INSIGHT
MAGAZINE

AUSTRALIA'S HOUSING BATTLE: INTEREST RATES VERSUS SUPPLY AND DEMAND

PAGE 13

CROMWELL PROPERTY GROUP

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Dear reader,

For years, Cromwell's Insight magazine has been one of the commercial property sector's premier publications – a regular way for us to connect with you, our investors. We continue to endeavour to bring you the most relevant, engaging, and insightful content in each edition – and, from 2024, we're migrating to a new way of achieving that goal.

We're conscious of the current challenging economic environment – and the need to reduce spend and minimise waste – while still delivering Insight to our eager readers. As such, we're currently examining how to best deliver the magazine in the future, including more online content.

For those who prefer a physical copy of Insight, we're still intending to deliver an edition each quarter next year – currently slated for February, May, August, and November in 2024. However, this will be an 'opt-in' service only, meaning you will need to request a hardcopy of Insight in 2024. You'll find instructions on this process inside this edition.

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REDEFINING THE OFFICE FLIGHT TO QUALITY: **A SYDNEY CBD CASE STUDY**

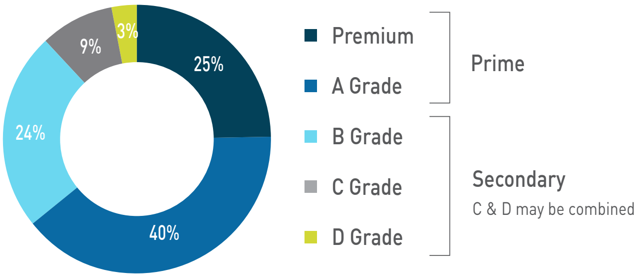
Colin Mackay
Research & Investment Strategy Manager
Cromwell Property Group

"Flight to quality" has been the real estate industry's phrase of the year, particularly as it pertains to the office sector. While Cromwell agrees that a flight to quality is occurring and will continue to play out over the medium-term, our opinion of what that flight actually is – and indeed our definition of quality – is somewhat contrarian.

Quality has become synonymous with Premium – the top grade of office buildings. These buildings are modern developments with the largest floorplates, most internal amenity, and luxurious finishes and fitouts – and which naturally charge the highest rents. While this type of asset is an important part of the market, it's worth assessing whether the popular narrative fits all the facts.

Are occupiers flocking to Premium assets at the expense of Secondary stock? Does the top-end of town hold all the cards?

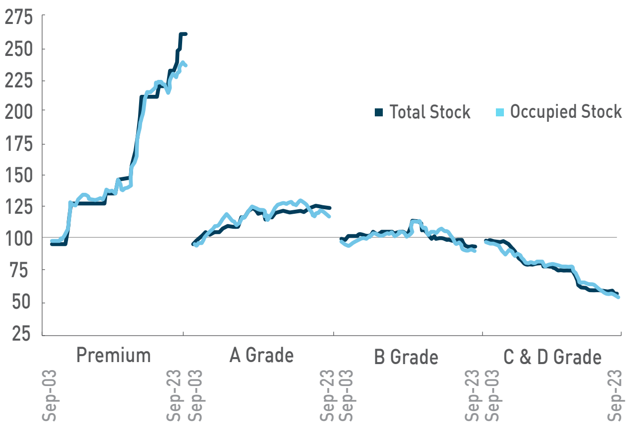
Share of Sydney CBD Stock by Grade



Source: JLL (Jun-23); Cromwell

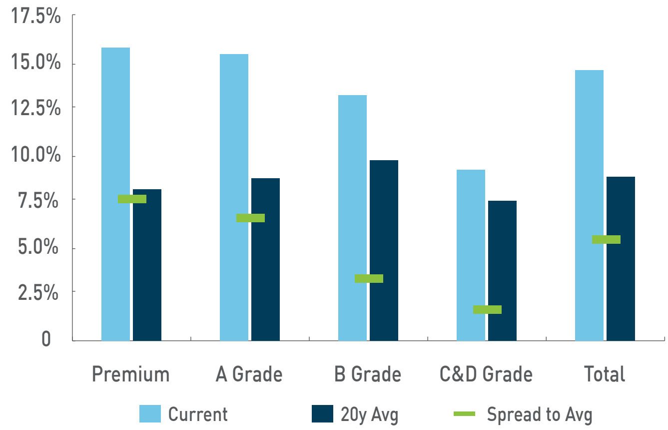
> On face value, it's easy to see why the "Premium is best" narrative has emerged – but there's more to the story!

Premium: Stronger occupier demand or just more of it?
Sydney CBD Stock (sqm) Indexed to Sep 03



Source: JLL (Sep-23); Cromwell

Premium: Highest Sydney CBD vacancy rate in absolute terms and vs historical average



Source: JLL (Sep-23); Cromwell

Net absorption is important but doesn't tell the whole story

Net absorption is the metric often cited as evidence of the flight to (Premium) quality. In the Sydney CBD, Premium stock has recorded the strongest net absorption over the last 20 years at around +624,000 square metres (sqm), an increase in occupied stock of +137%. A Grade's net absorption (+270k sqm) has been the second strongest over that time period, with the amount of occupied space increasing +18%. On face value, it's easy to see why the "Premium is best" narrative has emerged – but there's more to the story!

Premium has also seen the largest increase in total space.

Growth in occupied space is an expected by-product of the substantial increase in supply. On the other side of the coin, B Grade has recorded negative net absorption but also a decrease in total space – occupiers can't lease space that doesn't exist.

This dynamic is often seen in the lower grades as buildings are "withdrawn" (removed) from the market through conversion to different uses (e.g. residential). When we consider that rents are a function of demand and supply, it becomes clear that looking only at net absorption provides an incomplete picture of market conditions – we also need to look at the supply side of the equation.

Vacancy paints a different picture

Vacancy rates highlight a deterioration of demand relative to supply at the top end of the asset grade spectrum. In the Sydney CBD, Premium has the highest vacancy rate in absolute terms and when compared to its historical average.

B Grade has proven more resilient from an occupancy perspective, with vacancy actually decreasing over the last year.

Despite elevated vacancy, Premium's net effective rental growth has outpaced A Grade and B Grade over recent quarters. There are a couple of potential explanations for this counterintuitive result.

Time lags: It takes time for changing conditions to be grasped by market participants, for negotiations to be had and leases signed. Premium had the lowest vacancy rate until mid-2022, with its main occupiers adopting a "wait-and-see" approach to space decisions through the pandemic. Now, Premium occupiers are handing back space and driving vacancy higher, but current rental outcomes are reflecting the tight conditions of prior quarters.

