THE CAPITAL Courier
an Investor Update
ISSUE No.6

## PROPERTY Update


*PFA's Cameron Donaldson with Mr John Pippos (right) of Post Office Square News in front of his new relocated newsagency.*

## POST OFFICE SQUARE NEWSAGENCY OPENS

We are pleased to advise the Post Office Square newsagency has opened for trading in its new Queen Street entrance location. In your last investor update, we reported on the new 12 year lease.

The new location for the long-term tenant of Post Office Square, has allowed the newsagency's owners to double the size of their shop and design their shop fit-out to allow easy access from both its Post Office Square and adjoining 300 Queen Street food court entrances. The newsagency is now one of only three within the CBD that has direct exposure to Queen Street.

Mr John Pippos, one of the newsagency owners, said "We've tried to make it an interesting place to browse. We've diversified and are selling a greater range of stock."

We believe the newsagency complements the service nature of the pharmacy opposite and provides a far more inviting entrance to the retailing area from Queen Street.

## HOMEWORLD'S VALUE JUMPS

As advised in your last investor update, a revaluation of the Homeworld Centre has been completed for the purposes of the Fund. We are pleased to advise that as at March 2002, the property was revalued at $26,600,000.

In September, 1999, at the time of purchase of the property, the Homeworld Centre was valued at $23,700,000.

This new valuation reflects a 12% increase in the value of the property since the commencement of the Fund.

The finalisation of the 15 year lease to 2017 to ALDI Supermarkets and the increase in rent achieved in the last ACT Government's office lease rent review have been the principal contributing factors to the increased valuation for the Centre.

Upon the conclusion of the forthcoming Woolworths liquor 15 year lease (announced elsewhere in this update) we are confident of a further increase in the value of the Homeworld Centre.

## WOOLWORTHS LIQUOR COMES TO HOMEWORLD

Lease terms have been agreed with Woolworths Limited to lease the 1,272m$^2$ previously occupied by BBC Hardware whose lease expired in May this year. Scheduled to commence in December, this lease is to be for 15 years at a rental well in excess of that previously paid by BBC Hardware for the same space.

The premises will be operated by Woolworths as a Dan Murphy's liquor outlet. Dan Murphy's is one of the many Woolworths liquor brands which include Macs Liquor, BWS and Safeway Liquor. Woolworths is keen to develop the Dan Murphy's brand in Victoria and the ACT.

*(continued overleaf)*

PROPERTY FUNDS AUSTRALIA LIMITED
ACN 078 199 569

## WOOLWORTHS LIQUOR COMES TO HOMEWORLD (CONT.)

Dan Murphy's

Woolworths through its many brands already has 422 liquor outlets throughout Australia. The Homeworld outlet will be the 14th Dan Murphy's outlet in Victoria and ACT.

We are confident that this new lease deal will materially further increase the value to the Homeworld property over and above the increases in value which have been recently gained (see article "Homeworld Value Jumps").

To achieve the transaction, it was necessary for us to be successful in a town planning application which was the subject of an objection by the owner of the adjoining retail centre, the Hyperdome.

The deal, however, does not come without some cost and pain to the Owner as some $550,000 of capital expenditure and incentives will have to be borne by the Fund. Nevertheless, the Dan Murphy's transaction is another step in the process of re-setting Homeworld for the future.

## ON-SITE MANAGER APPOINTED

We are pleased to advise that an on-site Centre Manager commenced at The Homeworld Centre on 1 July, 2002. As previously reported, Knight Frank were appointed as the principal property manager for The Capital Collection properties. Subsequently, they have now also been appointed to carry out the physical day-to-day management of Homeworld replacing previous manager, Jones Lang LaSalle.

We believe that the appointment of an on-site manager to Homeworld will give a significant boost to the Centre.

Jones Lang LaSalle previously handled the physical management on an off-site basis.

## QUEENSLAND GOVERNMENT INCREASES LAND TAX

Contrary to the previous commitment by the Queensland Government to reduce land tax, the Queensland Government in its last annual budget resolved to abolish the land tax rebate which was (for corporations and trusts) 15% of the assessable land tax.

