

# Independent Research

# May 2008

## EntRE Fund

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Richard Cruickshank, Managing Director.

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# Research Report

Research - Unlisted Hybrid Fund (Stapled Security)

May 2008

## EntRE Fund

### Evaluation Summary

Real Estate Capital Partners Managed Investments Limited (ReCap) is seeking equity for the EntRE Fund. The Fund's portfolio provides investors with the opportunity to invest in a diversified range of property investments and securities with the aim of providing both stable income returns and capital growth, with benchmark returns for the annual distribution from cashflow of 1% above the average 90 day Bank Bill yield (financial year basis) and a total annual return above the rolling five year Mercer Unlisted Property Funds Index as at 30 June each year.

EntRE's mandate comprises direct real estate assets in Australia and overseas; real estate securities including listed and unlisted securities; and potential participation as a pre IPO financier and underwriter for selected offers.

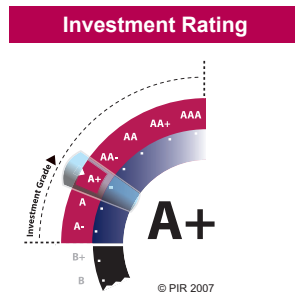
The Fund utilises a Stapled Fund structure with each unit comprising a unit in Real Estate Capital Partners EntRE Fund, the investment trust which owns the initial portfolio, and a unit in Real Estate Capital Partners EntRE 2 Fund, a trading trust which owns the internal Manager (ReCap 2).

PIR's rating is based on a number of assumptions in respect to the investment of funds forthcoming from the liquidation of interests in the PH Sydney Hotel Group following the sale of the Park Hyatt Sydney and a direct asset in Perth. It has been assumed that funds will be principally invested in direct property as well as an allocation to listed property securities. Should an alternative and materially different use of funds eventuate, PIR's rating as outlined within this report will not remain applicable.

Established in 2006, ReCap assumed management of the Trafalgar Enhanced Income Fund (subsequently renamed to Real Estate Capital Partners Enhanced Income Fund) and thereafter established the Hi Q Fund in mid-2007. As at 30 June 2007, on a combined basis these two funds amounted to in excess of \$130 million of funds under management.

### Major Considerations

- ▲ Strategy based property fund with value-driven focus. Manager interests linked with that of investors via performance fees.
- ▲ Diversified portfolio with exposure to property derivatives, direct and indirect property assets.
- ◀ Ongoing success of this Fund will be linked to long-term property fundamentals and astute asset selection and allocation across the income-producing investment classes.
- ◀ Exposure to other property securities increases portfolio diversification, however Fund returns from these investments are dependent on the operational capabilities of the respective Managers.
- ◀ With a substantial emphasis on management, any changes can improve or diminish investment performance.
- ▼ Property securities markets are currently under stress, largely as a result of turmoil in global credit markets, and may result in weak investment performances.



**Latest report expiry:** 1 November 2008<sup>1</sup>

### Scheme Details

EntRE Fund	
Real Estate Capital Partners EntRE Fund ARSN 119 993 618 Real Estate Capital Partners EntRE 2 Fund ARSN 128 509 526	
PDS dated 30 November 2007	
Fund type	Hybrid Property Fund
Duration of investment	3 – 5 years
Unit price	\$1.00
Minimum investment	\$5,000
Distribution frequency	Quarterly
Liquidity	Low-Medium*
Adviser Commissions	Up to 4.0% upfront / 0.5% p.a. trailing (+GST)
Responsible Entity: Real Estate Capital Partners Managed Investments Ltd (ABN 55 115 913 810)	
Custodian: Trust Company Limited of Australia (ABN 59 004 027 749)	

\*35% (by value) of the portfolio listed property securities

### Investment Profile\*\*

Number of properties***	1 (50% interest)		
Property location	VIC		
Property sector(s)	Office		
Future borrowing commitments	Nil		
Gearing ratio (% of total assets)	17.9%		
Purchase price- total funds (%)	93%		
Equity sought	\$17.25m	Purchase Price	\$19.53m
Debt	\$3.75m	Related costs	\$1.47m
Total Funds	\$21.0m	Total Assets	\$21m

\*\*Prior to sale of Perth property \*\*\*Held directly

### Returns forecast by RE

<b>Year end 30 June</b>	<b>2008</b>
CPU	8.00
Income Return (%)	8.00%
Tax advantaged (%)	100%

<sup>1</sup> This report, dated 2 May 2008 expires when the initial offer closes or after 6 months or if there are any material changes in relation to the information contained in this report or any disclosure or offer document issued in relation to this offer. This report was not prepared for inclusion in any offer document and investors must only rely on information contained in the offer document and other associated information. PIR reserves the right to change its opinion, ratings and/or withdraw the report at any time on reasonable grounds.

