

# Unlisted Property Trust Report

## APN Nowra Property Fund

October 2018

Large format regional retail site with Woolworths guarantee  
targeting 7.8%+ distributions

For wholesale investors only

## APN Nowra Property Fund

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## About Core Property Research

Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research cover sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

### IMPORTANT NOTICE

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For further information, please refer to the Disclaimer & Disclosure notice at the end of this document.

## APN Nowra Property Fund

October 2018

The APN Nowra Property Fund (the "Fund") is a single asset, unlisted property fund with an initial term of five years to November 2023. The Fund's Responsible Entity, APN Funds Management Limited (the "RE" or "Manager") is seeking to raise \$13.1M through the offer of 13.1M units at \$1.00 per unit ("the Offer"). The funds will be used, in conjunction with bank debt, to invest in the retail property located at 198 Princes Highway, Nowra NSW ("the Property"). The Offer is only available to Wholesale investors as defined in the IM.

The Property consists of a large format retail site constructed in 2016 for the Masters hardware business in Nowra, on the south coast of NSW. Following Woolworth's exit of the Masters business, the Property is currently unoccupied but backed by a Woolworths rental guarantee for the remaining 13 years of the initial lease term until 2031. Home Consortium has taken over the lease (with the Woolworths guarantee remaining) with a view to repositioning the property as a large format retail centre. Home Consortium is a consortium consisting of Aurrum Group, Spotlight Group, Chemist Warehouse, and PrimeWest.

Home Consortium acquired the Masters operations from the Woolworths/Loewe's joint venture in 2016 and has since relaunched 15 ex-Masters sites with new retail offerings. A further 14 sites are expected to open in 2018/2019 with expectations that Home Consortium may consider an Initial Public Offering (IPO) on the ASX.

Home Consortium has been actively pursuing the repositioning of the Property at its own expense over the past 2 years. This includes a DA approval to subdivide the site into 7 separate tenancies. Bunnings will potentially sublease the Property for 2-years whilst undertaking an upgrade to its existing store. Core Property considers Home Consortium to be incentivised to sub-lease the Property to suitable retail businesses for the remaining 13 years of the head lease given that it retains the excess rent above the contracted rent and has last rights to purchase the Property if an offer is made. However, the risks include the possibility that the Property remains unoccupied, which would impact its valuation and saleability, potentially impacting the ability for investors to exit the Fund.

The Fund has a number of attractive features for investors, including: (1) an initial NTA of \$1.05 per unit (due to the purchase price being at a discount to independent valuation and low transaction costs); (2) an attractive distribution of 7.8% p.a. in FY19; and (3) annual rental increases of CPI or 3.5% (whichever the lesser) over the initial lease term.

The Fund will have a five-year debt facility for \$10.5M, which the Manager will need to renew or replace four months prior to the expiry of the Initial Term of the Fund. The initial Loan to Valuation Ratio (LVR) of 43.5% is within the bank LVR covenant of 50.0%. The initial Interest Cover Ratio (ICR) of 3.7x is well above the bank ICR covenant of 2.0x and supported by the rental guarantee from Woolworths.

Fees paid by the Fund as a percentage of gross assets are at the high end of what Core Property has seen in the market.

Core Property estimates the Fund to deliver a pre-tax Internal Rate of Return (IRR) of between 7.5% p.a. - 13.8% p.a. (midpoint 10.5%) based on a +/- 100bps movement in capitalisation rates and a +/- 50 bps movement in interest rates. The analysis includes the potential that investors may receive a capital gain or loss, based on market conditions and an IRR outside this range is possible based on the extent to which the Property can be repositioned.

### Investor Suitability

In Core Property's opinion, the Fund would suit investors who seek an attractive distribution yield with low risk to income backed by a strong rental guarantee and a high initial NTA. Investors may experience limited capital growth from the Property whilst the tenant undertakes its repositioning strategy or if the Property remains unoccupied for an extended period of time. The Fund is illiquid for the initial five-year term and if the Property is not repositioned and remains unoccupied for the full term, further illiquidity may be experienced which also has the potential for a capital loss. Alternatively, should the Property be repositioned and occupied by sub-tenants, there is potential for an increase in the capital value.

### Recommended

See the Appendix for a description of our ratings. The above rating must be viewed in the context of comparable Funds and not across all products

### Fund Details

Offer Open:	29 June 2018
Offer Close <sup>1</sup> :	26 October 2018
Min. Investment:	\$100,000, multiplies of \$10,000 thereafter
Unit Entry Price:	\$1.00
Net Tangible Asset per unit:	\$1.05
Liquidity:	Illiquid
FY19 Forecast Distributions:	7.8 cpu <sup>2</sup>
Distribution Frequency:	Monthly
Initial Investment Period:	5 years to November 2023

1. Indicative only. The RE has reserved the right to close the Offer early or extend the Offer.  
2. Based on the RE's forecasts for FY19.

### Fund Contact Details

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Note: This report is based on the APN Nowra Property Fund Information Memorandum dated 29 June 2018, together with other information provided by APN Funds Management.

## Key Considerations

**Management:** APN Funds Management is a specialist property manager with a “property for income” philosophy. Established in 1998 as part of the APN Property Group, APN currently manages over 100 properties and \$2.8 billion in funds under management. APN has 12 funds including direct property funds, property securities funds and two ASX listed funds, which are managed for institutional and retail investors. Directors of APN Property Group intend to subscribe for up to 5% of units in the Fund on the same terms as investors, providing a greater alignment of interests.

**Property:** The Fund’s sole asset is a large format retail property located at 198 Princes Highway, South Nowra NSW. The Property was originally constructed in 2016 and intended to be a Masters hardware store, prior to the closing of the business by Woolworths Limited (ASX: WOW). The site is fully leased with Home Consortium acquiring the Masters lease, with the initial lease expiring in 13 years (August 2031) and protected by a rental guarantee from Woolworths. The site is ~28,000sqm with 13,032 sqm of lettable area and has an independent valuation of \$24.2M as at 21 June 2018.

