INSIGHT
MAGAZINE

IGNORE THE NOISE: AUSTRALIAN OFFICE ISN'T DEAD (OR DYING)

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CEO UPDATE

Jonathan Callaghan
Chief Executive Officer
Cromwell Property Group

Dear Investor,

We are coming to the end of the 2023 financial year – and what a trying year it has been, with inflation persisting and interest rates at an 11-year high, placing added pressure on the economy, businesses, and families.

The impact of rising interest rates and concerns about structural changes in work habits on property valuations, particularly in commercial property, has been a hot topic in the media. While some of these concerns about the office market have been addressed in the article "Ignore the noise: Australian office isn't dead (or dying)" in this edition of Insight, I'd like to reiterate a few important points here.

At Cromwell, we apply a prudent valuation policy to all our assets and will continue to have our assets frequently independently valued to ensure that our portfolio valuations reflect market changes.

The most important thing we can do to protect to the value of our assets is to keep them full and our team has been working hard to ensure our occupancy levels remain high. Average occupancy across our Australia portfolio sits at 95.3% as at 31 March 2023. Active asset management has been Cromwell's strong suit for many years and incremental upgrades, refurbishments, and additions identified through strong tenant relationships and market intel are what sets us aside from our peers and is reflected in our strong portfolio metrics.

Anecdotally, we have witnessed several tenants change their office layouts to suit new flexible working arrangements, which has resulted in modified office space focused on collaborative and gathering spaces and amenity. We have witnessed far less reduction in tenant space than the media is portraying at a sector level.

Despite the challenging market, Cromwell has made progress on our strategy to sell down non-core assets, negotiating some successful sales. In late February, 84 Crown Street, Wollongong, settled for $53 million, a 3.9% premium to book value. 117 Bull Street, Newcastle, was settled for $33.4 million in April. Overseas, we are well progressed on finalising a deal on the logistics assets in the Cromwell Italy Urban Logics Fund. The proceeds of these sales will go towards reducing our debt, further stabilising our balance-sheet.

There are challenges ahead, however Cromwell has demonstrated a long-standing ability to adapt and continue to drive success through complex market conditions. We remain focused on executing on our strategy and delivering returns for our investors over the longer term.

In Edition #42 of Insight, Jordan Lipson, Portfolio Manager for the Cromwell Phoenix Global Opportunities Fund, outlines the opportunities that exist in the hotel sector for the Fund; we unpack the complexity of tax-deferred distributions; we get to know our Head of ESG Lara Young and much more.

I hope you enjoy this edition of Insight.

Yours sincerely,

Jonathan Callaghan
Chief Executive Officer
Cromwell Property Group

IN BRIEF

Low carbon glass at Nervesa21

The project to refurbish Cromwell's Italian Nervesa21 asset - part of the CEREIT portfolio - is currently underway and is steadily progressing toward its planned December 2023 completion. The building consists of two communicating towers of eight and 14 floors, respectively, with a total floor space of 10,000 sqm. The project is in the vibrant Porta Romana district, which is slated to undergo one of the largest regeneration projects in the Italian capital. Cromwell's team is aiming to achieve the highest ESG credentials and is targeting LEED Platinum and WELL Gold.

To achieve this ambition, a huge team effort was made to ensure that environmental factors were considered when selecting its supply chain partners. One of the key focuses of the project is to identify the most efficient and effective ways to reduce the project's carbon footprint.

Following a review of the market solutions available, the Italian team partnered with AGC Glass, a low-carbon glass provider based in Louvain-la-Neuve (Belgium), to help reduce the emissions associated with the building's façade.

From AGC's research across the industry, they have identified that glass accounts for between 5% to 15% of the embodied carbon emissions in a building. To produce low-carbon glass, AGC has taken a holistic approach investigating reduction options in every part of the manufacturing process including delivery to the customer. By opting for low-carbon glass instead of traditional standard glass, Nervesa21's embodied emissions have been significantly reduced.

The Italian delivery team is busy installing the first elements of this new full-height façade and thanks to the selection of this innovative material have achieved an embodied carbon footprint reduction of 40%, which equates to a reduction of 81tCO2eq.

Cromwell celebrates World Facilities Management Day 2023

World Facilities Management Day is usually observed on the second Wednesday in May each year and, this year, it fell on 10 May. The day is an opportunity to celebrate the contributions of the behind-the-scenes professionals who keep our assets healthy, safe, and productive.

At Cromwell, we have a number very talented individuals who work in facilities management roles across the organisation – each managing different challenges and opportunities daily.

We recognise that facilities management is essential for ensuring the safety and comfort of a work environment; we know that if a workplace is well-managed, people will be encouraged to be more productive and enthusiastic about their work; and we fully appreciate that facilities managers provide fundamental support to Cromwell's business operations.

So, a heartfelt thank you to all our wonderful FMs – and those across the industry – we hope you enjoyed your day!

National Reconciliation Week marked at Cromwell

This year, National Reconciliation Week was celebrated across Australia from Saturday, 27 May until Saturday, 3 June. Celebrated annually, it is a time for all Australians to learn and explore how each of us can contribute to achieve reconciliation and equality for Aboriginal and Torres Strait Islander peoples.

In 2023, the theme was "Be a Voice for Generations" and all Australians were encouraged to be a voice for reconciliation.

At Cromwell, we recognise we have an opportunity educate ourselves, engage in meaningful conversation, and explore what it means to be a voice for reconciliation. We used the week to educate our people about our Reconciliation Journey and the progress towards creating Cromwell's Reconciliation Action Plan. We reaffirmed our commitment to using our platform to be a voice for learning, action, and unity.

Cromwell attends MIPIM 2023

In late April, the largest real estate conference in the world, MIPIM, took place in Cannes, France.

The four-day real estate event for the most influential players provided members of Cromwell's European team with the opportunity to network and engage with several key industry players, as well as potential investors and business connections in the real estate community.

Pertti Vanhanen, Managing Director – Europe and his team welcomed a large number of guests to the Cromwell-branded beachfront suite, and, throughout the event, various members of the Cromwell team met with journalists for several interviews, including TV and podcasts, to promote the brand.

McKell Building Electrification Project begins

Cromwell has commenced work on a 'Sydney first' facility upgrade at our McKell Building in the city's Central Business District.

Cromwell's Head of Property Operations, Tessa Morrison, said the upgrade of the 24-storey building has been designed to help 'future-proof' the asset by replacing outdated, 1970s-era infrastructure with modern, energy saving equipment.

"The project involves converting the building's existing commercial gas-fired heating system to an electric heat-recovery reverse cycle heating, ventilation, and air conditioning (HVAC) system," said Ms. Morrison.

"This is the first time that a multistorey, 25,000sqm commercial building in the Sydney CBD has undergone an electrification upgrade – and we're excited to have engaged experienced mechanical air conditioning contractor Velocity Air to help deliver the project."

"By modernising our building's infrastructure this year, we're helping to reduce its carbon footprint in the future."

Ms. Morrison said the project was only achievable with support from the building's sole occupier – a NSW Government tenant – and was expected to be completed in early 2024.

Cromwell ranks highest in Australian NABERS Sustainable Portfolio Index

The NABERS Sustainable Portfolio Index (SPI) results for 2023 were released in late April – and Cromwell again achieved outstanding results for its energy and water portfolio performance.

Cromwell Direct Property Fund

- A rating of 5.5 stars in energy performance, ranking 3rd best office portfolio overall in Australia and the highest-ranked geographically diversified office property fund in Australia.
- A rating of 4.7 stars in water performance, ranking equal 8th in Australia

Cromwell Diversified Property Trust

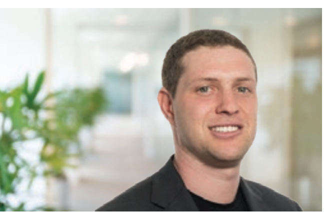
- A rating of 5.4 stars in energy performance, ranking 4th best office portfolio overall in Australia.
- A rating of 4.8 stars in water performance, ranking equal 8th in Australia.

This result reaffirms Cromwell's continued commitment to sustainability across our business, and we commend everyone in the business who helped achieve these impressive results.

The NABERS Sustainable Portfolios Index (SPI) showcases 64 leading property portfolios across Australia according to their NABERS ratings and percentage of portfolio rated. The Index covers office buildings, shopping centres, and carbon neutral portfolios. NABERS is a national rating system that measures the environmental performance of Australian buildings and tenancies.

ROOM SERVICE

EXPLORING INVESTMENT OPPORTUNITIES IN THE HOTEL SECTOR



Jordan Lipson
Portfolio Manager
Phoenix Portfolios

The Cromwell Phoenix Global Opportunities Fund assesses potential investments in a bottom-up manner, selecting the best opportunities, rather than following broad thematics.

Despite this, investment opportunities may have similar drivers – or operate in similar industries – from time-to-time. This is currently the case for the Fund's exposure to hotel properties – these opportunities all exist for different reasons and have unique risk/reward propositions; however, the true value of each is predominantly derived from the ownership of hotels.

Before examining specific examples, it is worth touching on how to think of the value of a hotel.

Like other types of property, one way to think about valuing hotels is to apply a capitalisation rate to the earnings the asset generates. Unlike some types of property (but much more similar than some realise), hotels need to be refurbished frequently to stay up-to-date and attract customers. Any income should be adjusted lower for a normalised capital expenditure amount.

Those who buy and sell hotels also often think of valuing hotels on a "per key" basis – this describes the hotel's value relative to the number of rooms available. A well-located, extremely high-end hotel may trade for well above $1 million per key, while a motel in the middle of nowhere would likely trade for less than $100,000 per key.

The per key valuation of a hotel can be used to compare hotel valuations to replacement cost, which is the amount required to replace the hotel from the ground up (inclusive of land). This is important because, if hotels are trading for below replacement cost, it is less likely that new hotels will be supplied in that market. Hotels are extremely sensitive to demand and supply, as anyone who has travelled in peak periods can attest to. As an example, a high-end hotel on the Las Vegas Strip is commonly available for AUD$200 per night. Booking even a basic room in that same hotel during the Las Vegas Formula One event would set you back more than AUD$3,500.

Recognition of the value of hotel properties by listed markets is held back by two components. Firstly, financial results have been negatively impacted by COVID restrictions, meaning that those looking solely at the recent income generated by many properties are underestimating the true earning power. Applying a capitalisation rate to this smaller income number is understating the property's true value. Secondly, unlike some other forms of property, hotels are held on a company's balance sheet at the lesser of its depreciated cost or net realisable value. If a hotel was built long ago, this may significantly understate its true value and make it difficult to identify for investors screening for discounts to book value.

With this background detail out of the way, let's look at some examples in which the Fund invests.

Hilton Hawaiian Village Waikiki Beach Resort

Park Hotels & Resorts Inc. (NYSE:PK)

Historically, the world's leading hotel operators used to own hotel properties and manage their operations. In more recent times, these companies realised they could split the businesses, with one company managing the hotels – requiring very little capital (and, therefore, generating high returns on equity) – and one owning the more capital-intensive properties. Recognising this, Hilton Hotels spun-out its physical real estate in 2016, creating Park Hotels. At the time of the spin, Park comprised Hilton assets from all over the world. Today it is an entirely US-based portfolio of predominantly Hilton-run hotels.

> A well-located, extremely high-end hotel may trade for well above $1 million per key

Park owns some of the world's most iconic hotels, including the 1,921-room Hilton San Francisco Union Square and the 1,878-room New York Hilton Midtown, which both dominate prime blocks in their respective cities. Perhaps more importantly, it owns two exceptional hotels in Hawaii – the Hilton Hawaiian Village Waikiki Beach Resort and the Hilton Waikoloa Village. We previously discussed the importance of replacement cost; however, these two sites are genuinely irreplaceable.

Despite the challenge in assessing the replacement cost of these hotels, a reasonable estimate for Park's hotels is USD$735,000 per key. At the current share price, Park is trading for less than USD$250,000 per key. Using capitalisation rates from comparable property transactions ascribes a net asset value of $28.50 per share, compared with Park's period end closing share price of $12.36. With a solid management team in place and a world class array of assets, Park Hotels appears very attractively priced.

Sotherly Hotels Inc. (NASDAQ-CM:SOHO)

While Sotherly Hotels is another US-based hotel owner, it is in a very different situation to Park. As its name suggests, the organisation's hotels are based in the South of the US, predominantly in states like Florida, Georgia, and North Carolina. These hotels are smaller and more downmarket than Park's hotels, with many branded as Doubletree by Hilton, the company's lower upscale brand.

The investment opportunity for Sotherly Hotels is largely tied into its capital structure. Most recently, Sotherly took on too much debt and preferred equity instruments to grow assets. This proved to be ill-advised when COVID hit, and their business was effectively shut down. They stopped paying dividends on their preferred equity, which began to accrue, and the company took on emergency debt.

