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Unlisted Property Fund Report

KM Property
Thynne Street Property Fund

April 2020

Office property fund with secure lease to Commonwealth government agency, targeting 7.0%+ distributions

Thynne Street Property Fund

Contents

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

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

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Thynne Street Property Fund

April 2020

The Thynne Street Property Fund ("the Fund") is an unlisted property fund that provides an opportunity to invest in a government agency leased office property located in the suburb of Bruce, ACT. The Fund's Responsible Entity, KM Property Funds ("the RE") is seeking to raise $24.3M through the offer of 24.3M units at $1.00 per unit ("the Offer"). Funds raised will be used, in conjunction with bank debt, to invest in the office property at 1 Thynne Street, Bruce, ACT ("the Property").

The Fund provides predictable distribution income with the Property being 100% leased to the Commonwealth government agency, the Australian Institute of Health and Welfare ("AIHW"). The Property consists of a 9,578 sqm site, with a three-level office building providing 5,848 sqm of net lettable area. The building is classified as B-grade but is considered the highest graded office in Bruce, ACT. AIHW is the national agency for providing information and statistics on Australia's health and welfare. The agency has a strong history of occupying space in Bruce and has pre-committed to additional office space being built on the adjoining land for overflow office space.

The Property metrics are excellent: (1) a Weighted Average Lease Expiry (WALE) of 9.2 years, with 2 x 3 year options to extend; (2) 100% occupancy; (3) fully leased to a Commonwealth government agency; and (3) fixed annual rent increases of 3.0% p.a.

The Fund will have an initial five-year debt facility with an assumed average cost of debt of 2.18% p.a. The Manager will fully hedge the interest rate for the term of the facility. The initial debt facility of $25.5M will be reduced to $18.5M upon the successful establishment of the Fund (from a minimum subscription of $7.4M). The initial Loan to Valuation Rate (LVR) of 47% is below the bank LVR covenant of 65.0% and the initial Interest Coverage Ratio (ICR) of 5.4x is well above bank ICR covenant of 1.75x. Core Property notes that the initial fund term is 6.2 years and that the Manager will need to renew or extend the debt facility for the full term of the Fund.

The Fund will have an initial NTA of $0.88 per unit, with most of the dilution coming from stamp duty.

Fees charged by the Fund are considered to be low compared to what Core Property has seen in the market (see Figure 5: Fees In Perspective).

The Manager is forecasting a distribution yield of 7.0% (annualised) for the 3 months to 30 June 2020 (FY20), increasing to 7.1% in FY21. Core Property estimates distributions to increase to 8.0% by the sixth year of the Fund, based on fixed rental increases of 3.0%.

The Fund has a minimum subscription amount of $7.4M. If this amount is not achieved by the minimum subscription date of 31 October 2020 then investors will have their application monies returned in full plus an additional 7.0% p.a. interest (pro rata).

Core Property estimates the Fund to deliver an Internal Rate of Return (IRR) of between 7.1% - 10.2% (midpoint 8.7%) based on the Manager's assumptions and assuming a +/- 50 bps movement in the terminal capitalisation rate. Investors should note the majority of returns are expected to be derived from income distributions, as capital returns remain volatile in the current environment. The analysis includes the potential that investors may receive a capital gain or loss, based on market conditions.

Core Property recognises the Fund has an initial term of 6.2 years, however an optimal sale price for the Property may be achieved earlier in order to fully realise the value of the lease. This would depend on market conditions and the remaining lease term at that time.

It is important that investors acknowledge that the pandemic caused by the spread of the COVID-19 virus can adversely impact the performance of the Fund amidst significant macroeconomic uncertainty. The duration and severity of the outbreak remains uncertain and may negatively impact property values and potentially lower investor returns.

Investor Suitability

Core Property considers the Fund will appeal to investors seeking an attractive distribution yield, supported by a secure Commonwealth government lease. Capital returns will be dependent on the RE's ability to maintain the strong tenancy at the Property as well as overall market conditions, including any potential impact as a result of COVID-19. The Fund should be considered as part of a Core investment strategy. The Fund is illiquid, and investors should expect to remain invested for the minimum initial term of 6.2-years.

Recommended

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

Fund Details	
Offer Open:	6 April 2020
Offer Closing Date:	31 October 2020[1]
Min. Investment:	$25,000, multiples of $5,000 therafter[2]
Initial NTA:	$0.88
Liquidity:	Illiquid
FY20 Forecast Distributions:	1.74 cpu (3mths) (7.0 cpu annualised)
FY21 Forecast Distributions:	7.1 cpu
Distribution Frequency:	Quarterly, in arrears
Fund Investment Period:	6.2 years to 30 June 2026

1. The Trustee may close the Offer earlier or extend the offer at its discretion. The Trust has a Minimum Subscription date of 31 October 2020 to raise $7.4M, which may also be amended at the Trustee's discretion provided that this does not exceed 12 months form the date of the PDS.
2. The Responsible Entity may waive or vary the minimum amount at its discretion.

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Note: This report is based on the Thynne Street Property Fund Product Disclosure Statement dated 6 April 2020, together with other information provided by KM Property Funds Ltd.

Key Considerations

Management Experience: KM Property Funds was established in 2013 as Placer Property and was acquired by KordaMentha in August 2017 as part of its Investment Division. KordaMentha is a leading investment and advisory firm, with over 350 staff across Australia, New Zealand and South East Asia. Senior management are experienced and skilled in property investment with each member having over 20 years' experience in real estate and funds management.

The Property: The Fund will invest in an office property located at 1 Thynne Street, Bruce ACT. The site includes a 5,848 sqm office building with car parking for 210 vehicles including 68 undercroft and 142 on grade car spaces. The Property was purpose built in 2014 and is 100% occupied as the headquarters for the Australian Institute of Health and Welfare with a Weighted Lease Expiry (WALE) of 9.2 years (the current 15-year lease expires in June 2029 with 2 x 3-year options to renew). The lease has fixed annual increases of 3.0% p.a. The tenant appears committed to it's location as AIHW has a long history of occupying space in the suburb. AIHW has also pre-committed to an additional 1,865 – 1,965 sqm of overflow space at a new office to be built on adjoining land, and has a short lease for space at its former offices at 26 Thynne St.

Fund structure: KordaMentha has effectively underwritten the Fund via the purchase of Acquisition Units via KM Develop Trust. The Fund will require a minimum subscription of $7.4M to proceed. The balance of monies received under the Offer will be used to redeem KordaMentha's acquisition units.

