Lonsec

5 Highly Recommended Lonsec Research

Direct Assets Review
Cromwell Direct Property Fund

ISSUE DATE: 27-02-2019

February 2019

Fund Financial Position	As at 31 Dec 2018
TOTAL INVESTMENTS	$258M
DIRECT ASSETS	$182M
INDIRECT ASSETS	$63M
CASH	$11M
DEBT	$47M
GEARING - FUND	18%
GEARING - LOOK-THRU	28.8% (TARGET 25-35%)
NTA/UNIT[1]	$1.21
UNIT PRICE	$1.25

Portfolio Summary	
NO. OF PROPERTIES	9 (5 DIRECTLY HELD)
PROPERTY TYPE	OFFICE 76%; RETAIL 21%; INDUSTRIAL 3%
PROPERTY LOCATION	QLD 72%; SA 15%; ACT 7%; VIC 6%
WTD AVG LEASE EXPIRY	9.2 YRS

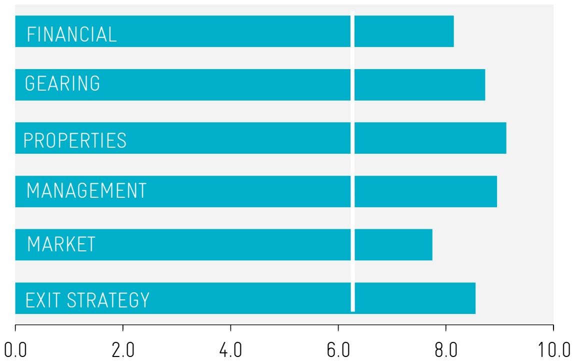
Fund Returns	Lonsec Estimates
EST. FUND 10-YEAR IRR PRE-TAX	8.5% (HURDLE: 7.1%)
IRR (AFTER TAX @ 47%/15%)	6.2% / 7.8%
YEAR END JUNE	**FY19**
DISTRIBUTION PER UNIT	7.0C
PRE-TAX YIELD	5.6%
TAX DEFERRED ASSUMPTION	60%

Other Fund Details	
RESPONSIBLE ENTITY	CROMWELL FUNDS MANAGEMENT LTD
APIR CODE	CRM0018AU
DISTRIBUTION PAID	MONTHLY
MINIMUM INVESTMENT	$10,000 (THEREAFTER $1,000 LOTS)
FUND INVESTMENT TERM	INITIAL TERM EXPIRES 1 JULY 2020
REDEMPTIONS	LIMITED MONTHLY
MANAGER FUND HOLDING	NIL (LONG-TERM)

Manager Fees & Expenses	
ACQUISITION FEE	2.0% OF GROSS VALUE OF DIRECT ASSETS[1]
ANNUAL FEES & EXPENSES	0.77% (GROSS); 0.95% (NET)[2]
DISPOSAL FEE	1.0% OF SALE PRICE
PERFORMANCE FEE	20% OF OUTPERFORMANCE ABOVE BENCHMARK (PCA/IPD UNLISTED RETAIL PROPERTY FUND CORE INDEX)
BUY / SELL SPREAD	NIL
R.E. REMOVAL FEE	NIL

1: Acquisition Fee of 2.0% may also be charged when the Fund purchases units in a syndicate which has recovered its initial acquisition costs.
2: 20% gearing is assumed.

Lonsec Rating of Critical Determinants



Conclusion and Ratings Rationale

Lonsec has maintained its '**Highly Recommended'** rating for the **Cromwell Direct Property Fund** ('Cromwell DPF', 'CDPF', or 'the Fund') following this review.

The Cromwell DPF has an interest in nine properties totalling $245m, with five assets held directly by the Fund totalling $182m, and partial ownership of four properties via three Cromwell unlisted property syndicates totalling $63m. The Fund's holding represents between 13%-21% of the total units in each syndicate.

Cromwell Funds Management Limited ('CFM', or 'the Manager') has a **tight investment mandate** to continue to build a portfolio of direct assets for the Fund, specifically targeting smaller direct assets that meet the requirements of Cromwell DPF rather than other Cromwell entities.

In line with this mandate, the Fund acquired a 100% interest in 420 Flinders St, Townsville for $63.5m in December 2018. Despite Townsville being considered by Lonsec as a secondary location, the property hosts a recently constructed (2013) A-grade office building and is tenanted by a State Government organisation on a long WALE (9.5yrs).

In comparison to its peers, the Fund rates well on the following criteria:

- The direct property portfolio consists of **five good quality properties** that are likely to **require minimal immediate capital expenditure**.
- Investors also gain an exposure to **high quality assets** via investments in three Cromwell property syndicates. These properties have market values in excess of $50m and are viewed as having **better defensive characteristics** than smaller properties. The investments in the underlying syndicates also **improve the property sub-sector and regional diversification** of the Fund.
- The Fund has a mix of **high quality tenants** with 91% of passing net income derived from properties primarily tenanted by an ASX-listed or Government-owned organisation. The portfolio has

Cromwell Direct Property Fund

a **weighted average lease expiry (WALE) of 9.2yrs** which is longer than average in Lonsec's direct property peer group. This **provides greater income certainty** for investors.

- The Fund has a **conservative gearing target (25%-35%)** allowing **significant headroom to the Fund covenant (50%)**. Lower levels of debt are considered an attractive feature at this point of the commercial property cycle. Furthermore, the underlying syndicate investments have separate debt funding arrangements, with varying maturities and attractive / flexible funding terms.
- Cromwell's experienced team of property professionals have demonstrated an ability to make sound strategic decisions and form strong relationships with industry participants for the benefit of investors.

The Fund is considered to be in line with peers on the following facets:

- Lonsec's estimated pre-tax total returns (ten-year IRR calculation) for the Fund is 8.5% p.a.**; above the Lonsec hurdle rate** of 7.1% p.a. **and broadly consistent with the peer group average.**
- The overall fees and expenses of the Fund are **below the Lonsec peer group (on a net assets basis)**. However, investors in this Fund benefit from **CFM not charging a Management Fee on the cash holding**.
- The **Performance Fee of 20% above the Benchmark is at the high end** of Lonsec's sample of unlisted property funds and Lonsec would prefer to see a **performance fee be payable only if the Fund achieved a positive return**. There could also be some double charging if performance fees at the underlying syndicate level (20% share above 10% p.a. return) are triggered.
- The **CDPF unit price is currently $0.97** on a per dollar basis**. T**his discount is in line with most open-ended funds in the peer group.

