Diversified Property Fund

Fund Update
31 December 2022

Established in August 2006, the Australian Unity Diversified Property Fund (Fund) currently holds 9 properties* in New South Wales, Victoria, South Australia and Western Australia. The Fund aims to deliver a stable income stream with the potential for capital growth. *Consolidated for reporting purposes.

Blackburn Square Shopping Centre Stage 2, North Blackburn, VIC

Fund Facts as at 31 December 2022

Gross Asset Value	Unit Price	December Quarter Ordinary Distribution~
$558.08 m ($531.15m at 30 September 2022)	**$1.1645** exit price (cum distribution)	**1.3500 cents per unit (CPU)** (1.3500 CPU September 2022 quarter)

Gearing Ratio	Portfolio Occupancy	Weighted Average Lease Expiry (WALE)
40.50% (37.47% at 30 September 2022)	**98.8%** (leased by income)	**8.3 years** (by gross rental income)

~ distributions are paid monthly

Ratings / Awards

Recommended Lonsec Research

Core Property Fund Research & Ratings Recommended

Zenith APPROVED

Performance as at 31 December 2022

	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Since inception % p.a.
Distribution return	1.19	6.75	8.33	7.85	8.04	8.67	8.12
Growth return	1.95	(2.21)	4.21	4.02	5.73	3.95	0.89
Total return	3.14	4.54	12.54	11.87	13.77	12.62	9.01
Benchmark distribution return	0.73	2.88	3.01	3.32	3.58	4.12	5.08
Benchmark total return	2.30	8.89	5.99	6.65	8.14	8.77	7.92

Inception date for performance calculations is 22 August 2006.
Returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance.
The Fund's Benchmark distribution return is 1% p.a. above the average Commonwealth Government 10-year bond yield calculated on a rolling basis over the previous five-year period. The Fund's Benchmark total return is the MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index.

Contribution summary as at 31 December 2022

The relative contribution of major variables on growth returns over the last quarter and year.

Contributor	3 mths %	1 yr %
Property revaluations	1.37	2.60
Interest Rate Swaps (realised and unrealised marked to market movements)	0.06	0.05
Unrealised gains/losses on investments in listed/unlisted trusts	0.89	(1.69)
Performance fee	0.00	0.00
Other	(0.37)	(3.17)
Growth return	1.95	(2.21)

Return calculations are based on actual distributions reinvested, which may vary slightly to the performance table illustrated above. Past performance is not a reliable indicator of future performance. Property revaluations are calculated in accordance with accounting standards and includes capital expenditure, lease incentives and/or commissions (both of which are amortised), this represents the increase/decrease from the property book value immediately prior to valuation. 'Other' may include: retained earnings during the period, swap break costs, estimated gains distributed, realised gains/losses on property, distributions from prior period retained earnings, realised gains/losses from unlisted property trusts and non-material movements.

Key portfolio statistics as at 31 December 2022

Geographical allocation (by value)

State	No. assets	%
NSW	3	37.88
WA	4	30.69
VIC	1	21.94
SA	1	9.49
Total	9**	100.00

** Consolidated for reporting purposes.

Sector allocation (by value)

Sector	No. assets	%
Retail	4	49.67
Convenience	2	26.88
Industrial	2	12.45
Office	1	11.00
Total	9**	100.00

** Consolidated for reporting purposes.

Top 5 tenants (by income)

Tenant	%
Caltex - Ampol	24.63
Woolworths	11.76
Coles	11.29
Commonwealth of Australia	9.24
Boeing	3.80
Total	60.72

Property data

Number of properties	9**
Total number of tenants	118
WALE (by income)#	8.3 yrs
Occupancy rate (by income)	98.80%

** Consolidated for reporting purposes
# Excludes assets under development.

Financials

	$m
Gross assets	558.08
Total debt	226.00
Other liabilities^	3.52
Net assets	328.56

^ Other liabilities include a provision for the distribution.

Debt

Gearing (RG 46 ASIC definition)	40.50%
Loan-to-Value Ratio (LVR) (Financier's definition)	43.21%
Interest Cover Ratio (ICR) (RG ASIC definition)	3.41 times
Hedging (% of debt hedged)	0.00%

Valuations

Valuations during the quarter	8
Change in total direct property book value	3.83%
Change in book value of the properties revalued	3.83%

* Change in book value over the quarter includes revaluation impacts along with capital expenditure and other minor variations but excludes acquisitions and disposals.