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## Executive Summary

Qualitative Criteria					
Assessment of income stream	★	★	★	▶	
Anticipated capital returns	★	★	★		
Anticipated total return	★	★	★	▶	
Diversification	★	★	★		
Capital structure and debt management	★	★	▶		
Level of fees	★	★	★	▶	
Risk	★	★	★	▶	
Track record and capacity of management	★	★	★	★	
Quality of disclosure	★	★	▶		
Assessment of assets	★	★	★		
Strength of relevant property markets	★	★	★		

Table i

An unlisted investment fund which offers the opportunity to invest in a diversified portfolio of real estate investments and is structured as a stapled security with one unit in each of the Stapled Funds which are:

- ◆ an investment trust, ReCap EntRE Fund, which owns the Fund's investment portfolio; and
- ◆ a trading trust, ReCap EntRE 2 Fund, which owns the Manager, ReCap 2.

The RE's focus is to develop active management strategies and to invest at below intrinsic value in direct and indirect property backed assets. The RE intends to make further acquisitions for the expansion of the Fund and the allocation of funds may therefore deviate in the future as the Fund acquires further investments and undertakes additional equity raisings. The ability of the RE to source properties and or property based investment vehicles that show sufficient and stable yields in a market which is currently experiencing historically low yields in addition to negotiating new or increased debt facilities on reasonable terms in a somewhat uncertain interest rate environment, will also have a significant bearing on the Fund's ultimate performance. The RE has in place several service based mandates in regard to the Fund's operation. Key amongst these will be management of the Fund's listed property securities portfolio, which has been outsourced to SG Hiscock.

Fees associated with the ongoing management and growth of the Fund are largely favourable in comparison with PIR's benchmarks. There is no base management fee under the management agreement which ReCap 2 has entered into for the management of the Fund's portfolio. Under this arrangement the Fund only pays

for the management services it uses and any fees that ReCap receives are revenue to the Fund as ReCap2 is owned by the Fund through the stapling structure. ReCap 2 receives fees for managing the Singapore Airlines property portfolio joint venture. The acquisition fee is noted to be below PIR's benchmark of 5.1% (Incl. GST) of gross assets. A Performance Fee is payable if the Fund exceeds its Benchmark total return of 12%, the fee is 15.38% of the excess returns above the benchmark. This means that the Manager's interests are closely aligned with those of investors in the Fund.

The Benchmark by which investments are assessed and by which the Fund seeks to outperform has two components:

- ◆ annual distributions from cash flow of 1% above the average 90 day Bank Bill yield over the 12 month period to 30 June each year; and
- ◆ total annual return above the rolling five year Mercer Unlisted Property Funds Index as at 30 June each year.

PIR considers the management capacity to be adequate given the breadth of qualifications and multi-disciplinary experience present.

Defined as illiquid by the Corporations Act, any investment should be considered long term. However, the RE is offering a limited redemption facility based on six-monthly redemptions limited to 35% of the Fund's investment in listed property securities. The first redemptions will be processed on 30 September 2008. The buy/sell spread is applied to investments and withdrawals from the Fund with the buy cost being 1.37% and the sell cost being 0.37%.

## Key Assessment Issues

The degree of diversification present within the Fund portfolio, which comprises a range of derivatives, direct and indirect assets, is thought generally sufficient to avoid overly excessive exposure to a single asset sector, geographic region or tenant and the inherent concentration of risk.

While exposure to other unlisted securities, derivatives and listed securities increases portfolio diversification, returns from these investments are reliant on the operational capabilities of their respective Managers and the listed and derivatives markets. Also, given that the Fund tends to rely on being highly strategic in its allocation approach as opposed to being more passive in allocating investments, a key aspect of the success of the vehicle is a conviction based approach to the abilities of the management team to be able to derive value while managing risk.

The Fund will also invest in listed property securities which will assist in providing liquidity for the Fund, enhanced diversity and both income and potential capital growth. This part of the portfolio will be managed by SG Hiscock, which has an established reputation in managing this type of investment. Investors should note that investment may be in funds managed by ReCap such as Real Estate Capital Partners Enhanced Income Fund (REIF) and Real Estate Capital Partners Hi Q Fund (Hi Q).

Given the nature of the Fund as an actively managed investment vehicle, performance will be inherently driven by the skill and abilities of the fund manager in sourcing investment opportunities from a range of markets as well as the underlying performance of those markets and in cases where investments are made into other managed funds, the performance of the underlying managers.

Significant yield compression in real estate markets over this decade has placed increased reliance on even further capital growth and continued rental escalation to achieve total returns commensurate with the attendant level of risk associated with any Fund acquisitions of both securitised and 'direct' property assets. While the weight of funds seeking a home in securitised property has increased competition for assets and contributed to this yield compression (and therefore often yield dilution to existing funds), this trend is unlikely to be sustainable over the medium to long term. Recent events in global property markets suggest that a general re-pricing of risk is underway and that the existing cycle of capitalisation rate compression may be largely complete. There may be some further isolated instances of compression, however based on property investment fundamentals, it is likely that some subsequent reversal (unwinding of yields) will undo some of the capital value gains made to this point, notwithstanding currently solid property market fundamentals. It is at that time that the performance of some acquisitions across the broader property market - without discrimination across sectors, funds or managers - may no longer be masked by a benign environment.

