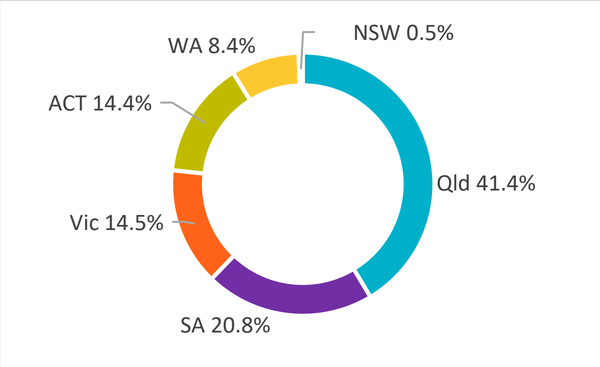
- The Manager is seeking to target smaller direct property assets in the $20m-$50m range that meet the following requirements of the Fund.
  - Industrial, commercial or social infrastructure property;
  - tenanted by government organisations or large ASX-listed companies;
  - financed using a borrowing facility targeting 45% gearing of the asset value.

- The directly owned office properties are mostly A-grade (one B-grade) and located in suburban/regional areas, with one in Canberra CBD. The industrial properties are in established precincts.
- Most of the recently acquired assets are fairly new, with the older ones having been recently refurbished (the average age of the Fund's portfolio has increased from 16 to 18 years).
- The portfolio as a whole has achieved an average 5.0 star NABERS Energy rating. The Manager is focussed on additional energy efficiency upgrades to property assets over FY24.

Sector allocation

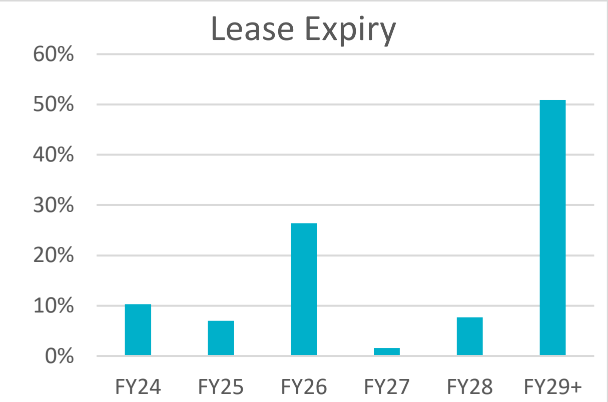


Geographic allocation



Lease Expiry Profile

- As of June 2023, the Fund had a weighted average lease expiry (WALE) of 5.4 years.
- Leases generally have built-in fixed rental increases (average 3.4% p.a.). Generally, there are provisions for market reviews upon expiry for leases with options to extend.
- Tenant lease expiries are reasonably low over the next five years, with around 50% FY29+.



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Major Tenants

TOP TENANTS	% INCOME
ENTAIN – LISTED MULTINATIONAL	17.8
APEX STEEL	13.2
TRANSPORT ACCIDENT COMMISSION	6.6
CLEANAWAY	5.5
OPTUS	5.4
TOTAL	49%

Source: Centuria

The direct and unlisted fund property portfolios comprise a diversity of good quality major tenants, with lease expiries spread over a number of years. Overall occupancy is 96%.

Debt Position / Interest Costs

- The Manager can borrow to assist with acquiring direct properties, but will not borrow to invest in funds that are already geared.
- The Fund has three debt facilities with Australian banks. The following table shows the combined details.

Debt Facility	June 2023
FACILITY LIMIT	$116M
DRAWN-DOWN	$86.5M
EXPIRY (WTD AVG)	3.17 YRS
COST OF DEBT	3.19% P.A.
HEDGED	99%
BANK LVR	39%
BANK LVR COVENANT	60%
ICR (YR 1)	3.65X
ICR COVENANT	1.75X

- The Manager intends to limit total gearing to a maximum of 50%, currently 39%.
- The weighted average gearing (LVR) of the Fund's **direct property investments only** is 40% and leaves a comfortable margin to the bank covenant of 60%. The direct property portfolio values would have to fall by over 33% before the bank LVR covenant was breached. The income from the properties would have to reduce by 50% before the interest cover covenant was breached.

Management

The Responsible Entity (RE)

- **Centuria Property Funds Ltd** (CPFL) is the Responsible Entity for the Fund and is a wholly-owned subsidiary of **Centuria Capital Ltd** (Centuria).
- Centuria was established in 1999 and is an ASX listed company (code: CNI) with a current market capitalisation of $1.6b. As at June 2023, the Group manages $21.0b of assets ($20.2b of real estate assets and $0.8b of investment bonds).
- Centuria's property funds under management consists of $13.8b unlisted property funds as well as $6.4b in listed property trusts (ASX: Centuria Office REIT; Centuria Industrial Fund; NZSX: Asset Plus Ltd). The group has expanded its unlisted fund offering into the Healthcare and Agriculture sectors.
- Centuria operates a 'vertically integrated property business', across both property funds management and property services. The group employs 400+ staff and manage asset acquisition/disposal, leasing and tenant relationships in-house.