As things began to improve, they have been able to repay their most costly debt that was taken on in their darkest days. They have also been able to retire some of their

preferred equity and have resumed paying dividends on these instruments, reducing arrears. Dividends to regular shareholders can be paid again once the arrears are repaid. At a market capitalisation of just US$37 million, the implied value per key is approximately USD$175,000. This is a long way below replacement cost. As some property investors like to say, you couldn't build those hotels out of playdough for that price!

Sotherley's high debt load is a risk, however, which could be destructive should the macroeconomic environment turn more negative as a meaningful reduction in cash flow could make the interest burden extremely difficult. The Fund's position sizing of approximately 2% of assets acknowledges this risk.

Stamford Land Corporation (SGX:H07)

Stamford Land is a Singaporean-based owner of the Stamford hotel portfolio in Australia, and it is run by eccentric Chairman CK Ow. In 2021, Mr. Ow put the entire portfolio on the market for sale. The portfolio attracted bids at multiples of the share price, but the offers did not hit Mr Ow's target, so he u-turned and decided to raise capital at a massive discount.

Stamford has perpetually traded at a discount to the value of its properties, in part due to governance concerns, but also due to the aforementioned accounting treatment of hotels. Some of these hotels were purchased in the 1990's and therefore their book value significantly understates their true value. Despite initially raising capital and saying he was no longer selling the hotels, Mr Ow has begun selling some assets. This includes the Stamford Circular Quay, sold as a development site, at a price of more than $2 million per key and the Stamford Plaza Auckland, sold at a price of more than $550,000 per key. Stamford has not yet reported its financial accounts since these transactions closed. When it does, the book value will reflect the sale prices of these properties highlighting some of the company's latent value.

What the Ow family will choose to do with the money received from these sales, or whether they will sell more properties in the future remains a mystery. However, trading at a big discount to the value of the properties, with a near term revelation of value, we maintain a holding in the company.

Sheraton Saigon Hotel & Towers, Ho Chi Minh City

Keck Seng Investments Limited (SEHK:184)

Keck Seng is controlled by Ho Kian Guan, one of Singapore's 50 richest people. Keck Seng predominantly owns upscale hotels across North America and Asia – its major assets include the W Hotel San Francisco, the Sofitel New York, and the Sheraton Saigon Hotel. It also owns residential property in Macau. It has approximately zero net debt, with almost all gross debt held in the form of non-recourse mortgages tied to the US hotels.

Current earnings for these properties understate their true value due to the impact of COVID restrictions. The Sofitel New York was closed for most of 2021 and occupancy through 2022 was meaningfully below current levels. Restrictions in Macau and Vietnam have only recently been lifted and travel is still recovering to pre-covid levels. Keck Seng's hotels are held on the balance sheet at depreciated cost. These hotels were purchased more recently than those owned by Stamford; however, book value still almost certainly understated their true value. At book value, the hotels are held at less than $175,000 a key, despite being predominantly 5-star properties. Even before considering how much this undervalues the property, Keck Seng's book value is HKD$8.63 per share. This compares to a share price at period end of HKD$2.85.

Hilton Midtown, New York City

Keck Seng's governance is reasonable, with dividends regularly paid to shareholders and the share count remaining stable over time. Related parties are paid fair salaries and transactions seem sensible. Despite this, there is no reason why this discount is likely to close in the near term.

The stock is illiquid and, while it trades at one of the largest discounts in its history, it has always traded at somewhat of a discount to its fair value. Given the size of the discount and the quality of the underlying properties, Keck Seng appears to be a very attractive investment idea.

Checking Out

Hopefully, the above provides examples of the different ways the Fund is investing in hotel properties. Despite the similarities in the underlying assets held by each, they are all somewhat unique from an investment perspective. Collectively at quarter end, these four investments constituted approximately 10% of fund assets.

For the period, they added a small amount of value relative to global indices, however as described above, they still appear to be attractive investment propositions ■

CROMWELL PHOENIX
GLOBAL OPPORTUNITIES FUND

Please visit the Fund webpage for the latest performance figures

11.5%[1]
Total Returns P.A.
Since inception (December 2019)

- Diversification across multiple geographic jurisdictions
- Exposure to an area of global capital markets that has little to no broker research coverage
- Fees only paid when your investment increases in value

Past performance is not indicative of future performance.

1. As at 31 March 2023. Cromwell Funds Management Limited ABN 63 114 782 777 AFSL 333 214 (CFM) has prepared this notice and is the responsible entity of, and the issuer of units in, the Cromwell Phoenix Global Opportunities Fund ARSN 654 056 961 (Fund). In making an investment decision in relation to the Fund, it is important that you read the product disclosure statement dated 26 October 2021 (PDS) and the target market determination (TMD). The PDS and TMD are issued by CFM and are available from www.cromwell.com.au/gof or by calling Cromwell's Investor Services team on 1300 268 078. This notice has been prepared without taking into account your objectives, financial situation or needs. Before making an investment decision, you should consider the PDS and assess, with or without your financial or tax adviser, whether the Fund fits your objectives, financial situation or needs. CFM and its related bodies corporate, and their associates, do not receive any remuneration or benefits for the general advice given in this notice. If you acquire units in the Fund, CFM and certain related parties may receive fees from the Fund and these fees are disclosed in the PDS. Phoenix Portfolios Pty Ltd ABN 80 117 850 254 AFSL 300 302 (Phoenix) is the investment manager of the Fund. None of CFM, Phoenix, nor their related entities, directors or officers makes any promise or representation, or gives any guarantee as to the success of the Fund, distributions, the amount you will receive on withdrawal, your income or capital return or the tax consequences of investing.

Please note: Any investment, including an investment in the Fund, is subject to risk. If a risk eventuates, it may result in reduced distributions and/or a loss of some or all of the capital value of your investment. See the PDS for examples of key risks. Past performance is not a reliable indicator of future performance. Forward-looking statements in this notice are provided as a general guide only. Capital growth, distributions and tax consequences cannot be guaranteed. Forward-looking statements and the performance of the Fund are subject to the risks and assumptions set out in the PDS.

A GUIDE TO TAX-DEFERRED DISTRIBUTIONS

Michael McLaughlin
Head of Tax
Cromwell Property Group

Property real estate income funds can be an attractive investment for those people seeking a reliable source of regular income. Most of this income comes from rent earned on the fund's underlying properties and, as rent is usually paid monthly, a property fund is able to pay distributions monthly or quarterly, which is an advantage for an investor's personal cash flow.

At times, some of the income from property funds may include a component of "tax-deferred distributions".

Due to their complexity, however, tax-deferred distributions are rarely understood by anyone outside professional investor or tax specialist circles.

Tax-deferred distributions occur when a fund's cash distributable income is higher than its net taxable income. This difference arises due to the trust's ability to claim tax deductions for certain items – such as tax decline in value on plant and equipment; capital allowances on the building structure; interest and costs during construction or refurbishment periods; and the tax amortisation of the costs of raising equity.

In tax technical terms, tax-deferred amounts can give rise to distributions from property trusts of "other non-attributable amounts" for trusts that have elected to be Attribution Managed Investment Trusts (AMITs) and "tax deferred" components in non-AMITs – all referred to as tax-deferred distributions in this article.

Tax-deferred distributions are generally non-taxable when received by investors. Instead, these amounts are applied as a reduction to the tax cost base of the investor's investment in the property fund, which is relevant when calculating any Capital Gains Tax (CGT) liability upon disposal of the investment units or once the tax cost base has been reduced to nil. Therefore, any tax liability in relation to these amounts is 'deferred', typically until the sale or redemption of an investor's units in the fund when CGT may arise.

At its simplest, tax deferral works as follows: suppose a trust earns rental income of $100 and has building allowance deductions of $20. Then the net taxable income is $80, which is distributed to unitholders to be included in their taxable income. The remaining $20 of cash is distributed to the unitholders too, but for tax purposes it is regarded as a reduction in cost base of the units invested in the fund by the unitholder.

So long as the accumulated tax-deferred income is less than the investor's acquisition cost, the tax is generally able to be deferred. If tax-deferred amounts have reduced the cost base to zero – that is, if the investor has received total tax-deferred distributions at least equal to the original cost of the investment – then any excess must be declared as a capital gain in the year it is received.

Capital gains are distributed by a trust only when the trust sells capital assets at a tax profit. These gains are then subject to tax in the investor's hands, the same as other gains. Alternatively, investors are taxed on any capital gains, including any accumulated tax-deferred distributions, when they dispose of their units in a trust or the trust is wound up.

Benefits

An incidental benefit of tax-deferred distributions for investors is the 'deferral' of tax until a CGT event, such as when the sale of your units or the wind-up of the trust, triggers a CGT liability.

Tax-deferred distributions reduce the investor's cost base for CGT purposes, thereby increasing the CGT gain upon realisation. If the investor holds the units for more than twelve months, they may be able to significantly reduce the tax payable by applying the 50% discount for individuals, or by the one-third discount for superannuation funds.

Tax-deferred distributions may also be reinvested until such time as a CGT event occurs. The compounding benefit from reinvesting these distributions can be significant over time.

Case Study

The case study below shows the effect of tax-deferred distributions for an investor on the top marginal tax rate (assumed to be 45%). The case study compares a hypothetical $100,000 investment into an interest-paying investment earning 5% per annum with a property investment paying 5% distributions.

	Interest Investment ($100,000 initial investment)			XYZ Investment ($100,000 initial investment)			Difference
Year	**Interest**	**Tax Payable**	**Net Income**	**Distribution**	**Tax Payable**	**Net Income**	
Year 1	$5,000	$2,250	$2,750	$5,000	-	$5,000	$2,250
Year 2	$5,000	$2,250	$2,750	$5,000	-	$5,000	$2,250
Year 3	$5,000	$2,250	$2,750	$5,000	-	$5,000	$2,250
Year 4	$0	$0	$0	-	$3,375[1]	-$3,375	-$3,375
TOTAL	**$15,000**	**$6,750**	**$8,250**	**$15,000**	**$3,375**	**$11,625**	**$3,375**

As you can see, an investor on a marginal tax rate of 45% and entitled to a 50% CGT discount makes a tax saving of $3,375.

Assumptions used in the case study:

a. An individual investor invests $100,000 into XYZ Investment (for example, an unlisted property trust) in Year 1 at a cost of $1.00 per unit (XYZ Investment).

b. The XYZ Investment is redeemed in Year 4 (i.e., after three years) at a unit price of $1.00. No allowance has been made for any potential capital gain or loss from unit price increases or decreases during the period the investment is held. This would also have CGT implications.

c. Distributions from XYZ Investment are 100% tax-deferred for the full period of the investment (in order to illustrate the potential savings).

d. XYZ Investment distributes 5.0 cents per unit, per annum.

e. The investor does not have any capital losses available to offset gains.

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1. Capital gain = $100,000 capital redemption, less reduced cost base of $85,000 ($100,000 initial investment less $15,000 tax-deferred distributions = $85,000) = $15,000 capital gain. Tax payable = $15,000 x 45% x 50% = $3,375. The tax payable does not take into consideration any Medicare Levy surcharge.

IGNORE THE NOISE: AUSTRALIAN OFFICE ISN'T DEAD (OR DYING)

Colin Mackay
Research & Investment Strategy Manager
Cromwell Property Group

The future of offices in a post-pandemic world continues to be a topic of robust conversation.

Arguably, most airtime on the subject has been given to dramatic statements like "expect the death of the office" – perhaps recycling articles from the past decade that incorrectly asserted a retail apocalypse was nigh! The reality is that, as retail has adapted to the internet age – and survived – so too will office spaces adapt to these changing conditions.

It can be easy to fear the worst, especially as reports of landlords handing keys to the bank; assets sitting unoccupied; and valuations declining 80% take up the front page of newspapers.