The current volatility in the A-REIT sector following fallout from the global credit crisis and the massive slide in Centro Properties Group in December potentially spells a period of considerable uncertainty for the market. While underlying property fundamentals had peaked, they remain generally sound at this point. The A-REIT market is currently exhibiting negative investor sentiment that in many cases would appear to be de-coupled from underlying valuations. As a result however, many trusts are beginning to show attractive yields which may begin to provide buying opportunities. However, the sector is expected to be significantly volatile in the short term with sentiment based trading dominant.

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## 1. Offer Overview

### 1.1 Objectives and Strategy

Through the application of a value-driven approach, the RE is seeking to distribute consistent returns while cognisant of providing a total return commensurate with investor interests and the underlying risk present within the initial portfolio. Seeking outperformance of investment benchmarks, investment strategy outlined by the RE seeks to emphasis ease of exit, entry at a discount to inherent value, robust market positioning, growth and the maximisation of total return

Distinct benchmarks are utilised by the Fund to gauge potential investments in respect to distribution and total return. A 1.00% premium to the average 90-day bill rate over the 12 months to the 30 June each year will be used to benchmark distributions whereas the rolling five year Mercer Unlisted Property Fund Index as at 30 June each year will be employed to measure total returns.

### 1.2 Fund Profile

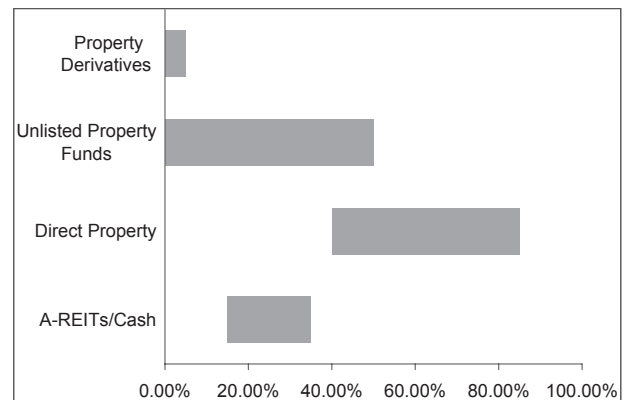
An open ended trust, further capital raisings may be undertaken in the future to expand the present portfolio or to retire Fund debt. The Fund is intended to comprise a diversified portfolio of direct and indirect property interests in both Australia and overseas. Through the use of service based mandates established with external organisations, the management of listed and international holdings will be delegated to respective external parties with expertise within such areas. Direct real estate assets are intended to be sourced at prices representing value in the market and will be held either for long term to access ongoing rental returns, or short term to take advantage of opportunistic gains. Indirect property assets such as property securities will focus on 'active' and 'active plus' strategies in both listed and unlisted property markets. The Fund may also participate in pre IPO as a financier or underwriter for selected opportunities which can present an elevated risk profile.

A portfolio of listed property securities will be managed by SG Hiscock, and targets trusts which have solid fundamentals over the medium to long term and representing value in the marketplace.

The Fund's direct property asset, a 50% joint venture in the Singapore Airlines portfolio, currently entails exposure to the Melbourne CBD office market. Until mid April 2008, the portfolio also contained a Perth property which has now been disposed of. The portfolio's existing indirect property interest is via the PH Sydney Group, whose solitary asset – the Park Hyatt Hotel in Sydney, has also been disposed of recently, leaving the Fund in a position to source additional acquisitions.

The Fund portfolio is not bound by set asset allocations, however guidelines have been put forward by the Investment Review Committee. These asset allocation ranges are shown in Figure 1. The RE has indicated that currently, due to the global liquidity crisis, it will not invest in property derivatives or other market linked investments.

Figure 1: EntRE Asset Allocation Ranges



### 1.3 Legal Structure

The Fund is an open-ended fund structured as a unit trust with a Responsible Entity, constitution, compliance plan, custodian, and public offer for units achieved by way of Product Disclosure Statement. The prime responsibility of the Responsible Entity is to safeguard the interests of investors and to manage the Fund to ensure that it achieves its objectives. The Custodian's duties include: entering into contracts to purchase properties; holding the assets; maintaining bank accounts to hold application monies, rents and other income and issuing cheques; and entering into leases of the properties. The assets are held in the Custodian's name. The Custodian must not effect any transactions involving the assets of the Fund unless it has received proper instructions from the RE.

## 2. Investment Analysis

### 2.1 Income Returns

PIR has examined the financial projections of the RE based on the valuations and supporting evidence. Based on forecasts as presented the Fund's proposed 8 Cents Per Unit (CPU) annualised pre-tax distribution for the period to June 2008 is possible, subject to best practice corporate governance being undertaken by the RE's Directors, staff and consultants.