Market commentary

While 2022 commenced with a continuation of the post-COVID economic upswing, over the year this gave way to a more challenging environment as the impacts of conflict in Ukraine, escalating inflation levels globally and commencement of unprecedented monetary policy tightening globally took hold. While ongoing volatility is expected to continue in the early part of 2023, the current market consensus is that interest rate rises are likely to pause later this year and inflation levels may start to reduce, which in turn should bring a level of much-needed pricing stability to financial markets. To this point, the December 2022 quarter alone saw further volatility in the Australian 10-year bond yield, a proxy for the risk-free rate, recording a quarter low of 3.29% and a high of 4.19%, before closing the year at 4.05%.

At its final meeting of the year in December 2022, the Reserve Bank of Australia (RBA) raised the cash rate by a further 0.25% bringing the total overnight cash rate to 3.10%, up a remarkable 3.00% over the course of 2022. Retail spending has yet to be notably impacted by such rises with reasonably strong sales levels expected in the December quarter, as household savings levels decrease. There is however typically a lagged effect of the impact of rate rises on consumer spending as higher mortgage costs can take up to 3 months to be passed through to borrowers. As such it will be interesting to see how the RBA interprets this data over the coming months. Inflation levels in Australia remain high, with the RBA forecasting headline Consumer Price Index (CPI) inflation to peak at 8% in December 2022. However, there are indications that goods inflation has started to moderate and the RBA notes that inflation in several international economies appears to have peaked.

Looking forward, growth in the Australian economy is forecast to slow in 2023 albeit remain positive. The RBA is forecasting inflation levels to average 4.75% in 2023 before falling lower towards the targeted 2%-3% band in 2024, reaching 3.25%. With regards to the cash rate, economic forecasters are anticipating further rate rises over the first half of 2023 with Bloomberg reporting an average peak cash rate forecast of 3.60% in Q2 2023.

Research data from Jones Lang LaSalle (JLL) indicates positive office property net absorption (i.e., where take-up of accommodation is higher than office space becoming vacant) in four of the six capital city markets for the December 2022 quarter. Brisbane CBD office property was the notable outperformer, recording its third successive quarter of positive absorption, positioning it as the highest absorption CBD market over 2022. Negative absorption was noted in the Melbourne CBD office market as several smaller occupiers consolidated their occupations while the impact of newly refurbished office space coming online also impacted, increasing Melbourne CBD office vacancy to 15.4% (from 14.6%). Despite this, quarterly growth in face rents was recorded across all CBD office markets with only Canberra seeing a minor decrease in effective rental growth as incentives increased slightly. Monthly Property Council of Australia (PCA) Office Occupancy data continues to show improvement in office attendance nationally. In November 2022 overall physical office occupancy rates in Perth reached a post-pandemic national high of 80%, while Melbourne reached its own post-COVID-19 high of 57%. Melbourne CBD's result is particularly pleasing given the extent of the COVID-19 impact on this market and bodes well for an improvement in the vibrancy of the CBD and associated positive impacts on retail and other services. Interestingly, peak day levels are approximately 70% or higher across all CBD markets highlighting the current preference for hybrid working arrangements.

The Industrial property market continues to see attractive rental growth for asset owners as the ongoing shortage of available accommodation for lease drives up competition for space. For the December 2022 quarter, JLL data highlights that the rate of prime net rental growth rate has slowed versus prior quarters but remains positive. Over the 2022 calendar year, the average annual rental growth rate for all industrial property markets covered by JLL research equated to an uplift of 18.7%. Nationally, vacancy in the sector remains at record low levels which is limiting the extent of actual leasing activity achieved (i.e., lease deals), while placing further upward pressure on rents. To date, the supply response has been unable to keep pace with demand despite historically high levels of development. Looking toward 2023, Knight Frank forecast a record year for industrial development completions, led by Brisbane and Melbourne, however, Sydney is expected to remain notably undersupplied. Evidence of improvements in recent supply chain challenges as well as the broader macro-economic challenges may work to slow warehouse demand levels as inventory levels are managed down, however, it remains to be seen whether the recent post-COVID-19 opening in China will result in productivity decreases which serve to counteract this in the short term. The tenant demand versus available supply imbalance is thus likely to remain in the short to medium term and support further rental growth.