Fund Strategy: The Fund's goal is to provide unitholders with regular, reliable and considerably tax deferred income with the potential of capital growth. The RE believes the Property meets the Fund's objective through a quality lease to a Commonwealth government agency, with a long WALE delivering regular income for investors.

Debt Profile: The Fund has established a five-year debt facility with a major bank for $25.5M, which will be reduced to $18.5M once a minimum subscription of $7.4M is achieved. The interest rate is 100% fixed at an all-in cost of 2.18% p.a. The initial LVR is expected to be 47% against a covenant of 65%. The RE will need to renew or establish new debt facilities for the remainder of the Fund term. Asset values need to fall by around 28% and/or income needs to fall around 68% for the Fund to breach its covenants.

Initial NTA: The Fund's initial NTA is $0.88 per unit with most of the dilution coming from stamp duty.

Distributions: The RE is forecasting distributions of 7.0% p.a. (annualised) for the 3 months to June 2020 (FY20), increasing to 7.1% in FY21. If the minimum subscription amount of $7.4M is not achieved, investors will receive a return of their application monies plus interest at 7.0% p.a. (annualised).

Fees: Core Property considers the Fund's fees to be low when compared to what has been seen in the market (see Figure 5: Fees in Perspective). Performance Fees are 20% over an 8% IRR hurdle, which is in line with current market experience.

Total Return: The Fund is estimated to deliver an Internal Rate of Return (IRR) of 7.1% - 10.2% (midpoint 8.7%) based on the Fund's +/- 50 bps sensitivity to capitalisation rates (see the *Financial Analysis section*). Investors should be aware the Fund is exposed to a capital gain or loss based on the sale price of both assets and the overall market conditions, which may deliver an IRR outside of this range.

COVID-19 Impact: Investors should be aware that property valuations may be impacted by short term volatility as a result of the impact of COVID-19 on investment markets. This may affect the long-term capital returns of the Fund. It is also important to recognise that property markets are cyclical as history has proven. Over a 25-year history of measuring returns, typically, 70% - 80% of total returns are derived via income returns which is an important feature for long-duration assets such as property.

Illiquid investment: Investors must accept that by their very nature, unlisted property funds are illiquid and should remain invested for the initial 6.2-year term of the Fund. The Manager may extend the Fund for up to three years subject to a Special Resolution (75% of votes in favour). The Manager does not provide any withdrawal facility during the initial term of the Fund and Investors should expect to remain fully invested during this period.

Investment Scorecard

Management Quality

★★★★★

Governance

★★★★☆

Portfolio

★★★★☆

Income Return

★★★★☆

Total Return

★★★★☆

Gearing

★★★☆☆

Liquidity

★☆☆☆☆

Fees

★★★☆☆

Key Metrics

Fund Structure	
A registered managed investment scheme investing in an office building located in Bruce, ACT.	

Management	
Experienced Australian fund manager with demonstrable experience in property syndication. Good mix of executive and non-executive Directors. Ability to draw upon the wider skill base of the parent being KordaMentha.	

Property Portfolio	
No of Properties:	1
Acquisition Price:	$39.3M
Property Valuation:	$39.3M
Property Location:	1 Thynne Street, Bruce, ACT
Property Sector:	Office
Key Tenant:	Australian Institute of Health and Welfare
Occupancy:	100%
WALE:	9.2 years (at April 2020)

Return Profile	
Forecast Distribution:	FY20: 1.74 cents per unit (7.0 cpu annualised) FY21: 7.1 cents per unit
Distribution Frequency:	Quarterly, in arrears
Tax advantage:	Est. 100% tax deferred distributions (FY20 and FY21)
Estimated Levered IRR (pre-tax, net of fees):	7.1% - 10.2% (midpoint 8.7%)
Initial Investment Period:	6.2 years to 30 June 2026

Risk Profile	
Property/Market Risk:	Capital at risk will depend on a single office property with a single tenant, located in Bruce, ACT.
Interest Rate Movements:	Interest rate on the debt facility is 100% fixed for the first five years of the Fund. Any change in the cost of borrowings may impact the distributable income in the remaining term of the Fund.
Property Specific Risks:	Property investments are exposed to a change in vacancy rates (noting the Property has a single tenant), prevailing market rents, and economic supply and demand.
For a more detailed list of the key risks, refer to the Risks section (Section 4) of the Product Disclosure Statement.	

Fees Paid	
Core Property considers the fees paid to the Manager to be fair when compared to what Core Property has seen in the market (see Figure 5: Fees in Perspective).	
Entry Fees:	Nil
Exit Fees:	Nil
Property Acquisition Fee:	2.0% of purchase price.
Property Disposal Fee:	1.5% of the sale price. Includes any fees to external agents.
Ongoing Management Fees:	- Management Fee of 0.65% p.a. of the Gross Asset Value (GAV) of the Fund - Fund Expenses of 0.23% p.a. (est.) of GAV.
Performance Fee:	20% of the outperformance of the Fund over an equity IRR of 8.0% (pre-tax, net of fees).

Debt Metrics	
Initial Debt / Facility Limit:	$18.5M/$18.7M (based on minimum subscription amount)
Loan Period:	5 Years to March 2025
Initial LVR / Loan Covenant:	47.5% / 65%
Initial ICR / Low ICR / ICR Covenant:	5.4x / 5.2x / 1.75x

Legal	
Offer Document:	Product Disclosure Statement dated 6 April 2020
Wrapper:	Unlisted Unit Fund
Responsible Entity:	KM Property Funds (ACN 164 635 885, AFSL 442806)
Custodian:	Perpetual Corporate Trust Limited (ABN 99 000 341 533)
Manager:	KordaMentha Real Estate Pty Ltd (ACN 121 326 207)

Fund Overview

The Fund is a closed-ended, unlisted property fund that invests in an office property in Bruce, ACT. The Fund has an initial term of 6.2 years and the Manager is targeting distributions of 7.0% p.a. (annualised) for the 3 months to 30 June 2020 (FY20), increasing to 7.1% p.a. in FY21.

KM Property Funds ("the Responsible Entity", "RE") is seeking to raise $24.3M in equity through the issue of 24.3M ordinary units at an issue price of units at $1.00 per unit ("the Offer"). The Fund has a minimum investment of $25,000, however the Manager may accept lesser amounts at its discretion.