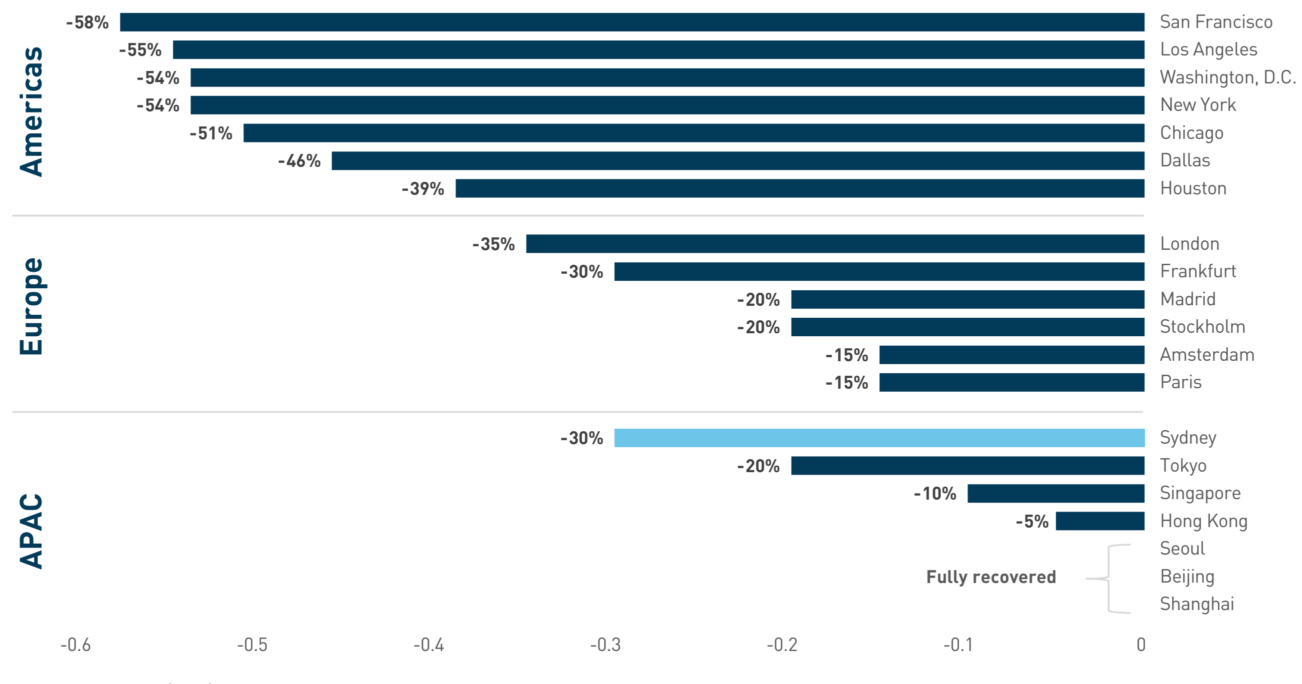
It's important, however, to understand that these events have been limited to the US, a challenged market with different financial, social, and real estate context. The outlook for office in Australia is markedly more positive for several reasons.

Higher office occupancy

The return to the office has been strongest in Asia Pacific, where office occupancy is sitting at 70-100% of pre-pandemic levels[1]. Workers in North America have been the most reluctant to come back to CBDs (45-65%), with Europe (65-85%) splitting the two regions. At the individual market level, the likes of Shanghai and Beijing are back at pre-pandemic occupancy; Sydney has recovered to 70%; London is a bit weaker at 65%; and the major US cities are significant laggards with office-based work still below half of pre-pandemic levels in Chicago (49%), New York (46%), and San Francisco (42%).

1 The Future of the Central Business District, May 2023 (JLL)

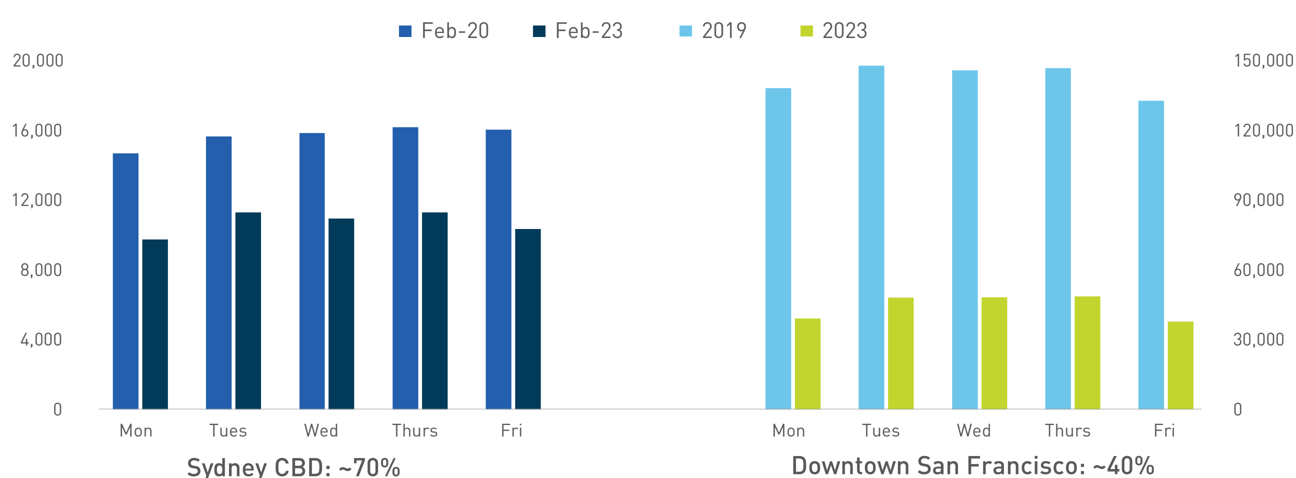
Office Usage Vs. Pre-Pandemic



Source: JLL Research (2023); Cromwell

Propensity to return to the office appears to be driven by a number of factors, including cultural expectations (e.g., Tokyo/Seoul); industry composition (e.g., finance vs tech); and ease of commute (e.g., rapid transit vs LA traffic). While commute time is highlighted by workers around the globe as the most important driver of returning to the office[2], another critical factor is the micro-location of each office building. In addition to influencing commute time, different locations can vary significantly in terms of crime and safety risks, amenity (e.g., restaurants), and environmental desirability (e.g., proximity to water/green spaces). Australia measures up very attractively on these characteristics, offering reliable rapid transit, exceptional proximity to desirable environmental features, a high density of quality amenity integrated throughout the CBDs, and very low rates of crime. The return to the office will likely gather more steam in the coming months as large employers mandate a minimum number of days in the office per week, as announced recently by NAB and CommBank. However, over the long-term, locations and assets which can attract employees through choice rather than coercion will outperform.

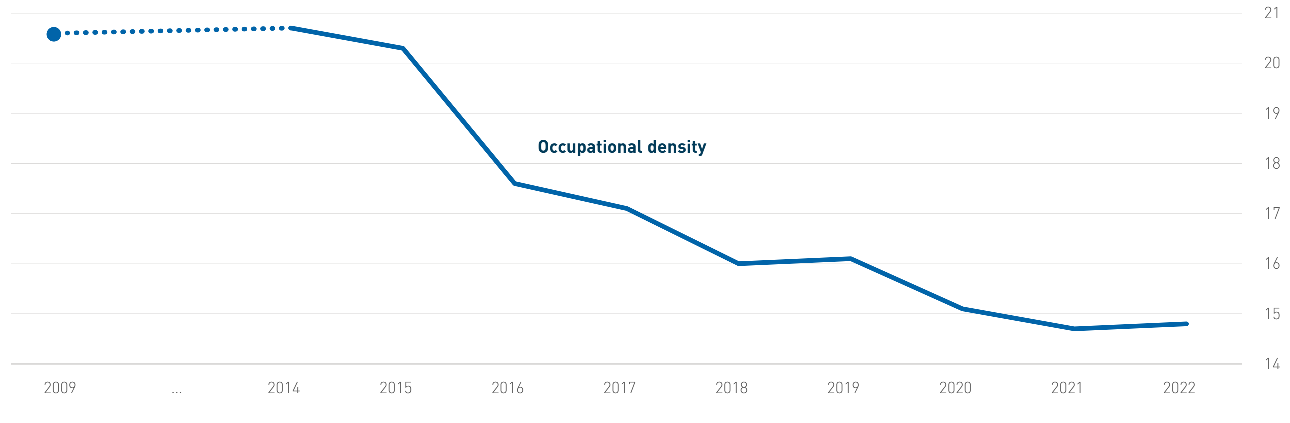
Transport ridership numbers align with industry estimates of office occupancy
Weekday Ridership vs Pre-COVID (Opal Train & BART)



Source: City and County of San Francisco; Transport for NSW; Cromwell

2 The Global Live-Work-Shop Report, November 2022 (CBRE)

While less dense than the overall market, Government data shows early signs of de-densification Australian Government Office Workpoint Density per sqm



Source: Australian Government Department of Finance; Cromwell

Expanding space requirements

One of the forces expected to offset the impact of remote work is the expansion of workspace ratios – the amount of office space per employee. Forty years ago, in the days of private offices, Australian offices had more than 20 square metres (sqm) of space per employee. Over time, as occupiers sought more "bang for their buck", desks became more tightly packed together and the corner office was sent to the scrap heap.

The result has been densification of the workplace, with the pre-COVID workspace ratio sitting at 11.1 sqm per employee for Sydney and 12.0 sqm for Melbourne[3].

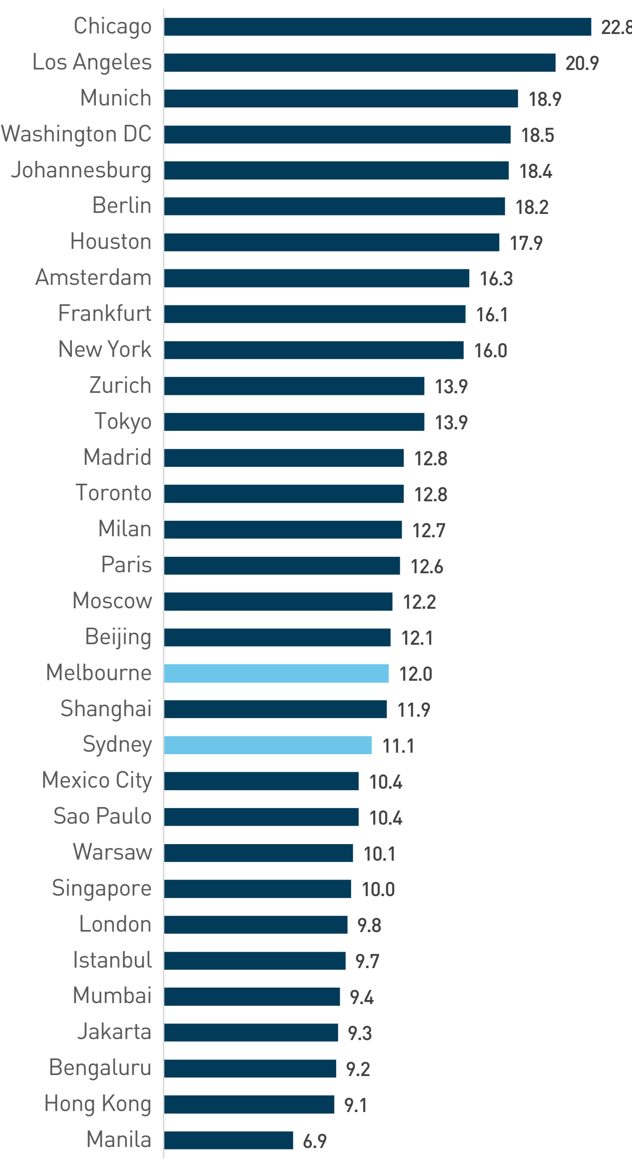
The experience of the pandemic has initiated a shift in the purpose of the workplace and workstyles. The office is increasingly becoming a place for collaboration and social connection rather than focus work, meaning a greater need for meeting, gathering, and collaboration spaces. There is also a need to lower density and make workplaces more comfortable from an employee wellbeing and retention perspective, as employers fight for top talent. Studies have shown that inadequate privacy and space is the dominant cause of workspace dissatisfaction[4].

> The office is increasingly becoming a place for collaboration and social connection

In the US, markets such as Chicago and Los Angeles have ratios above 20 sqm per employee, with even New York at 16.0 sqm[3]. The pandemic-initiated evolution of the work environment can be achieved in these markets by simply recalibrating (and even shrinking) existing footprints.

Contrast this environment with Australia, where workspace ratios are below the global average of 13.3 sqm[3] and potential space efficiencies are limited. In this market, the recalibration will likely require additional space, providing a source of demand and limiting the amount of rent-dampening excess stock.

Usable Area Per Person Pre-COVID (sqm)

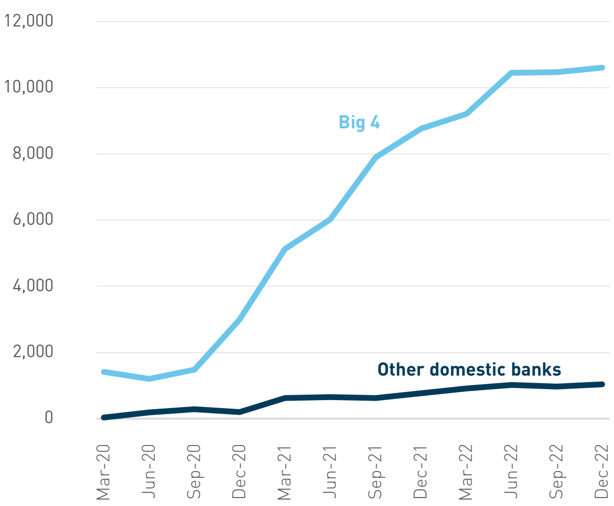


Source: JLL Global Benchmarking Services (2021); Cromwell

3 Benchmarking Cities and Real Estate, June 2021 (JLL)

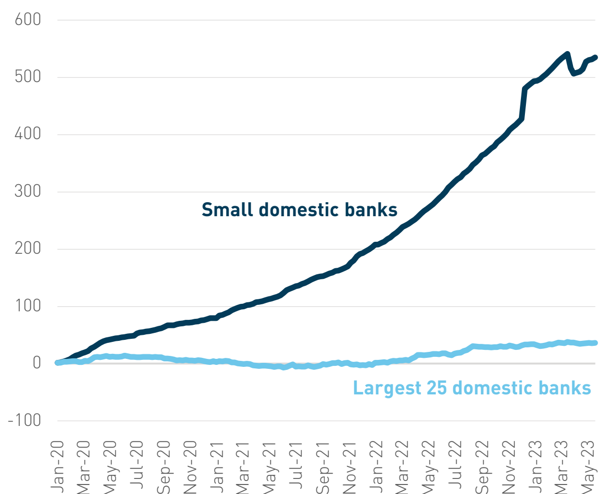
4 A data-driven analysis of occupant workspace dissatisfaction, August 2021 (Kent, Parkinson & Kim)

Australian Banks' Office Loan Exposure Change Since Dec-19 ($m)



Source: APRA (Dec-22); Cromwell

US Banks' Commercial Real Estate Loan Exposure Change Since Dec-19 ($b)



Source: Federal Reserve (May 23); Cromwell

Appropriate financing

Earlier in the year, some high-profile office defaults in the US by Brookfield, and a PIMCO-owned landlord, kicked off concerns about a real estate debt crisis. Risks are certainly elevated in the US, given the aforementioned demand challenges, which will pressure serviceability and put significant downwards pressure on valuations. While pockets of distress may emerge in Australia, the likelihood of a widespread crisis is much lower. Banks remain confident in Australian commercial real estate, increasing their exposure by 5% in December 2022 compared to a year ago[5]. Loan quality has also remained stable, with non-performing commercial property loans as a share of total exposure unchanged at 0.5%.