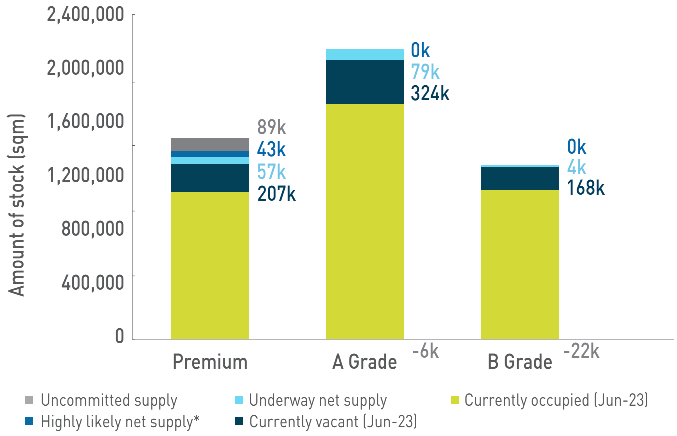
Affordability: The spread between Premium and A Grade rents narrowed over 2021-22 as Premium incentives increased. Industry feedback suggests occupiers have taken advantage of the relative affordability to upgrade, taking up

Net absorption *is the change in occupied (leased) space over a given period (often a quarter or year), represented in square metres. It is calculated by subtracting the amount of occupied space at the start of a period from the amount of occupied space at the end of a period. Positive net absorption means the amount of occupied space has increased, while negative net absorption represents a decrease.*

Sydney CBD: Difference between Premium & A Grade Net Effective Rents

Source: JLL (Jun-23); Cromwell

Sydney CBD Current Stock & Net Development Pipeline to 2030^



Source: Cromwell analysis of JLL data (Jun-23). *Development projects that have a very high probability of proceeding (90%+). ^Net space to be added minus pre-commitments, adjusted for the probability of proceeding.

less space but at a higher rate per sqm. This is positive for market rental growth but less so for income growth, given the occupancy effect. We expect Premium upgrading to run out of steam as affordability worsens, with the spread recently increasing to its widest level since 2014.

In any case, for investors, there's limited value in knowing today's performance – what really matters is the future.

***Incentives** are financial 'sweeteners' offered by landlords to encourage tenants to lease space. Common incentives include contributions to tenant fitout costs, rent-free periods, and rental abatements where the amount payable is reduced for a period of time. The rent received by a landlord after incentives are accounted for is referred to as an "effective" amount.*

Good things come in small packages

In our view, it will be difficult for Premium stock to maintain the current pace of rental growth, with A Grade stock likely to outperform over the medium-term due to lower vacancy, a less substantial supply pipeline, and favourable occupier trends.

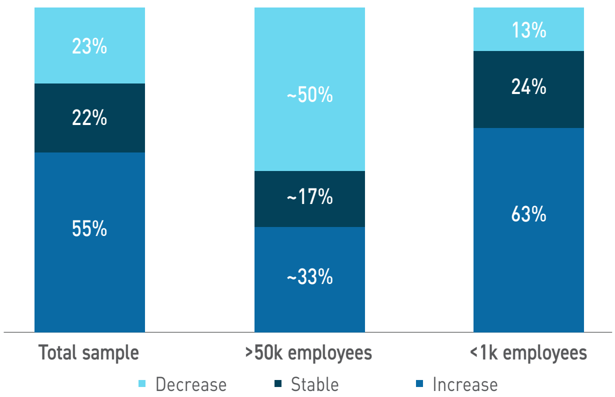
Cromwell estimates there are 265k sqm of Premium space in the Sydney CBD which will need to be leased in the near term based on space currently vacant or completing by the end of 2024. This "baked in" amount is equivalent to 19.7% of current Premium stock. Future developments may deliver new supply to the market post-2024, however we only consider 43k sqm as highly likely on a probability-adjusted basis.

A Grade has a larger amount of space requiring leasing (403k sqm); however, it is smaller as a proportion of existing stock (18.8%). Unlike excess B Grade stock which may be withdrawn from the market via change of use, the only feasible option for Premium space is absorption via leasing. On this front, the Premium end of the market faces some challenges.

Space contraction impacts from work-from-home are being felt most keenly by assets with large floorplates. These buildings are expensive to divide into smaller tenancies and typically cater to the largest occupiers. Research[1] points to an inverse relationship between occupier size and office usage, which is then being reflected in organisations' plans to expand or contract their office footprint. The industries that predominantly occupy Premium buildings (financial services, professional services, tech) also demonstrate a lower propensity to use the office post-COVID.

1. Empty spaces and hybrid places (McKinsey, Jul-23); U.S. Office Occupier Sentiment Survey (CBRE, May-23)

Expected 3y Office Space Change by Company Size



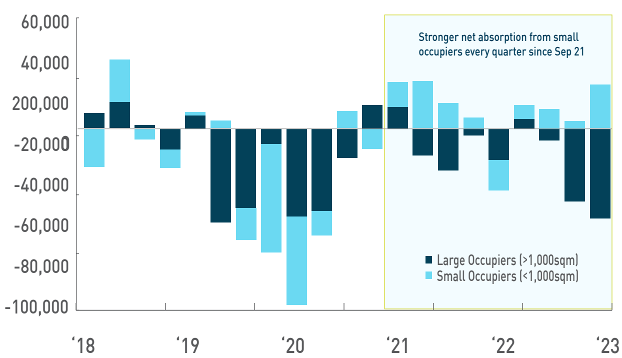
Source: JLL (Jun-23); Cromwell

Australian leasing data corroborates the research findings. Net absorption has been far stronger across smaller (<1,000sqm) occupiers than large occupiers. The tendency to expand has also been far more positive, with smaller occupiers on average **expanding** their footprint by ~20% (national leasing deals from 1Q21 to 2Q22) compared to an average **contraction** of ~13% for occupiers larger than 3,000sqm[2].

We believe the in-office bias of smaller occupiers versus larger occupiers reflects the nature of work typical across these organisations. Bigger firms are more regimented and siloed, with large administrative "back office" functions that predominantly perform focused tasks individually. These firms may have also invested more heavily in digital collaboration tools which facilitate remote work across a more geographically dispersed workforce. Smaller firms are more dynamic, with employees wearing multiple hats and undertaking work that tends to favour face-to-face interactions. Regarding smaller firms' space expansion, this may be linked to their much stronger headcount growth through the pandemic. Businesses with 5-199 employees saw employment growth across the main office-using industries of 4.6% p.a. from Jun-19 to Jun-22, compared to -0.2% p.a. for businesses with 200+ employees[3].