**Repositioning Strategy:** The tenant, Home Consortium, was established in June 2016 to acquire the former Masters hardware business and has successfully reopened 13 sites as new large format retail centres. As such, Core Property views Home Consortium to have demonstrated ability in turnaround and repositioning strategies. Since acquiring the lease, Home Consortium has received development approval to subdivide the Property into 7 separate large format tenancies under a new Home Consortium Centre. Currently it is looking to sub-lease the Property to Bunnings South Nowra for 2 years and is expected to resume its plans for a Home Consortium Centre in 2021.

**Demographics:** Market estimates for the Nowra catchment area is for population to grow by around 1.15% p.a., reaching around 131,200 persons in 2031 (from 113,070 in 2018). Household income is currently around \$74,230 with retail spending estimated to be around \$14,500 per person (Location IQ). Although these estimates appear to be well below non-metro averages, it nonetheless provides a stable catchment area for a quality large format offering in the region.

**Debt Profile:** The Fund has a five-year \$10.5M debt facility with the Bank of Melbourne. The initial Loan to Valuation Ratio (LVR) of 43.5%, provides a 13% buffer to the LVR bank covenant of 50.0% The initial Interest Coverage ratio (ICR) of 3.7x is well above the bank ICR covenant of 2.0x which is supported by the rental guarantee from Woolworths.

**Initial NTA:** The Fund’s initial NTA of \$1.05 per unit is above the Offer Price of \$1.00 per unit, providing a capital buffer for investors. The initial NTA benefits from the Property being acquired at a discount to the current valuation as well as lower costs with no stamp duty charged.

**Distributions:** The Manager is forecasting distributions of 7.8% p.a. (annualised) in FY19, which Core Property expects to increase to 8.0% in FY20.

**Fees:** Core Property considers the fees to be above what it has seen in the market. Performance Fees are high, at 30% above a 7.5% IRR.

**Total Returns:** Core Property estimates the Fund to deliver an IRR of between 7.5% and 13.8% (midpoint 10.5%) based on a +/- 50 bps sensitivity to the cost of debt and a +/- 100 bps movement in capitalisation rates. Investors should be aware the Fund is exposed to a capital gain or loss based on the extent to which the Property can be repositioned in addition to overall market conditions, which may deliver an IRR outside this range.

**Illiquid investment:** The Fund should be considered illiquid as there is no withdrawal facility during the initial five-year term to November 2023. Investors should note the Manager may, at its discretion, extend the Fund by a further two years if it is in the best interests of unitholders. An extension beyond seven years must be approved by an ordinary resolution of unitholders (requiring more than 50% approval). Investors should expect to remain invested for the minimum five-year term, with the possibility of a longer term if the Property remains unsold.

## Investment Scorecard

<b>Management Quality</b>	★★★★☆
<b>Governance</b>	★★★★☆
<b>Portfolio</b>	★★★☆☆
<b>Income Return</b>	★★★★☆
<b>Total Return</b>	★★★☆☆
<b>Gearing</b>	★★★☆☆
<b>Liquidity</b>	★☆☆☆☆
<b>Fees</b>	★★☆☆☆

Trust Structure	Fees Paid
An unlisted property fund investing in a single large format retail asset located in South Nowra NSW.	Core Property considers the Fees charged by the Fund to be above what it has seen in the market (see Figure 6: Fees in Perspective).
Management	Entry Fees: Nil
APN Funds Management is a specialist property manager, established in 1998 as part of the APN Property Group. With a "property for income" philosophy, APN currently manages \$2.8 billion of funds under management, including two ASX-listed funds, direct property funds and property securities funds.	Exit Fees: Nil
Property Portfolio	Establishment Fee (Acquisition Fee): 2.5% of GAV of the Fund
No. of Properties: 1	Property Disposal Fee: 1.00% of the Gross sale price of the Property.
Valuation: \$24.2M	Ongoing Management Fees: Estimated to be 1.20% p.a. of GAV of the Fund, consisting of: • 0.75% of GAV p.a. for Management Fee; • 0.20% of GAV p.a. for Property and Facilities management; • 0.25% of GAV p.a. for Expense recoveries;
Property Location: 198 Princes Highway, South Nowra, NSW	Performance Fee: A 30% Outperformance fee over a 7.5% internal rate of return p.a.
Property Sector: Retail	
Key Tenant: Masters Home Improvement Australia (owned by Home Consortium) Rental guarantee from Woolworths Limited to August 2031.	Debt Metrics
Occupancy: Property is currently unoccupied by the tenant, however is fully leased until August 2031.	Initial Debt / Facility Limit: \$10.5M / \$10.5M
WALE: 13.1 years as at June 2018	Loan Period: Five Years expiring 15 March 2023
Return Profile	LVR / Loan Covenant: 43.5% / 50%
Forecast Distribution: FY19: 7.8% pa. (annualised)	ICR / ICR Covenant: 3.9x / 2.0x
Distribution Frequency: Monthly	Legal
Tax advantage: est. 90% tax deferred (FY19)	Offer Document: Information Memorandum, dated 29 June 2018
Estimated Levered IRR (pre-tax, net of fees): 7.5% - 13.8% (midpoint 10.5%)	Wrapper: Unlisted Property Trust
Investment Period: 5 years to November 2023 (Initial Term)	Manager & Responsible Entity: APN Funds Management Ltd (ACN 080 674 479) AFSL 237500
Risk Profile	
Property/Market Risk: Capital at risk will depend on a single asset property in South Nowra, NSW. Investors will be exposed to a potential capital gain or loss, based on market conditions.	
Interest Rate Movements: Interest rates are expected to be hedged for at least 50% of the debt in the Fund. Any change in the cost of borrowings may impact the distributable income in the remaining term of the Fund.	
Property Specific Risks: Property investments are exposed to a change in vacancy rates, prevailing market rents, and economic supply and demand.	
For a more detailed list of the key risks, refer to the "Risk Factors" section of the Information Memorandum.	