The Fund's sole investment is a three-storey office building with car parking located at 1 Thynne Street, Bruce, ACT ("the Property"). The Property was purposed built in 2014 and fully leased to the Commonwealth government agency, the Australian Institute of Health and Welfare. The initial 15-year lease expires in June 2029 with 2x3 year options. Income is supported by fixed rental increases of 3.0% p.a.

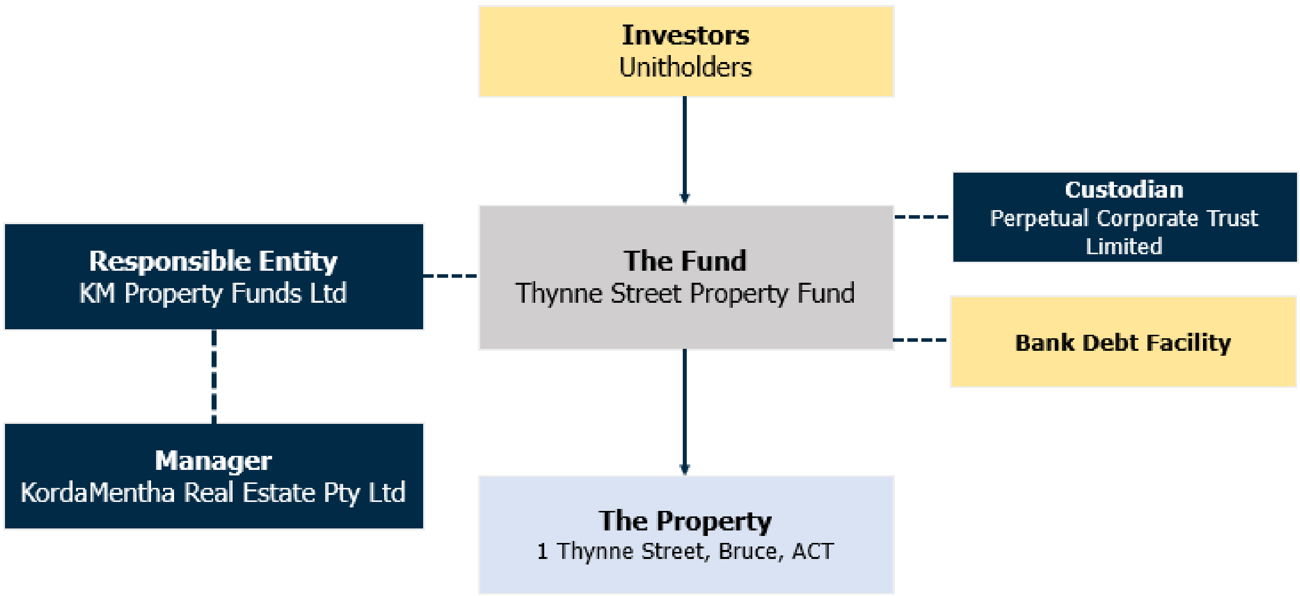
KordaMentha has effectively underwritten the Offer through the purchase of Acquisition Units by KM Develop Trust to fund the deposit and settlement of the Property on 31 March 2020. As part of the Offer, the Fund will need to achieve a minimum subscription of $7.4M on or before 31 October 2020 in order to proceed. The minimum subscription amount will be used to reduce debt to $18.5M (from $25.5M), reducing the Fund's initial Loan to Valuation Ratio (LVR) to 47%. Amounts raised in excess of $7.4M will be used to redeem Acquisition Units into Ordinary Units for investors.

In the event the minimum subscription amount is not achieved, investors will have their application monies returned in full, plus interest at 7.0% p.a.

The Fund should be considered illiquid and investors should expect to remain invested for the Fund's initial term of 6.2 years. The term of the Fund may extend beyond the initial term by up to three additional years if approved by more than 75% of votes cast.

A summary of the Fund structure is provided below.

Figure 1: Fund structure



Source: Core Property

Fund Strategy

The Fund's goal is to provide unitholders with regular, reliable and considerably tax deferred income with the potential of capital growth. The RE believes the Property meets the Fund's objective through a quality lease to a Commonwealth government agency, with a long WALE delivering regular income for investors.

To achieve the fund's objectives, the RE will actively manage the Property to maximise its income and capital growth potential and engage with the Australian Institute of Health and Wealth to seek to retain it as a tenant beyond the current term of its lease.

Liquidity / exit strategy

The Trustee intends to terminate the Fund in 6.2 years, on or about 30 June 2026 ("the Initial Period"). On or before this date, the Trustee will offer Unitholders the opportunity to vote on a Special Resolution (requiring 75% of the votes cast to be voted in favour) to extend the Fund by a further three years. If Unitholders wish to wind up the Fund, the Property will be marketed for sale, the Fund wound up and proceeds distributed to Unitholders. The Trustee may sell the Property prior to the end of the Initial Period if it considers it to be in the best interest of Unitholders.

The Trustee may also continue to operate the Fund beyond the Initial Term only if it receives Unitholder approval by:

- Fund term extension – for three years, provided a Special Resolution (75% of votes cast) is passed.
- Fund term renewal – for an extension of up to six years, provided a Special Resolution (75% of votes cast) is passed and all Unitholders who wish to exit are able to do so at the prevailing NAV per Unit.

Apart from this, the Fund does not offer any liquidity facility. Investors should consider the Fund to be illiquid and be prepared to invest for the minimum initial term of 6.2 years to 30 June 2026.

Sources & Application of funds

The PDS sets out the sources and application of funds under the terms of the Offer.

Figure 2: Sources and Application of funds

	$M	% of purchase price	% of total funds
Sources of funds			
Equity subscriptions	24.3	61.7%	56.8%
Bank Debt	18.5	47.0%	43.2%
Total source of funds	**42.7**	**108.7%**	**100%**
Application of funds			
Purchase price of property	39.3	100%	92.0%
Acquisition Costs (Stamp Duty & Costs)	2.1	5.4%	4.9%
Debt & Fund establishment costs	0.3	0.9%	0.8%
Acquisition Fee	0.8	2.0%	1.8%
Working Capital & Other	0.2	0.5%	0.5%
Total application of funds	**42.7**	**108.7%**	**100%**

Source: KM Property Funds

Debt Facility & Metrics

The Manager has agreed to terms from a large national bank for a five-year debt facility to fund the acquisition of the Property with an initial draw down of $25.5M. Upon achieving the minimum subscription amount of $7.4M, the Fund reduce the debt to facility to $18.5M, equivalent to a Loan to Valuation (LVR) ratio of 47%. The interest is 100% fixed for the full five-year term at an all-in-cost of 2.18% p.a.