Most importantly, the office demand outlook in Australia is much more positive. Solid cashflow will support serviceability as debt rolls onto higher interest rates and help prevent valuations from declining to the extent that is expected in the US. Australia's lending market is also well regulated, diversified, and strong, and doesn't face the concentrated exposure or balance sheet issues that smaller regional banks in the US have been contending with throughout 2023.

Additionally, Australian gearing is more conservative with typical loan-to-value (LTV) ratios pre-pandemic of 55%, compared to 72% for the US[6]. While lending conditions have tightened somewhat over the last six months (LTVs now 50%), the US has seen significant tightening (to 57%), contributing to a significant funding gap which will need to be plugged with discount-seeking capital.

5 Quarterly authorised deposit-taking institution property exposures, December 2022 (APRA)

6 Analysing the Funding Gap: Asia Pacific, May 2023 (JLL)

The final word

Office is going through a period of change, and assets need to evolve to meet the needs of post-pandemic workstyles. While there will be challenges – and opportunities – as a result, the current narrative erroneously extrapolates issues from offshore to the domestic market.

Australian office is well-placed to contend with increased rates of remote working and tighter capital markets given its resilient demand drivers, quality of stock, and sensible financing arrangements. Skilled managers with the expertise to identify underappreciated assets and adapt them to the future of work will continue to deliver strong investment returns. ■

MANAGING RISING INTEREST RATES IN THE PROPERTY MARKET

Stuart Cartledge
Managing Director
Phoenix Portfolios

Interest rates and property

In almost every market update or investor discussion, Phoenix Portfolios reminds investors that property is an interest rate sensitive sector. If interest rates decline, the value of property should go up – all else being equal. The opposite is also true, as has been proven recently: when interest rates go up, property prices are likely to decline.

This concept is simple, but its impact is not necessarily spread evenly across different types of property. Below, we cover the impact of changing interest rates on various types of property and highlight some of the ways our investment process for the Cromwell Phoenix Property Securities Fund responds to a changing environment.

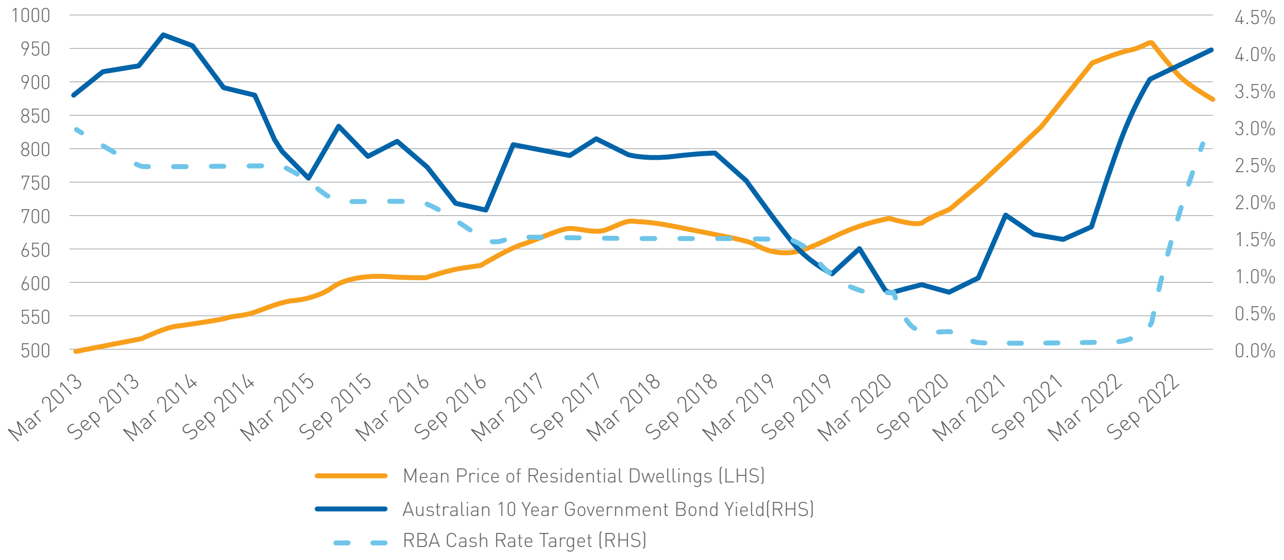
Residential Property

Owning a home is seemingly the goal of almost every Australian. It is ingrained in Australian culture that one should strive to own a home; after all, it is the Australian Dream! A common refrain is "house prices always go up". This has seemingly been true in most Australian capital cities, but the housing market is, as the name suggests, a market. Prices in a market are determined by demand and supply. This is also true for houses.

Before discussing the demand side of the equation, let's briefly touch on supply. Many cities across Australia have notoriously challenging property planning regimes. Any proposal to develop new residential housing, or densify existing housing, tends to be faced with local opposition, combined with long and costly planning processes. An example can be seen in one of the portfolio's holdings, Mirvac Group (MGR), which bought an old hotel in Brunswick, in Melbourne's Inner North in 2021. Plans to knock down the hotel to build more than 150 apartments are still going through a planning process. At best, these apartments will be delivered in 2026, although delays are likely. Since 2011, the number of residential dwellings in Australia has grown at 1.7% per annum[1], with much of that growth taking place on the outskirts of existing capital cities.

Demand for housing is insatiable. Australia's population has roughly grown in line with new dwellings, and the amount of people living in each dwelling has been consistently decreasing. In a world where supply is limited, what stops prices going up infinitely? The answer is, of course, people's capacity to pay. The vast majority of home buyers make use of a mortgage to buy their homes, and so the amount that they can afford to borrow will be very closely linked to how much they are willing to pay for a house. In this context, the impact of changing interest rates should be obvious.

To illustrate this point. The Reserve Bank of Australia's Target Cash Rate (Cash Rate) has moved from 0.1% to 4.1%. The monthly repayments on a $900,000 mortgage today are equivalent to the monthly repayments on a $1,420,458 mortgage when the Cash Rate was 0.1%. The change in house prices will naturally (inversely) follow changes in interest over time, albeit with somewhat of a lag. This can be seen in the chart below. Note how home prices accelerated when interest rates were at record lows.



1 Source: Australian Bureau of Statistics

Commercial Property

Shopping centres, office buildings, industrial properties, and other commercial property types may have bigger price tags than your average three-bedroom home; however, many of the same dynamics are at play. Like residential property, most commercial property purchases are partly funded with debt. Unlike residential property, where mortgages can commonly comprise 90% of the value of the property, listed commercial property owners in Australia typically employ gearing levels of approximately 30%. Unlike many owner occupiers, commercial property investors require a financial return on their capital. In most cases, this means that debt must be "accretive" to the owner. Put more simply, the cash flow yield of the property should be greater than the interest rate on debt[2]. A natural relationship that comes from this is that as interest rates increase, the income yield owners require also rises. Assuming the amount of income is stable, this means that the value of the property must go down.

Again, much like residential property, market prices for commercial property are determined by supply and demand. The factors playing into demand are however different to residential markets. Many commercial property investors can, and do, invest across many asset classes. As a collective, their goal is to earn the best return they can in the least risky way possible. To invest in a riskier asset type they naturally require a higher return. An abbreviated list of asset classes and their risk levels can be seen below.

When interest rates increase, so does the income that investors can earn from investing in cash, government bonds, and corporate debt. That makes these options relatively more attractive. When this happens, the demand for property (at the same price as before rates increased) decreases. The return required from property then increases in order to make those returns relatively more competitive with lower risk alternatives.

Asset Class	Risk level
Cash	Very low
Government Bonds	Low
Corporate Debt	Low to Moderate
Property and Infrastructure	Moderate to High
Shares	High

How Cromwell Phoenix Property Securities Fund manages the impact of rising interest rates

So, with all the negative impacts of rising interest rates, does this mean investing in listed property is doomed? We do not believe so, and we have been managing the portfolio for the current environment. Some ways we can adjust to investing in this environment include:

Buying securities at large discounts

The stock market is forward looking and the market prices changes in interest rates on a daily (even moment-by-moment) basis. In some cases, the market can overreact, leaving great buying opportunities. One such example we have discussed in the past is GPT Group, which ended the quarter trading at a discount of almost 30% to its net tangible asset backing.

Buying higher returning assets

Higher yielding assets are less affected by interest rates than their low yielding counterparts. For example, a 0.5% increase in capitalisation rate for an asset previously trading at 4%, represents a greater than 11% decline in value, while a similar move for an asset with a 7.5% capitalisation rate equates to only a 6.3% decline. Phoenix has invested in GDI Property Group, which owns higher capitalisation rate assets such as offices in Perth. The properties have the added benefit of being valued below their replacement cost, further adding to their relative attractiveness.

Buying assets with higher growth outlooks

When interest rates were at record lows, assets with high levels of growth were priced for perfection. This has moderated in recent times. Industrial property rents are growing at record levels, up 20% year-on-year in some domestic markets (and more than 50% in some foreign markets). In fast moving markets these assets may look optically expensive based on this year's income yield, however are attractive if one looks forward. Phoenix has increased its stake to industrial property, taking meaningful positions in Goodman Group and Centuria Industrial REIT.

Once more it is worth reiterating that property is an interest rate sensitive sector. When we inevitably say this again in the future, hopefully the information above is useful in explaining what we mean. We are however very cognisant of the impact of interest rates along with many other extraneous factors. We will always strive to buy attractively valued securities and are constantly assessing assumptions and adjusting the portfolio to achieve this goal. ■

2 This is true in most cases, however many consider accretion to "total return", which includes capital growth as well as income.

IN CONVERSATION WITH... LARA YOUNG

GROUP HEAD OF ESG, CROMWELL PROPERTY GROUP

Lara Young joined Cromwell in January 2023. Lara recently became a fellow of Institute of Environmental Management and Assessment and has been a chartered Environmentalist since 2020. She was named Young Person of the Year by the Construction Leadership Council (CLC) in 2022, and Energy and Carbon Leader of the Year at the 2021 edie Awards – the United Kingdom's industry leading sustainability awards –and since 2021 has been the Chair of the Carbon Champion Review Panel, which is convened by the Institution of Civil Engineers (ICE).

Can you walk us through your role at Cromwell, Lara? What are some of the key responsibilities you take on daily?

As it is for many other people, I find that no two days are alike in my role. My key responsibility is to ensure the delivery of the ESG ambitions and commitments that Cromwell has set out while continually building on this ambition. That entails working closely with every facet of the business, and our value chain, to fully integrate ESG into everything we do.

I am committed to ensuring that we aren't just talking ESG, but delivering tangible action to drive sustained positive change. To achieve this, we need everyone to fully understand what ESG means in their world. As such, part of my role is helping to translate what ESG is and what it looks like in different areas of the business.

We don't need everyone to be an ESG expert; however, we do need everyone to fully appreciate, and deliver on their part, to ensure Cromwell is an environmentally and socially sustainable business. Another important facet of my role, with the help of my team, is to make sure these initiatives happen at pace - and that we provide guidance, direction, and support whenever and wherever needed.

Looking back, how did your career in ESG and sustainability begin – where did your interest originate?

As cheesy as it sounds, I've always wanted to make a difference. I didn't always know exactly how or in what field, but I've always known that I wanted to help make a positive change on the biggest scale possible.