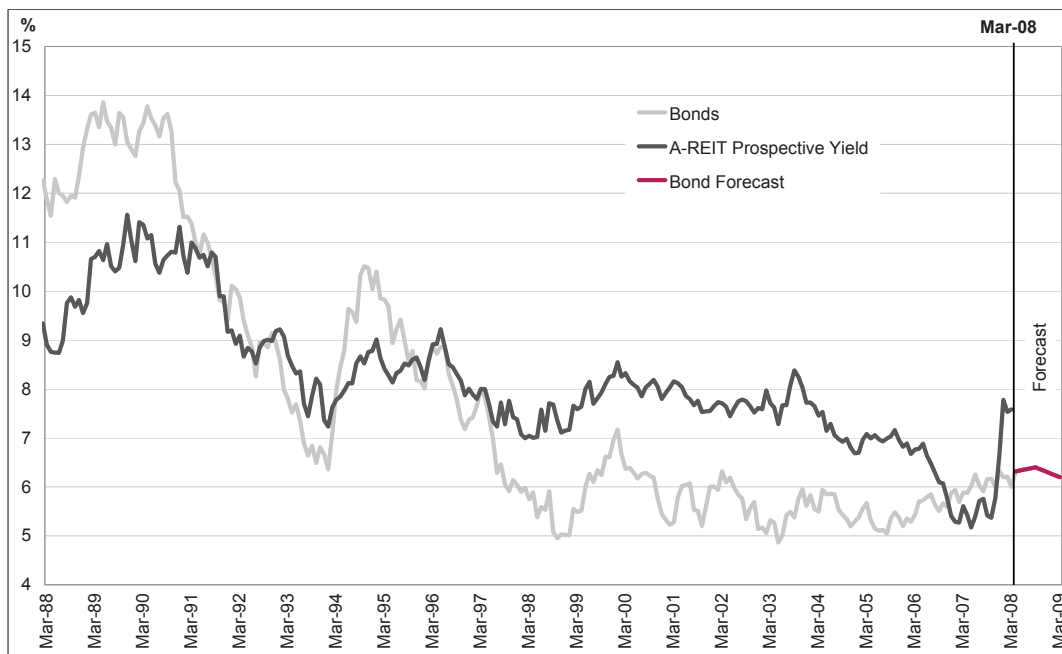
Income returns from the investment portfolio are expected to be generally stable given the range of investments and current yield indication in both listed and unlisted markets.

The RE has stated an intention that subsequent acquisitions will be made by the Fund. For the Fund to purchase further properties yielding in approximately the same range as current Fund distributions in the current climate of cyclically tight yields,

the Fund may be restricted in buying opportunities which could therefore translate to a dilution of returns or investments further up the risk spectrum. However, PIR acknowledges that the yield compression of the past five years is largely considered to be over for this cycle and the issues surrounding assets which are yield accretive rather than decreative is potentially likely to be less of a problem going forward.

Yield compression for listed property securities has also seen a sharp reversion over the past several weeks due to the rapid sell-off of the sector. While this is a positive outlook for the Fund, it should be noted that the likelihoods of cuts to A-REIT distributions over the remainder of 2008 is a strong possibility, which would be likely to put further pressure on security prices in the short term.

**Figure 2: A-REIT Prospective Yield vs 10 Year Bond Rate**



### 2.2 Capital Returns

Based on PIR's assumptions and modelling, the Fund's portfolio is likely to experience low to moderate capital growth over PIR's three year analysis. The modelling process has excluded the impact of any further property acquisitions during this period (which is anticipated by the RE).

However, given the nature of the Fund to place emphasis on targeting undervalued assets, the potential for high levels of capital growth is implied. Listed property securities are currently experiencing a period of severe price falls which in many cases would appear to discount fair valuation principals. The limits to which the market rebounds (presupposing it does) in the interim will, however, be crucial to value considerations for the Fund and potential investors, particularly in the short to medium term.

Likewise, direct real estate assets are potentially poised for an unwinding of value, particularly outside super prime assets. As such, the Fund is potentially well positioned to access distressed assets from a valuation perspective, however risks will be present from the point of view of the ultimate depth of the fall in this cycle and how long recoveries will take. On a longer term basis however, the likelihood of reaping the benefits of this strategy are likely to become clear.

PIR has adopted an average terminal capitalisation rate for the direct property held for the expected case scenario taking into account the valuers' initial capitalisation rates and their terminal capitalisation rates. PIR has also used its analysis of the Fund's property markets.

### 2.3 Risk and Total Returns

The Fund is subject to various micro and macro level risks that may adversely affect its ultimate financial performance. Micro-level risks are considered in PIR's risk-adjusted financial analysis through varying assumptions with respect to the Fund's ongoing operations. Invariably regard will be had to anticipated conditions in the broader macroeconomic environment as well as other qualitative factors whilst forming appropriate assumptions for such inputs. Some macro-level risks are considered in part through the assumed capitalisation rates which reflect to an extent certain economic, social and other broader macro-level trends (subject to the usual limitations of the capitalisation of income technique). Varying assumptions between upside and downside scenarios can assist in the measurement of the Fund's sensitivity to movements in key variables, such as terminal capitalisation rates, and assist in quantifying the level of foreseeable risk to which the Fund may reasonably be exposed.