## Overview

The Fund is a single asset property fund investing in a large format retail centre located at 198 Princes Highway, South Nowra NSW ("the Property"). The Property was constructed in 2016 originally for the Masters hardware business, and has remained unoccupied following Woolworths Limited's exit of the business in the same year. The current tenant, Home Consortium, has acquired the Masters business and the lease, with Woolworths providing a rental guarantee for the remaining 13 years of the initial lease term expiring in August 2031.

The Fund is seeking to raise \$13.1M in equity through the issuance of 13.1M units at \$1.00 per unit under ("the Offer"). The minimum investment is \$100,000, however, the Manager may accept investments less than the minimum at their discretion.

The Fund provides a degree of support for investors via a higher initial NTA, higher forecast distributions and the Woolworths rental guarantee. An initial NTA of \$1.05 per unit provides an immediate capital cushion for investors, whilst an initial distribution yield of 7.8% p.a. (which Core Property expects to increase to 8.0% in FY20) underpinned by annual rental increases of CPI or 3.5% (whichever the lesser).

Investor returns will be largely impacted by the exit price of the Property. To this end, the current tenant, Home Consortium, has 13 years remaining on the lease and is incentivised to generate operating cashflow and thereby support the value of the Property. Home Consortium, has been successful in repositioning a number of other Masters stores in the past 2 years. It is looking to subdivide the Property into 7 smaller large format retail tenancies and is currently considering a sub-lease to Bunnings South Nowra for ~2 years. Home Consortium, took over the lease as part of its acquisition of the Masters business in 2016 and has met all rental payments, whilst the Woolworths rental guarantee remains in place.

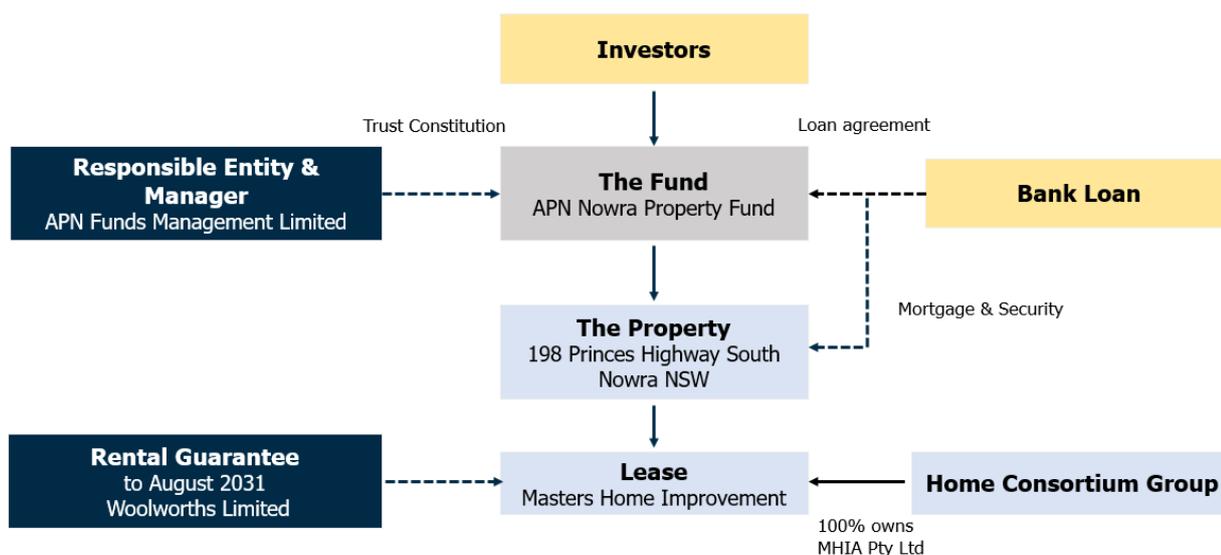
The Fund has a five-year debt facility for \$10.5M, which the Manager will need to renew or replace four months prior to the expiry of the Initial Term of the Fund. At least 50% of the debt will be hedged and the initial LVR of 43.5% is within the bank LVR covenant of 50.0%. The initial ICR of 3.7x is well above the bank ICR covenant of 2.0x and supported by the rental guarantee from Woolworths.

Fees paid by the Fund are at the high end of what Core Property has seen in the market.

Core Property estimates the Fund to deliver an Internal Rate of Return (IRR) of between 7.5% - 13.8%p.a. (midpoint 10.5%pa) assuming a 100 bps movement in capitalisation rates and a 50 bps movement in interest rates. Investors should be aware the Fund is exposed to a capital gain or loss based on the extent to which the Property can be repositioned in addition to overall market conditions.

The Fund has an initial term of five years and should be considered illiquid. If the Property continues to remain unoccupied at the end of five-years, this may impact on the ability of investors to successfully exit the Fund and investors may be required to maintain their holdings for a longer term.

Figure 1: Fund structure



Source: APN, Core Property

## Property repositioning

The Fund benefits from a rental guarantee from Woolworths Limited which underpins a highly secure income stream for 13 years until the expiry of the initial lease in August 2031. The Manager has confirmed that the rental guarantee has not been called upon to date, as all lease payments by Home Consortium (and Masters previously) have been met.

Home Consortium was established in June 2016 and is a consortium consisting of Aurrum Group, Spotlight Group (which operates Spotlight and Anaconda), Chemist Warehouse and PrimeWest. In August 2016 Home Consortium acquired 61 former Masters stores with a view to repositioning the sites as large format retail centres. Since then, 21 stores have been sold and the portfolio currently has 40 stores across five states. During 2017-2018 Home Consortium reopened 13 sites as large format retail centres and is targeting the remaining sites to be opened by 2019.