- The initial LVR of 47% is well below the bank LVR covenant of 65.0%. Core Property calculates that the value of the Property must fall by 27.7% for the LVR covenant to be breached.
- The initial Interest Coverage Ratio (ICR) is 5.4x for FY21 against a bank ICR covenant of 1.75x. Core Property calculates the net operating income must fall by 67.4% for this covenant to be breached.

Investors should be aware that any change in the final debt terms may impact final returns provided by the Fund. Given that the term of Fund is 6.2 years, it is assumed that the Manager will refinance the debt for the full initial term of the Fund.

Figure 3: Debt Metrics

Details	Metric
Bank	Commonwealth Bank of Australia
Security	First ranked mortgage secured against the Property and a general security over the assets of the Fund
Debt Facility Limit at Settlement / at Minimum Subscription Date	$25.5M / $18.7M
Initial Draw Down / as Minimum Subscription Date	$25.5M / $18.5M
Initial Loan Period	5 years to 31 March 2025
% Hedged at Minimum Subscription Date	100%
Assumed all-in cost of Debt	2.18%
Initial LVR / Peak LVR / LVR Covenant	47.0% / 47.5% / 65.0%
Initial interest covered ratio / ICR bank covenant	5.4x (FY21) / 1.75x
Amount by which valuation will have to fall to breach LVR covenant	27.7%
Amount by which income will have to fall to breach ICR covenant	67.4%

Source: KM Property Funds, Core Property

Fees Charged by the Fund

Overall, Core Property considers the ongoing management fees charged to be appropriate and at the low end what has been seen in the market (0.7% – 1.1%). A summary of the Fees is provided below.

Figure 4: Summary of Fees charged by the Fund

Fee Type	Fee Charged	Core Property Comment
Entry/Establishment Fee	Nil	
Exit /Withdrawal Fee	Nil	
Transaction Fee (Acquisition Fee)	2.0% of the purchase price of the property.	The Acquisition Fee is at the high end of what Core Property has typically seen in the industry of 1.5% - 2.0%.
Disposal Fee	1.5% of the sale price of the Property.	The Fee is at the mid-point of what Core Property has typically seen in the industry of 1.0% - 2.0%. The Fee includes any payments to external agents if appointed.
Management Fee	Total Management Fees of around 0.65% of the Gross Asset Value (GAV) of the Fund	The Fee is at the low end of the range of what Core Property has typically seen in the industry (0.7% - 1.1% p.a. of GAV).
Administration Costs & Expenses	Costs and expenses are estimated at 0.23% p.a. of the GAV of the Fund	
Performance Fee	20% (excluding GST) of the Fund's performance above an IRR of 8% p.a. after fees and costs.	Fee is in line with current market expectations.

Source: KM Property Funds, Core Property

All-in fee analysis

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

Core Property estimates that KM Property Funds is entitled to 7.3% of the total cash flow. Core Property considers the fees paid to the Manager to be low when compared to similar products, which are typically around 7% - 9%. In terms of the fees paid to the Manager, Core Property estimates that 24.8% of the estimated fee is paid upfront and the remainder relates to ongoing management fees. Core Property stresses that these are estimates of how much investors will receive and not guaranteed amounts. For further details, please refer to the *Financial Analysis* section.

Figure 5: Fees in Perspective

Core Property estimates that for every $1.00 of equity invested the Fund can return:	Amount per $1.00 unit
Principal repayment to investors:	$1.00
Income and capital gains to investors:	$0.66
Total cash to investors:	**$1.66**
Acquisition fee:	$0.03
Base management fee:	$0.07
Disposal fee:	$0.03
Fees for the Manager (excluding disposal/admin):	**$0.13**
Total cash generated by Fund:	**$1.79**
Fees = % of total cash generated (before fees)	7.3%
Fees= % of gains (before fees)	16.5%
Up-front fee vs total fees	24.8%

Source: Core Property

The Property

The Property is a 9,578 sqm site located within the Fern Hill Business Park in Bruce, ACT. The site comprises a modern three level office building constructed in 2014. Net lettable area (NLA) is 5,848 sqm with upper floor plates of around 1,950 sqm around a central core with two lifts. Parking is available for 210 vehicles, including undercroft parking with 68 bays as well as on grade car parking with 142 bays. The Property enjoys a 5-star NABERS Energy rating.

The Property was purpose built as the headquarters for the Australian Institute of Health and Welfare (AIHW), which entered into a new 15-year lease from June 2014 to June 2029, with a further 2 x 3 year options available. The Australian Institute of Health and Welfare is the national agency for information and statistics on Australia's health and welfare. Statistics are used to inform discussion and policy decisions on health, community services and housing assistance. The agency was established under the *Australian Institute of Health and Welfare Act 1987*. AIHW has a long history of occupying space within the suburb of Bruce, and within the Fern Hill business park. This includes its prior location at 26 Thynne Street, where AIHW still maintains occupies 1,000 sqm of space.

The Property provides a number of benefits to AIHW, including:

- Close proximity to the University of Canberra, which AIHW has collaborated with on a number of occasions.
- Close proximity to nearby facilities including the Belconnen Town Centre, the Australian Institute of Sport and Canberra Stadium.
- The leading, highest rated office building within the Bruce office market. The Property is classified as a B-grade property by the Property Council of Australia (PCA), with arguably many A-grade features.

In addition to its tenancy at the Property, AIHW has pre-committed to additional office space of between 1,865 sqm and 1,965 sqm on the adjoining site, which is under construction and expected to be completed around mid-2021. The adjoining site is expected to be smaller in scale and includes ancillary ground floor retail/commercial suites as well as third floor residential apartments as part of a larger mixed-use project known as "Wish". This new building will provide "overflow" accommodation for AIHW. The expiry of the new building's lease is expected to extend beyond the current lease term at the Property, which is indicative of AIHW's commitment to the location.

Figure 6: 1 Thynne Street, Bruce ACT

Source: KM Property Funds, Knight Frank, ACTMAPi, Google maps

Valuation of the property

An independent valuation was undertaken by Knight Frank in January 2020 valuing the Property at $39.3M, in line with the acquisition price.

The RE intends that, commencing 30 June 2021, the Property will be independently valued annually by a qualified valuer.