Given the structure of the Fund, the actual physical makeup of the portfolio in the future is relatively unknown. As opposed to some direct property funds, or fund of fund structures with distinct mandates as to what they will invest in, the RE has elected to take a much broader approach in terms of what types of investment vehicles may be entered into (albeit they need to

be property backed). As such, investors are heavily reliant on the abilities of management personnel to select appropriate investment opportunities while managing risk, in order to attain their objectives for the Fund and to an extent, the abilities of the underlying fund managers when taking a position in other funds. While this approach will likely allow for a greater level of flexibility in pursuing investment opportunities which will be accretive to the Fund's returns, investors should be cognisant of the somewhat heightened level of risk of such a structure.

Table ii indicates a range of IRRs for results in downside, upside and expected cases. For investors with a marginal tax rate of 46.5% and assuming 0% gearing, PIR's model produces an expected, post-tax IRR of 14.11%; a downside post-tax IRR of 8.65% and an upside post-tax IRR of 15.71%. The divergences between these IRRs are indicative of the assumed level of risk attached to an investment in the Fund and the necessary adjustment to be made through the rating process to arrive at a risk-adjusted IRR.

The analysis outcomes however do not fully reflect the potential implications imposed by certain exogenous and some endogenous risks as outlined in Table iii.

Fund Estimated After-Tax IRRs	Downside	Expected	Upside
46.5% tax rate	8.65%	14.11%	15.71%
31.5% tax rate	10.54%	16.52%	18.34%
15% tax rate	12.39%	18.81%	20.84%

Table ii

Risk	Potential Implication
<b>General Economic Conditions</b>	Changes in prevailing economic conditions may impact unfavourably on the company's businesses, and possibly the market price of the Manager's Securities. Relevant economic factors will include changes in interest rates and inflation, changes in gross domestic product and economic growth, employment levels and consumer spending, consumer and investment sentiment and property market volatility.
<b>Securities Risk</b>	Investments held in other investment vehicles are inherently exposed to the underlying risks of that investment and are reliant on the management ability of the underlying entity. These risks are generally outside the control of the the Fund.  Investment in listed securities, although managed by an external party with a favourable track record, may be subject to additional risks in respect to exposure to broader market sentiment and its potential influence on the capital value and viable liquidation of listed holdings.
<b>Foreign Currency Exchange Risk</b>	The risk that the income flows from foreign domiciled assets will be affected by changes in currency exchange rates. At commencement exposure is thought constrained given the limited weighting (4% by value) to overseas interests. The absence of disclosure of any mitigating strategies (e.g. hedging arrangements) is noted within the current disclosure document.
<b>Property Value</b>	Events outside the RE's control such as market demand and supply may affect the end value of the property. Ensuring valuations are carried out at regular intervals provides knowledge to manage this risk and it is proposed that a diversified mix of assets will reduce the concentration of risk.
<b>Tenant Risk</b>	The risk of a tenant vacating a property, failing to meet their rental obligations or failing to renew a lease, can have a detrimental impact on rental returns. In view of the proportion of the portfolio which is allocated to direct property and given that such interests are multi-tenanted, this risk although not entirely overcome can be thought partially mitigated.
<b>Gearing / Interest rate Risk</b>	Gearing of property investments is often utilised to enhance returns. Investors should be aware that the effects of gearing can magnify both gains and potential losses. The risk of a change in interest rates may impact on gearing levels and interest payments, with a flow-on effect on distributable income to the Fund. In view of the Fund's low initial gearing position, some 18% of total assets, this risk can be thought constrained by the Fund's limited debt burden.
<b>Personnel</b>	The risk of the loss of key personnel, especially those involved within the compliance and governance of the Fund, could have an adverse effect on the Responsible Entity's ability to manage and administer the Fund. This risk is mitigated by ensuring key personnel are engaged on a contractual basis and a succession plan that is common to all such schemes is put in place. This risk can be reduced by ensuring that the operating division of the business is appropriately resourced and backed up.
<b>Fund Liquidity</b>	Liquidity of the Fund will be affected by the trading range and the liquidity of the underlying investments as well as the perceived risk held by an investment. There exists the possibility that the RE may be forced to freeze redemptions under certain circumstances such as a global downturn in property values.
<b>Market Risk</b>	Performance of the broader property market will influence the performance of the individual securities which make up the Fund as does sentiment in the broader equities market. Market downturns will have a flow on effect to the Fund's performance in terms of income distributions.