The value of the Property will ultimately be driven by how well Home Consortium repositions the site as a new retail offering.

Home Consortium, as lessee, has undertaken a number of initiatives in the past 2 years to potentially fill the unoccupied space and extract value from the lease.

- In June 2017 the Property received Development Approval (DA) from the council to be split into 7 large format retail spaces. The costs of the DA were paid for by Home Consortium.
- In August 2018 a separate DA was lodged for Bunnings Warehouse South Nowra to temporarily occupy the premises whilst it undertakes construction to expand its nearby existing premises (located at 147-167 Princes Highway, South Nowra). If approved by council, Bunnings is likely to sub lease the Property from Home Consortium for around 2 years. To the extent that Bunnings will temporarily occupy the site, this may increase the profile of the site and its attractiveness to future tenants. In addition, we expect other large format retail tenancies in the vicinity may consider the possibility of relocating to the site once their existing leases are due.

Core Property considers Home Consortium to be an incentivised tenant:

- Home Consortium acquired the Masters operations from the Woolworths/Loewe's joint venture in 2016 and has since relaunched 15 ex-Masters sites with new retail offerings. A further 14 sites are expected to open in 2018/2019 with expectations that Home Consortium may consider an Initial Public Offering (IPO) on the ASX.
- Home Consortium is liable for rental payments at the Property for the remaining 13 years to August 2031. The lease has a further 6x5 year options.
- The current rent equates to a relatively low \$135 per sqm, which provides the potential for Home Consortium to sub lease the space at a higher rate and effectively earn profit rent from the site.
- If the Property is offered for sale, Home Consortium have last rights to purchase the Property.

As such, we expect that any improvements undertaken by Home Consortium will flow through to the valuation of the Property.

## Liquidity / exit strategy

Investors should view the Fund as illiquid in nature during the initial five-year term of the Fund. Investors may not withdraw from the Fund during this period, however units may be transferred/sold to other Investors.

After the initial five-year term, the Fund may be extended by up to an additional two years if the Manager considers it in the best interests of the investors.

The Fund may be extended beyond seven years upon approval by an Ordinary Resolution (requiring more than 50% approval).

As the Units in the Fund are not proposed to be listed on any securities exchange such as the ASX, unitholders may only transfer their units to another party subject to the provisions of the Constitution.

The Manager may consider an early exit strategy if it considers it is in the best interests of investors.

## Sources & Application of funds

The Information Memorandum sets out the sources and application of funds under the terms of the Offer. It should be noted that the Property is already owned by the Fund and, as such, new investors do not incur any Stamp Duty costs for the acquisition. Core Property estimates the Fund to be saving approximately \$1.5M in stamp duty costs.

Figure 2: Sources and Application of Funds

	\$M	% of purchase price	% of total funds
<b>Sources of funds</b>			
Equity subscriptions	13.1	57.4%	55.4%
Bank debt	10.5	46.2%	44.6%
<b>Total sources of funds</b>	<b>23.6</b>	<b>103.6%</b>	<b>100.0%</b>
<b>Application of funds</b>			
Purchase price	22.8	100.0%	96.5%
Acquisition Costs (Stamp Duty etc.)	-	-	-
Fund Establishment Costs	0.7	3.2%	3.0%
Working Capital	0.1	0.4%	0.4%
<b>Total application of funds</b>	<b>23.6</b>	<b>103.6%</b>	<b>100.0%</b>

Source: APN Funds Management, Core Property

## Debt Facility & Metrics

The Fund currently has a \$10.5M debt facility with the Bank of Melbourne expiring in March 2023. The debt facility will need to be renewed or extended prior to the end of the initial term of the Fund in November 2023.

The initial Loan to Valuation Ratio (LVR) is 43.5%, against a bank LVR covenant of 50%. Core Property calculates that the value of the Property must fall by 13% for this covenant to be breached.

The initial Interest Coverage Ratio (ICR) is 3.9x against a bank ICR covenant of 2.0x. Core Property calculates the net operating income must fall by 49% for this covenant to be breached. Core Property considers a breach of the ICR covenant to be unlikely, given that the remaining lease term is 13.1 years and the income is protected by rental guarantee from Woolworths Limited.

Figure 3: Debt Metrics

Details	Metric
Bank	Bank of Melbourne
Security	First ranked mortgage secured against the Property
Debt Facility Limit/ drawn debt	\$10.5M / \$10.5M
Loan Period	Five years to 15 March 2023
% Hedged	50% (target minimum)
All-in cost of Debt	4.18%
LVR / Peak LVR/ LVR Covenant	43.5% / 43.5% / 50%
Initial interest covered ratio (Lowest ICR)/ ICR covenant	3.9x / 2.0x
Amount by which valuation will have to fall to breach LVR covenant	13%
Decrease in rent income to breach ICR covenant	49%

Source: APN Funds Management, Core Property

## Fees Charged by the Fund

Overall, Core Property considers the fees charged to be at the higher end of what we have typically seen in the market.

Core Property notes that the Performance Fee is calculated at 30% of the Fund's outperformance above an IRR of 7.5%. This is higher than what we have typically seen in the market (20% above a 10% IRR), which the Manager has attributed to the fact that the Property is being sold at a \$1.4M discount to the latest independent valuation.