The aspects of the Fund that are less attractive include:

- The Canberra office asset currently has a **low WALE (3.6yrs).** Jacobs Australia (48% of income) lease expires in July 2021.
- The now defunct Masters Hardware was to be the anchor tenant of the Parafield Complex. The rent on this tenancy is now paid by Home Consortium but remains **guaranteed by Woolworths**. However, the **space is currently empty, reducing the overall foot traffic and appeal of the site**.
- The Fund's most recent direct property acquisitions has **skewed exposure towards Brisbane, Adelaide and now Townsville.** There locations are considered by Lonsec to be more cyclical and less defensive markets than Melbourne and Sydney.
- The Fund's estimated distribution yield (both in pre and after tax terms) are **below the average** of the Lonsec peer group, but considered reasonable given the lower levels of gearing employed.
- The Manager offers investors a **limited monthly redemption facility** (up to 0.5% of the Fund's net asset value per month or higher if the Fund's cash exceeds 6% of assets). In relation to its peers (average 10% p.a.), the Fund has a less accessible liquidity feature.
- While the individual properties should easily be sold, it has been shown with similar fund-of-funds during financial market crises, **disposing of investments in unlisted funds may not be readily completed**. However, Lonsec is pleased to observe that any gearing on the Fund's balance sheet is secured by directly held properties that are 100% controlled by the Fund.
- Lonsec would like to see Cromwell Property Group commit to a **permanent unit-holding in the Fund** (some Directors and other senior management have holdings in the Fund).

Changes Since Previous Lonsec Review

- The Fund acquired a **7-level office building at 420 Flinders St, Townsville (Qld) for $63.5m on the 21st December 2018**. The sale transacted on a 6.50% capitalisation rate and 7.3% passing income yield. The property is located within the Townsville CBD on the corner of Flinders and Stanley Streets. At the time of writing, the building comprises 26% of the portfolio and is directly owned by the Fund.
- The building has six floors of office space and the ground floor retail space. Constructed in 2013 it has 5-star NABERS Energy rating and a 5 Green-Star rating for sustainability.
- The property is tenanted by Ergon Energy (Energy Queensland), a State Government entity with 92.6% of net lettable area (NLA). The lease expires in September 2028. Minor tenants are National Australia Bank (6.7%) and Energy Shot (0.7%).
- In December 2018 Cromwell Funds Management finalised an amendment of the Fund's existing debt facility with Bank of Queensland**. Debt held directly by the Fund has risen from $11m (9% LVR) at Lonsec's last review to $47m (18% LVR**), mainly to fund the Townsville acquisition. There has also been significant equity inflows (approx. .$44m or +24%) over calendar 2018.
- At the end of the initial term of the Fund in July 2020, the Fund may be extended for a further five-year period (and every five years thereafter). Previously, the Fund renewal period (coinciding with a full withdrawal opportunity for investors) was to be at three-year intervals.

Using This Fund

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

- Cromwell Direct Property Fund is an unlisted property trust which invests in a portfolio of property assets with a small cash reserve.
- The Fund aims to provide investors with a monthly tax advantaged income, along with the potential for some capital growth.
- 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.

Cromwell Direct Property Fund

- As such, Lonsec considers the Fund suitable for medium to high-risk profile investors with a five+ year investment-time horizon and it will generally sit within the growth component of a balanced portfolio.
- Due to the Fund's significant exposure to illiquid assets (direct property) and the fact that the redemption facility is limited and at the discretion of the RE, liquidity risk in the Fund is deemed to be high.
- Forward looking estimates of returns are either sourced from the PDS forecasts or Lonsec estimates based on data supplied by the Manager, external valuation reports or other third-party data sources deemed to be reliable, but are not a guarantee of future performance.

Risk Assessment

Lonsec rates the **key risk factors** associated with the Cromwell DPF in the following table, which are assessed in the overall context of both competing unlisted property funds and relative to other asset classes.

Taking all these factors into consideration, Lonsec considers an investment in the Fund to be of **low to medium risk**.

The main improvement over previous Cromwell unlisted trusts is that this Fund is more diversified, both by location, tenant, lease expiry and to a smaller extent, sector exposure.

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			●

Capital Gain vs. Income is deemed medium given that property funds have a higher element of capital risk than some other asset classes (e.g. cash or bonds).

Gearing Risk is considered medium, given the Fund's maximum gearing level of 50%. However, the gearing of the Fund (look-through basis) is currently much lower at 29% and has historically been managed well below the 50% threshold. Lonsec's unlisted peer group average is 42%.

The risk of **Related Party Transactions** is deemed medium as some of the Fund's property and leasing services are provided by other CMW entities. The Manager will also utilise Cromwell's internal resources. This said, the Manager has clearly defined protocols for managing conflicts of interest.

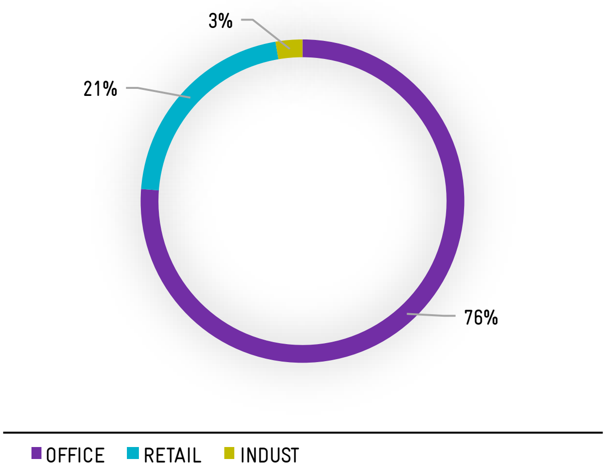
While the **liquidity** of separate interests in direct properties and other unlisted property trusts in theory may be more liquid than ownership of units in a single unlisted property trust, liquidity risk in the unlisted property sector is regarded as high compared to other asset classes.

1. Properties

1.1 Portfolio Overview

The portfolio consists of investments in nine properties; 100% ownership of five direct properties constituting 66% of the Fund, and four properties via syndicates which account for 34%.

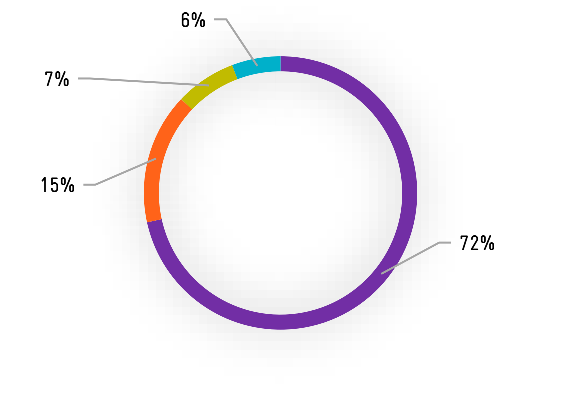
Assets by sector



The Fund is predominately invested in the office and retail sector, with the industrial sector only accounting for a 3% allocation. The Fund's industrial exposure is via its investment in the CPT12 syndicate.