Table iii

This analysis assumes that there is no change to the portfolio in the form of redevelopment, forced or other deleterious sale or expansion not assumed in the RE's current forecasts during the anticipated investment horizon. Earlier-than-expected or delayed disposal of the assets may have a significant impact on investor returns. Alternative assumptions (where warranted) are in accordance with the standard PIR methodology. Whilst no forecasting can be guaranteed to be correct, providing differing assumptions can create both positive and negative outcomes within the PIR framework.

Forecasting future investment performance is problematic at best and relies on a number of assumptions about future events that may or may not necessarily occur. Changes in even one of the variables affecting investment market performance may have a significant and decisive impact on future outcomes. This report provides no more than a general guide to possible future market conditions and must not be relied on in isolation.

## 2.4 Assumptions and Methodology

PIR's analysis extends to three years, when the investors' units are assumed to be sold for the purpose of analysis. PIR's forecasts assume that rents increase in line with lease terms and or markets and tenants will be financially capable of servicing their leases. PIR has had regard to the assumptions applied in the respective valuations in determining reasonable parameters to apply to the modelling process. Key assumptions are summarised in Table iv.

PIR's rating is largely conditional on the fulfillment of assumptions in respect to the use of funds received from the closure of the PH Sydney Hotel Group. PIR has assumed that funds received

will, in entirety, be invested into listed property securities and derive returns of an income and capital nature as indicated within Table iv. The management of such funds in respect to listed property securities is expected to mirror that of the existing listed portfolio whereby the lion share is externally managed by SG Hiscock with a small (unspecified proportion) managed directly by the RE. Should the RE invest funds in a materially different manner and derive returns not reflective of the assumptions made by PIR, the resultant variation in income and capital growth will materially change the financial characteristics of an investment in the Fund and thereby cause PIR's present rating to become void.

Key PIR Assumptions	Downside	Expected	Upside
Interest Expense	7.75%	7.45%	7.25%
Terminal cap rate (Melbourne)	8.50%	7.50%	7.50%
Listed Securities Distribution Return	6.50%	8.00%	9.50%
Reinvestment of PH Sydney Funds (Distribution)	6.50%	8.00%	9.50%
Reinvestment of PH Sydney Funds (Total Return)	8.00%	11.0%	14.0%

Table iv

## 2.5 Capital Management

The Fund is anticipated to be initially geared to approximately 18% (equating to \$3.75 million), which in view of the nature of the portfolio is thought low in respect to comparable vehicles. A targeted gearing range of 20-30% with a maximum of 50%, although markedly above the initial level of gearing, is still below that of many trusts within the market. Investors should note that gearing can magnify both gains and losses, with highly geared vehicles inherently carrying a greater proportion of risk than vehicles which are comparatively lowly geared as is this Fund.

Under a prime brokerage agreement, finance has been provided to the Fund by UBS in respect to the portfolio of listed property securities. PIR has not been advised as to the specific arrangements surrounding the hedging or duration of finance terms. An indicative rate of 7.45% p.a. as quoted by UBS in respect to ReCap facilities has been assumed within the modeling process and is not thought unobtainable. Uncertainty and increasing tension within global credit markets may place upward pressure on the market cost of capital thereby exposing the Fund to a potential increase in interest expenses should suitable hedging arrangements not be entered into.

## 2.6 Taxation

**Income tax:** There are taxation benefits available to investors in the way of tax advantaged components which represent a percentage of 'tax deferred' income. This tax advantaged component is due to allowable deductions, such as building allowance and depreciation of the property, plant and equipment and certain establishment costs. The RE's forecast level of tax advantaged income for the 12 months to 30 June 2008 is 100%.

**Capital Gains Tax:** Tax paid on accumulated tax deferrals as well as on increases in property values (net of sale costs). PIR understands that under current law the taxable income of the Fund will include any capital gains made on the sale of assets owned by the Fund. The cost base used in calculating such capital gain will be reduced by any amounts already claimed as a deduction.

The taxation implications of investing in the Fund may vary according to the investment structure adopted by investors and potential changes to the taxation Acts.

**It is strongly recommended that investors seek/obtain professional and independent financial and taxation advice before choosing to purchase units in this or any investment property vehicle.**

## 2.7 Fee Structure

Fee	Fund*	PIR Average (24 month)*
Upfront / Establishment Fee	4.10%** of application monies plus 1.025%† of acquisitions	5.1% of purchase price
Ongoing Management	Nil	0.63% p.a. of total assets
Ongoing Operating Expenses	0.74% of total assets	0.25% p.a. of total assets
Withdrawal	Nil	-
Disposal	Not specified	1.9% of sale proceeds
Custodian	Included within operating expenses	-
Performance	15.38% of returns that exceed a total return of 12% p.a.	2.6%
Commissions	Up to 4.40%** Upfront / Up to 0.55%** trailing	Up to 4.2% Upfront /Up to 0.35% trailing

\*Inclusive of GST

\*\*Discretionary/negotiated

† Exclusive of listed securities and alike

Table v

Fees and charges associated with the establishment and management of an investment in the Fund are, on the whole, below PIR benchmarks. Although expense recovery is approximately three times that of PIR's benchmark, in light of no ongoing management fee and the inclusion of custodian expenses within the figure of 0.74% (incl. GST) investors are not thought disadvantaged.