Figure 7: Property summary

1 Thynne Street, Bruce, ACT	
Title	Crown Leasehold Title
Construction Date	2014
Ownership	100%
Site Area	9,578 sqm
Gross Lettable Area	5,848 sqm
Net Lettable Area	5,848 sqm
Tenant	Australian Institute of Health and Welfare
Weighted Average Lease Expiry (WALE)	9.2 years
Occupancy	100%
Initial net passing income	$2.5M
Net market income (fully leased)	$2.5M
Purchase price	$39.3M
Valuation (DCF)	$39.3M
Passing initial yield	6.28%
Cap rate	6.125%
Valuer	Knight Frank Valuations
Value/sqm	$6,720 per sqm
Valuer’s unleveraged 10-year IRR	6.53%

Source: Knight Frank Valuations

Leases, tenants and income

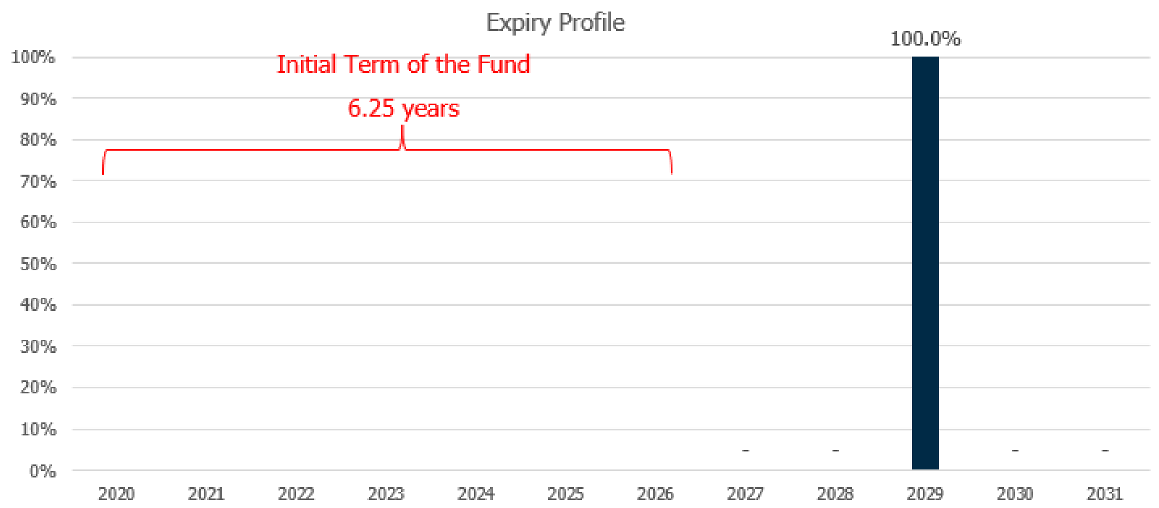
The Property was specifically built for the Australian Institute of Health and Welfare (AIHW), which fully occupied the Property upon completion and entered into an initial 15-year lease from June 2014 to June 2029, with 2 x 3 year options to renew by the tenant. The lease is structured on a semi gross basis, with the lessee, (AIHW) responsible for increases in statutory charges over the base year defined amount with rent subject to fixed annual increases of 3.0% p.a.

Commencement rent in 2014 was $2.5M p.a. gross ($422 per sqm) and is currently $2.9M p.a. gross or around $497 per sqm. The rent is inclusive of 210 car parking spaces (68 undercover and 142 on-grade). The independent valuer, Knight Frank, has estimated this to be equivalent to $437 per sqm excluding car parking, based on market estimates for comparable car parking.

The Property is Leasehold and is subject to a Crown Lease to the Commonwealth, commencing June 2016 and expiring February 2085, with approximately 65 years remaining. Land rent to the Commonwealth is a nominal 5 cents p.a.

The tenant is not obliged to make good upon vacating the premises but must do so if any tenant fittings are removed.

Figure 8: Property Lease Expiry (by income)



Source: KM Property Funds, Core Property

Market Sales Evidence

The figure below shows the comparable sales transactions for similar assets provided by the independent valuer, Knight Frank over the past 12 months. The sales evidence suggest that the Property is being acquired at a price equivalent to $6,720 per sqm compared to an average of $6,393 per sqm (excluding vacant properties) over the past 12 months. Core Property considers the slightly higher rate is indicative of the longer WALE and strength of the tenant.

Figure 9: Recent sales evidence

Property	Sale Price	Sale Date	WALE (years)	Occ (%)	Initial Passing Yield	Core Market Yield	IRR	NLA (sqm)	Price per sqm (NLA)
2 Phillip Law St, New Acton, ACT	$256.0M	Dec 19	7.9	99.5%	NA	5.1%	6.1%	27,411	$9,330
The Nishi building at 2 Phillip Law St is an 11-level, A-grade office building with a hotel and cinema on the ground and mezzanine levels. Completed in 2012, the key tenants are the Commonwealth government (54% of income), Ovolo Hotels (11%) and Clayton Utz (8%).									
205 Anketell St, Greenway, ACT	$10.8M	Aug 19	2.1	~34%	NA	13.0%	13.1%	5,852	$1,837
205 Anketell St is a refurbished, secondary office building partially leased to the ACT government (Canberra Institute of Technology), plus ground floor tenancies.									
40 Allara St, Canberra, ACT	$23.0M	Jul 19	Vacant on settle	NA	NA	NA	NA	5,572	$4,128
40 Allara St was acquired off market by Meriton with settlement delayed until expiry of all leases in mid-2020. Meriton have announced the building will be demolished with a five-star, 230 room hotel to be developed at the site.									
16-18 Mort St, Canberra, ACT	$108.5M	Jun 19	6.6	100%	6.8%	5.7%	6.5%	14,146	$7,670
16-18 Mort St is an A-grade office located on a high exposure corner site in the northern fringe of the Canberra CBD. Constructed in 1992, with refurbishments between 2010 and 2014, the building is full leased to key tenants Telstra (97.6%) as well as F45 gymnasium, Wollemi Ethical and Pack & Send.									
Finlay Crisp Offices, 1 Constitution Ave, ACT	$62.0M	May 19	NA	NA	NA	NA	NA	14,300	$2,174
Finlay Crisp Offices comprises three B-grade buildings on individual titles. Two buildings are occupied by the Department of Home Affairs which will vacate in mid-2020. The third building is occupied by the ACT government, who are constructing their new headquarters opposite, with retention prospects unclear. Settlement in mid-2020, following expiration of the Department of Home Affairs leases.									
10 Moore St, Canberra, ACT	$35.0M	May 19	4.3	100%	6.9%	6.7%	7.3%	6,709	$5,217
10 Moore St is a level A-grade office built circa 1985. The property was placed on the market following the retention of major tenant, Optus (33.9% of NLA) in early 2019.									
121 Marcus Clarke St, Canberra, ACT	$102.9M (50% share)	Apr 19	4.9		6.0%	5.6%	6.4%	25,692	$8,003
An off market sale of a 50% interest in 121 Marcus Clarke St, a high profile 11-storey A-grade tower with strong corporate and Commonwealth government tenants.									
24 Wormald St, Symonston, ACT	$29.8M	Mar 19	8.6	100%	6.9%	6.5%	6.9%	4,720	$6,303
24 Wormald St is a 3-level, high specification, commercial facility completed in 2007. The building was purpose built for the Commonwealth for data centre and office uses and is located within the AMTECH estate.									
Average (excl vacant properties)			**5.7**		**6.65%**	**7.1%**			**$6,393**
Range			**2.1 – 8.6**		**6.0% - 6.9%**	**5.1% - 13.0%**			**$1,837 - $9,330**
1 Thynne St, Bruce, ACT	**$39.3**	**Mar 20**	**9.25**	**100%**	**6.3%**	**6.2%**	**6.5%**	**5,848**	**$6,720**