Management Team

Board of Directors – Centuria Property Funds Ltd

NAME	POSITION	JOINED CPFL BOARD	EXP.[1] (YRS)
MATTHEW HARDY	EXTERNAL NON-EXEC. CHAIRMAN	2014	30+
PETER DONE	EXTERNAL NON-EXEC. DIRECTOR	2007	35+
DARREN COLLINS	EXTERNAL NON-EXEC. DIRECTOR	2017	20+
ELIZABETH MCDONALD	EXTERNAL NON-EXEC. DIRECTOR	2022	15+

1: Experience in property industry

- The CPFL Board is currently comprised of all external directors. Other Executives closely involved in the management of the Fund include:

NAME	POSITION	JOINED CENTURIA	EXP.[1] (YRS)
JOHN MCBAIN	JOINT GROUP CEO	1999	30+
JASON HULJICH	JOINT GROUP CEO	1999	20+
DOUG HOSKINS	CO-HEAD UNLISTED FUNDS (CDPF FUND MANAGER)	2010	10+
STUART WILTON	CO-HEAD UNLISTED FUNDS	2010	15
ROSS LEES	HEAD OF FUNDS MANAGEMENT	2017	15+
ANDREW ESSY	HEAD OF TRANSACTIONS	2013	10+
BEN HARROP	HEAD OF DISTRIBUTION	2018	25+
VICTOR GEOROS	HEAD OF PORTFOLIO & ASSET M'MENT	2013	25+
SAMUAL ROBBIE	CDPF ASST. MANAGER	2019	10

1: Experience in property and/or investment industry

- Centuria has recently appointed a GM Sustainability.

CPFL Audit, Risk and Compliance Committee

NAME	POSITION
PETER DONE	CHAIRMAN AND NON-EXEC. DIRECTOR
MATTHEW HARDY	NON-EXEC. DIRECTOR
DARREN COLLINS	NON-EXEC. DIRECTOR

- CPFL have an established **Audit, Risk Management and Compliance Committee** consisting of the three non-executive directors from the CPFL board. The

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role of the committee is to oversee how conflicts of interest /potential conflicts of interest and related party issues are managed.

- The **Chief Risk Officer** and is responsible for maintaining the compliance policies within Centuria. Any changes made to these policies need to be reviewed and signed off by the CPFL board.
- CPFL's Fund Managers are assigned responsibilities as 'risk gate-keepers' and are responsible for identifying any actual or potential conflicts of interest that arise from day-to-day operations. This is part of the Fund Manager's key performance indicators.

Investment Style / Process

Investment style/Acquisition criteria

- Centuria predominately focuses on 'Core Plus' and 'Value Add' investment opportunities in the office sector and view their competitive advantage as being able to add value via their active management approach, including:
- Proactive leasing campaigns
- Upgrading of building services and reducing occupancy costs
- Refurbishment and redevelopment projects
- Re-zoning and development application strategies
- In the office sector, the major eastern seaboard markets of Sydney, Melbourne and Brisbane are the key areas of focus. Centuria's in-house, end-to-end property capability enables them to take on a wide range of investments and leverage these resources to add value. The team seeks to target mis-priced opportunities or properties that are likely to benefit from infrastructure investment or urban renewal projects.
- Centuria has a heritage of establishing and managing single asset property funds and has historically acquired assets with either short WALEs, poor lease profiles or properties in need of re-leasing, re-positioning or re-development during the investment term.
- This extends to disposing of properties in the event that an attractive offer is presented before the end of the initially proposed investment term.

On-going Property Management

- The day-to-day asset management and maintenance tasks are managed by Centuria's in house asset management team, which is a key competency of the company and is reflected in the strong occupancy of the Fund.
- Centuria will also liaise closely with the on-site facility manager to ensure efficiencies are being realised.
- The overall property management will be undertaken by Centuria including liaising with the major tenants.

Potential Conflict of Interest / Related Party Issues

- The Manager has a 'Conflicts of Interest' and 'Acquisition and Deal Allocation Procedures' policies that are designed to ensure that any interactions and services received between related parties are consistent with 'industry best practice'.

Centuria DPF Performance (to August 2023)

Returns % p.a.	1yr	3yrs	5yrs	Since Incep.[1] %p.a.
INCOME	5.15	4.92	4.67	4.48
CAPITAL	-7.85	-0.59	0.53	5.32
TOTAL	**-2.70**	**4.33**	**5.20**	**9.80**

1: Inception 24 June 2016.

- The Fund has performed well since inception generating a steady and attractive income return of around 4.5%p.a. together with capital growth reflecting the increase in income and asset values up to August 2023. In recent years, the Fund has been in acquisition mode and this, along with the pandemic related impacts on the office sector, have curtailed near-term returns.

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About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately-owned entity with a multi-brand strategy of providing leading financial services research and investment execution.
Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.

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Analyst

Michael Elsworth

Approved by

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