After a fall in month-on-month retail sales in October 2022, the first in 9 months, positive sales impacts of Black Friday in November and the holiday period in December are expected to result in substantial consumer spending for the final quarter of 2022. Despite this, challenges remain for the retail sector as the heightened cost-of-living pressures of increased mortgage repayments and goods inflation impact consumer spending which is likely to result in more cautious spending patterns in 2023 and a focus on non-discretionary purchases. Over the December 2022 quarter, rental levels in the retail property sector have remained broadly unchanged across most submarkets save for CBD retail in Sydney and Melbourne which showed further declines, albeit at a slower rate than that previously experienced. With office attendance in these CBD markets showing signs of increasing as well as an expected increase in tourism levels following the border opening from China, there are some green shoots for affected CBD retailers. While JLL report that retail property transactional activity over 2022 has been weighted toward large format and neighbourhood shopping centres (52%), the December 2022 quarter saw several sub-regional shopping centre transactions materialise as investors targeted higher-yielding assets.

Financial markets remain highly sensitive to macroeconomic headlines. Such volatility is likely to continue over the short term whilst global challenges and the impact and extent of monetary policy tightening play out. The impacts of rising interest rates have already manifested in a notable decline in residential property prices, value declines in the broader commercial property sector have largely been minimal to date, as evidenced by numerous A-REITs recently announcing their 31 December independent valuations highlighting a minor expansion in capitalisation (i.e., property yields) rates. A slowdown in commercial property transactional activity has presented challenges for independent valuers seeking to benchmark commercial asset values to real-world sales activity, as buyers and sellers remain in price discovery mode. Pressure to dispose of assets by owners is not being experienced, with conservative debt levels and favourable loan management more widespread than in prior cycles. Despite this, short to medium-term asset pricing challenges remain within some secondary asset classes or impaired assets. In turn, this may present future opportunities to extract value for those investors prepared to actively manage property risk while, institutional support for the sector remains, notably from overseas parties attracted to the relatively superior outlook for the Australian economy and supported by a weaker Australian dollar.

Portfolio activity for this quarter

Developments

Blackburn Square Shopping Centre

Stage 1 of the Blackburn Square Development reached completion in mid-April 2022, with Coles commencing trade. Stage 2 construction commenced in late April 2022 with a projected programme of thirteen months. The head contractor for Stage 2 is Maben Group, with a contract value of $37.2 million. Stage 2 comprises of a new Aldi, Woolworths Direct to Boot facility, medical centre, gyms, 102-place childcare centre, external dining precinct and approximately 35 specialty shops. Practical Completion of the Stage 2 base build is scheduled to take place in May 2023. A staged approach has been taken with the first separable portion of tenancies scheduled to trade in March 2023, with the remainder to trade in May and June 2023. Stage 2 leasing is nearing completion with 90% of net income pre-committed.

Busselton Central Shopping Centre

Stage 3 of the redevelopment commenced in November 2021. The Stage 3 works underway comprise an additional 6,180 square meters (sqm) of gross leasable area (GLA) with ~4,000 sqm of quality food and beverage on the ground floor to include a boutique tavern, as well as 14 dining and retail specialty shops including Benesse Cafe, Inara Restaurant, Dome, Funkee Monkee Bar & Eatery and Cotton On Mega and a quality selection of national fashion retailers. A new five-screen Reading Cinema will be located on level one. The state-of-the-art complex will feature Titan Luxe auditoriums with Dolby Atmos, bespoke dine-in menu options and powered full recliner seating. The centre will create a unique dining and entertainment experience for the Southwest region of WA. Stage 3 leasing is at an advanced stage with 90% of leasing income pre-committed. The project is scheduled to be complete and trading in mid-2023.

Revaluations

100% of the Fund's properties were independently valued during the December 2022 Quarter, with a net increase of $4.10 million or 0.79% from the property book values immediately before valuation.

Valuation changes include:

- 6-8 Geddes St Balcatta, WA (incl. 5 Kenhelm St Balcatta) – The property's value increased by $1.25 million or 8.7% from book value primarily due to the strength of market rents in the industrial sector and limited supply.
- Dog Swamp Shopping Centre, WA - The $0.72 million or 1.34% increase from book value was driven by improved net property income resulting from minor changes to the commercial terms with major tenants and underlying specialty income growth. The capitalisation rate remained unchanged.
- Woodvale Boulevard, WA – Achieved a $4.21 million or 12.1% increase over book value due to the capitalisation rate firming from 6.50% to 6.00%, reflecting increased leasing activity in the centre, the strong trading performance of the major tenant and the strength of the neighbourhood shopping centre market in WA.
- 620 Mersey Road Osborne, SA - Whilst the capitalisation rate softened marginally from 5% to 5.13% due to market conditions, an above-average Consumer Price Index (CPI) rental increase saw a $0.47 million or 0.94% increase in property value.
- Busselton Central Shopping Centre, WA – The property's value decreased by ($6.06) million or (10.63%) from the previous book value primarily due to project-related lease incentives being significantly higher than initial estimates. The capitalisation rate tightened marginally from 6.00% to 5.75%.
- Blackburn Square Shopping Centre, VIC - The property is currently under redevelopment and the $2.02 million or 1.86% increase in value was primarily driven by the capitalisation rate tightening from 5.50% to 5.00%.
- Caltex Service Centres, Wyong NSW – Value increased by $1.0 million or 0.70% from the book value primarily attributable to the prevailing CPI driving a higher-than-anticipated rental increase.
- 1 and 2 Technology Place, Williamtown, NSW – The property's value increased by $0.49 million or 0.84% from the book value due to recent favourable lease renewal outcomes achieved.