In Queensland, land tax is not recoverable from tenants. As a consequence, the State Government's decision goes directly to the bottom line of property owners like Post Office Square in The Capital Collection – Diverse Sector Fund. The Property Council of Australia, the property industry's peak body, has strongly expressed the industry's concerns at this significant "about face" by the Queensland Government. This is, particularly so, at a time when the State Government has the benefit of GST revenues enabling it to work towards reducing imposts such as land tax and stamp duty. The Queensland Government had previously undertaken to abolish land tax completely by 2006.

## SIGNIFICANT JUMP IN INSURANCE COSTS

As many of you have no doubt read and experienced, there have been significant increases in premiums in many areas of insurance. One of the areas that has been most significantly affected has been public liability insurance where increases in premiums of up to 600% have been experienced.

In the case of The Capital Collection, insurance premiums have increased 375% for Post Office Square and the Homeworld Centre over the last two years or so.

There are a number of reasons that have been given for insurance premium increases and, in particular, public liability insurance. These include:-

- the collapse of HIH insurance;
- the events of September 11, 2001;
- reduction in insurance market capacity;
- significant increases in re-insurance costs;
- insurers needing to improve profitability;
- changes in public expectation such that "if something happens – someone else pays".

Unfortunately for The Capital Collection (despite the good insurance record of the properties) both Post Office Square and the Homeworld Centre, as high traffic retail properties, are considered a potentially high liability hazard with consequent premium charges.

We have taken a proactive stance to risk management and engaged Risktech, an independent risk manager to professionally survey each of the properties under our funds management and provide a risk analysis and control program report for insurance underwriting purposes. Whilst this partly assisted in our last premium negotiations, we are hopeful that it will stand us in better stead at our next insurance renewal negotiations, particularly compared with many insured who have not recognised the benefits of taking action of this nature. To put the issue in context, it should be remembered that there are a number of bodies that were unable to obtain public liability cover.

You should also be aware that as with most entities of the Fund's nature, you do not have the benefit of terrorism cover, although the Federal Government is working towards a “pooled” arrangement similar to that operating in the UK.

## 02/03 DISTRIBUTION POLICY TO BE 8.00%

The PFA Board has determined that the distribution policy for the balance of the forthcoming financial year will be at 8.00% p.a. until further notice.

### WHY THE CHANGE TO DISTRIBUTION?

A number of positive events have occurred for both properties over the last year. Whilst these events have helped secure the underlying value of the properties, they have come at some cost to cashflows of the Fund in the short to medium term. The incentives, rent free periods and capital works necessary to enable the number of long term tenancies to be put in place, in the end affect short term cashflows.

Long term leases negotiated over some of the larger tenancy areas within the retail component of the Homeworld property include:-

- ALDI Supermarkets – 15 years;
- Woolworths Limited – 15 years;
- ACT Government – 10 years;
- NCDI Radiology – 10 years.

Similarly, in Post Office Square, the following long term leases have also been negotiated in recent times:-

- Post Office Square News – 12 years;
- Pharmacy – 10 years;
- Coffee Club – 10 years.

To enable some of these transactions to occur, surrender and relocation costs were incurred, and vacancies purposely created to enable the overall property strategy to be given effect.

In addition to this impact, the operating expenses have been subjected to unanticipated levels of increase (particularly in areas outside owner / manager control) such as the unprecedented jump in insurance costs and the government's abolition of land tax rebates both referred to elsewhere in this investor update.

The alternatives faced by us as Manager have been either to take options which might see distribution levels potentially maintained short term or to make decisions in the long term interests of the properties themselves, their underlying value and longer term distributions. The latter has been the approach that we have taken.

### PFA DEFERS FEE AS ASSISTANCE TO INVESTORS

We at PFA are conscious of the distribution expectations of our investors and the affect a drop in distributions can have. Consequently, as a demonstration of good faith and to assist with the Fund's cashflow, PFA is deferring the income based component of its annual management fee (approx. one half of its annual fee) until such time as it considers it appropriate to reclaim that amount from the Syndicate.