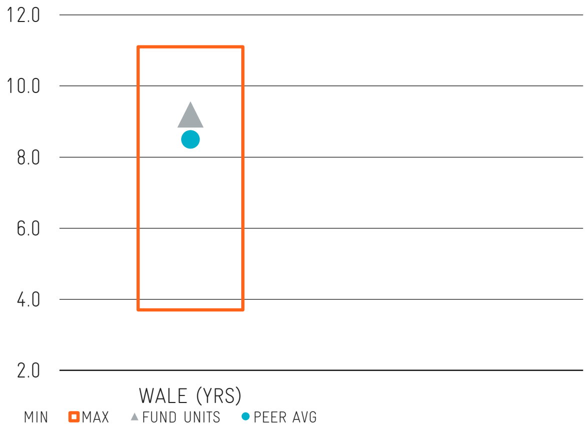
Cromwell Direct Property Fund

Assets by location



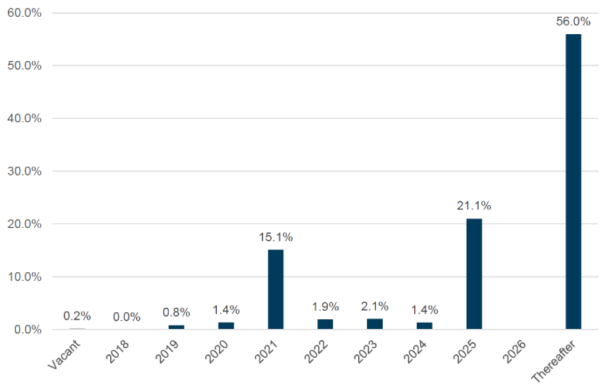
The Fund's two most recent acquisitions in Spring Hill and Townsville, mean that the geographic exposure is now most heavily weighted to Queensland (72%). Three of the Fund's properties (two direct, one indirect) are in Adelaide, comprising 15% of the total portfolio.

Weighted Average Lease Expiry (WALE)



The Fund's Weighted Average Lease Expiry (WALE) is presently 9.2 years which is slightly above the peer average. The WALE has fallen marginally from 10.1 years in Lonsec's previous review.

Lease Expiry



*By gross income. As of 21 December 2018. Source: Cromwell.

The Fund has no significant leases coming up for renewal in the short to medium term, with the first, **Jacobs International** (a major US-based global engineering firm) at 64 Allara Street, reaching expiry in 2021.

Tenant Mix

TENANT	% GROSS INCOME
ENERGY QUEENSLAND	38%
BUNNINGS GROUP LTD	10%
HOME CONSORTIUM	10%
INTERNATIONAL EDUCATION SERVICES (IES)	8%

*AS OF 21 DECEMBER 2018.

Energy Queensland is a State-owned Corporation that accounts for 38% of the Fund's gross income. Other tenant exposures are relatively minor.

Capital Expenditure

The majority of the properties were recently constructed and are of a high standard and require little immediate capital expenditure (capex). The portfolio is further improved by high quality environmental ratings on many of the office properties.

Cromwell Direct Property Fund

1.2 Overview of Fund investments

PROPERTY	STATE	TYPE	OWNERSHIP BY FUND(%)	UNDERLYING PROP VALUE $M	DPF INVEST $M	% PORT	PASSING NET INCOME (100%) $M	INCOME YIELD FY19	NET LETT› AREA (100%) SQM	OCCUP.	CAP'N RATE	DISC. RATE	WALE (INC.) YRS	MAJOR TENANTS
DIRECT INVESTMENTS														
420 FLINDERS STREET TOWNSVILLE QLD	QLD	OFFICE	100%	63.5	63.5	26.0%	4.62	7.27%	7,929	100%	6.50%	7.25%	9.5	Ergon Energy (Energy Queensland)
433 BOUNDARY STREET, SPRING HILL	QLD	OFFICE	100%	42.0	42.0	17.2%	2.75	6.55%	5,997	100%	6.25%	7.25%	9.9	International Education Services
BUNNINGS MUNNO PARA WEST, SA	SA	RETAIL	100%	31.3	31.3	12.8%	1.88	6.00%	17,067	100%	6.00%	7.50%	9.8	Bunnings (Wesfarmers)
MASTERS MAIN NORTH ROAD PARAFIELD	SA	RETAIL	100%	27.3	27.3	11.1%	2.17	7.96%	15,857	96%	7.00%	8.25%	11.8	Home Consortium (Woolworths)
64 ALLARA STREET, ACT	ACT	OFFICE	100%	18.0	18.0	7.4%	1.28	7.12%	3,155	100%	7.00%	7.25%	3.6	Jacobs Intern'l; Peet; Knight Frank
TOTAL DIRECT				182.1	182.1	74.4%								
SYNDICATE INVESTMENTS														
33 BREAKFAST CREEK ROAD, NEWSTEAD	QLD	OFFICE	21.0%	273.0	37.6	15.4%	17.22	6.31%	30,604	99%	6.00%	7.00%	6.8	Energex Ltd (Energy Queensland)
117 BRISBANE ST, IPSWICH	QLD	OFFICE	12.9%	123.0	9.7	4.0%	8.92	7.26%	17,866	99%	7.13%	8.13%	9.4	Queensland Government
11-13 ROBINSON STREET, DANDENONG	VIC	OFFICE	15.1%	95.2	10.1	4.1%	5.73	6.02%	13,807	100%	5.50%	7.00%	11.2	ATO (Commonwealth Govt)
RAND DISTRIBUTION CENTRE, DIREK SA	SA	INDUSTRIAL	15.1%	49.0	5.1	2.1%	3.34	6.82%	11,113	100%	6.50%	8.00%	17.5	Rand Transport (Automotive Holdings Group)
TOTAL INDIRECT				540.2	62.5	25.6%								
TOTAL/WTD AVG				722.3	244.6	100.0%		6.84%		99%	6.4%	7.4%	9.2	

1. Except for 'Ownership by Fund' and 'DPF Invest' Syndicate Investments all numbers are sourced from Valuation reports.

2. The Home Consortium lease for Masters Main North Road Parafield is guaranteed by Woolworths. Other major tenants have their Parent Entity in brackets. Except for International Education Services and Jacobs, all major tenants are ASX-listed or Government-backed entities.

3. 117 Brisbane St Ipswich is held indirectly through the Cromwell Ipswich City Heart Trust. 33 Breakfast Creek Road Newstead is held indirectly through the Cromwell Riverpark Trust. 11-13 Robinson Street Dandenong and Rand Distribution Centre Direk are held through ownership in Cromwell Property Trust 12.