Distributions

Ordinary cash payments of the Fund's regular income of 1.35 cents per unit were paid for the December 2022 Quarter, taking total payments for the half-year to 2.70 cents per unit.

Blackburn Square Shopping Centre Stage 2, North Blackburn, VIC

Busselton Central Shopping Centre Stage 3, Busselton WA

Busselton Central Shopping Centre Stage 3, Busselton WA

Fund portfolio as at 31 December 2022

Property Details			Tenancy Details				Valuation Details			
Address	Note	Lettable Area (sqm)	Major Tenant	Number of Tenants	Occupancy Rate (% by income)	WALE (years by income)	Current Valuation ($m)	Valuation Date	Capitalisation Rate (%)	Book Value ($m)
Industrial										
Mersey Road North, Osborne, SA	-	8,006	Commonwealth of Australia	1	100.0	7.5	50.50	Oct-22	5.13	50.51
6-8 Geddes Street, Balcatta, WA	-	14,786	IGA Distribution	2	100.0	<1	15.70	Oct-22	6.00	15.71
Sub total				3			66.20			**66.22**
Retail										
Blackburn Square Shopping Centre, VIC	-	10,405	Coles	18	100.0	9.4	111.00	Nov-22	5.00	116.73
Dog Swamp Shopping Centre, WA	-	8,083	Woolworths	31	95.5	7.4	54.40	Oct-22	5.75	54.60
Busselton Central Shopping Centre, WA	-	7,166	Coles	20	96.6	6.0	50.92	Nov-22	5.75	53.92
Woodvale Boulevard Shopping Centre, WA	-	6,378	Woolworths	24	96.4	3.5	39.00	Oct-22	6.00	39.03
Sub total				93			255.32			**264.28**
Convenience										
Wyong Service Centres, Wyong, NSW	-	4,286	Ampol	2	100.0	15.5	143.00	Nov-22	5.00	143.00
Sub total				2			143.00			**143.00**
Office										
1 and 2 Technology Place, Williamtown, NSW	-	7,557	Boeing	20	100.0	3.3	58.50	Nov-22	5.88	58.53
Sub total				20			58.50			**58.53**
Listed property										
Australian Unity Office Fund (AOF)										15.33
Cash and other assets										10.73
Total Cash and other assets										**26.06**
Total (T) / Weighted Average (A)				**118 (T)**	**98.80 (A)**	**8.3 (A)**	**523.0 (T)**		**5.36 (A)**	**558.08 (T)**

Notes

1. Valuation Policy - Regular valuation of underlying property assets is an important aspect of managing the Fund. Valuations are conducted by qualified independent valuers in accordance with industry standards. We also have a policy of generally obtaining independent valuations on Fund direct properties each year and, for assets under development, within an 18-month period. Additionally, as part of our active management approach, we may test asset values on market. At times we may enter arrangements at arm's length with third parties which may impact the value of assets within the portfolio including, but not limited to, put and call options in respect of all or part of an asset within the portfolio. If the value of an asset is impacted in this way, the value may replace the last independent valuation obtained.
2. Weighted Average Lease Expiry (WALE) by gross rental income. Vacancies are valued at market income. Assets under development excluded.
3. A market capitalisation rate is the rate, expressed as a percentage, that reflects the likely yield a property will generate over the medium term. It has regard to a property's unique characteristics and is a measure of the property's risk/return profile with higher rates reflecting higher risk and its function is to convert a property's income into value. The market capitalisation rate is assessed by the independent valuer by dividing the stabilised net property income of the property or a portfolio of properties by the assessed valuation of the property or portfolio, excluding costs of acquisitions and fees.

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