Contribution fees and commissions to advisers are discretionary in nature, and as such are subject to negotiation between investors and their respective adviser (if used). It is worth noting that the RE has agreed not to recover Fund establishment costs or ongoing expenses until such a time whereby unitholder subscriptions from the current PDS exceed \$4.0 million.

## 2.8 Liquidity and Exit Mechanism

Aspect	Fund
Frequency	Semi-annually
% of Fund value	35% of the value of the Fund's listed property portfolio
Buy/Sell spread	1.74% (1.37% / 0.37%)

Table vi

From 30 September 2008, the Fund is anticipated to offer redemptions semi-annually that are limited to 35% by value of the Fund's listed property portfolio (therefore is limited to approximately 14% of the portfolio as a whole based on current allocations). The composition of the initial portfolio indicates a portfolio weighting of 21.5% or approximately \$7.85 million towards listed securities. The allocation of funds to listed property will likely fluctuate to a

degree over the duration of the investment. Hence, the ability of the Fund to offer redemptions may materially change and may be somewhat different as at 30 September 2008. Although a liquidity mechanism is offered, investors should still largely consider an investment in the Fund mid to long-term and somewhat illiquid given that redemptions are by no means guaranteed.

## 3. Management

### 3.1 Profile

Established in 2006 by Andrew Saunders (the residing Chief Executive Office), Real Estate Capital Partners Managed Investments Ltd initially assumed management of Trafalgar Enhanced Income Fund (subsequently renamed to Real Estate Capital Enhanced Income Fund) and thereafter established the Hi Q Fund in mid-2007. As at 30 June 2007, on a combined basis

these two funds reported in excess of \$130 million in funds under management. Notably, the portfolios of both funds are absent of direct property assets with the majority of funds directed towards listed property securities with management largely, although not exclusively, undertaken in-house.

### 3.2 People

The experience and qualifications of the RE's directors and senior management staff are outlined in Table vii.

Director	Position	Qualification/s	Background	Relevant experience
Mr Andrew Saunders	Chief Executive Officer	B.Sc, Qualified Chartered Surveyor	Previous senior positions with CB Richard Ellis, Macquarie Bank, Challenger Group and Mariner Financial.	In excess of 20 years' experience (domestic and international) in property, banking and funds management.
Mr Linden Toll	Executive Director – Distribution		Previous senior positions with Ord Minnett, Macquarie Bank, HSBC and Sanwa Bank. Current President of the Australian Direct Property Investment Association (ADPIA).	More than 14 years' experience in domestic and international financial markets and funds management.
Mr Paul Nielsen	Executive Director – Funds Management	MBA	Previous senior positions with Aegis, Lonsec and Property Investment Research (PIR).	In excess of 15 years' experience within the property investment and research fields.
Mr Jason Bennett	Divisional Director – Funds Management	B.Bus (Land Economics), Dip. App Fin, Licensed Real Estate Agent	Property consultant and qualified valuer, background in leasing and sales experience is noted.	More than 17 years' experience within the commercial and residential sectors. In addition to being a qualified valuer, prior experience in portfolio and asset management is noted.
Ms Jaime Chan	Associate Director – Funds Management	CPA	Prior roles with Maple-Brown Abbott Ltd and BT Funds Management.	International experience within direct property securities and fixed interest investments.
Mr James McNally	Executive Director – Compliance and Governance	B.Bus (Land Economy), Dip. Law, CPV, Licensed Real Estate Agent	Previous compliance orientated roles with Perpetual Trustees Australia Ltd and MIA Services Pty Ltd.	An external member on a number of compliance committees, and a Responsible Office for a number of companies in possession of an AFSL.
Mr David Adishesan		B.Com, MBA	Background in funds management with senior roles with organisations including Rothschild, Massachusetts Financial Services and Lend Lease Corporation.	Over 18 years' funds management experience including development of new funds and fund management activities.

Table vii

### 3.3 Style

The RE will seek to emphasise rental income and capital growth through the application of a value-driven approach to investment in direct and indirect property holdings. An inherent degree of flexibility and opportunism is present within this management style given that potential investments in direct or indirect property may be considered in any sector or location. The absence of an asset class based approach enables the RE to pursue a diverse range of opportunities that are compliant with the Fund's strategic objectives and are ultimately beneficial to unitholder interests.

The RE has enlisted the use of partner organisations, namely SG Hiscock and Sun Hung Kai Financial, to manage the Fund's listed and Hong Kong interests respectively given their expertise within these fields.