Cromwell Direct Property Fund

Assessment of Fund investments

	% OF PORTFOLIO (31. DEC 2018)	LOCATION / INFRAS.	BUILDING CONDITION	TENANTS / LEASES	MARKET / POTENTIAL
420 FLINDERS STREET, TOWNSVILLE	23%	GOOD	EXCELLENT	EXCELLENT	AVERAGE
433 BOUNDARY ST, SPRING HILL	15%	GOOD	GOOD	GOOD	GOOD
BUNNINGS MUNNO PARA	11%	GOOD	EXCELLENT	EXCELLENT	GOOD
PARAFIELD RETAIL COMPLEX	10%	GOOD	EXCELLENT	GOOD	AVERAGE
64 ALLARA ST, CANBERRA	7%	GOOD	GOOD	AVERAGE	GOOD
ENERGEX HOUSE	21%	EXCELLENT	EXCELLENT	EXCELLENT	EXCELLENT
IPSWICH CITY HEART	6%	GOOD	EXCELLENT	EXCELLENT	AVERAGE
ATO DANDENONG	4%	GOOD	EXCELLENT	EXCELLENT	GOOD
RAND DISTRIBUTION CENTRE	3%	GOOD	EXCELLENT	EXCELLENT	GOOD

	Strengths	Weaknesses
420 Flinders Street Townsville	• Major tenant is **Energy Queensland** (93% NLA), a Queensland State-Owned Corporation. • Long WALE of 9.5 yrs with fixed rental increases of 4% p.a. • An A-Grade office building last refurbished in 2013. 5 Star NABERS Energy and Green Star Ratings.	• The property is over-rented. The gross passing office rent of $662/sqm is well above the average of $350-$400/sqm for A and B Grade office stock in the local market. The Verde Building opposite is of equivalent quality and the market rent for these buildings is considered to be around $550/psm. • Given the comparatively thin market in Townsville for this type of property there may be some unpredictability in the sale price should the building be sold.
433 Boundary St, Spring Hill	• Long WALE of 9.9yrs by income. • Primary tenant, **Independent Education Services Limited (IES)**, has exclusive agreements with leading organisations such as the University of Queensland to essentially work as a feeder university for international students. The organisation has had growth in student numbers from 40 to 2,000 since inception in 1997. • The large site area of 3,776sqm provides some potential for the property to be incorporated in either tenant development plans, part-residential/childcare conversion, or has alternative use in healthcare (high floor to ceiling space).	• IES is a Brisbane-based not-for-profit organisation. In regards to property income security, IES is a deemed lower quality tenant than a government entity or long-running, profitable, ASX-listed company. • High tenant concentration risk with IES due to become the sole tenant of the property in 2019 (aside from Wilson Carparking). • The property was purchased on a capitalisation rate of 6.25% which historically is sharp for a fringe-Brisbane CBD building. However, the site does have above average potential for development.
Bunnings Munno Para	• Completed in 2016 the property has been built to the tenant's specifications. • Lease to high quality tenant **Bunnings (Wesfarmers)**, still has just under 10 years to run. • The property well located near the busy Northern Expressway with over 16,800 cars and trucks travelling along the route daily. The site is 30 kms north of Adelaide CBD. • Limited short-term expenditure requirements.	• The property forms part of a greenfield development. There is no other big box retail in the area.
Parafield Retail Complex	• High profile bulky goods retail location (Parafield Airport) 14.5 kms north of Adelaide. Another brand outlet centre being proposed on site opposite. • **Home Consortium** has taken over the Masters lease and Woolworths is still guarantor.	• The ex-Masters site remains unused (86% of NLA), although Home Consortium is actively looking to fill the space. • 610sqm (4% of NLA) of vacancy remains. However, this space is under a rental guarantee from the developer until 2021.

	• **Officeworks** and **Hungry Jack's** trading well despite no anchor tenant in complex. • **Overall property WALE is 11.8 years.** • Smaller lots could be sold separately.	• Leasehold interest (31 yrs + 49 yrs option) with future risk of increases in ground rent. • A Bunnings Hardware is already operating close by. • Not zoned for industrial as an alternate use.
64 Allara St, Canberra	• Modern A-grade building with good car park allocation (4.1 per 100 sqm). • Major tenants include **Jacobs International** (US based engineering firm); **Peet Group**; **Knight Frank** property group. • Minimum short and medium-term capital expenditure anticipated. • Good location with broad purpose clause permitting alternate use (hotel/residential).	• Fringe Canberra CBD location. • Relatively short WALE of 3.6 years.
Energex House	• A-grade office building with 6-star Green Rating and 5.5-star NABERS Energy Rating. • Excellent location within 2kms Brisbane CBD. Was the first major office development in the Riverpark/Gasworks precinct in 2010. Considerable office development has occurred in the area since. • 92% leased to **Energex** (Queensland Government entity) with long WALE of 6.8yrs and 3.75% or CPI (whichever greater) annual rental increases. • Large floor plates & expensive tenant fit-out.	• Leasing risk due to limited re-leasing opportunities on a single tenant basis. • The Brisbane 'near city' office market has considerable competition for tenants.
Ipswich City Heart	• 90% leased to the **State of Queensland Government** tenant with long WALE of 9.4yrs and 3.75% p.a. rental increases. • Strategic central location above transport terminal. • Built in 2013, with a 4 star NABERS Energy rating and a 5 Green-Star rating. The site was the first stage of a $1bn project that is planned to transform the Ipswich CBD.	• Large exposure to one tenant. • Ipswich is a secondary office market. However, the building is considered one of the best of its class in the area (A-Grade quality.)
ATO Dandenong	• Modern building purpose built for the **Australian Tax Office (ATO)** completed in September 2015. • 92% leased to a Commonwealth Government tenant with a long WALE of 11.2 years and 3.75% p.a. rental increases.	• Secondary suburban location. • Lower level retail has no main street frontage. • The property's current Net Passing Income of $5.7m p.a. is above the Valuer's assessed Net Market Income of $5m p.a. resulting in the potential for a decrease in rent if the ATO was to vacate the building.
Rand Distribution Centre	• Purpose built specialised industrial facility to meet tenant specifications (Dec 2013) and extended in 2015. • Significant expansion land area. • Long WALE of 17.5 years with solid rental yield increases of 3.5% p.a. and backed by ASX-listed **Automotive Holdings Group**. • Located beside Edinburgh Airport (an RAAF airbase.) Due to its close proximity to the airbase it is likely to remain zoned industrial over the long term, suiting a long-term tenant with specialised needs.	• Secondary location 23kms north-west of Adelaide CBD. • Vacant land in close proximity, highlighted by closure of General Motors Holden in adjacent Elizabeth Parks precinct.