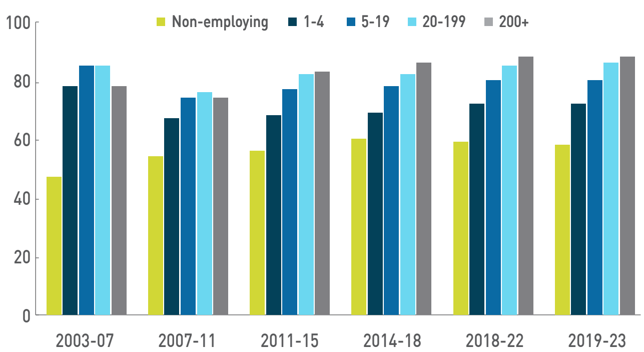
One of the arguments often made against exposure to smaller occupiers is that they are riskier than large occupiers, but the data shows this isn't the case. While very small firms do fall over more often, those with 20-199 employees have nearly identical survival rates to firms with 200+ employees. The smaller occupier bracket is also broader and more diversified, with office-using businesses spanning many industries. By comparison, the large firm bracket is dominated by financial and professional services. Overexposure to large occupiers can also increase the risk that a significant portion of an asset becomes vacant at a single point in time, rather than being spread over a manageable leasing horizon.

Sydney CBD - Quarterly Net Absorption by Tenant Size



Source: JLL (Sep 23); Cromwell. Small occupiers calculated as the residual of total net absorption minus large occupier moves.

Four-Year Survival Rate of Businesses by Employment Size (%)



Source: ABS (Aug-23); Cromwell

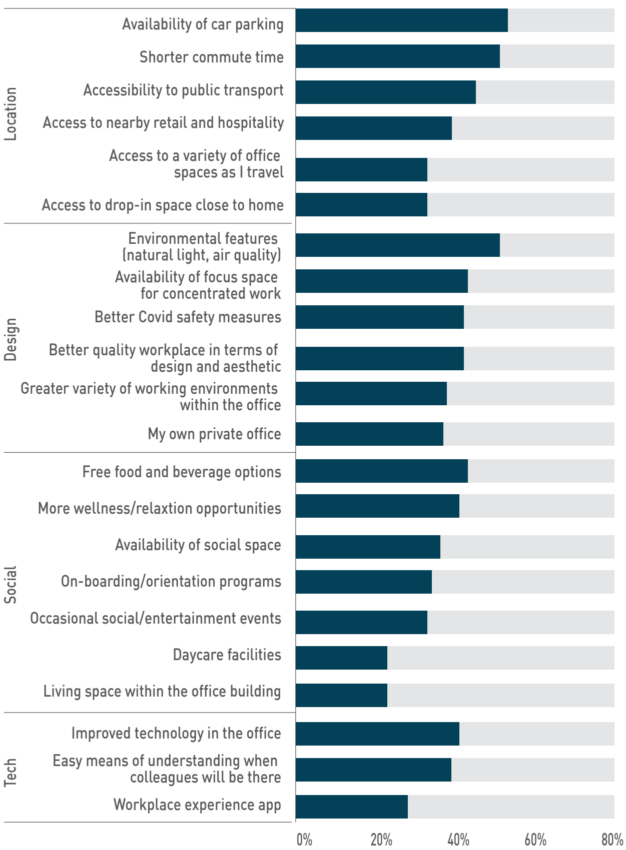
2. Australian Office Footprint Analysis (CBRE, Oct-22)
3. ABS (May-23); Cromwell. Main office-using industries includes: Information media and telecommunications; Rental, hiring and real estate services; Professional, scientific and technical services; Administrative and support services; Education and training (private). Financial services employment breakdown is not published by the ABS.

Price doesn't always equal quality

Conflating luxury with quality ignores the needs of many office occupiers. While the largest companies attract the most attention, most office-using Australian businesses are small and medium-sized enterprises (SMEs)[4]. With cost being the top driver of real estate decisions[5], these SMEs are in the market for a Toyota, not a Rolls-Royce with all the extras. They want the highest quality office, in the best location, but within their price bracket. So then, what is "high quality" office? Ultimately, it's space which meets the needs and preferences of its target occupiers.

Some occupier preferences are timeless and will persist no matter how workstyles and space usage evolve, for example availability of natural light, convenient access to transport and plenty of nearby amenity (e.g. dining and gyms). These are hygiene factors valued by occupiers of any industry or size.

What, specifically, makes a quality office environment?
% = Top 2 choices of importance



Source: Live Work Shop Report - Australia (CBRE, Dec-22)

> Greater diversity of spaces is needed to support focused work, collaboration, and flexibility, with implications for building layouts and landlord-led fitouts.

The pandemic has rendered some requirements less important. Floorplate size has historically been a measure of quality and is one of the criteria that determines whether a building is considered Premium or a lower grade. But with occupiers' office usage shifting towards collaboration and social connectivity, a smaller floorplate can create more incidental interactions and a better 'buzz' in the office. While there is a minimum viable size in terms of efficiency and layout, we're finding bigger isn't always better in the eyes of occupiers.

Other requirements have increased in importance as occupiers shift to a new way of working. A greater level of embedded technology is expected, to ensure a flexible working model can be facilitated. Greater diversity of spaces is needed to support focused work, collaboration, and flexibility, with implications for building layouts and landlord-led fitouts.

Sustainability also continues to increase in importance, with a wider array of organisations focusing on both the financial and social benefits it can provide, including staff attraction and retention.

Not always the more sustainable choice

The preference for sustainable space is becoming more tangible and spans a variety of stakeholders, including end users, occupiers, and investors. Premium buildings often have the highest sustainability ratings (e.g. NABERS), something which is used to support the view that occupiers will increasingly gravitate to these assets over time. But again, these ratings don't tell the whole story.