After completing a Bachelor degree in Biology in Southwest France, I realised that the biggest impact I could have would be to help drive positive change within corporate organisations, and thus went on to complete an MBA specialised in sustainable development and environmental management at La Rochelle International Business School. Following my studies, I led a variety of sustainability and ESG roles, always in the most carbon intensive industries, with the aim to achieve my ambition of helping make a difference on the biggest scale possible.

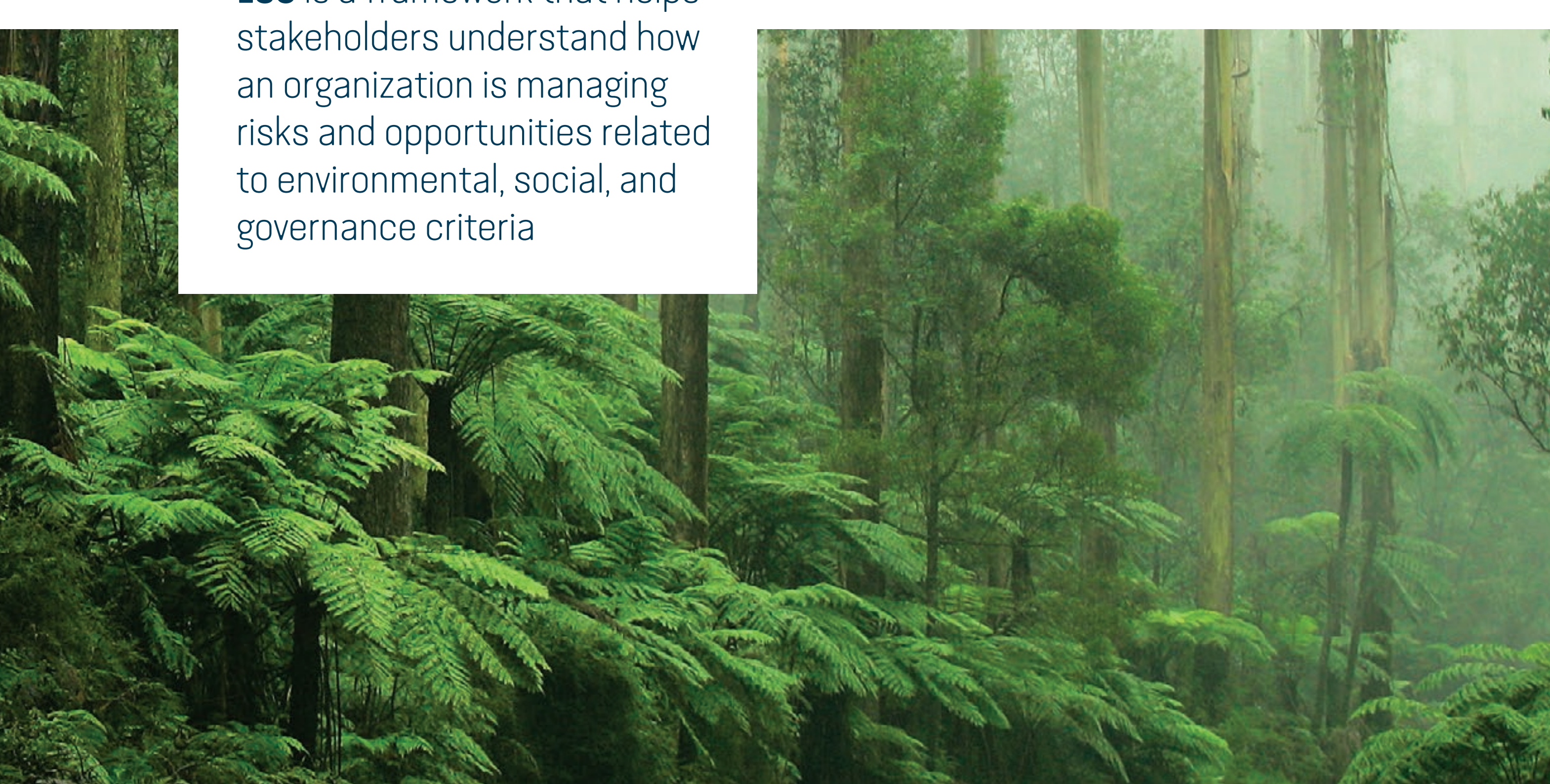
In the last decade, particularly, there has been an increasing emphasis on sustainability within the property sector. How does Cromwell intend to manage the expectations of investors, tenants, and staff regarding ESG now; and what does the future hold for Cromwell regarding ESG?

Indeed, the pace of change and maturity regarding sustainability and what it is (and isn't) has grown exponentially, and I anticipate this will only continue. I expect the breadth of topics will also continue to expand.

For example, some in the industry can still be somewhat biased, and/or have tunnel vision, solely focusing on greenhouse gas emissions and achieving net zero; however, while reducing emissions is crucial, this cannot be at the expense of biodiversity, social value, or natural capital. These topics are all interlinked, and we cannot be successful by focusing on each in isolation. While the industry needs to remain pragmatic, we also need to balance this with a wholistic systems view.

In the spirit of ensuring we aren't just talking about ESG but delivering tangible action, Cromwell is always actively

ESG is a framework that helps stakeholders understand how an organization is managing risks and opportunities related to environmental, social, and governance criteria



looking to implement circular and sustainable practices, in addition to constantly seeking opportunities to reduce emissions at scale and at source. Cromwell Property Group has committed to achieve net zero for its entire portfolio for Scope 1, 2 and 3, including tenant emissions and embodied carbon, by 2045 and net zero operational control by 2035.

As a fund manager, a significant proportion of our emissions fall into to our Scope 3 footprint.

> “Cromwell is always actively looking to implement circular and sustainable practices, in addition to constantly seeking opportunities to reduce emissions at scale and at source

Additionally, the business has committed to continuously positively contribute to the communities it operates in and support tenants with their evolving needs. Cromwell has set targets to improve tenant-customer satisfaction to a minimum score of 80% and achieve and maintain an employee engagement score of 80% or higher across the business by 2030.

In terms of what the future holds for Cromwell, the Group recognises the industry challenges relating to environmental, social, or governance topics. While it's not the easy option, the Group is not shying away from these challenges. As an example, despite the challenges many in the industry face around data quality and availability for Scope 3 emissions, we recognise that this emission scope represents a significant part of the Group's footprint. We are therefore proactively engaging clients and tenants to obtain Scope 3 data via the roll out of our green lease initiative. We have already achieved 24% roll-out of green leases across our CEREIT portfolio since this initiative was launched. And it's not just about data collation, Cromwell is proactively engaging its value chain partners about volunteering opportunities within the local community often supporting them with their own ESG agendas.

What are some changes or shifting attitudes/trends/practices that you currently see playing out in the corporate ESG space?

Several come to mind. The corporate ESG space has suffered from a constant flow of buzz words, jargon, and acronyms that have led the topic to be inaccessible, overwhelming, and confusing for many. While understanding the nuances of the many definitions is important, there has been a significant effort to simplify and harmonise language and approaches.

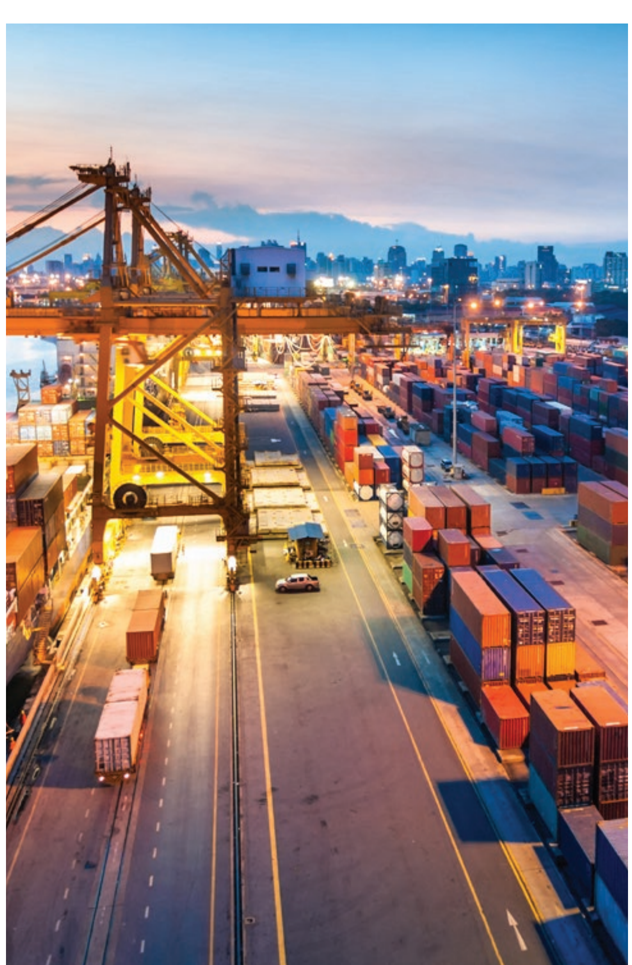
There is still some way to go in this regard; however, through this effort, we have seen the ESG agenda seep into disciplines that historically it was omitted from.

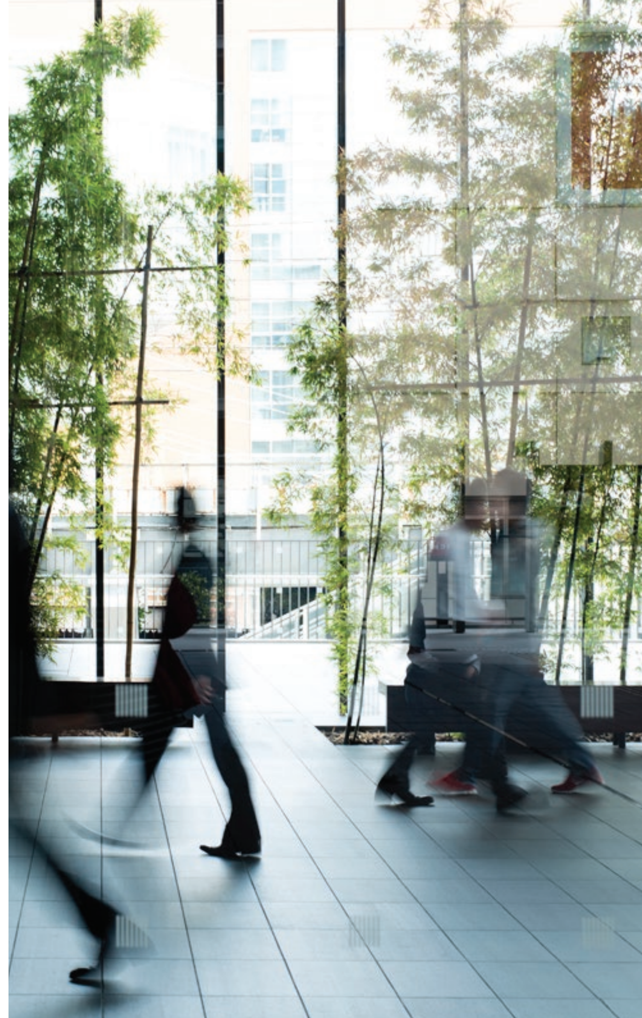
This simplification effort has provided greater awareness about ESG across the general public, organisations, and governments which, in turn, adds to the increasing pressure for all to demonstrable evidence the tangible actions and ESG results they are and have delivered so far.

With this growing maturity – and understanding as to what is credible and what is greenwashing – I expect we will soon see greater accountability and assurance from regulators and policy makers on corporate ESG commitments made. This will result in raising the industry norms and standards, positive recognition for those that have delivered on their commitments and litigation and penalties for those that are unable to provide quantifiable and robust results of the ESG benefits delivered.

What opportunities regarding ESG excite you, and how do you think Cromwell's strategy overall could be developed moving forward?

I'm excited about the opportunity to deliver tangible positive change at scale, and not just at Cromwell but in collaboration across the industry with our value chain. Nearly every actor in the industry is faced with the same challenges, and I'm a great advocate of not reinventing the wheel, but rather ensuring that we support and learn from each other. No single organisation can achieve this agenda alone and the opportunity to collaborate at such scale and with so many other disciplines is hugely exciting.





Cromwell's ESG agenda is a long-term plan that will have to evolve as the ESG agenda matures over the years to come. There is no perfect plan; however, our approach to ensure we recognise, adapt and deliver as the ESG agenda evolves which will ensure Cromwell's strategy remains aligned to the industry needs.

What do you enjoy most about your role?

There are many things I enjoy about my role, but the people I get to meet, engage, and work with is the aspect I enjoy most. Successfully delivering and bringing to life an ESG strategy is a huge team effort that no one person can deliver alone. Thanks to the diversity of my role and the fact that ESG impacts every facet of the organisation and wider industry, I am fortunate to meet many brilliant and inspiring individuals from who I learn a great deal. ■

DIRECT PROPERTY UPDATE

MARCH 2023 QUARTER

Peta Tilse
Head of Retail Funds
Cromwell Funds Management

Inflation and interest rates were pushed from the front page in March, as the emergence of a US-led banking crisis took centre stage. A month later, the damage appears to have been largely contained to a few US regional banks and Credit Suisse. However, some financial stability risks remain ¬– and banks are expected to adopt a more cautious approach to lending, which could be a headwind for economic growth. In a positive for domestic investors, however, Australian banks are some of the strongest and most resilient in the world and remain on healthy footing.