Cromwell Direct Property Fund

2. Financial Analysis

2.1 Income / Expense analysis

Year	FY19 $m
DIRECT PROPERTY INCOME	10.816
INVESTMENT INCOME (SYNDICATES)	4.083
TOTAL INCOME	**14.900**
MANAGEMENT FEE	1.333
INTEREST EXPENSE	1.143
TOTAL OPERATING EXPENSES	**2.476**
NET OPERATING INCOME	**12.424**
INCOME SUPPORT	-0.866
NET DISTRIBUTION	**11.558**
WTD AVG UNITS (MILL)	165.1
DISTRIB./UNIT	7.00c
YIELD @ $1.25	**5.60%**
% TAX DEFERRED	**60.0%**

Annualised yield calculated assuming a unit price of $1.25

The above income and expense estimates are based on

- the Manager's and Valuer's estimate of net income from the existing portfolio of nine properties, including reasonable allowances for potential vacancies (including incentives and leasing costs).
- No further direct property acquisitions.
- Capital expenditure averages around $300,000 p.a.

2.2 Distribution yield comparison

Cromwell DPF Estimated Distributions

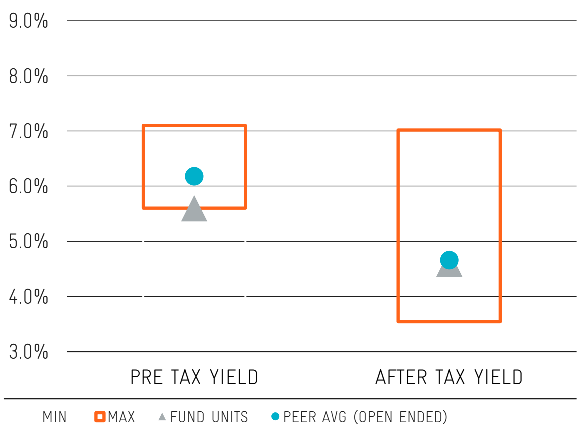
Year end June	FY19
DISTRIBUTION/UNIT	7.0C
PRE-TAX YIELD (@ $1.25)	5.6%
TAX ADVANTAGED ESTIMATE	60%
YIELD AFTER 47% TAX	4.6%
GROSSED-UP YIELD	8.6%
YIELD AFTER 15% TAX	5.3%
GROSSED-UP YIELD	6.2%

The level of distributions on a monthly basis will be impacted by the number of equity units being issued and if any additional properties are acquired. Should the Fund continue to raise new equity beyond current estimates without further property acquisitions, then the distributions in the near-term will be impinged.

Lonsec estimates distributions in FY19 to be 7.0c per unit, consistent with the 7.0c per unit distribution paid in FY18. While the Fund has maintained the distribution per unit in absolute terms, the yield has been diluted by the increasing unit price due to strong capital growth.

Lonsec believes that an average annual 7.0c dividend per unit is achievable for the Fund to deliver over the medium-term.

Lonsec Industry Distribution Comparison



Above, Lonsec has compared CDPF's estimated distribution yield with a sample of open-ended direct property trusts.

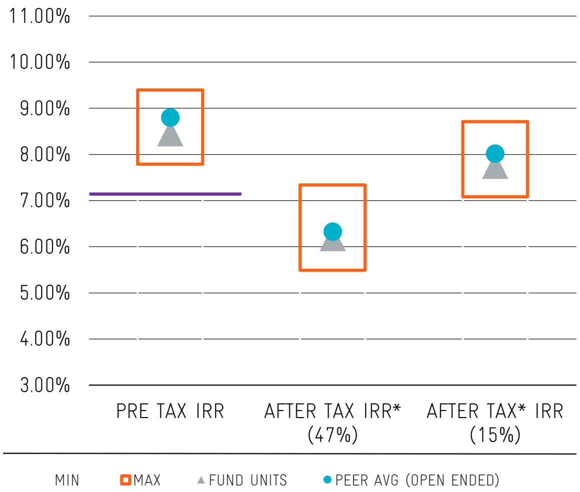
On a pre-tax basis, the Fund offers a distribution yield at the bottom of the range. Part of this is due to CDPF's relatively low gearing and the large equity inflows experienced by the Fund.

On an after-tax basis, the Fund remains marginally below the average yield in Lonsec's peer group but above the bottom range due to a higher estimated tax deferred component (tax free as income, but reduces the cost base of units) than some funds. This is owing to the Fund's higher level of activity in development projects (i.e. Parafield Retail Complex, Bunnings Munno Para West) that are more likely to attract tax depreciation deductions.

Cromwell Direct Property Fund

2.3 Total Returns

The key financial performance measure that Lonsec focuses on is the ten year Internal Rate of Return (IRR) of the Fund and sensitivities. The basic rationale behind using the IRR financial analysis is that it attempts to find a single number that summarises the merits of an investment and depends on only the cash flows of the investment. The IRR is compared with Lonsec's benchmark discount rate.



* Also net of capital gains tax.

Lonsec estimates the Fund may deliver a total return of 8.5% p.a. over the next ten years, based on conservative income, expense and asset growth assumptions. This exceeds Lonsec's hurdle rate (7.1%) for this type of unlisted property fund at this point in the cycle.

The Fund's estimated returns are marginally below the pre-tax peer group average due mainly to its lower gearing.

The Fund's estimated IRR is broadly in line with the average of recent open-ended unlisted property trusts on after-tax basis, assisted by the mid-range tax deferred percentage (after-tax returns).

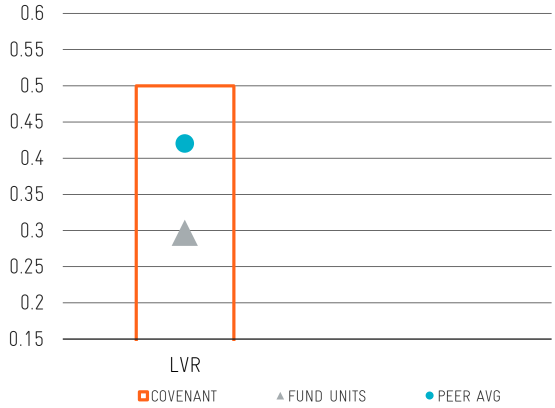
Assumptions underlying income

These estimates assume growth in rental income in line with current leases (avg. 3.0%p.a.) and that the capital value of the portfolio increases in line with this.

Lonsec's total return estimates incorporate allowances for **potential vacancies** (including leasing costs and incentives) upon lease expiries and **capital expenditure** adopted in the Valuation reports. Should some of these vacancies not occur, then the estimated returns could be greater. However, other assumptions with regard to rental levels and operating costs (both direct property costs and those associated with the Fund) may be higher than Lonsec has factored in and total returns may be less than estimated.