Embodied carbon: *the emissions generated during the manufacture, construction, maintenance and demolition of buildings – Green Building Council of Australia (GBCA)*

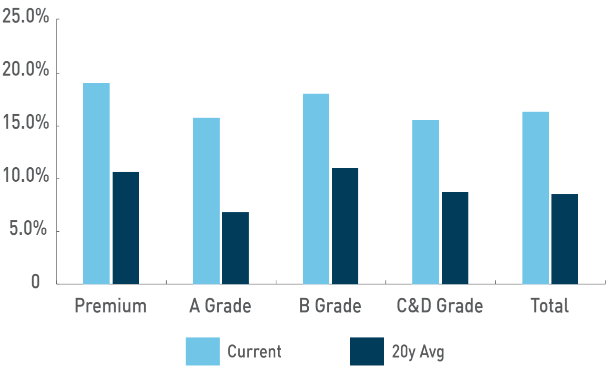
4. SMEs defined as businesses with 5-199 employees, within the same office-using industries as previously defined.
5. What Occupiers Want (Cushman & Wakefield, Jul-23)

While new Premium assets are top performers from an operational emissions perspective (e.g. energy usage), production of building materials and construction activities are the largest producers of embodied carbon emissions[6]. As the grid decarbonises, embodied carbon's share of built environment emissions is expected to increase from 16% in 2019 to 85% by 2050[6] – in the pursuit of net zero, minimising the demolition of existing buildings and the construction of new ones will become far more important than building-specific energy efficiency. As the importance of embodied carbon becomes more well known and stakeholders adopt a whole-of-life view of emissions, newly built Premium assets may not be considered the greener option.

Is this only a Sydney theme?

While this paper has focused on the Sydney CBD for simplicity and brevity, we see the same dynamics playing out in Melbourne. The CBD Premium vacancy rate is almost 19%, and Cromwell forecasts the amount of Premium stock will increase by 15% by 2026 based on new supply currently under construction. The same occupier trends are also occurring, with small occupiers recording positive net absorption of over +23k sqm since Dec-19, compared to negative net absorption of almost -241k sqm for large occupiers.

Melbourne CBD: Another market with very elevated Premium vacancy



Source: JLL (Sep-23); Cromwell

> We believe the flight to quality is occurring across all grades – not just Premium – as occupiers seek space that is well-located, offers high amenity, and enables a flexible approach to working, but within their price bracket.

Look beyond the headline

"Flight to quality" has been a popular theme in the office sector. While positive net absorption has been used to support the notion that Premium buildings are outperforming lower grade assets, the metric can't be looked at in isolation. Investors gain a more comprehensive understanding of market conditions by also considering other factors such as vacancy, supply impacts and occupier demand trends. We believe the flight to quality is occurring across all grades – not just Premium – as occupiers seek space that is well-located, offers high amenity, and enables a flexible approach to working, but within their price bracket. In our view, the A Grade segment of the market is best-positioned as it occupies an affordability-quality sweet spot, supported by ongoing demand from smaller occupiers and a smaller supply pipeline.

6. Embodied Carbon & Embodied Energy in Australia's Buildings (GBCA; thinkstep-anz, Aug-21)

IN CONVERSATION WITH ROXANNE EWING

HEAD OF CORPORATE OPERATIONS, CROMWELL PROPERTY GROUP

As one of the senior leaders within Cromwell, Roxanne has spent years helping guide the direction of the business – including fostering an environment where staff can thrive. As workplaces continue to evolve, Roxanne continues to explore how Cromwell can be a positive work environment.

It's safe to say you've got a wide-ranging role at Cromwell, Roxanne – can you walk us through some of the key responsibilities you take on?

I do have a broad role here – and that means every day is different, which I love.

I am accountable for the People and Culture, Marketing, and Operations teams at Cromwell – so, in a nutshell, I'm responsible for ensuring that Cromwell has the right talent to execute on its strategy and deliver for our investors; execute on marketing strategies that attract and retain investors; and support the operations of the business from an office and administrative perspective.

You've been Cromwell's Head of People & Culture in the past – and helped shape our current organisational values. How did that process come about?

Everyone has heard the old "culture eats strategy for breakfast" adage but, for me, culture eats everything; culture is everything. Without the right culture, an organisation cannot succeed – and values are at the core of that. Values are the handful of words that attempt to sum up the enormity of an organisation's culture and vision.

It's no secret that Cromwell has undergone a significant amount of evolution of the past few years, as all organisations do. Like any organisation, we're not stagnant - and we had shifted significantly enough to justify redefining the terms that captured both who we were, and who we wanted to be.

And we could only achieve that by engaging everyone in the conversation. Over a three-month period, we engaged with our entire business – we asked people what our vision meant to them, who they felt we needed to be in order to achieve their best, as well as what our current strengths were that we could leverage. We also had transparent discussion about what activities we needed to stop doing.

It was a surprisingly simple process. There was general consensus about our strengths – we're respectful, we care, we're inclusive and we've got great people – as well as about those areas that we would need to focus on if we're to achieve our vision: increased agility, collaboration, and innovation.

We solidified the values that we would live by during the next stage of our evolution as Collaborative, Progressive and Accountable.

Over the past five or six years in particular, there's been an undeniable societal shift in attitudes on diversity and inclusion, gender equality, and cultural shifts/accepted norms. How does the ever-changing society attitude change translate into the workplace?

I think that shift started long before then, but certainly in more recent times we have seen government, regulatory bodies, talent, and the broader community really begin to hold organisations accountable for their role in diversity outcomes, as they should. Organisations, particularly large ones, have the power to make real and lasting change in this regard. And why wouldn't they? It's great for business.

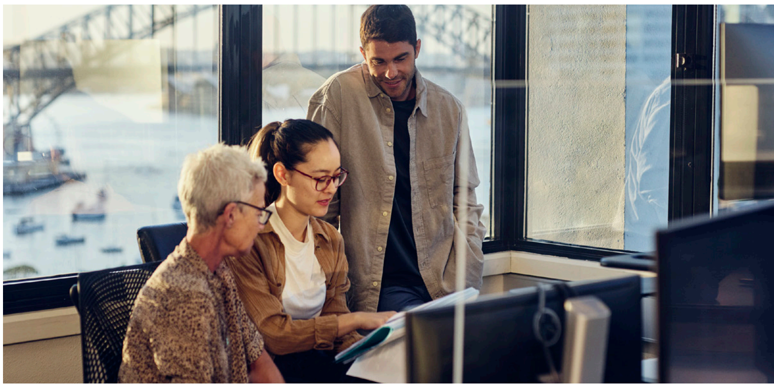
We're two years into our global five-year Diversity, Equity, and Inclusion journey, which has three simple goals; create a culture of respect and inclusion, foster and value diversity; and ensure equity.

What do you see as Cromwell's role in the lives of our people as an employer? Is it as simple as just providing a place to work?

No, we want people to love their time at Cromwell and when they decide it's time to move on, leave us as better people than when they joined.