Figure 4: Summary of Fees charged by the Fund

Fee Type	Fee Charged	Core Property Comment
Entry Fee:	Nil	
Exit Fee:	Nil	
Fund Establishment Fee (Acquisition Fee):	2.50% of the Gross Asset Value (GAV) of the Fund on the Unit Allotment Date.	The Fee is equivalent to an Acquisition Fee for the purchase of the Property. Core Property considers the Fee to be above the industry average of 1.0% - 2.0%.
Disposal Fee:	1.0% of the gross sale price of the Property upon disposal.	The Disposal Fee is at the low end of the industry average of around 1.0% - 2.0%.
Fees & Expenses – Management Fee, Property and Facilities, Expenses, Custody Fees	Total ongoing fees of around 1.2% of GAV p.a. of the Fund, consisting of: <ul style="list-style-type: none"> <li>• 0.75% of GAV p.a. for Management Fees;</li> <li>• 0.20% of GAV p.a. for Property and Facilities Management;</li> <li>• 0.20% (est.) of GAV p.a. for Expense Recoveries;</li> <li>• 0.05% of GAV p.a. for Custody Fees</li> </ul>	We consider the Fees to be at the high end of what we have typically seen in the industry (0.7% - 1.1% p.a. of GAV).
Leasing & Project Management Fees:	Leasing Fees of up to 3 months of gross rent payable upon the execution of any new lease or extension of an existing lease. Project Management Fees of up to 2.5% of the value of any works undertaken.	Core Property does not expect the Fees to be charged during the term of the Fund unless the Manager is able to find more attractive lease terms requiring associated capital works.
Performance Fee:	30% of the Fund's outperformance over a 7.5% Internal Rate of Return (IRR) p.a.	Core Property considers the Fee to be higher than industry average and the hurdle rate to be lower than industry expectations.

Source: APN, Core Property

## All-in fee analysis

Core Property has analysed the fees that accrue to the RE over the term of the Fund as a percentage of all cash flow generated after deducting interest costs but before management fees and performance fees.

Core Property estimates that APN is entitled to 7.6% of the total cash flow. Core Property considers the fees paid to the Manager to be at the mid-point when compared to similar products, which are typically around 7% - 9%.

In terms of the fees paid to the Manager, Core Property estimates that 33.8% of the estimated fee is paid upfront and the remainder relates to ongoing management fees.

Core Property stresses that these are estimates of how much investors will receive and not guaranteed amounts. For further details, please refer to the *Financial Analysis* section.

Figure 5: Fees in Perspective – over an estimated five-year period

Core Property estimates that for every \$1.00 of equity invested the Fund can return:	Amount per \$1.00 unit
Principal repayment to investors:	\$1.00
Income and capital gains to investors:	\$0.56
<b>Total cash to investors:</b>	<b>\$1.56</b>
Acquisition fee:	\$0.04
Base management fee:	\$0.07
Disposal fee:	\$0.02
<b>Fees for the RE (excluding disposal/admin):</b>	<b>\$0.13</b>
<b>Total cash generated by Fund:</b>	<b>\$1.69</b>
Fees = % of total cash generated (before fees)	7.6%
Up-front fee vs total fees	33.8%

Source: Core Property estimates

## The Property

The Property consists of a Large Format Retail property located at 198 Princes Highway, South Nowra, NSW. The total area of the site is approximately 28,000 sqm with the building occupying a gross lettable area of 13,032 sqm. The building is currently configured to a Masters' store layout which consists of a main retail hardware store, garden centre and admin, trade and receiving areas. Car parking is available on site with 329 at grade car spaces accessible via a service road from Princes Highway.

The Property is adjacent to Hungry Jack's restaurant and a Shell Coles express services station with attached Subway restaurant.

APN Property Group acquired the site in July 2015 from the developer. At the time, construction was underway for a large format hardware store, Masters Home Improvement Centre, to be operated by a joint venture between Woolworths Limited and Loewes. In January 2016, Woolworths announced that it would be exiting the Masters business and, although construction was completed, the Masters business has never operated at the site. In June 2016 Home Consortium was formed to acquire the Masters sites with a view to converting the locations into large format retail centres.

APN Property Group originally acquired the Property with a view to placing it in an unlisted property fund with the adjoining Shell Coles service station and Hungry Jacks, as well as a Seven-11 petrol station in Eagleby, Queensland. In 2016, the other assets were sold and the Property remained as the sole asset in a Fund that was owned by the ASX listed APN Property Group (ASX: APD). APN Property Group are now offering units in the Fund, which hold the Property in a single asset, unlisted property fund.

The Property has a long WALE of 13.0 years (by income) as at 31 July 2018, with the sole Tenant being Masters/Home Consortium Group, with a rental guarantee from Woolworths Limited until August 2031.

Figure 6: 198 Princess Highway, South Nowra, NSW



Source: APN, Savills

## Location

South Nowra is located approximately 160km south of Sydney and ~5km south of the regional city of Nowra. The Nowra CBD is the main hub of the local area accommodating for the majority of business, community, health and retail infrastructure and within the greater Shoalhaven catchment area. Location IQ estimates the population in the Shoalhaven catchment to be 113,070 persons in 2018, and is expected to grow at an annual growth rate of 1.15%, reaching around 131,200 persons in 2031. The average household income for the catchment is \$74,238 as at the 2016 census. This can be compared with the NSW non-metro average of \$82,520 and the Australian average of \$98,486.

South Nowra is close to many popular holiday destinations and retirement areas such as Jervis Bay and Hyams Beach. The traffic being drawn by the tourism industry allows South Nowra to prosper economically.

The Property is located in an attractive primary and secondary catchment area located near many similar large format retail centres.

## Property Valuation

An independent valuation was conducted by Savills Valuations Pty Ltd, which valued the property at \$24.2M as at 21 June 2018. The independent valuation makes several assumptions regarding market rent, tenant incentives, re-letting and other factors based on available market evidence. The main assumptions below have been adopted in the valuation model.