Source: Knight Frank

Market Rental Evidence

The figure below shows details of comparable site lease deals as provided by the independent valuer. Overall the independent valuer considers the current rental rate to be appropriate based on the comparable rental evidence in the market.

The valuer notes the lease for the Property is inclusive of car parking. As such, the comparable rents have been adjusted to exclude car parking in order to provide a like for like comparison. On a like for like basis, the independent valuer calculates the Property's passing rent to be $437 per sqm (excluding car parking), which is considered to be in line with the independent valuer's assessment of market rent at $435 per sqm.

A summary of recent comparable rents is provided below.

Figure 10: Recent comparable leasing deals

Tenant / Property	Commence	Term	Face Rent	Parking Incl	Incentives	Type	NLA
Comparable Locations, Lower Quality Buildings							
Commonwealth DHS 5 Fussell Lance, Gungahlin ACT	Sep 2019	12 years	$470 per sqm	Y	20.0%	Gross	1,020 sqm
NDIS 274 Reed St, South Greenway ACT	Sep 2018	3 years	$395 per sqm	Y	N/A	Semi Gross	2,174 sqm
Commonwealth DSS 286 Reed St, South Greenway ACT	Sep 2018	3 years	$395 per sqm	Y	5.6%	Semi Gross	2,174 sqm
AIHW 26 Thynne St, Bruce ACT	Sep 2018	3 years	$325 per sqm	Y	22.5%	Gross	1,000 sqm
Barnardos 26 Thynne St, Bruce ACT	Jun 2016	5 years	$350 per sqm	Y	17.0%	Gross	1,674 sqm
Commonwealth DHS 185 Scollay St, Greenway ACT	Aug 2018	3 years	$360 per sqm	Y	8.3%	Gross	2,783 sqm
ACT Government (CIT) 205 Anketell St, Greenway ACT	Feb 2016	10 years	$450 per sqm	N	20.0%	Semi Gross	1,665 sqm
Superior Locations – refurbished B-grade buildings							
Callida Consulting 28 National Circuit, Forrest ACT	Nov 2019	5 years	$505 per sqm	N	25.0%	Semi Gross	758 sqm
Australian National University 7-11 Barry Drive, Turner ACT	Oct 2019	5 years	$404 per sqm	N	NA	Semi Gross	2,058 sqm
MTAA Superannuation Fund 39 Brisbane Ave, Barton ACT	Aug 2019	6 years	$430 per sqm	N	18.5%	Semi Gross	1,117 sqm
BAE Systems Australia 39 Brisbane Ave, Barton ACT	May 2019	10 years	$415 per sqm	N	27.0%	Semi Gross	1,740 sqm
Accenture Australia 55 Wentworth Ave, Kingston ACT	Apr 2019	1 year, 5 mths	$440 per sqm	N	NA	Semi Gross	645 sqm
Ignite 55 Wentworth Ave, Kingston ACT	Apr 2019	3 years	$445 per sqm	N	NA	Semi Gross	479 sqm
Synergy Group 15 National Circuit, Barton ACT	Mar 2019	10 years	$410 per sqm	N	22.2%	Gross	1,579 sqm
AIHW 1 Thynne St, Bruce ACT	**Jun 2014**	**15 years**	**$437 per sqm (passing)**	**Excl car parking**	**10.1%**	**Gross**	**5,848 sqm**
Independent Valuer's assessment of market rent			**$435 per sqm**	**Excl car parking**		**Gross**	
Comparable Locations – Lower Quality buildings			$285 - $458 per sqm	Excl car parking	5.6% - 22.5%		
Superior Locations – refurbished B-grade buildings			$404 - $445 per sqm	Excl car parking	18.5% - 27.0%		

Source: Knight Frank, Core Property

The Canberra Office Market

The Canberra Office market is one of the largest office markets in Australia with 2,293,738 sqm of space as at July 2019. Around 30% of office space is located in the Canberra CBD with the remainder spread across key localities including the CBD Fringe, Parliamentary Precinct, Belconnen, Woden, Tuggeranong and the Airport.

The Canberra office market is characterised by a predominance of government tenancies with over 50% of space tenanted by the Commonwealth of Australia. Current vacancy levels are 10.6% at December 2019, the lowest level since 2012.

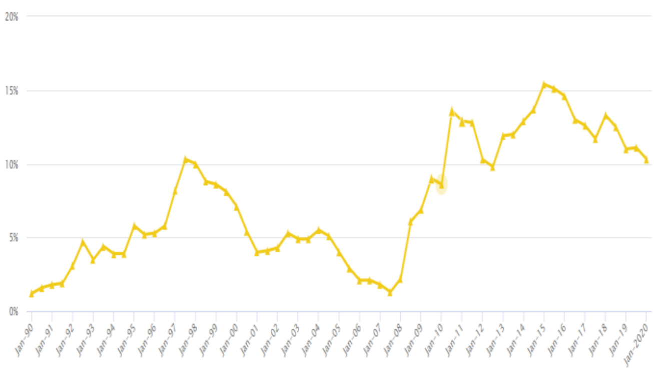
The following tables are provided as at December 2019, and it is noted that the market is likely to experience a fair amount of uncertainty in 2020 as a result of the economic conditions brought about by the COVID-19 virus.