For a lot of people, work significantly contributes to their meaning, their purpose, and we're very keen to help them fulfil that. In fact, at one of our recent Leadership Summits, we focused on how we can help our people reach a state of engagement, by meeting their psychological needs – physiological, safety, belonging, esteem and self-actualisation.

At Cromwell, this encompasses providing for people's basic needs with good remuneration, stability, and a physically and psychologically safe work environment. Creating a culture that is inclusive, allows people to bring their true self to work, and provides challenging and interesting work



is critical. It also involves giving frequent feedback and recognition and the ability for our people to continually grow and develop. And finally, we look to give people a vision and a purpose they can connect with.

We know we play a huge part in people's lives, and we take that very seriously. We're far more than a place to work, we really want to help our people achieve their professional and personal purpose.

What operational targets has Cromwell set to improve ourself as an employer?

What gets measured, gets done – and we have plenty of targets! In the DEI space, and as part of our commitment to the Property Champions of Change Coalition, we're using a 40:40:20 metric, a gender pay gap and a gender pay parity target to help keep ourselves accountable to our DEI Strategy.

For those that haven't heard the term, 40:40:20 is about achieving 40% male, 40% female, and 20% other/discretionary gender representation in our workforce – we're seeking to achieve that outcome at all levels of our organisation and we have already done so at the Executive, Senior Leader, Team Leader, and Emerging Leader levels.

Our target to reduce the gender pay gap year-on-year is an excellent measure of whether we're achieving equality, as well as meeting our gender targets. Since setting this target, we've reduced our pay gap by over 20%, and we're still making good progress.

We've also set ourselves an employee engagement target of 70%. Engagement is the level of emotional connection our employees have with our business and directly correlates with the level of discretionary effort they're willing to exert. We saw a 9% increase in employee engagement over the course of 2023 and we're hoping to keep that trend strong.

How has post-Covid hybrid working been addressed by Cromwell, and how are we shaping our office space to suit the needs of our workforce?

We have an 'agile working' approach at Cromwell. This approach dictates how and when our people work, and we recognise that agile working comes in all different shapes and sizes and will mean different things for different people and different roles.

Our people work flexible work hours, whether they be part-time, job-sharing, or simply altering their start and finish times to suit their lifestyle. It may also include different types of time-off and/or breaks from work altogether with our Career Break option. And, of course, it pertains to location in terms of where work happens, whether that be in a Cromwell office, at an employee's home or somewhere altogether different.

At first, we felt compelled to put all sorts of rules and guidelines around agile working, but we've stripped a lot of these away. Our culture is one of trust, accountability, and strong relationships between employees and their people leaders. On the whole, we generally leave it to the employee and the people leader to agree an agile working approach for each individual; something that works for them.

Collaboration is one of the company values and we do love to see our people connecting and collaborating when it suits them. As a result, we've designed a new Brisbane office to cultivate more meaningful relationships between our teams. We're taking up residence in one our DPF assets, 100 Creek Street. It's a conveniently located facility with great amenities that align with what we want to offer our people.

The new office is designed specifically for our people – and around our agile working approach. It's designed to be light, green, comfortable, accessible and to have a space for every activity our people may want to undertake. We know that our people will work remotely when they want quiet, focused time and therefore we have put a focus on oversupplying formal and informal break out and collaboration spaces in the office. We also recognise that life doesn't stop just because you've chosen to work from the office, so we have incorporated wellbeing spaces such as the wellbeing and multi-faith rooms. It's a really exciting time for Cromwell and we can't wait to welcome people to our new workspace in January 2024.

The new office is designed specifically for our people – and around our agile working approach. It's designed to be light, green, comfortable, accessible and to have a space for every activity our people may want to undertake.

Are there any initiatives that Cromwell has rolled out that you're particularly proud of?

Yes! There's too many to list here, really. I'll focus on a few of the more recent ones.

Over the last 12 months, we have partnered with some causes that are closely aligned with our culture, strategy and values.

This includes ReLove – a charitable organisation that partners with corporate entities to rescue furniture and whitegoods and use them to furnish homes for people experiencing domestic violence or seeking asylum. As part of our participation in '16 Days of Activism' against gender-based violence, we were able to help them furnish five homes as part of their 100 Homes Appeal.

Likewise, during the FIFA Women's World Cup, we were the principal sponsor of the Moriarty Foundations' Indigenous Footballer's "call time on inequality" campaign. The John Morarity Football programme is Australia's longest running, and most successful, Indigenous football initiative, with more than 2,000 Indigenous girls and boys participating.

I'm also really proud of our work in the gender equality space. We're an active member of the Property Champions of Change Coalition, a property industry coalition working to achieve a significant and sustainable increase in the representation and equality of women in the property industry. Though we joined the charge relatively late in the game, we have made enormous headway and currently have some of the best family-friendly policies and the second lowest gender pay gap within the coalition.

And finally, I'm proud of the major cultural shift that we've undergone in the last 12 to 24 months. We've taken firm stances on our view of diversity, equity, inclusion and respect and we've put our money where our mouth is and significantly improved our flexibility, wellbeing, family-friendly, remuneration, and time off benefits.

What do you enjoy most about your role?

The fact that I get to do all the above! I have so much ability to influence the lives of our people, and those in our broader community. Absolutely every day is different, but the one thing they have all have in common is the power to make a difference, in one way or another.

I have been with Cromwell for a long time and my role has never stagnated. I love the people that I work with in the Marketing, People and Culture and Operations teams as well as our broader Australian team and I'm inspired by what we're here to do. ■

AUSTRALIA'S HOUSING BATTLE: INTEREST RATES VERSUS SUPPLY AND DEMAND

Stuart Cartledge
Managing Director
Phoenix Portfolios

Residential property occupies much of Australia's news coverage and much of the brain space of Australians in general. Everyone seems to have an opinion on house prices and housing policy and not all of it seems to be based on fact. This article will try to provide an analysis of the current factors influencing residential property and in dealing with those facts, provide some examples of how Phoenix is making investments that are supported by the current environment.

Interest rates

It seems all of us have heard comments like "house prices always go up". Anyone with a basic understanding of maths and economics has told those people they cannot be correct. With that, let's look at the median house price in Sydney since 2002.

Looking at the figure 1 adjacent, it almost does seem like house prices always go up. But wait: what happens when interest rates go up, surely house prices will crash? Let's zoom into figure 2 and look at the effect of recent interest rate rises on the value of homes in Sydney.

Despite interest rates on new home loans more than doubling on their lows, it is clear that house prices have been stunningly resilient, growing once more after marginally decreasing when rates began to increase.