Figure 7: Valuation Metrics

<b>198 Princess Highway, South Nowra, NSW</b>	
<b>Title</b>	Freehold
<b>Construction Date</b>	2016
<b>Ownership</b>	100%
<b>Net Lettable Area</b>	13,032 sqm
<b>Major Tenant</b>	Masters Home Improvement Australia Pty Ltd
<b>Weighted Average Lease Expiry</b>	13.1 years (by income)
<b>Occupancy</b>	Property is currently unoccupied, and 100% leased until August 2031
<b>Initial net passing income</b>	\$1.70M p.a.
<b>Net Market income (fully leased)</b>	\$1.70M p.a.
<b>Purchase price</b>	\$22.8M
<b>Valuation (DCF)</b>	\$24.2M
<b>Passing initial yield</b>	7.04%
<b>Capitalisation rate</b>	7.00%
<b>Valuer</b>	Savills Valuations Pty Ltd
<b>Discount rate</b>	8.50%
<b>Value/sqm</b>	\$1,857 per sqm
<b>Valuer's unleveraged 10-year IRR</b>	8.51%

Source: APN, Savills Valuations

## The Tenant and Guarantor

The Property is leased to Masters Home Improvement Australia Pty Ltd ("Masters"). This company was previously owned by the Joint Venture between US hardware retailer Loewe's and Woolworths Limited. After the termination of the joint venture, Masters Home Improvement was bought out by Home Consortium Group. Following the buyout, Woolworths Limited has remained as the guarantor for the rental income at the Property.

Woolworths Limited is one of the major Australia companies with a market capitalization of around \$35B. Predominantly focused on the supermarket/grocery store business, Woolworths also operate other business functions such as petrol, hotels and general merchandise.

Home Consortium is a consortium consisting of Aurrum Group, Spotlight Group (which operates Spotlight and Anaconda), Chemist Warehouse and PrimeWest. The consortium acquired the former Masters holding entity, Hydrox Holdings Pty Ltd which owned 40 Masters sites, 21 development sites and 21 leasehold sides. Home Consortium has indicated plans to reposition these sites to become large format retail centres that include outlets such as Spotlight, Chemist Warehouse and JB Hi-Fi.

## Lease Summary

Key points on the lease agreement in place include:

- The Property is currently 100% leased to Masters.
- The lease term is 15 years with the initial lease term expiring 9 August 2031
- The lease includes annual rent reviews of CPI or 3.5% p.a. (whichever the lesser)
- Woolworths Limited is the guarantor for rental payments if Masters/Home Consortium defaults. The Manager has advised that all rental payments have been met to date and the Woolworths guarantee has not been called upon.

## Market Sales Evidence

The table below shows the comparable sales transactions as provided by the independent valuer. The transactions suggest the Property is reasonably priced at \$1,750 per sqm when compared to other former Masters stores and Bunnings hardware stores.

- In October 2017 Charter Hall Wholesale Management Limited acquired a portfolio of 6 unoccupied, former Masters stores from Home Consortium which were later negotiated into new 10-12 year leases with Bunnings Group Limited. The properties were sold at an average price of \$2,349 per sqm, which represents a 34% premium to the price paid for the South Nowra property (\$1,750 per sqm). Core Property considers the higher price paid by Charter Hall reflects the certainty provided by Bunnings as an incoming tenant.
- The second table shows recent sales of Bunnings hardware sites over the past 12 months. The Bunnings stores have been transacted at higher prices, once again reflecting the strength of the existing tenancies.

Figure 8: Recent Sales evidence

Masters sites	Sale Date	Sale Price	Land Area (sqm)	GLA (sqm)	Price per sqm (GLA)
Masters Hoxton Park, NSW	Oct-17	\$36.8M	59,000	13,407	\$2,747
Masters Albion Park, NSW	Oct-17	\$26.8M	34,820	12,808	\$2,091
Masters Bayswater, WA	Oct-17	\$31.8M	41,972	13,658	\$2,325
Masters Lansdale, WA	Oct-17	\$29.3M	34,226	13,520	\$2,164
Masters Mandurah, WA	Oct-17	\$26.1M	35,680	13,512	\$1,931
Masters Rockhampton, QLD	Oct-17	\$37.5M	40,570	13,222	\$2,839
<b>Total – 6 Masters sites</b>	<b>Oct-17</b>	<b>\$188.3M</b>	<b>246,268</b>	<b>80,127</b>	<b>\$2,349</b>
<b>Masters South Nowra, NSW</b>	<b>Nov-18</b>	<b>\$22.8M</b>	<b>28,000</b>	<b>13,032</b>	<b>\$1,750</b>

Bunnings sites	Sale Date	Sale Price	WALE (yrs)	Price per sqm	Passing Initial Yield	Expected Market Yield	IRR
Bunnings Orange, NSW	Mar-18	\$29.3	12.0	\$2,446	5.53%	5.53%	6.95%
Bunnings Bairnsdale, VIC	Dec-17	\$12.4	7.2	\$1,500	5.66%	5.66%	7.22%
Bunnings Caringbah, NSW	Jul-17	\$59.6	12.0	\$3,756	5.26%	5.26%	6.64%
Bunnings Bonnyrigg, NSW	Jul-17	\$45.5	12.0	\$2,994	5.28%	5.28%	6.68%
Bunnings Windsor Gardens, SA	Jul-17	\$38.5	12.0	\$2,819	5.50%	5.50%	6.89%
Bunnings Burnie, TAS	Jun-17	\$21.1	9.1	\$1,458	6.10%	6.10%	7.28%
Bunnings Mackay South, QLD	May-17	\$28.5	9.4	\$2,561	5.96%	5.96%	NA
Bunnings Bendigo, VIC	Apr-17	\$14.5	4.5	\$1,676	5.98%	5.98%	6.70%
Bunnings Bathurst, NSW	Dec-16	\$25.5	12.0	\$1,787	5.35%	5.35%	NA
Bunnings Gungahlin, ACT	Oct-16	\$65.3	9.6	\$2,915	5.62%	5.62%	7.27%
<b>Masters South Nowra NSW</b>	<b>Nov-18</b>	<b>\$22.8</b>	<b>13.1</b>	<b>\$1,750</b>	<b>7.04%</b>	<b>7.01%</b>	<b>8.51%</b>

Source: Savills

## Market Rental Evidence

The table below shows comparable lease deals for Bunnings tenancies as well as large format retail tenancies in the Nowra region as provided by the independent valuer. The evidence suggests that the Property's rent of \$135 per sqm is well below the comparable Bunnings rent and below the rent charged at Nowra House & Home and Harvey Norman Nowra which are approximately 350m west of the Property.