As banking concerns subsided, attention returned to the outlook for economic growth, inflation, and whether central banks can deliver a "soft landing". In April, the IMF slightly lowered its global growth forecasts for 2023 and 2024 by 0.1%, to 2.8% and 3.0%, respectively. Inverted yield curves (where short-term interest rates are higher than longer term rates) signal an increased risk of recession in the US, with the UK and Eurozone economies also forecast to contract in 2023[1].

Australia's outlook is more positive, with the domestic economy's expansion forecast to continue by 1.0% over 2023[1]. The labour market continues to be a bright spot, with employment rising by 53,000 in March and unemployment remaining unchanged (and very low) at 3.5%[2]. Exports have also been solid, aided by improvements in the Australia-China trade relationship, with coal exports resuming in the year's first quarter and tariffs on other products purportedly being reviewed. Significantly, travel restrictions on Chinese students and tourists have been removed, with the increase in student visitors exacerbating Australia's accommodation undersupply woes.

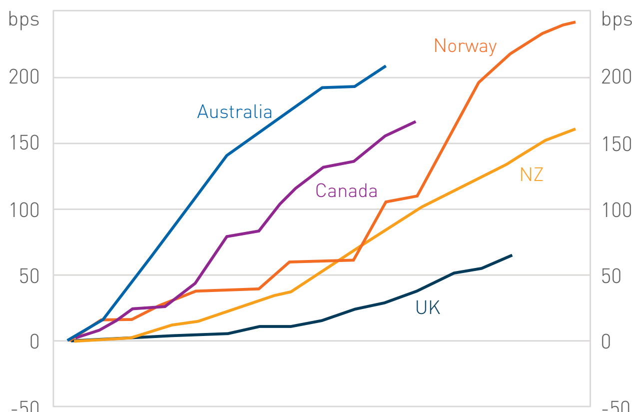
Balanced against these positives is the weakness in the household sector. Retail sales growth slowed to 0.2%[2] in February and broader household consumption is running well below trend. Sharply rising mortgage repayments have been the main pressure point, leading to a decline in real disposable incomes. While excess savings that families have built up over the pandemic may have provided a buffer so far, the RBA expects around 15% of households with a variable-rate mortgage will have negative cash flow – i.e., not be able to cover mortgage payments and essential

1. Capital Economics
2. ABS

Unemployment Rate

Source: ABS; Cromwell

Changes in Outstanding Mortgage Rates*



* Data for Canada and NZ to January, remainder to February.
** Cumulative basis point increase in the average outstanding mortgage rate relative to the month immediately preceding first policy rate increase since the onset of the pandemic.

Sources: APRA; central banks; RBA

living expenses – by year end. This cash flow pressure, plus pessimistic consumer sentiment, suggests household spending will remain soft over 2023 and below trend.

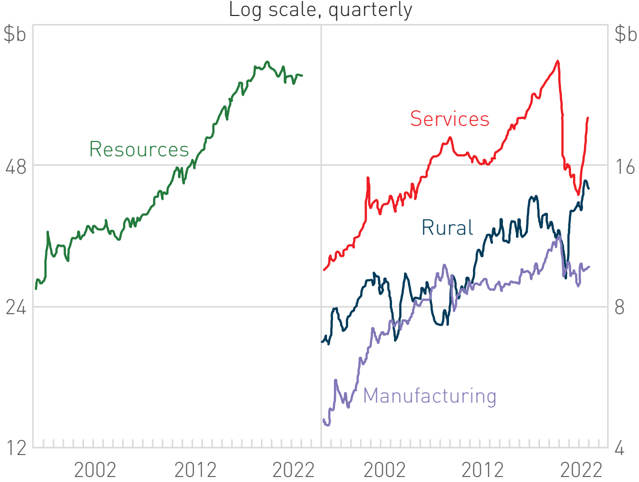
> Strong demand conditions and very tight vacancy continued to benefit industrial, which recorded double-digit rental growth

Like other central banks around the world, the RBA is expected to be nearing the end of its hiking cycle. The April pause was broadly welcomed; however, as a result of CPI rising 1.4% for the March quarter – and CPI rising 7.0%. over the twelve months to the March 2023 quarter – the RBA has made the decision to raise interest rates once more in May. Whether more hikes are needed in this cycle will ultimately depend on the trajectory inflation takes. The tight jobs market threatens to push wages higher, but the first quarter's surge of immigration should ease some pressure – though it will worsen the housing shortage and rental inflation. Cromwell's inflation forecast for 2023 is 6.2%.

Turning to real estate, demand fundamentals held up over the quarter across all the core sectors. Office recorded positive net absorption, led by Brisbane and Perth. Vacancy increased slightly as new supply reached completion but rents still grew across most markets. Strong demand conditions and very tight vacancy continued to benefit industrial, which recorded double-digit rental growth. In retail, vacancy improved across all centre types, with convenience retail outperforming discretionary shopping centres in terms of rental growth.

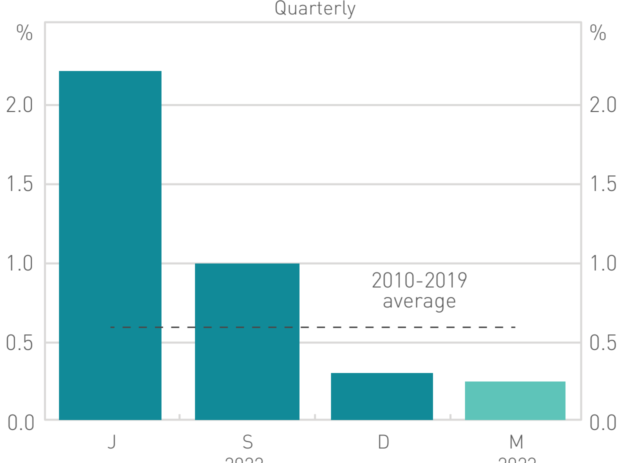
Transaction volumes were muted over the quarter, but with inflation moderating and interest rates expected to stabilise

Export Volumes



Source: ABS; RBA

Household Consumption Growth*



*March quarter 2023 is an estimate based on partial data received to date.

Source: ABS; RBA

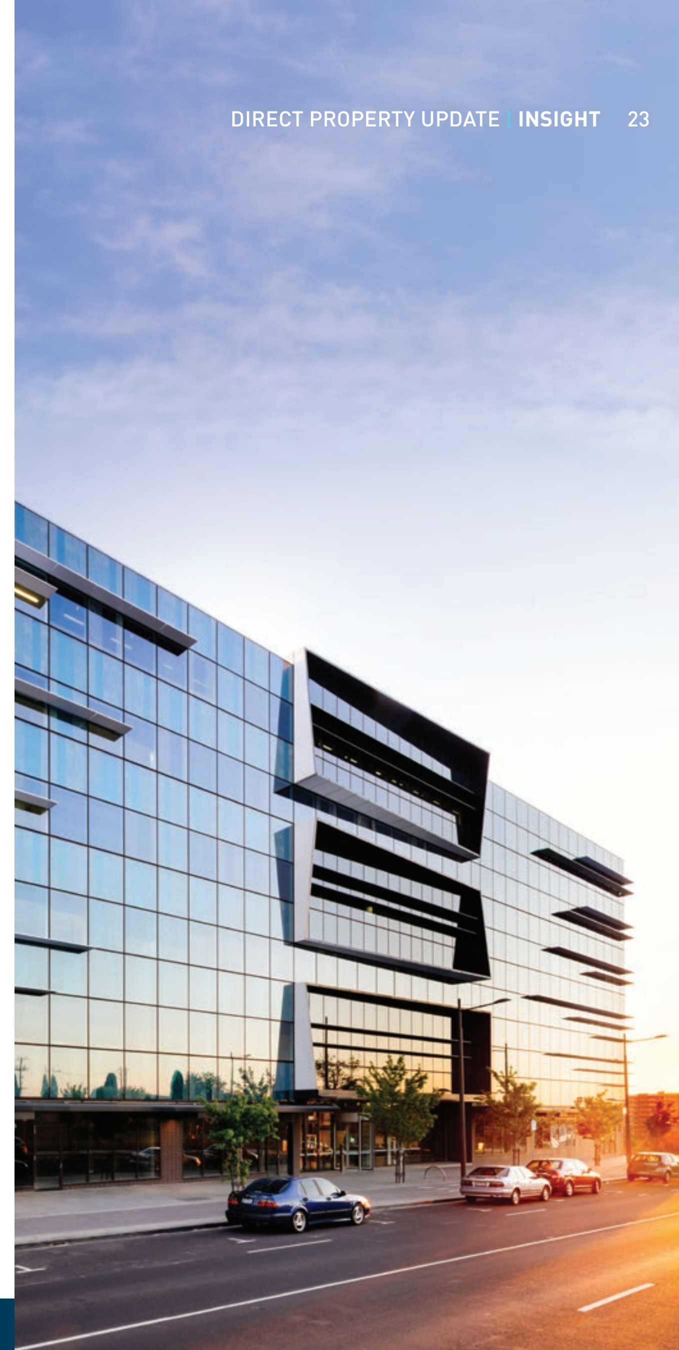
in the coming months, liquidity should improve and asset prices should find greater stability over the course of 2023. While listed markets suggest assets face sizeable devaluations, REITs typically experience bigger swings (both up and down) than what happens on the ground. An expansion of cap rates is expected, but income growth may limit the impact to asset valuations.

Outlook

The Australian economy remains in a solid position, despite global headwinds. Inflation is showing signs of slowing, employment is solid, and population growth will provide support to demand over the course of the year. The rate hiking cycle is nearing its end, and financial stability has been maintained despite ructions in the US and Europe.

These factors put the Australian commercial property market in good stead. Businesses continue to adjust size requirements for occupancy as hybrid working continues across industries, although in certain markets this is now largely known. Experiential workplaces with clever refurbishments and amenity continue to attract and retain quality tenants; something Cromwell continues to see within our assets. Capital continues to view Australia as a favourable investment destination, given its attractive demographic profile, growth prospects, and relative social and political stability.

Powerful megatrends – such as the need for more sustainable, energy efficient real estate and rising demand for segments serving the modern economy (such as urban logistics, data centres and highly amenitised offices) - will create income growth opportunities. ■



How did Cromwell Funds Management fare in the first quarter?

The Cromwell Direct Property Fund (DPF) had no major transactions this quarter and no valuation updates.

The DPF came 3rd among 64 Australian property funds vying for the NABERS 2023 Sustainable Portfolio Index. The Cromwell Group's Diversified Property Trust came an equally respectable 4th place.

It speaks to Cromwell's expertise in the all-important ESG space to have a fund with 7 properties of varying ages (including Creek St Brisbane completed in 1977 and Queen St Brisbane 1982) compete so strongly against assets that have been completed within the last 10 years (the winner Barangaroo completed in 2016 and runner up Parramatta Square in 2022).

This is a testament to our hard-working Property Team, which constantly monitor and manage our assets from the ground up, optimising operational efficiencies as well as providing superior tenant experience.

The Fund continues to distribute 6.75 cents per unit p.a., or 5.29% (payable monthly), and has generated annualised total returns since inception of 8.65% p.a. The Cromwell Direct Property Fund continues to demonstrate excellent risk adjusted returns for investor portfolios.

PERFORMANCE (%) P.A.

As At 31 March 2023

	Australian			
Year	Cash	Bonds	Shares	Cromwell Direct Property Fund
1	2.04%	0.35%	(0.57%)	**0.13%**
3	0.73%	(2.37%)	16.59%	**5.95%**
5	1.08%	1.27%	8.64%	**6.44%**

LISTED MARKET UPDATE

MARCH 2023 QUARTER

Stuart Cartledge
Managing Director
Phoenix Portfolios

The S&P/ASX 300 A-REIT Accumulation Index moved marginally higher in the first quarter of the year, rising 0.3%. This performance can be seen as relatively muted considering 10 Year Australian Government bond yield dropped 0.5% over the quarter. The broader equity market outperformed property, with the S&P/ASX 300 Accumulation Index adding 3.3%. In February, most companies under coverage reported their half yearly earnings to 31 December 2022.

Valuations were broadly flat across the sector, although the tone was more cautious looking forward. A feature of discussions surrounded the impact of rising interest rates on future earnings and property valuations. Interest rate relief towards the end of the quarter should support earnings and limit downward revisions to valuations.

REITs with exposure to office markets were underperformers in the quarter. Amongst an environment of concern over the future use of office spaces, vacancy and incentives in key markets have remained stubbornly elevated, leading some to have concerns surrounding the sustainability of cash flows coming from office building ownership.