Those concerned about the sustainability of current house prices will correctly point to just how much it costs to own a home. Approximately 75% of home purchases are supported by the use of a mortgage. Obviously, those making the purchase can only do so if they can service the payment on that mortgage. To show this, figure 3 looks at the monthly cost of servicing a new mortgage (Loan to Value = 90%) on the median home in Sydney and how it has changed over the same period.

Figure 1: Median Price of Established Houses - Sydney

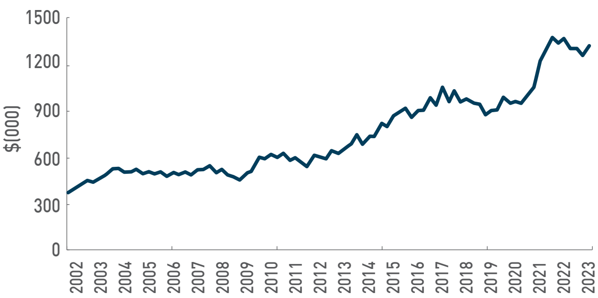


Figure 2: New Loan Rate (Owner Occupier)

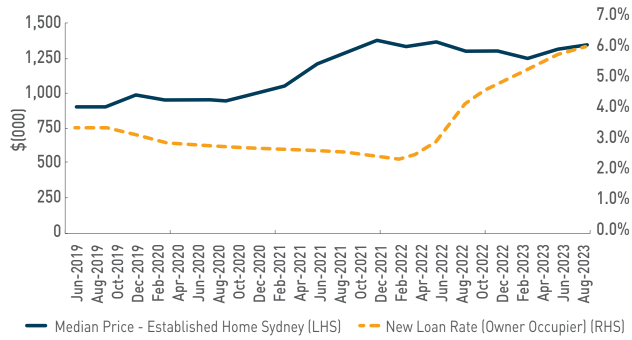


Figure 3: Mortgage Cost Per Month

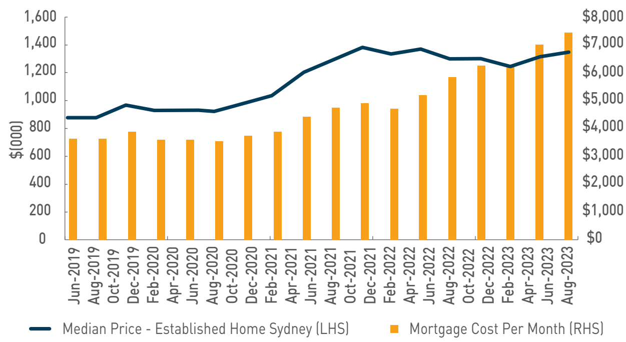
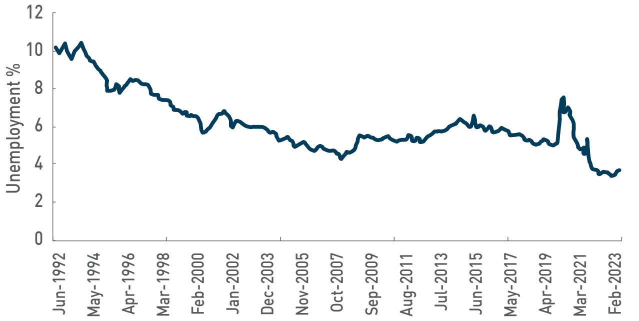
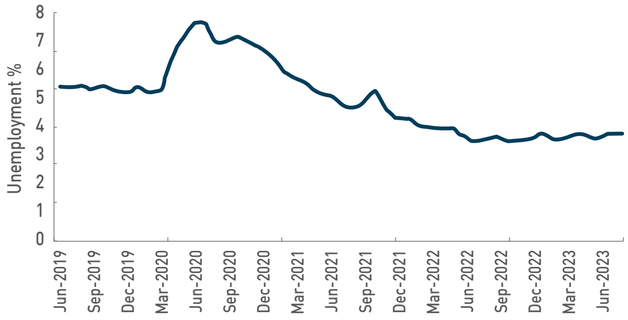


Figure 4: Unemployment (1992 - 2023)



Unemployment (2019 - 2023)



The cost of servicing a mortgage has clearly risen dramatically. A mortgage obtained on the median home in Sydney now costs more than $7,400 per month to service. This has increased by more than 50% since December 2021, less than two years ago. Common sense suggests that this must have a limit. Surely at some point people can't afford to service their mortgage anymore and surely even the ~25% of people who buy a home with cash won't have enough cash to buy the home they want. That all has to be true, but house prices prove that at this stage we have not reached that breaking point.

How can we afford this?

Basic economics states that in a market economy, the price of a good or service is a function of its supply and demand. Housing is no different. The demand for housing should be simple to understand. All Australians have demand for a place to live. To support "elevated" house prices and increased mortgage servicing, their has to be a capacity to pay monthly costs. This capacity is most commonly tied to a person's income. When entering into a 30-year mortgage, someone's view of their job security is also front of mind. In this context, a chart of long-term and more recent unemployment rates in Australia is presented in figure 4 above.

As can be seen, unemployment rates are at multi-generational lows, serving to add to demand for housing at ever-increasing prices.

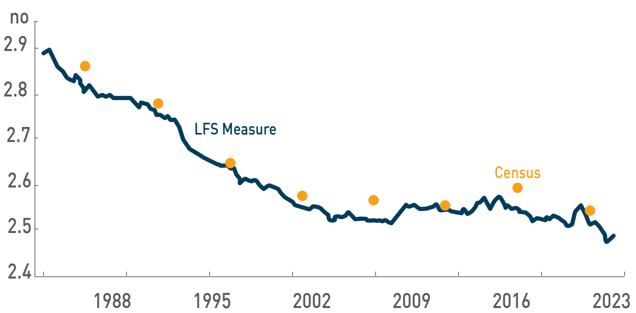
Housing demand

In the most basic sense, the quantum of dwellings needed in Australia is related to the amount of people in each dwelling and the population of the country. The Australian Bureau of Statistics (ABS) and Reserve Bank of Australia (RBA) have compiled the nation's historic average household size and recent trends as shown in figure 5 below.