### DISTRIBUTION BREAKUP

Investors should be aware that distributions have had and will have, for a period, a component of what is essentially capital return. This can occur in a number of ways including when distributions exceed accounting profit or retained earnings from the Fund's operating activities. The degree of capital return is increased by accounting depreciation and other non-cash items.

The Directors consider that this is appropriate in certain circumstances (for example, where the value of the Fund grows or is expected to grow principally as a result of value adding actions).

## RETAIL LEASE EXPIRY PROFILE SIGNIFICANTLY IMPROVES

As a consequence of the focus that we have had in improving the length and quality of the leases within the retail component of the portfolio, we are pleased to advise that there has been an impressive 50% increase in the average lease expiry profile from acquisition to the current date. This represents an increase from 4 to 6 years.

The average lease expiry profile is one of the tools used by valuers and property analysts to determine the value of the property and the cashflows generated to its owner. Obviously, lease expiry profiles run down over time until opportunities come to either renegotiate or renew leases. Whilst there is still a lot of work to be done, we at PFA are proud of the achievements to date in respect of this focus on the properties.

THE CAPITAL *Collection*

## EXCELLENT TAX EFFECTIVENESS CONTINUES

The Capital Collection continues to be a tax effective investment with a high tax sheltered component. Only 18% of the distribution you received in the last financial year was subject to tax. This is a significantly better percentage than that conservatively estimated in the prospectus. Investors should remain aware that this tax sheltering is essentially a tax deferral as the necessary deductions reduce the cost base of your investment for capital gains tax purposes. This is always a complex area. Investors should consult professional advisers to ascertain the impact on them of the tax implications of their investment.

## TRUST COMPANY MERGER

As you may be aware, there has been a recent announcement of a proposed merger between the publicly listed companies Trust Company of Australia Limited ("TCA") and Permanent Trustee Company Limited.

TCA as the appointed Custodian for The Capital Collection – Diverse Sector Fund amongst other things holds the property for the Owners as their nominee as well as Fund bank accounts. The proposed merger is not anticipated to affect the services provided or the fiduciary responsibilities of TCA. Conditions of the implementation of the merger include “no material adverse change in relation to the assets, liabilities or customer relationships of either party”.

## TAX RETURN TIME

You have now received the 2002 Distribution Summary you need to complete your tax return.

Please read this notice carefully prior to completing your tax return or pass it onto your accountant or tax agent.

## WANT TO KNOW MORE ABOUT US?

Why not visit us on our website **www.pfaltd.com.au**.

## FOR FURTHER INFORMATION CONTACT:

Bronwyn Risk
Manager - Investment Services
Level 23, Central Plaza 2,
66 Eagle Street, Brisbane Q. 4000
PO Box 10398, Brisbane,
Adelaide St. Q. 4000
Tel: (07) 3221 7170
Fax: (07) 3221 6729
Email: info@pfaltd.com.au
www.pfaltd.com.au

## CHANGE OF ACCOUNTING POLICY

In accordance with international trends to improve financial reporting PFA has resolved to disclose in accordance with the principles outlined in Exposure Draft 103 Investment Property.

The adoption of the Exposure Draft should enable readers of the financial statements to get a better understanding and appreciation for the performance of the fund’s property investments.

The adoption of this Exposure Draft means that depreciation will no longer be charged in the financial statements of this Fund.

Investment properties in the financial statements will be shown on a fair value basis based upon independent valuation or directors’ valuation.

Previously, the value of investment property was shown on a historical cost basis with valuations referred to in the notes to the accounts.

## ‘IN-HOUSE’ REGISTRY SERVICES

From 1 July, 2002 PFA’s Investment Services Division commenced providing all registry services for investors in The Capital Collection – Diverse Sector Fund.

These services include the payment of your monthly distributions (by electronic funds transfer), maintenance of your personal and investment details and investor reporting. PFA previously outsourced the registry function to BDO Kendalls.

The decision to bring the registry services ‘in-house’ was made so as to ensure a more efficient streamlined investor service with all your records, reporting and electronic distributions now under one roof.

Whilst PFA will be charging the Investment for the provision of the registry service, it is at an amount less than that charged by the previous external registry provider.

P F A
PROPERTY FUNDS AUSTRALIA LIMITED