Many listed office owners argue that there will be a bifurcation, by which higher quality offices will endure and lower quality buildings will face a challenging future. Time will tell if this is correct. For the quarter, Cromwell Property Group (CMW) lost 15.1%, while Mirvac Group (MGR) dropped 2.3% and Dexus was off 3.1%. Charter Hall Group's (CHC) earnings are particularly leveraged to office markets, given its franchise in office funds management. Its share price fell 8.2% during the quarter.

The drop in bond yields and short term interest rate expectations was supportive of residential property developers during the period. Stockland (SGP) is the largest residential land developer in the country and as such rose 9.6% during the quarter. SGP's management had previously suggested they would slow down land accumulation in a weakening market. At its half yearly report, the tone changed, with a goal to add to its land bank, supported by a new joint venture with Japanese real estate developer Mitsubishi Estates.

Smaller capitalisation residential developers AV Jennings Limited (AVJ) and Peet Limited (PPC) also outperformed, gaining 4.0% and 3.1% respectively. Owners of large shopping centres reported resilient financial results to 31 December, with specialty sales and rental outcomes broadly above expectations. Vicinity Centres (VCX) upgraded its full year earnings guidance, supported by almost flat re-leasing spreads, improving from -6.8% at the same time a year ago. VCX finished the quarter up 0.1%. Scentre Group (SCG) released earnings guidance for calendar year 2023, which

was higher than expectations. It finished the quarter down 1.6% with some fearing a weaker economy moving forward.

> Valuations were broadly flat across the sector, although the tone was more cautious looking forward

Offshore, Unibail-Rodamco-Westfield (URW) outperformed on the back of results that are best summarised as less bad than expected. For the quarter it rose 3.6%. Industrial property owners faced a mixed period. In terms of property valuations, capitalisation rates increased sharply, however valuations were mostly slightly higher, supported by an acceleration in market rents around the nation's industrial leasing markets. Industrial fund manager Goodman Group (GMG) led the way, adding 8.2%, while Growthpoint Properties Australia (GOZ) lifted 2.0% and Centuria Industrial REIT (CIP) gave up 2.6%.

Market Outlook

February's reporting season showed a property sector that was mostly performing solidly from an operational perspective. Increased interest rates are however unmistakably a drag to earnings, given the use of debt across real estate investment trusts. Current gearing levels are however very manageable. Property valuations to 31 December 2022 mostly showed slightly negative revaluations.

The industrial sub-sector continues to be the most sought after, given the tailwinds of e-commerce growth, the potential onshoring of key manufacturing categories and the decision by many corporates to build some redundancy into supply chains to cope with current disruptions. All of these factors will support ongoing demand for industrial space, which is evident by rapidly accelerating market rents for properties.

The jury is still out on exactly how tenants will use office space moving forward, but demand for good quality well located space remains. Transactional activity of office assets continues to provide some evidence of value, but transaction volumes have recently reduced. Incentives on new leases do remain elevated and some vacancy in the market is becoming apparent.

We remain cognisant of the structural changes occurring in the retail sector with the growing penetration of online sales and the greater importance of experiential offering inside malls. Recent performance of shopping centre owners has however been strong, with consumers showing resilience. It is interesting to note the juxtaposition of very high retail sales figures despite very low levels of consumer confidence, no doubt impacted by rising costs of living.

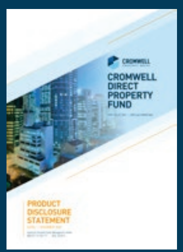
The recent increase in bond yields does present a headwind for all financial assets, and particularly yield based sectors such as property. However, with key large capitalisation REITs now trading at a significant discount to the value of their underlying assets and with no value ascribed to embedded active businesses, we believe the sector offers value, particularly in comparison to unlisted property.

Phoenix has for some time discussed the risk of inflation, given the enormous fiscal stimulus and extreme monetary policy setting that we have lived through. In recent times, commentators and bond markets have begun to react to the presence of such a risk. In this environment, long leases with fixed rent bumps, which were previously in high demand, may become relatively less attractive. Historically, real assets such as property and infrastructure have performed well during inflationary periods.

QUARTERLY **FUND REPORTS**

Investment Report to 31 March 2023

OPEN FOR INVESTMENT



CROMWELL DIRECT PROPERTY FUND

CROMWELL PHOENIX PROPERTY SECURITIES FUND

CROMWELL PHOENIX GLOBAL OPPORTUNITIES FUND

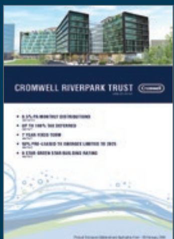
27 Cromwell Direct Property Fund
ARSN 165 011 905

28 Cromwell Phoenix Property Securities Fund
ARSN 129 580 267

29 Cromwell Phoenix Global Opportunities Fund
ARSN 654 056 961

CLOSED TO INVESTMENT

The closed property trusts below are only accessible via investment in the Cromwell Direct Property Fund



CROMWELL RIVERPARK TRUST

CROMWELL PROPERTY TRUST 12

CROMWELL PHOENIX OPPORTUNITIES FUND (CLOSED)

30 Cromwell Phoenix Opportunities Fund
ARSN 602 776 536

31 Cromwell Riverpark Trust
ARSN 135 002 336

32 Cromwell Property Trust 12
ARSN 166 216 995

Any investment, including an investment in Cromwell-managed Funds, is subject to risk. If a risk eventuates, it may result in reduced distributions and/or a loss of some or all of the capital value of your investment. See the disclosure document issued for the Fund for examples of key risks. Capital growth, distributions and tax consequences cannot be guaranteed.

Cromwell Funds Management Limited ABN 63 114 782 777 AFSL 333214 (CFM) has prepared these reports and is the responsible entity of, and the issuer of units in, the funds and trusts referred to in these reports (the Funds). In making an investment decision in relation to a Fund, it is important that you read the disclosure document for that Fund. The report for each Fund refers to the disclosure document (product disclosure statement and any supplementary product disclosure statement) and if applicable the target market determination (TMD) issued for that Fund. The disclosure document and TMD for each Fund is issued by CFM and is available from www.cromwell.com.au or by calling Cromwell's Investor Services Team on 1300 268 078. Not all of the Funds are open for investment. Applications for units in open Funds can only be made on application forms accompanying the disclosure document for the Fund.

These reports have been prepared without taking into account your objectives, financial situation or needs. Before making an investment decision, you should consider the report and the disclosure document for the particular Fund and assess, with or without your financial or tax adviser, whether the Fund fits your objectives, financial situation or needs. Past performance is not a reliable indicator of future performance. Forward-looking statements (provided here as a general guide only) and the performance of a Fund are subject to the risks and assumptions set out in its disclosure document. CFM and its related bodies corporate, and their associates, do not receive any remuneration or benefits for the general advice given in these reports. If you acquire units in a Fund, CFM and certain related parties may receive fees from the Fund and these fees are disclosed in the disclosure document for that Fund. Performance data for Cromwell-managed Funds are calculated based on unit prices for each Fund, which may differ from underlying net asset values. Performance data for periods longer than one year have been annualised. Distribution rates and yields are based on the 31 March 2023 unit price and are subject to change. The proportion of distributions that are tax deferred will depend on a number of factors (for example, building amortisation and depreciation of plant and equipment) and may vary from year to year. Deferred tax may be payable, in whole or in part, on the sale, transfer or redemption of units in the Fund.

OPEN FOR INVESTMENT

CROMWELL DIRECT PROPERTY FUND

Investment Report to 31 March 2023

The Fund's investment portfolio provides exposure to unlisted, direct property throughout Australia. The Fund aims to provide a monthly tax-advantaged income stream and future capital growth potential.

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/dpf

KEY STATISTICS

as at 31 March 2023

Status	**OPEN**[1]
Unit Price	**$1.2646**[2]
Distribution Yield	**5.3% p.a.**[3]
WALE	**4.5 years**[4]

PERFORMANCE

	1 Year	3 Years	5 Years	Inception (Aug-13)
Fund Performance After fees & costs	0.1%	6.0%	6.4%	8.7%
Benchmark PCA / MSCI Australia Unlisted Retail Quarterly Property Fund Index (Unfrozen)	5.4%	12.1%	12.7%	16.7%
Excess Returns After fees & costs	(5.2%)	(6.1%)	(6.2%)	(8.1%)

Past performance is not a reliable indicator of future performance.

FUND UPDATE

- The Fund had no major transactions or valuation updates this quarter.
- In March, CFM finalised additional interest rate hedging on 10% of the Fund's outstanding debt. The Fund's interest rate hedging is now at 50% of total drawn debt facilities.
- The Fund's look-through gearing at 31 March 2023 remained mostly the same at 38.7%, with direct gearing of 36.3%.
- 100 Creek St, Brisbane had a positive quarter with Heads of Agreement signed on three spec fitouts (completed in November 2022). Tenants are expected to take occupancy early FY24.
- The NABERS 2023 Sustainable Portfolio Index was released this quarter with the Fund coming 3rd amongst 64 major Australian property funds of differing size, scale, and age. This is an incredible achievement given the age of buildings referenced by the first and second place getters (being less than 10 years old), compared with DPF's portfolio including buildings completed in 1977 and 1982. The accolade highlights the quality work the Cromwell property team do in optimising the Fund assets. The Fund's performance to 31 March 2023 was 8.7% per annum annualised since inception with 12-month performance of 0.1%.

In addition to the footnotes below, please read the important disclaimer at the beginning of the Quarterly Reports section on page 26.

1. Withdrawals are limited, cannot be guaranteed and are subject to the assumptions and risks set out in the Product Disclosure Statement dated 17 November 2020 (PDS).
2. Unit prices are calculated daily. See the PDS for further information and www.cromwell.com.au/dpf for latest pricing.
3. Based on current distributions of 6.75 cents per unit p.a. and a current unit price of $1.2646 as at 31 March 2023.
4. Figures as at 31 March 2023. Calculated on a 'look-through' gross passing income basis.

See **www.cromwell.com.au/dpf** for further information.

OPEN FOR INVESTMENT

CROMWELL PHOENIX PROPERTY SECURITIES FUND

Investment Report to 31 March 2023

The Fund is one of the top performing property securities funds in Australia, with underlying investments chosen by Phoenix Portfolios using a 'best ideas' approach.

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/psf

KEY STATISTICS
as at 31 March 2023

Status	**OPEN**[1]
Unit Price	**$1.0972**[2]
Distribution Yield	**N/A**

	1 Year	3 years	5 years	10 years	Inception (Apr-08)
Fund Performance After fees & costs	(12.6%)	15.0%	4.6%	8.9%	7.4%
Benchmark S&P/ASX 300 A-REIT Accumulation Index	(14.0%)	14.2%	5.2%	8.0%	4.0%
Excess Returns After fees & costs	1.4%	0.8%	(0.6%)	0.9%	3.4%

Past performance is not a reliable indicator of future performance.

TOP TEN STOCK HOLDINGS[3]

ABACUS PROPERTY GROUP
CENTURIA INDUSTRIAL REIT
CHARTER HALL GROUP LIMITED
GENERAL PROPERTY TRUST
GOODMAN GROUP
HOTEL PROPERTY INVESTMENTS
MIRVAC GROUP
PEET LIMITED
SCENTRE GROUP
STOCKLAND LTD

FUND UPDATE

- Since inception, in April 2008, the Fund has delivered an annualised return, net of fees, of 7.4% compared to a 4.0% return from the S&P/ASX 300 A-REIT Accumulation Index.
- The Fund delivered a net return of -1.2% over the March 2023 quarter, underperforming the 0.3% return from the S&P/ASX 300 A-REIT Accumulation Index.
- Positive contributions to the Fund's relative performance over the quarter came from an overweight position in residential developer Peet Limited along with no holdings in some of the weaker stocks such as Region Group, Ingenia Communities and Dexus.
- Detracting from the Fund's relative performance over the quarter were overweight positions in Charter Hall Group, Qualitas Limited, and Hotel Property Investments, each of which performed poorly, along with underweight positions in relatively strong performers, Goodman Group and National Storage REIT.

In addition to the footnotes below, please read the important disclaimer at the beginning of the Quarterly Reports section on page 26.

Phoenix Portfolios Pty Ltd ABN 80 117 850 254 AFSL 300302 (Phoenix) is the investment manager of the Fund. None of CFM, Phoenix nor their related entities, directors or officers makes any promise or representation, or gives any guarantee as to the success of the Fund, distributions, amount you will receive on withdrawal, income or capital return or the taxation consequences of investing.

1. Withdrawals cannot be guaranteed and are subject to the assumptions and risks set out in the Product Disclosure Statement dated 16 December 2021 (PDS).
2. Unit price as at 31 March 2023. Unit prices are calculated daily. See the PDS for further information and www.cromwell.com.au/psf for latest pricing.
3. As at 31 March 2023. Positions in the Fund are subject to change.

See www.cromwell.com.au/psf for further information.

OPEN FOR INVESTMENT

CROMWELL PHOENIX GLOBAL OPPORTUNITIES FUND

Investment Report to 31 March 2023

The Fund invests in a portfolio of internationally listed, predominantly small capitalisation securities, which at the time of their acquisition, are considered to be trading at discounts to their observable net asset values (NAVs).