While perhaps a controversial figure, former RBA Governor Phillip Lowe summed up recent changes astutely, saying:

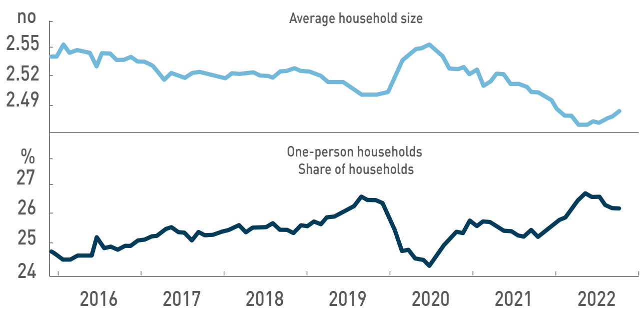
> "During the pandemic, the average number of people living in each household declined. People wanted more space. They were working from home. Rents actually declined for a while.

Figure 5: Average Household Size



Source: ABS, RBA (Mar-23)

Recent Trends in Average Household Size

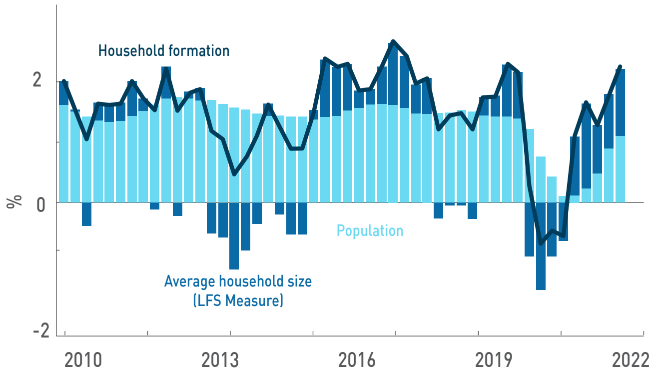


Source: ABS, RBA (Mar-23)

"During the pandemic, the average number of people living in each household declined. People wanted more space. They were working from home. Rents actually declined for a while. People said, 'Rather than have a flatmate I will just have an office at home,' so the average number of people living in each dwelling declined and that increased the demand as a result for the total number of dwellings".

So, we have less people living in each dwelling and the other component of household requirements, populaion, is also increasing strongly. Again, the RBA and ABS help by showing both the impact of population growth (in light blue) and change in household size (dark blue) over time in figure 6.

Figure 6: Household Formation: Year-ended growth with contributions



Again, Phillip Lowe sums up the situation:

"The other thing that is now happening is a big increase in population. The population is increasing by two per cent this year. Are there two per cent more houses? No. The rate of addition to the housing stock is very low. We have a lot of people coming into the country."

This comment touches on the other key element to home prices in Australia. Namely, the supply of new property.

Housing supply

So there clearly is a need to build new houses. Given the voracious demand for residential properties at elevated prices, one would think that residential developers would address this demand and supply the properties the population clearly want. Two major factors are holding back the supply that would otherwise naturally occur.

Firstly, the cost of building new homes is a major factor. A residential property developer will require approximately a 20% profit margin on top of their costs to put new housing supply into the market. The costs of developing that property comprise:

- the cost of the land on which it is built,
- the hard costs of the materials used,
- finance costs,
- architectural and planning costs and
- the cost of labour to physically build the property.

In recent times, all of these costs have been increasing. Materials costs increased significantly with supply chain disruptions during the COVID-affected period and only now is the "rate of growth" slowing. Labour costs are also ever increasing, as even the availability of workers is a significant challenge in many cases (see unemployment rates). Each of these increased costs place downward pressure on the supply of new properties.

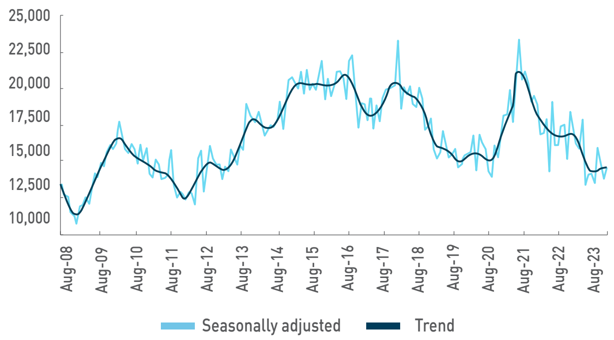
The real issue

Arguably the biggest factor limiting new supply however is simply being allowed to build new properties. New building requires a myriad of approvals, principally development approvals, from local councils or state governments. Local constituents tend to be against development in their area, often known as NIMBYs (Not In My Backyard). Local councils and members of parliament are voted in by existing residents of a geographic area and hence are incentivised to block the building of new houses.

To provide one such blatant example, one member of parliament (MP) made the comment: "Housing in Australia is in crisis," describing the cost of housing forcing "families [to sleep] in their cars". This same MP has vehemently opposed the development of more than 800 dwellings on an unused site in their electorate. Going further, in an attempt to justify the position, he argued that such development activity "drives up the cost of rent and house prices."

This is demonstrably false and fails to pass even the most basic test of common sense. We are not referencing it to call out an individual, but rather providing an example of just how difficult it is to obtain approval to address the housing supply shortage, even from those aware of the need. To see how dire this supply issue has become, see the figure 7 below, provided by the ABS, showing the trend in approvals for dwelling units despite the obvious need for housing.

Figure 7: Dwelling units approved (a)



Source: ABS, Building Approvals, Australia (Aug-23)

What are we doing about it?

Amending the long-held planning practices, incentives of government and fixing global supply chains is above our pay grade. What we can do is observe and acknowledge the situation and make investments that benefit from the realities of housing undersupply. This can be done by investing in companies that either have development approved housing projects, or a history of working with planning authorities to obtain approval, despite all the complexities inherent in residential development.

One such investment in the portfolio is Mirvac Group (MGR). Most of MGR's development takes place in urban infill locations. These projects often increase density and at times have included iconic projects across Australia. MGR is currently developing the old Channel 9 headquarters in Willoughby in Sydney's North, which will deliver 417 lots, with a total development value of $800 million.

What we can do is observe and acknowledge the situation and make investments that benefit from the realities of housing undersupply.

Peet Limited's Artist impression of Flagstone City's Future Town Centre

Existing iconic projects completed by MGR include The Melbournian, and The Eastbourne in Melbourne. MGR has also been a pioneer in the embryonic "build to rent" property sector. This involves building large apartment buildings, with all lots held for rent on an ongoing basis as opposed to being sold on completion. Those in Melbourne can inspect LIV Munro, adjacent to Queen Victoria Markets, which was recently completed and has 490 apartments available for rent. In the midst of record low rental vacancy, this business both addresses a need and provides low risk returns to investors.