Figure 11: Office Market – Vacancy Levels

Vacancy Rates	31 Dec 2019
Sydney CBD	5.0%
Chatswood	7.5%
St Leonards	9.4%
Canberra	10.6%
Brisbane CBD	11.7%
Brisbane Fringe	13.7%
Melbourne CBD	3.4%
Melbourne Fringe	6.3%
Perth CBD	19.1%
West Perth	19.9%
Adelaide CBD	14.4%

Source: JLL

Figure 12: Canberra Office Market – Historical Vacancy Levels



Source: Property Council of Australia

The Bruce office market was established in the 1980's as a technology hub with most of the C-grade buildings being built in the 1980's and 1990's. As at July 2019 the total office stock in Bruce totaled 27,112 sqm of office space with an 8.2% vacancy rate. The Property is the only B-grade office asset in the suburb.

Figure 13: Bruce Office Market – July 2019

Building Grade	NLA (sqm)	NLA (%)	Total Vacancy (sqm)	Total Vacancy (%)
A Grade	0	0%	0	0%
B Grade	5,848	21.6%	0	0%
C Grade	21,264	78.4%	2,231	10.5%
D Grade	0	0%	0	0%
Total	**27,112**	**100%**	**2,231**	**8.2%**

Source: Knight Frank, Property Council of Australia

Capital expenditure

The independent valuer has estimated approximately $0.8M of capital expenditure over the 6.2-year term of the Fund, increasing to $2.1M over 10-years to include end of lease upgrades to services.

As part of the RE's due diligence on the Property it has identified Aluminum Composite Panels (ACP) around the main entrance and the rear entrance of the building. An independent expert report has concluded the ACP represents an acceptable risk to life safety and no remediations works were recommended. Despite this, the RE has included an amount of $0.4M within the capital expenditure budget to replace the panels.

The RE's forecasts take into account the above capital expenditure, with the amount expected to be funded via the Fund's cashflow plus a $0.2M increase in debt.

Financial Analysis

Core Property has reviewed the financial forecasts as provided in the Product Disclosure Statement. The key observations are:

- Forecasts are based on fixed annual rental growth of 3.0% p.a. as per the terms of the lease.
- Assumes an all-in cost of debt of 2.18% p.a. fixed for five years.
- Assumes the Property remains fully leased for the initial term of the Fund.
- The Manager is forecasting distributions of 7.0% p.a. (annualised) on a pro rata basis from 1 April 2020 to 30 June 2020, increasing to 7.1% p.a. in FY21. Core Property estimates that, based on fixed annual rental growth of 3.0% p.a., distributions can increase to 8.0% p.a. (annualised) in the sixth year of the Fund, after taking into account capital expenditure.
- Forecasts assume the Fund raises the minimum subscription amount of $7.4M. If the amount is not raised by the Minimum Subscription Date, then investors will receive a full return of capital invested plus interest at a rate of 7.0% p.a. (annualised).

A summary of the RE's forecasts from the Product Disclosure Statement is presented in the table below:

Figure 14: Profit & Loss Forecast and Balance Sheet

Profit & Loss - Forecast $M	**FY20 – 3 months (1 April 2020 – 30 June 2020)**	**FY21 – 12 months to 30 June 2021**
Total Property Income	**0.7**	**2.9**
Interest Income	0.0	0.0
Expenses (Management Fee, Fair Value adjustments)	-0.2	-0.7
Interest Expense	-0.1	-0.5
Net Profit	0.4	1.7
Net Adjustments (Straight line rental income, amortisation of costs, fair value adjustments)	0.0	0.1
Funds available for distribution	**0.4**	**1.8**
Cash distribution	**0.4**	**1.7**
Cash distribution per unit (cents)	1.74	7.1
Annualised distribution yield	**7.0%**	**7.1%**

Balance Sheet – Forecast $M – Pro forma based on Minimum Subscription Offer	**Minimum Subscription Date (1 April 2020)**
Cash	0.2
Property	39.3
Other assets	-
Total Assets	**39.5**
Interest-bearing debt	18.5
Capitalised borrowing costs & Other Liabilities	-0.4
Total Liabilities	**18.0**
Net Assets	**21.5**
Units on Issue	**24.3**
NTA per unit	**$0.88**
Gearing	**46.8%**
Bank LVR – Drawn debt	**47.0%**
Bank LVR – Facility limit	**47.5%**

Source: KM Property Funds, Core Property

NTA Analysis

The starting NTA is an important consideration. It should be assessed in the context of statutory costs and fees paid to the Manager, which dilute investor's return over the term of the Fund. In this case, the starting NTA is $0.88 per unit, with most of the dilution coming from stamp duty costs.

Figure 15: Initial NTA

Amount per unit	$ per unit
Issue Price	$1.00
Less:	
Stamp duty	-$0.09
Debt & Fund Establishment costs	-$0.01
Managers Fee	-$0.03
Add back:	
Working capital & capitalised costs	$0.01
NTA per unit	**$0.88**

Source: Core Property

Expected Future Performance (IRR Sensitivity)

The three main performance drivers in a property syndicate are:

1. The property income profile (lease structure);
2. The terminal value upon the sale of the property (asset quality + market conditions); and
3. The cost of debt (depending on leverage).

Using these assumptions Core Property expects the Fund to deliver a 6.2-year Internal Rate of Return (IRR) in the range of 7.1% - 10.2% (midpoint 8.7%) The calculation is based on the RE's forecasts and assumes a +/- 50 bps movement in the terminal capitalisation rate. Core Property notes that the interest rate on the debt facility is fixed at 2.18% p.a. for 5 years, and is assumed to increase to 2.40% in year 6 and then 3.08% in year 7. Due to the fixed interest rate the performance of the Fund is less sensitive to interest rate movements and is more dependent on the terminal capitalisation rate of the Property.

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

The following table shows our estimated IRR for the Fund based on the Manager's assumptions.

Figure 16: Pre-tax, 6.2-year IRR (after fees) sensitivity analysis

Terminal cap rate	Cost of debt 2.18% (5 years), then 2.40% in year 6
5.63%	10.2%
5.88%	9.4%
6.13% (base)	**8.7%**
6.38%	8.0%
6.63%	7.1%

Source: Core Property

Management & Corporate Governance

Background of the Manager

KM Property Funds was established in July 2013 as Placer Property Limited with a primary objective to facilitate quality commercial property investment opportunities for investors seeking regular and reliable income. In August 2017 Placer Property was acquired by KordaMentha and now forms part of the Investment Division of its Real Estate Group. It was later renamed to KM Property Funds ("The Manager"). KordaMentha is a leading investment and advisory firm, with over 350 staff across Australia, New Zealand and South East Asia. Since 2007, KordaMentha Real Estate has advised or transacted on over $14.0B of property and has over 35 real estate staff.