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/gof

KEY STATISTICS

as at 31 March 2023

Status	**OPEN[1]**
Unit Price	**$1.2303[2]**
Distributions	**Annually**

PERFORMANCE

	3 Months	6 Months	1 Year	2 Years	Inception (Dec-19)
Fund Performance After fees & costs	6.1%	15.4%	11.7%	6.2%	10.4%
Benchmark Vanguard Total World Stock ETF	9.1%	13.3%	4.0%	5.9%	7.9%
Benchmark MSCI World Microcap AUD	4.1%	8.2%	(4.9%)	(7.6%)	4.6%

Past performance is not a reliable indicator of future performance.

FUND UPDATE

- Since inception, in December 2019, the Fund has delivered an annualised return of 10.4% (net of fees).
- The Fund delivered a net return of 6.1% over the March 2023 quarter.
- Global share markets finished the March quarter sharply higher, with the Vanguard Total World Stock ETF (in AUD) up 9.1%. Smaller stocks were significant underperformers, with global microcaps up approximately 4% in AUD.
- Contributing positively to performance over the quarter were positions in Toronto Stock Exchange listed Capstone Copper Corp and London Stock Exchange listed Flutter Entertainment.
- Detractors to performance included Nasdaq listed Liberty Sirius XM, which suffered from weaker than expected guidance from its major holding, Sirius XM, and London Stock Exchange listed Nanoco Plc which settled a significant lawsuit at a disappointing value.

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1. Withdrawals cannot be guaranteed and are subject to the assumptions and risks set out in the Product Disclosure Statement dated 26 October 2021 (PDS).
2. Unit prices are calculated monthly. See the PDS for further information and www.cromwell.com.au/gof for latest pricing.

See www.cromwell.com.au/gof for further information.

CLOSED TO INVESTMENT

CROMWELL PHOENIX OPPORTUNITIES FUND

Investment Report to 31 March 2023

This value orientated fund invests in ASX-listed microcaps using Phoenix Portfolios' 'best ideas' approach and aims to find hidden value in under-researched stocks.

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/pof

KEY STATISTICS

as at 31 March 2023

Status	**CLOSED**
Unit Price	**$2.1481**[1]
Distributions	**Quarterly**

PERFORMANCE

	1 Year	3 years	5 years	Inception (Dec-11)
Fund Performance After fees & costs, inclusive of the value of franking credits	(4.6%)	27.2%	15.0%	18.4%
Fund Performance After fees & costs, excluding the value of franking credits	(7.2%)	24.4%	12.6%	16.5%
Benchmark S&P/ASX Small Ordinaries Index	(13.2%)	13.2%	3.9%	5.1%

Past performance is not a reliable indicator of future performance.

FUND UPDATE

- Since inception, in December 2011, the Fund has delivered an annualised return of 18.4% (net of fees, inclusive of franking credits).
- The Fund delivered a return of 2.0% (net of fees, inclusive of franking credits) over the March 2023 quarter, broadly in line with small capitalisation indices.
- Positive contribution to the Fund's performance came from positions in Alkane Resources, MMA Offshore and Matrix Composites and Engineering.
- Negative contributions to the Fund's performance came from positions in industrial companies including Korvest and Fleetwood Ltd.

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1. Unit price as at 31 March 2023. Unit prices are calculated monthly. See the PDS dated 29 September 2017 for further information and www.cromwell.com.au/pof for latest pricing.

CLOSED TO INVESTMENT

CROMWELL RIVERPARK TRUST

Investment Report to 31 March 2023

This was the first of Cromwell's next generation 'back to basics' single property trusts and served as a bellwether for the type of investments being sought in an uncertain economic environment.

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/crt

KEY STATISTICS

as at 31 March 2023

Status	**CLOSED**
Unit Price	**$2.19**
Distribution	**12.25 cpu**
WALE	**7.1 years**[1]

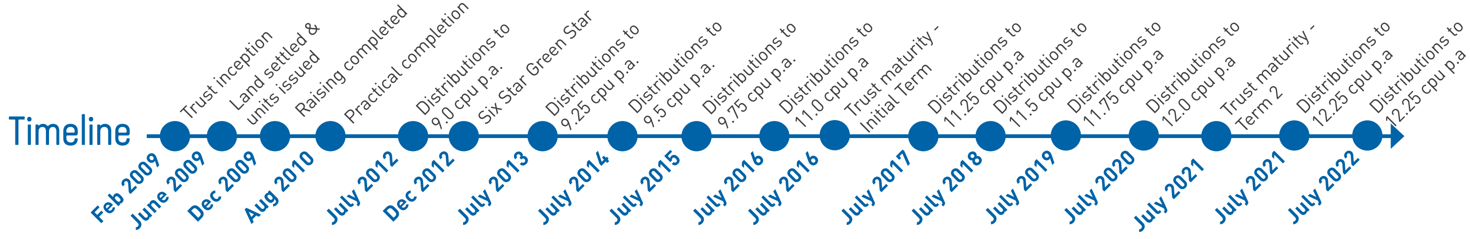
PERFORMANCE

	1 Year	3 Years	5 Years	7 Years	Inception (July-09)
Trust Performance After fees & costs	(7.4%)	8.9%	9.3%	12.2%	13.6%
Benchmark[2] The Property Council of Australia/MSCI Australia Unlisted Retail Quarterly Property Fund Index (Unfrozen)	5.4%	12.1%	12.7%	14.7%	n/a

Past performance is not a reliable indicator of future performance.

TRUST UPDATE

- The Trust's unit price is currently $2.19.
- The Trust's performance to 31 March 2023 was 13.6% per annum annualised since inception.



In addition to the footnotes below, please read the important disclaimer at the beginning of the Quarterly Reports section on page 26.

1. As at 31 March 2023. Calculated by gross income
2. Changes to MSCI's methodology for Benchmark performance reporting has resulted in an index start date that falls post the inception date of the Trust, consequently Benchmark comparison data is no longer available.

See the Product Disclosure Statement dated 25 February 2009 (PDS) and the Supplementary Product Disclosure Statement dated 30 June 2009 (SPDS).

CLOSED TO INVESTMENT

CROMWELL PROPERTY TRUST 12

Investment Report to 31 March 2023

This Trust replicates many features of Cromwell's other unlisted property trusts, including the seven-year investment period, innovative construction funding structure and long lease term. Now in its second term, the Trust is underpinned by a single asset located at 19 George Street, Dandenong and valued at $124 million[1].

Please visit the Fund webpage for the latest performance figures: www.cromwell.com.au/c12

KEY STATISTICS
as at 31 March 2023

Status	**CLOSED**
Unit Price	**$1.18**
Distribution Yield	**5.09% p.a.**
WALE	**7.2 years[2]**

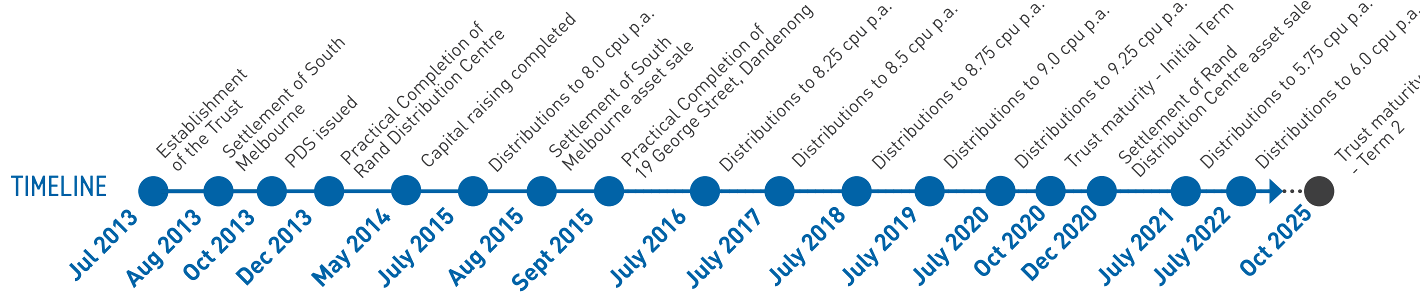
PERFORMANCE

	1 Year	3 Years	5 Years	7 Years	Inception (Oct-13)
Trust Performance After fees & costs	5.0%	19.4%	15.3%	14.7%	15.3%
Benchmark PCA / MSCI Australia Unlisted Retail Quarterly Property Fund Index (Unfrozen)	5.4%	12.1%	12.7%	14.7%	16.7%
Excess Returns After fees & costs	(0.4%)	7.3%	2.6%	0.0%	(1.4%)

Past performance is not a reliable indicator of future performance.

FUND UPDATE

- The Trust's unit price is currently $1.18.
- The Trust's performance to 31 March 2023 was 15.3% per annum annualised since inception.



In addition to the footnotes below, please read the important disclaimer at the beginning of the Quarterly Reports section on page 26.

1. Based on valuations for 19 George Street, Dandenong as at 30 September 2022.
2. As at 31 March 2023. Calculated by gross income.

See the Product Disclosure Statement dated 29 October 2013 (PDS).

CROMWELL PROPERTY GROUP QUARTERLY SNAPSHOT

Cromwell Property Group (ASX:CMW) is a real estate investor and fund manager with operations on three continents and a global investor base. The Group is included in the S&P/ASX 200. As at 31 December 2022, Cromwell had a market capitalisation of $1.8 billion, an Australian investment portfolio valued at $2.8 billion and total assets under management of $12.0 billion across Australia, New Zealand and Europe.

ASX announcements update - see www.asx.com.au (ASX:CMW)

6 February 2023	Details of HY23 Results Briefing
27 February 2023	Appendix 4D and Half Year Financial Report
27 February 2023	HY23 Results Announcement
27 February 2023	HY23 Results Presentation
24 March 2023	Dividend/Distribution - CMW

For further information, speak to your broker or visit www.cromwellpropertygroup.com

Cromwell Property Securities Limited ABN 11 079 147 809 AFSL 238052 (CPSL) has prepared this report and is the responsible entity of the Cromwell Diversified Property Trust ARSN 102 982 598 (DPT). This report is issued by CPSL as responsible entity of DPT and on behalf of Cromwell Corporation Limited ABN 44 001 050 980. This report has been prepared without taking into account your objectives, financial situation or needs. In making an investment decision, you should consider all available information and assess, with or without your financial or tax adviser, whether the product fits your objectives, financial situation or needs. Past performance is not a reliable indicator of future performance. Forward-looking statements in this report are provided as a general guide only. These statements are not guarantees of future performance. Actual results could differ materially from those expressed. CPSL does receive fees as responsible entity of DPT.

Key Events Calendar

The following dates are indicative

Date	Event
Friday 17 February	December 2022 quarter distribution payment date
Monday 27 February	HY23 results announcement
Thursday 30 March	March 2023 quarter distribution ex date
Friday 31 March	March 2023 quarter distribution record date
Friday 19 May	March 2023 quarter distribution payment date
Thursday 29 June	June 2023 quarter distribution ex date
Friday 30 June	June 2023 quarter distribution record date
Friday 18 August	June 2023 quarter distribution payment date
Thursday 31 August	FY23 results announcement (tentative)
Thursday 28 September	September 2023 quarter distribution ex date (tentative)
Friday 29 September	September 2023 quarter distribution record date (tentative)
Wednesday 1 November	2023 Annual General Meeting (tentative)
Friday 17 November	September 2023 quarter distribution payment date (tentative)
Thursday 28 December	December 2023 quarter distribution ex date (tentative)
Friday 29 December	December 2023 quarter distribution record date (tentative)

Glossary

Term	Definition
$	All dollar values are in Australian dollars
A-REIT	Australian real estate investment trust
AUM	Assets under management
Cap rate	Capitalisation rate
CCL	Cromwell Corporation Limited
CPSL	Cromwell Property Securities Limited
CPS	Cents per security
CPU	Cents per unit
DPS	Distribution per security
DPT	Cromwell Diversified Property Trust
Distribution yield	Return on investment, based on current unit price
EPS	Operating Earnings per Security
EBITDA	Earnings before interest, taxes, depreciation, and amortisation
FY	Financial year (1 July to 30 June)
Gearing	Total borrowings less cash/total assets less cash
GDP	Gross domestic product - total dollar value of all goods and services produced over a specific time period
GFC	Global Financial Crisis
IRR	Internal rate of return
NOI	Net operating income
NLA	Net lettable area
NTA	Net tangible assets per security
p.a.	Per annum
RBA	Reserve Bank of Australia
RE	Responsible Entity
REIT	Real Estate Investment Trust
Securityholder	A person who holds a Security
Security	Stapled security consisting of one share in CCL and one unit in DPT
Small Cap	Stock with a relatively small capitalisation
SMSF	Self-managed superannuation fund
WALE	Weighted average lease expiry by gross income

CONTACT US
WITH ANY QUESTIONS

For the answer to any questions regarding Cromwell and our funds, please contact your financial adviser, broker or Cromwell's Investor Services Team directly.

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CROMWELL
PROPERTY GROUP