Another investment in the portfolio is Peet Limited (PPC), which specialises in master planned communities across the country. These tend to be extremely large plots of land on the urban fringe of major cities and will effectively be new suburbs and in some cases almost new cities. PPC's largest project is Flagstone, located between Brisbane and the Gold Coast in Southeast Queensland. It will take a generation to complete, however once built will house 120,000 people and become Australia's 20th largest city, a similar scale to Cairns. It will include a 100-hectare town centre, with a regional shopping centre similar in size to Chatswood Chase and will have a bigger town centre than the Brisbane CBD. This project has all relevant approvals. It is projects such as this that will go a small way to addressing Australia's housing undersupply.

A closing note

The current balance in Australian housing is a bit like an unstoppable force meeting an immovable object. Interest rates are having a meaningful impact on the affordability of housing and clearly are putting downward pressure on housing prices. Fighting against this, ever increasing demand and insuffcient supply are supporting home values. Over time, these factors should find an equilibrium. Investing in those who are helping to address this undersupply is prudent both from an investment perspective and for the benefit of the nation.

CROMWELL DIRECT PROPERTY FUND

Investment Report to 30 September 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 30 September 2023

Unit Price	**$1.1069**[1]
Distribution Yield	**6.1% p.a.**[2]
WALE	**4.3 years**[3]

PERFORMANCE

	1 Year	3 Years	5 Years	Inception (Aug-13)
Fund Performance After fees & costs	(11.0%)	2.3%	3.5%	7.1%
Benchmark PCA / MSCI Australia Unlisted Retail Quarterly Property Fund Index (Unfrozen)	(4.7%)	8.9%	10.2%	15.3%
Excess Returns After fees & costs	(6.3%)	(6.6%)	(6.7%)	(8.2%)

Past performance is not a reliable indicator of future performance.

FUND UPDATE

- Reflecting the good leasing activity in Brisbane, it was a busy quarter for 100 Creek Street, Brisbane with the leasing of speculative suites helping to lift the asset's occupancy to 88.4%
- The Fund's current WALE (on a look-through basis) is 4.3 years, and occupancy sits at 94.4%
- There were no valuation updates in the quarter ending 30 September 2023, given the Fund's entire portfolio was independently revalued last quarter
- Despite positive property based activity, it was weaker valuations (which reflected higher interest rates and expanding capitalisation rates) that impacted gearing. Look-through gearing rose to 43% as did direct gearing to 40.3%
- Understanding regular income is important to all unitholders, the Cromwell Funds Management Board made some financially prudent changes to the Fund in September. These included ceasing to offer redemptions for a period of 6 months, and reducing distributions to 5.75cpu p.a; bringing it in line with expected profit from operations. Other important changes included the addition of a 5% discount to the Distribution Reinvestment Plan. Further details are listed www.cromwell.com.au/september-2023-direct-property-market-update/
- Since inception, the Fund has delivered an annualised return of 3.48% per annum with 12-month performance of -11%

In addition to the footnotes below, please read the important disclaimer on final page.

Applications for Cromwell Direct Property Fund are temporarily suspended, with likely reinstatement in early 2024. Please refer to continuous disclosure notice dated 20 November 2023 on our website for further information – www.cromwell.com.au/dpf.

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).

1. Unit prices are calculated daily. See the PDS for further information and www.cromwell.com.au/dpf for latest pricing.
2. Based on current distributions of 6.75 cents per unit p.a. and a current unit price of $1.1069 as at 30 September 2023.
3. Figures as at 30 September 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 ORDINARY UNITS

Investment Report to 30 September 2023

Cromwell Phoenix Property Securities Fund - Ordinary Units. *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 30 September 2023

Status	**OPEN**[1]
Unit Price	**$1.0199**[2]
Distribution Yield	**N/A**

PERFORMANCE

	1 Year	3 years	5 years	10 years	Inception (Apr-08)
Fund Performance After fees & costs	4.0%	6.4%	2.0%	7.9%	6.9%
Benchmark S&P/ASX 300 A-REIT Accumulation Index	11.9%	4.9%	2.8%	7.6%	3.8%
Excess Returns After fees & costs	(7.9%)	1.5%	(0.8%)	0.3%	3.1%

Past performance is not a reliable indicator of future performance.

TOP TEN STOCK HOLDINGS[3]

- ABACUS 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 6.88% compared to a 3.84% return from the S&P/ASX 300 A-REIT Accumulation Index
- The Fund delivered a net return of -6.27% over the September 2023 quarter, underperforming the -3.04% return from the S&P/ASX 300 A-REIT Accumulation Index
- Positive contributions to the Fund's relative performance over the quarter came from overweight positions in residential developer Peet Limited and Desane Group
- Detracting from the Fund's relative performance over the quarter were overweight positions in Charter Hall Group, Hotel Property Investments, Abacus Property Group and Abacus Storage King, each of which performed poorly. An underweight position in strongly performing Goodman Group also weighed on relative performance

In addition to the footnotes below, please read the important disclaimer on final page.

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 15 November 2023 (PDS).
2. Unit price as at 30 September 2023. Unit prices are calculated daily. See the PDS for further information and www.cromwell.com.au/psf for latest pricing.
3. As at 30 September 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 30 September 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 30 September 2023

Status	**OPEN**[1]
Unit Price	**$1.2260**[2]
Distributions	**Annually**

PERFORMANCE

	3 Months	6 Months	1 Year	2 Years	Inception (Dec-19)
Fund Performance After fees & costs	(0.7%)	1.6%	17.3%	2.5%	9.4%
Benchmark Vanguard Total World Stock ETF	(0.1%)	6.4%	20.5%	3.4%	8.6%
Benchmark MSCI World Microcap AUD	(1.2%)	(0.9%)	7.2%	(10.9%)	3.7%

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 9.4% (net of fees)
- The Fund delivered a net return of -0.7% over the September 2023 quarter, outperforming microcap securities, but underperforming larger capitalisation global indices
- Increasing interest rates weighed heavily on securities which derive their value from the ownership of property. The underperformance of property-related stocks during the period, was offset by solid idiosyncratic performance of non-property-backed holdings
- Contributing positively to performance over the quarter were positions in Hong Kong listed First Pacific Corporation and Tokyo Stock Exchange listed Osaka Steel Co Ltd
- Detractors to performance included London Stock Exchange listed Weiss Korea Opportunity Fund and Compagnie de l'Odet which trades on the Paris Stock Exchange

In addition to the footnotes below, please read the important disclaimer on final page.

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.

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