Figure 9: Recent rental evidence

Property	Tenant	Commence Date	Area sqm	Rent per sqm (gross)
Bonnyrigg, NSW	Bunnings	Jul-17	15,196	\$158
Caringbah, NSW	Bunnings	Jul-17	13,604	\$197
Windsor Gardens, SA	Bunnings	Jul-17	11,307	\$155
Chatswood, NSW	Bunnings	Jun-12	12,485	\$298
Kingsgrove, NSW	Bunnings	Oct-16	16,243	\$210
Kirrawee, NSW	Bunnings	May-16	13,833	\$215
Marsden Park, NSW	Bunnings	Apr-15	14,893	\$168
Northmead, NSW	Bunnings	Aug-15	12,127	\$203
Castle Hill, NSW	Bunnings	Jun-12	18,525	\$244
<b>Average</b>			<b>14,246</b>	<b>\$205</b>
<b>South Nowra</b>	<b>Masters</b>	<b>Aug-16</b>	<b>13,032</b>	<b>\$135</b>

Centre	Tenant	Commence Date	Area sqm	Term (Yrs)	Rent per sqm (gross)	Rent Reviews
Nowra House & Home	Spotlight	Mar-16	2,512	10	\$143	CPI
Nowra House & Home	Godfreys	Aug-14	358	5	\$219	Fixed 3.00%
Nowra House & Home	Original Mattress Factory	Sep-14	632	6	\$178	CPI
Nowra House & Home	Pillow talk	May-13	1,601	8	\$173	Fixed 3.00%
Harvey Norman Nowra	Café Rene	Nov-12	86	9	\$347	Fixed 3.00%
Harvey Norman Nowra	Super Cheap Auto	Jul-14	1,081	10	\$208	Fixed 3.00%
<b>South Nowra, NSW</b>	<b>Masters</b>	<b>Aug-16</b>	<b>13,032</b>	<b>15</b>	<b>\$135</b>	<b>Lesser of CPI or 3.5%</b>

Source: Savills Valuation

## Financial Analysis

Core Property has undertaken a financial forecast of the Fund based on the Manager's assumptions. The key observations are:

- The Manager is forecasting distributions of 7.8% (annualised) in FY19, which Core Property expects to increase to 8.0% in FY20.
- The current lease with Home Consortium allows for annual rent increases of CPI or 3.5% (whichever the lesser) until August 2031. Core Property has assumed a minimum of 2.0% annual rent increases for the initial term of the Fund.

A summary of the Manager's forecasts from the Information Memorandum is presented below.

Figure 10: Profit & Loss Forecast & Balance Sheet

<b>Profit &amp; Loss - Forecast \$M</b>	<b>11 months to 31 August 2019</b>
Net Property Income	1.6
Interest Income	0.0
<b>Total Income</b>	<b>1.6</b>
Management Fee	-0.2
Property & Facility Management Fee	-0.0
Ongoing Fund Costs	-0.1
<b>Total Expenses</b>	<b>-0.3</b>
Interest on Bank Loan	-0.4
<b>Net Cash Earnings</b>	<b>0.9</b>
<b>Distributable Funds</b>	<b>0.9</b>
<b>Distributions per Unit (cpu)</b>	<b>7.15</b>
<b>Distribution Yield % (Annualised)</b>	<b>7.80%</b>

<b>Forecast Balance Sheet – \$M</b>	<b>On acquisition (est 1 Nov 2018)</b>
Cash	0.1
Investment Properties	24.2
<b>Total Assets</b>	<b>24.3</b>
Bank Borrowings	10.5
<b>Total Liabilities</b>	<b>10.5</b>
<b>Net Assets</b>	<b>13.8</b>
<b>Debt/ Total assets</b>	<b>43.3%</b>
<b>NTA per unit</b>	<b>\$1.05</b>

Source: APN, Core Property

## Initial NTA

The starting NTA is an important consideration. It should be assessed in the context of statutory costs and fees paid to the Manager, which dilute investors' return over the term of the Fund.

In this case, the starting NTA is \$1.05, with the Fund benefitting from a lack of stamp duty acquisition costs, as well as the Property being purchased at a discount to valuation.

Figure 11: Initial NTA

Amount per unit	\$ per unit
Issue Price	\$1.00
Less:	
Stamp Duty/Acquisition Costs	-
Debt & Fund Establishment costs	-\$0.06
Other	-
Add back:	
Acquisition (premium)/ discount to valuation	\$0.11
Working capital & capitalised costs	\$0.01
<b>NTA per unit (with capitalised costs)</b>	<b>\$1.05</b>

Source: Core Property

## Expected Future Performance (IRR Sensitivity)

Core Property has estimated the total return from the Fund based on the assumptions provided by the RE.

**Using these assumptions Core Property expects the Fund to deliver a 5-year Internal Rate of Return (IRR) in the range of 7.5% - 13.8% (midpoint 10.5%).**

**Investors should be aware the sensitivities include the potential for the valuation of the assets to increase or decrease (depending on market conditions) which will result in either a capital gain or loss for investors.**

Our calculations are based on the assumption that 50% of debt is hedged for the full 5-years of the Trust, which reduces the impact that interest rates have on the IRR. A change in the terminal capitalisation rate has a more material impact on IRR.

The table below summarises our expected IRRs.