2.4 Debt Position / Interest Costs

The Manager can borrow to assist with acquiring properties in its own right and to invest in underlying property syndicates.



At the time of Lonsec's review, the Fund's LVR on a look-through basis was 29%, well below the Lonsec peer group average of 42% and the Fund's LVR covenant of 50%.

The Manager recently drew down $47m of debt from the facility to assist with the acquisition of 420 Flinders St Townsville.

Bank Loan Terms

BANK	BANK OF QUEENSLAND
FACILITY LIMIT	$55M
EXPIRY	17/12/2021
BANK LVR COVNT[1]	50%
BANK LVR[1]	39%
DEBT DRAWN-DOWN (21 DEC. 2018)	$47M
COST OF DEBT (+ESTAB FEE)	3.95% (+0.06%)
% HEDGED	0%

Fund Gearing

DIRECT LVR	18%
LOOK-THRU LVR	29%
LOOK-THRU LVR FUND COVEN'T	50%
LOOK-THRU ICR (FY18)	10X

1.The debt facility is secured against four directly held properties in the Fund (excluding 420 Flinders Street) valued at approx. $118m.

The Fund's actual level of debt will fluctuate depending upon acquisitions, capital expenditure and the level of equity inflows. The Manager intends to limit gearing on the direct properties to a maximum 50% and won't acquire units in any unlisted property trust that would result in a look-though gearing level above 50%.

Gearing Underlying Trusts	% Ttl	Gearing (LVR)
RIVERPARK TRUST	21%	36%
IPSWICH TRUST	6%	39%
CPT 12	8%	28%

Cromwell Direct Property Fund

2.5 Fee Structure

Acquisition Fees

Should the Cromwell DPF acquire any properties directly (or via an interest in another trust/fund), an acquisition fee of 2% of gross assets will be payable to Cromwell Funds Management.

The acquisition fee on units in an **unlisted property trust/fund** will be reduced so that CFM does not double up on fees already earned in an underlying property syndicate (unless that fee has been recovered since the issue of the units by an improvement in the net asset value of the property trust/fund).

Annual management fees and expenses

The Manager will ensure that investors in the Cromwell DPF will only pay 0.60% pa of the Fund's gross assets (including the Fund's share of gross assets in the underlying property syndicates). This effectively reduces the fee on the Cromwell DPF to take into account the fees already being charged by CFM on the underlying property syndicates.

Expenses of the Cromwell DPF (at the fund level) are quoted by the Manager to be up to 0.20% p.a. of net assets (0.17% p.a. of gross assets). Unlike the Management Fee, investors are to note that they are also indirectly charged for their share of fund administration expenses (generally around 0.15% p.a. of net assets) within the underlying syndicates as these services require to be completed at both levels (i.e. audit, registry).

Comparison of Management Expense Ratios

	M/ment Fee	Other Exp	Total MER
CROMWELL DPF	**0.60%**	**0.17%**	**0.77%**
LONSEC CLOSED-END AVG	0.62%	0.17%	0.80%

Comparison of Indirect Cost Ratios

	M/ment Fee	Other Exp	Total ICR
CROMWELL DPF[1]	**0.75%**	**0.20%**	**0.95%**
LONSEC FUND AVG	1.11%	0.31%	1.45%

1. 20% gearing is assumed. Actual gearing levels may fluctuate affecting the indirect cost ratio.

Lonsec's fee analysis shows the current fee and expense level being levied to be in line with the average of the Lonsec peer group average for the Management Expense Ratio. However, due to the lower level of gearing (20%), the Fund has a lower Indirect Cost Ratio than the Lonsec peer group.

Other fees

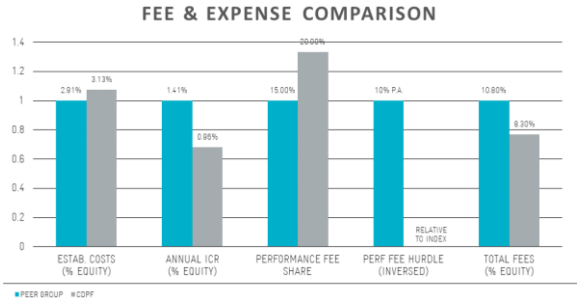
Performance Fee: The RE/Manager is entitled to be allocated a **20% share of the excess total return** above the benchmark index (PCA/IPD Unlisted Retail Fund Index). The Performance Fee is payable provided the Fund beats the benchmark, therefore a performance fee may still be payable if the Fund incurs a negative return . However, the Performance Fee will only be charged for a quarter if any previous underperformance of the benchmark has been recovered.

Property Sale Fee: A fee of 1% of the gross value of assets sold may be payable to CFM if it acts as the selling agent on the fund's direct properties. If an external agent is appointed, the total fees (including those paid to the agent) will not exceed 1% of gross assets sold.

Similar fees are payable within the underlying trusts.

It should also be highlighted that there are **no 'poison pill' fees payable** should the RE be replaced by way of unit-holder vote (Extraordinary Resolution) under the Corporations Act.

Fee and expense comparison



The Fund has establishment costs that are in line with the peer group and annual costs are expected to be lower than average over a ten-year period. However, the Fund's fee load could be impacted by a higher than estimated Performance Fee which is above the Lonsec average take-out of 15% and has no absolute hurdle return.

For the total fees comparison, Lonsec has estimated the present value of total fees and expenses paid to the RE/Manager by the Fund over a ten-year period. This takes into consideration the differences in timing of initial establishment costs, on-going expenses and back-end performance/ disposal fees and varying investment terms. In order to calculate performance fees for other funds, Lonsec has assumed a 30% increase in the gross asset value over ten years.

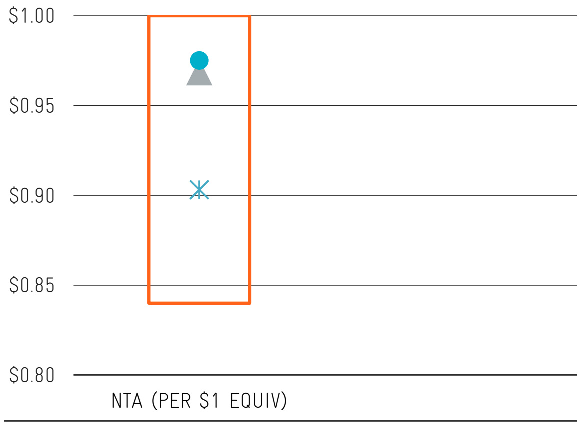
Cromwell Direct Property Fund

2.6 Balance Sheet / Net Asset Backing

As at end	Dec-18 $m
CASH	10.46
PROPERTY VALUE (DIRECT)	184.11
PROPERTY VALUE (OTHER)	62.92
TRADE AND RECEIVABLES	0.70
TOTAL ASSETS	258.18
CURRENT LIABS	4.57
INTEREST BEARING LOAN	47.00
OTHER NON CURRENT LIABS.	1.98
TOTAL LIABILITIES	53.56
NET ASSETS	204.62
NO. OF UNITS ISSUED (mill)	169.59
NTA PER UNIT	$1.21

The above balance sheet is at 31 December 2018 and includes the recent acquisition of 420 Flinders Street Townsville.