Core Property has reviewed the composition of the senior management team and consider it has the relevant skills and experience to operate the Fund successfully.

Figure 17: Board and Management

Name & Role	Experience
James Walsh Non-Executive Chairman	James has over 30 years' experience as a company director with considerable expertise across industrial and service businesses in the areas of strategy, M&A, risk management, financing and the management of growth. James was appointed to the Board in March 2018 and is a member of the Audit, Risk Management and Compliance Committee. James is currently the Chairman of GMHBA Limited and is a Non-Executive Director of Secos Group Limited. James holds a Bachelor of Commerce from Deakin University, a Master of Business Administration from Melbourne Business School, is a graduate from the Australian Institute of Company Directors and is a Fellow member of the Institute of Chartered Accountants ANZ.
Janette Kendall Non-Executive Director	Janette has more than 23 years' board experience across public, private and not-for-profit organisations. Janette has significant expertise in strategic planning, digital innovation, marketing, operations and leadership across industry sectors including digital and technology, marketing and communications, media, retail, fast-moving consumer goods, hospitality, gaming, property and manufacturing. Janette was appointed to the Board in March 2018. Janette is currently a Non-Executive Director of Vicinity Centres, Costa Group, Australian Venue Co and Melbourne Theatre Company. Janette holds a Bachelor of Business – Marketing and is also a Fellow of the Australian Institute of Company Directors.
Tom Davis Managing Director	Tom is an Executive Director since August 2017. Tom is a Partner with the KordaMentha Real Estate division and has been at KordaMentha since 2005 where he has worked on strategic property portfolio reviews, asset divestment, investment analysis and management. Tom is responsible for real estate investment advisory, principal investment and structured finance investment, transaction and asset management. Tom holds a Bachelor of Business (Property) with Distinction from RMIT University and a Graduate Diploma of Applied Finance and Investment from the Financial Services Institute of Australasia. Tom is also a Licensed Real Estate Agent.
David Omond Joint Managing Director	David has more than 25 years' experience in commercial property management, development, funds management and corporate finance. David has held numerous senior management positions at Heine Management, MCS Property and Centro Properties Group. David is a co-founder of KM Property Funds and was appointed Joint Managing Director in September 2013. David holds a Bachelor of Business (Property) from the University of South Australia.
Mario Papaleo Joint Managing Director	Mario has more than 22 years' experience in direct real estate, listed and unlisted property investment and funds management, including working as a fund manager of Centro Retail Trust, as an Analyst and Syndicate Fund Manager for Heine Management Limited, as a consultant for Jebb Holland Dimasi as well as direct property and asset management experience for McDonald's Australia Limited Store Development Group. Mario is a co-founder of KM Property Funds and as appointed Joint Managing Director in September 2013. He holds a Bachelor of Business (Property) from RMIT University and a Graduate Diploma of Applied Finance and Investment from the Securities Institute of Australia.
Bernadette Spiteri Director, Investment Services	Bernadette has over 25 years' experience in financial services and has held senior executive management roles in distribution, marketing, product development and investor relations. She has worked with Bankers Trust Australia, MCS Property, Centro Properties Group, Portfolio Partners Limited and Orchard Funds Limited before joining KM Property Funds in January 2015. Bernadette is a Senior Associate of the Financial Services Institute of Australasia (FINSIA).
Mary Barnett Chief Financial Officer	Mary has 20 years' experience in Australia and Singapore in managing bid pricing, consolidations, forecasts, budgets, tax and reporting obligations. Mary is a Director with KordaMentha and has worked with the firm for 9 years. Prior to this Mary was the Financial Controller of the Real Estate Services division at United Group. Mary was appointed Chief Financial Officer in December 2017. Mary holds a Bachelor of Science Education, Mathematics from the University of Melbourne, a Masters in Practising Accounting from Monash University and is a Chartered Accountant.

Source: KM Property Funds

Compliance and Governance

ASIC Regulatory Guide 46 "Unlisted property schemes: Improving disclosure for retail investors" describe ASIC's preferred disclosure principles and benchmarks.

Core Property has reviewed the PDS in reference to the six benchmarks and eight disclosure principles recommended by RG46. The PDS adheres to and meets the relevant benchmarks and disclosure principles as required by ASIC guidelines.

The Fund's compliance committee comprises three independent members, with Chairperson Nick Stretch (who is a partner of Denton's law firm), and independent directors Peter Flynn (Director at Intercommercial Property Group) and James Walsh.

Related Party Transactions

The Manager has a "Related Party and Conflict of Interest Policy" which addresses disclosure of conflicts of interests to unitholders and, if required, steps to manage the conflict in an appropriate manner.

The Manager has advised in the PDS that a related party transaction was undertaken to fund the initial acquisition of the Property by the Fund. This involved KM Develop Trust acquiring the "Acquisition Units" to establish the Fund. KM Develop Trust is an associated entity of the Manager.

Past Performance

Since July 2013 KM Property Funds has established seven other unlisted property funds:

- The NewActon East Property Fund was launched in September 2014 and has delivered distributions of 7.75% - 8.7% p.a. since inception. The Manager has advised the Fund has delivered an IRR of 10.7% p.a. since inception, after fees.
- The Stables Property Property Fund was launched in May 2016 and has delivered distributions of 7.6% p.a. since inception. The Manager has advised the Fund has delivered an IRR of 9.0% p.a. since inception, after fees.
- The 333 Exhibition Street Property Fund was launched in March 2018 with average distributions of 6.7% p.a. The Manager has advised the Fund has delivered an IRR of 17.6% p.a. since inception, after fees.
- The Cambridge Bedford Property Fund was launched in February 2019 and owns two office assets at 7 Laffer Drive, Bedford Park Adelaide and 89 Cambridge Drive, Cambridge, Hobart TAS. The Fund is targeting distributions of 8.5% during its initial year.
- The Laverton North Property Fund was launched in August 2019 and owns an industrial cold store facility in Laverton North, located in Melbourne VIC. The fund is targeting distributions of 8.25% during its initial year.
- Terrace Office Park Property Fund is a value add opportunistic fund for wholesale investors only. The Fund owns a commercial property in Fortitude Valley, QLD.
- Thebarton Square Fund owns a commercial property in Thebarton, SA for wholesale investors.

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

Appendix – Ratings Process

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

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

The Ratings

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

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

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