Figure 12: Pre-tax, 5-year IRR (after fees) sensitivity analysis

Terminal cap rate	Cost of debt				
	3.18%	3.68%	4.18%	4.68%	5.18%
6.00%	13.9%	13.8%	13.7%	13.7%	13.6%
6.50%	12.2%	12.2%	12.1%	12.0%	11.9%
<b>7.00% (base)</b>	10.7%	10.6%	<b>10.5%</b>	10.4%	10.3%
7.50%	9.2%	9.1%	9.0%	8.9%	8.8%
8.00%	7.9%	7.8%	7.6%	7.5%	7.4%
8.50%	6.1%	6.0%	5.8%	5.6%	5.4%
9.00%	4.4%	4.2%	4.0%	3.8%	3.6%

Source: Core Property

## Management & Corporate Governance

### Background of APN Property Group and the Manager

APN Property Group is a real estate investment manager managing funds on behalf of institutional and retail investors. Established in 1996, APN Property currently has \$2.8 billion of funds under management, comprising Real Estate Securities Funds, two ASX listed funds and unlisted property funds.

APN Funds Management Limited was established in 1998 as a wholly owned subsidiary of APN Property Group Limited. Based in Melbourne, Australia, APN Funds Management manages property funds for its clients where it specialises in investments in retail properties including supermarkets, and leisure and regional shopping centres. Currently, APN actively manages 12 funds that consist of domestic and international property securities, direct property and listed funds.

### Board of the Responsible Entity

Core Property has reviewed the composition of the RE board and believes that it has the relevant skills and experience to operate the Fund successfully. Each Director has demonstrable property and investment management skills. Core Property notes the Board consists of a majority of independent directors, providing a strong governance structure. We summarise the background of the directors and key managers, as provided in the IM.

Figure 13: The Board of the Responsible Entity

Name & Role	Experience
<b>Geoff Brunsdon</b> Independent Chairman	Geoff has been the Chairman since April 2012 and a Director since 2009. He has over 25 years' experience in investment banking and up until 2009 served as the Managing Director and Head of Investment Banking of Merrill Lynch Australia.
<b>Michael Johnstone</b> Independent Director	Michael has over 40 years' experience in global businesses in key positions such as Chief Executive and general management. He currently serves as the non-executive director of the Responsible Entity of the listed Folkestone Education Trust and the Folkestone Social infrastructure Fund.
<b>Jennifer Horigan</b> Independent Director	Jennifer has over 25 years' experience across investment banking, financial communications and investor relations. She currently serves as a director of QV Equities after coming across from the independent investment bank Greenhill & Co as the Chief Operating Officer in Australia.
<b>Howard Branchley</b> Independent Director	Howard has over 30 years' experience within the Property sector where he founded the property research firm PIR. He established APN's Funds management business and currently serves as a Non-Executive Director of National Storage REIT.
<b>Michael Growth</b> CFO & Alternate for Howard Branchley	Michael currently serves as the Chief Financial Officer for APN Property Group. He holds previous experience with KPMG Melbourne and in London working for various organisations including Santander Group.

Source: APN

### Compliance and Governance

The RE has a Compliance Plan which has been lodged with ASIC, as required by the Corporations Act. The Compliance Plan outlines the policies and procedures for the RE to administer the Trust's assets, engagement of external service providers, valuation practices, borrowings and reporting to unitholders. The Compliance Committee consists of three members, including two external members, and meets half yearly.

## Related Party Transactions

The Fund has in place a Related Party Transactions and Conflict of Interest policy. All related party transactions will be assessed for any conflict of interest and to ensure they are at a reasonable arm's length basis on appropriate terms and conditions.

The Manager may transact with or invest in other funds managed by the APN Property Group.

## Past Performance

APN has provided a summary of returns on unlisted property funds, which is summarised in the table below.

Investors should note that that past performance is not a reliable indicator of future performance as each fund, and its respective underlying property, has its own specific risks and attributes.

Figure 14: Performance of APN unlisted property funds

Previous APN Unlisted Funds	Asset Type	Fund Life	Total Equity Return per annum
Property Plus Portfolio	Convenience Retail Portfolio	2002 - 2017	~14.6%
Auburn Property Fund	Retail Development	2014 - 2015	~52.0%
541 St Kilda Road	Office Building	2013 - 2014	~31.0%
Brisbane Technology Park (BTP)	Office Development	2005 - 2013	~15.0%

Source: APN

## Appendix – Ratings Process

Core Property has developed a framework for rating property and property related investment product offerings in Australia. The methodology gives consideration to a number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: product and underlying portfolio construction; strength and depth of management team, product structure, risk management, financial analysis, and likely outcomes.

**It is important for financial planners and investors to view the recommendation and rating in the context of comparable products only and not across all products rated by Core Property.**

### The Ratings

Financial Advisers and investors should note that for all ratings categories, the product may not suit the risk/return profiles of all investors.

Rating	Definition
Highly Recommended	This is the highest rating provided by Core Property and is indicative of the product exceeding the requirements of our review process across a number of parameters.
Recommended	Indicates that the product has an above average grade profile across a number of Core Property's parameters and has the potential to deliver above average risk adjusted total returns.
Approved	Indicates that the product has met the aggregate requirements of Core Property's criteria. The product has an acceptable risk/return trade-off and is potentially able to generate risk-adjusted returns in line with stated investment objectives.
Speculative	Core Property believes this is a product that has a number of positive attributes; however, there are a number of risks that make investing in this product a speculative proposal. While Core Property does not rule out investing in this product, investors should be very aware of, and be comfortable with the specific risks. The product may provide unique diversification opportunities, although concerns over one or more features mean that it may not be suitable for most investors.
Not Approved	Indicates that the product has failed to meet the minimum aggregate requirements of Core Property's criteria. While the product may have some positive attributes, Trusts in this category are considered high risk.

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