Net Asset Backing Comparison



New investors to Cromwell DPF would start with a Net Tangible Asset backing of $1.21, a marginal discount to the current Unit Price of $1.25 (or $0.97 on an equivalent basis to compare the asset backing to price of different funds). This is in line with most open-end funds due to the recent Townsville acquisition. It is also well above the 5-15% discount for other start-up (mostly closed-end) funds with higher establishment costs. Unlike many direct property funds reviewed by Lonsec, the Fund has no additional buy/sell spread.

3. Management

An assessment of Management is another key performance measure and is largely qualitative, focusing on the ownership, operating and reporting structure, property investment policy and selection criteria. Capable and experienced management is vital to the success of the Fund. Previous performance is evaluated, but is not necessarily a guide to future returns.

3.1 The Responsible Entity (RE)

Cromwell Funds Management Limited (CFML) will act as Responsible Entity (RE) for the Cromwell DPF. CFML is a specialist funds management company licensed by the Australian Securities and Investment Commission (ASIC) to act as the RE for a range of managed investment schemes.

CFML is a 100%-owned subsidiary of **Cromwell Property Group** (ASX Code: CMW), an integrated property group with its own property portfolio, funds management business and internal property services team. CMW is listed on the Australian Securities Exchange (market capitalisation $2.4bn as at February 2019). As at 30 June 2018, CMW had $11.5bn of funds under management (FUM) across Australia, New Zealand and Europe.

The Group first listed on the ASX in 1971 as Cromwell Corporation Ltd (CCL). The current executive team began its involvement in 1998.

3.2 Management Team

In line with industry best practice, Cromwell has established a separate board for Cromwell Funds Management Ltd which has a **majority of independent representatives**. Cromwell Funds Management Ltd will oversee the CDPF with **Hamish Wehl** appointed as the Fund Manager.

Board of Directors – Cromwell Funds M'ment Ltd

Name	Position	Service C'well (Yrs)	Industry Exp (Yrs)
PAUL WEIGHTMAN	CH, EXEC DIRECTOR	20	34
MICHELLE MCKELLAR	NON-EXEC DIRECTOR	11	33
JANE TONGS	NON-EXEC DIRECTOR	3	31
RICHARD FOSTER	NON-EXEC DIRECTOR	20	50

Source: Cromwell

Other Senior Executives & Staff

Cromwell have 380+ staff in 30 offices across 15 countries. Lonsec also notes Cromwell's strong internal capability in finance, treasury and compliance.

3.3 Investment process

Overview investment style

The Group relies on the following core business strengths:

- Defensive property portfolios with strong recurring cash flows and minimal short-term lease expiries.
- A strong retail direct property brand.
- Traditionally a domestic focus with limited exposure to offshore property markets; however this has recently changed with a focus on overseas acquisitions of fund management businesses.
- A loyal diversified retail and institutional investor base for its unlisted property funds.
- An experienced and stable executive team.

Cromwell acquisition process

The Manager has a five-step acquisition process that is employed to evaluate, approve and implement potential property acquisitions. The Cromwell property acquisitions/property services team has specific experience in project managing more complicated delivery and construction programmes to project completion. They have also shown a discerning due diligence process by passing up opportunities that do not measure up.

The process is mapped out below:

- Step 1: All potential property acquisitions are reviewed in accordance with the Investment Policy of Cromwell, objective market criteria and prevailing market conditions. The acquisition is modelled to ensure that threshold IRR and yield targets can be met.
- Step 2: Potential acquisitions that meet minimum investment criteria are subject to initial technical, financial and legal due diligence. Due diligence models are revised in accordance with due diligence findings. If applicable, an initial conditional Heads of Agreement is negotiated with the potential vendor.
- Step 3: The Board appoints a formal Due Diligence Committee (includes a number of Cromwell Directors) and an Investment Committee (must include at least one non-executive Director) to steer the acquisition process. The Due Diligence Committee undertakes a range of technical, financial and legal due diligence investigations, utilising a range of internal and external experts in this process. Key findings are used to update the acquisition model.
- Step 4: The Due Diligence Committee commissions and reviews an external property valuation and secures a commitment from its financiers to provide debt financing for the acquisition. The Due Diligence Committee makes a recommendation to the Investment Committee.
- Step 5: If the Investment Committee is satisfied with the due diligence recommendation and the terms of the financiers, it may elect to proceed with the investment. Major transactions may also require full Board approval.

Portfolio construction / acquisition criteria

Larger properties with value-add opportunities are usually suited for the Cromwell balance sheet and more passive assets under $100m are ideal for syndication. Generally, acquisitions for the listed entity need to be neutral to Group earnings, although there may be a compelling future upside to consider.

Recent preference has been for office properties, with government/blue-chip tenants in key CBD markets. Sourcing opportunities have benefited from strong relationships with developers like Grocon and Leighton.

After the internal due diligence process, the target total returns at the property level are determined. The Group noted that they have completed multiple due diligences in recent years and ultimately screened out properties as they have not been able to meet the total return hurdle rate.

On-going Property Management

Cromwell has an internal Property and Facilities Management team (including Cromwell Project & Technical Solutions) that operates like an external services provider. This team is responsible for the control of the portfolio capital works.

Each property has a rolling ten-year capital expenditure plan, which is developed as part of the acquisition due diligence process.

They work closely with Property Managers, Leasing Managers and Facility Managers to ensure capital expenditures/tenant fit-outs are well managed.

Potential Conflict of Interest / Related Party Issues

Lonsec has sighted Cromwell's **'Conflicts of Interest Policy and Procedure'** as well as **'Related Party Protocol'** documents. It is noted that the Company Secretary has overall responsibility for managing conflicts of interest and the Compliance Manager monitors compliance with the policy and procedure. The Manager has adequate policies and procedures in place to manage the risk of any actual and perceived conflict of interest as a result of related party transactions. The Manager or related parties benefit from charging project management; property management; and leasing fees. "All service arrangements are documented and conducted on arm's-length terms".

3.4 Previous Performance

Cromwell Funds Management Ltd performance

Cromwell Direct Property Funds (inception to 31 December 2018)

FUND	1 YR % P.A.	3 YRS % P.A.	5 YRS % P.A.	B/MARK INDEX[1] P.A.	B/MARK INDEX[2] P.A.	SINCE INCEPTION.	FUND INCEPTION DATE
CROMWELL DIRECT PF	7.5%	8.5%	10.5%	20.5%	11.3%	10.5%	AUG-13
CROMWELL P/T 12	10.5%	11.1%	14.5%	20.5%	11.3%	14.2%	OCT-13
CROMWELL IPSWICH CITY HEART TRUST	14.0%	14.6%	15.9%	20.5%	11.3%	13.7%	DEC-11
CROMWELL RIVERPARK TRUST	12.5%	17.5%	19.9%	20.5%	11.3%	16.0%	JUN-09

1. Benchmark: PCA/IPD Unlisted Retail Property Fund Core Index five years to 31 December 2018.

2. Benchmark MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index five years to 31 December 2018.

4. Market Analysis

4.1 Australian Property Market

- Underpinning economic factors for Australia's property markets currently include:
  - Relatively strong population growth;
  - Attractive yields relative to bonds drawing in overseas capital;
  - Resources states have stabilised as commodity output is strong and there is some recovery in prices.
  - Infrastructure spending is at a heightened level.
- Lonsec is cognisant of the compression of capitalisation rates to cyclical lows and believe that capital appreciation for commercial property assets from these levels will be difficult, especially as interest rates begin to rise.

4.2 Townsville Office Market

- Townsville is Australia's 13th largest city with a population of around 250,000. The main activities supporting the economy are defence, education as well as acting as a base for surrounding agriculture and mining industries.
- Relative to other regional locations Townsville comprises a greater depth of office assets in terms of scale and value, primarily driven by the size of the local economy and the various industries and government departments that underpin the region.
- Yields are currently sitting at between 8-9%. There have been examples of yields well below this (e.g. 420 Flinders St), although those assets have exhibited characteristics that are far superior to what is expected in the local market (e.g. long WALE and modern improvements).
- Rents in the area currently range between $350-$400/sqm gross for A and B grade stock. Incentives are currently ranging between 15-25%. However, 420 Flinders St and the Verde Building opposite are the two highest quality office buildings in the Townsville CBD with the current gross rent around $660/sqm. Market rent for these buildings is considered by the Valuer to be around $550/psm, so slightly over-rented.
- The building is located in an area of the CBD which was not directly affected by the recent floods in the city, however access to the building was limited during the crisis.

4.3 South Australian Stamp Duty

- A proportion of the Fund's portfolio is located in South Australia. After a three year phase out from December 2015 stamp duty on commercial property was abolished on 1 July 2018. Furthermore, recent amendments also included minor changes to the State Land Tax by increasing threshold values by 2.0%-2.5%. Overall these changes should lower the tax burden on commercial property investments in South Australia.

5. Exit Strategy / Liquidity

5.1 Withdrawals and Liquidity

The initial term of the Fund is seven years (expiry July 2020), with only a limited opportunity for withdrawals during this period.

The Manager currently provides a **Limited Monthly Withdrawal Facility** (up to 0.5% of the Fund's net asset value per month or higher if the Fund's cash exceeds 6% of assets).

The underlying syndicates that the Fund has invested in have varying expected expiry dates (from October 2020) which gives the Manager the opportunity to exit these investments progressively. However, subject to unit-holder votes, the underlying trusts may continue on for further terms.

Direct properties can be sold at any time by the Manager. The proceeds of selling either an interest in an underlying trust or direct property could be used for withdrawals.

At the end of the initial investment term of seven years, the Manager intends to offer a **full withdrawal** opportunity. If withdrawal requests are less than 50% of net asset value, the Manager will attempt to satisfy them within six months. Redemptions could be satisfied through cash; sale of assets; issue of new units or facilitating unit transfers between investors.

If all withdrawal requests can be satisfied within six months, the Fund will continue and there will be further withdrawal opportunities every five years thereafter.

If withdrawal requests are 50% or more of net asset value (or if all withdrawal requests can't be satisfied within the six-month period), the Manager will take steps to wind up the Fund.

6. Lonsec Methodology

The research methodology includes a rating process designed to assess the qualitative and quantitative factors of the investment. The process is consistent for comparable investment products, enabling projects to be individually rated, comparatively ranked, and to establish a Lonsec Research recommendation status for use by financial planners.

The rating determinants are:

- Financial Analysis / Gearing
- Properties
- Management
- Market Analysis
- Exit Strategy

Lonsec Direct Assets Research Rating Definitions

Highly Recommended	The Highly Recommended rating indicates that Lonsec has very strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered a preferred entry point to this asset class or strategy.
Recommended	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.
Investment Grade	The Investment Grade rating indicates that Lonsec has conviction the financial product can generate risk adjusted returns in line with relevant objectives. However, if applicable, Lonsec believes the financial product has fewer competitive advantages than its peers.
Fund Watch	The Fund Watch rating indicates that no new investment into this financial product is recommended. A significant change has occurred with the financial product and a detailed assessment of the change is needed and / or series of rectifying actions required prior to this rating being changed.
Screened Out	The Screened Out rating indicates that Lonsec currently does not have conviction that the financial product can generate risk adjusted returns in line with relevant objectives. The financial product currently has insufficient competitive advantages relative to its review peer group (if applicable).
Redeem	The Redeem rating indicates the financial product is no longer considered worthy of investment for any time period and investors should immediately redeem units from the financial product, subject to seeking financial advice. An adverse development has taken place that is considered detrimental to the interests of investors.

Financial Products withdrawn from research process

Capital Raising Closed	As the Trust is closed to new investment, it is no longer included on the Lonsec Recommended List and existing Lonsec research reports and ratings have been withdrawn from the Lonsec website. Going forward, Advisers should not rely on prior research in respect of this product. Lonsec will only be providing further updates should circumstances require. The Trust manager will have to obtain a new Lonsec rating for any new capital raising. Lonsec may also make a recommendation if a roll-over of investor capital is proposed or a liquidity offer is made. An investment in the Trust can be retained.
Discontinued Review	The Discontinued Review status is applied where a fund manager that has approached Lonsec and agreed to tender a financial product for assessment, subsequently elects to discontinue participating in the Review prior to its completion for any reason, other than the financial product being closed or unavailable to retail investors. The Discontinued Review status will be published on the Lonsec website.
Cease Coverage	The Cease Coverage status is applied to financial products where fund managers withdraw from the Lonsec research process after the research process has been completed.
Closed / Wind Up	The Closed / Wind Up status is applied to a financial product when the fund manager advises Lonsec that the financial product is being wound up and the capital is to be returned to investors.

Lonsec

Cromwell Direct Property Fund

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 and independent 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.

Date released

February 2019

Analyst

Callum Yule

Approved by

Kevin Prosser