### 3.4 Compliance

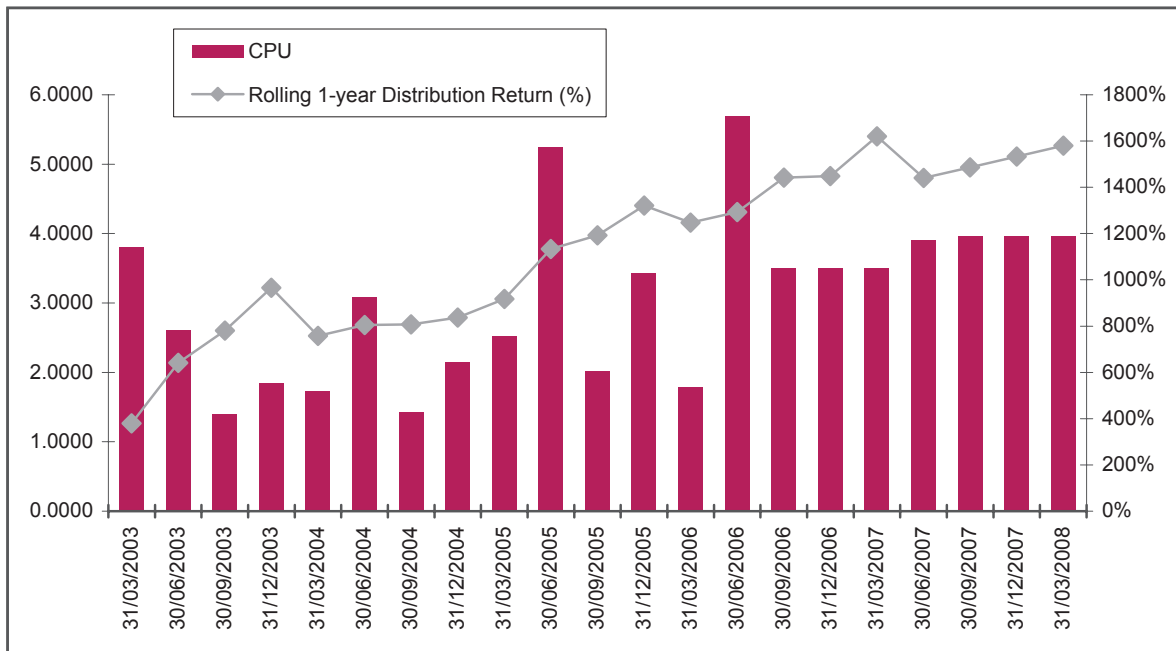
The RE has a small team of six fulltime staff and two part time staff. The two part time staff are those responsible for compliance; Brendan Howell and James McNally, both Executive Directors – Compliance and Governance.

PIR is satisfied that the necessary compliance procedures and structures have been established by the RE. However, PIR notes that the two key members in respect to compliance and governance have departed ReCap subsequent to PIR's compliance review.

PIR has been informed that this was in order to allow full time management of these functions by ReCap and that ReCap has appointed replacement staff to take up these roles. It should be noted, however, that this will be an acid test of the effectiveness of the compliance system in place. PIR also notes that some issues identified during the original compliance review have now been resolved by the RE.

### 3.5 Historical Performance

**Figure 3: Real Estate Capital Partners Enhanced Income Fund**



Source: Real Estate Capital Partners Managed Investments Limited.

Distributions (Cents Per Unit) and rolling 1-year distribution returns are presented within Figure 3. With assets in excess of \$100 million (and hence the lion's share of the approximate \$130 million of funds under management as at 30 June 2007) the Real Estate Capital Partners Enhanced Income Fund (REIF) provides an indication of the recent returns and volatility of the largest fund under management by the RE.

Investors are reminded that the REIF possesses innate differences from the EntRE Fund and that historical performance provides no certainty as to future returns.

### 3.6 Financial Position

PIR has reviewed limited financial information on the Product Issuer provided by the Product Issuer as detailed in this evaluation report and within the limited scope of the appointment of PIR to evaluate the Fund. In some cases PIR has reviewed financial information from other associated entities to the extent provided by the Product Issuer. However PIR does not hold itself to be expert in matters related to accounting or legal disciplines and therefore cannot make comment on the performance or operation of associated entities. Investors should be aware that the financial performance of any entities associated with the Product Issuer may have a significantly deleterious impact on the operation of this Fund. Over time, the Product Issuer may encounter unforeseen detrimental circumstances which may impact on its subsequent operating performance and which may not have been evident at the time of evaluation. Any investor should note that specific due diligence has not been undertaken on the current or ongoing financial viability of the Product Issuer and that PIR does not assume an obligation to undertake ongoing monitoring of the financial viability of a Product Issuer. An evaluation is based on a snapshot in time from information provided by the Product Issuer and does not purport to predict the financial viability of the operational or other management of the financial Product Issuer.

<b>Financial Position: Real Estate Capital Partners Funds Management Ltd</b>		
<b>Year end 30 June</b>	<b>2006</b>	<b>2007</b>
Total Assets (\$000)	2,320	4,184
Total Liabilities (\$000)	2,320	4,174
Net Assets (\$000)	0	10
Current ratio (%)	15.9	1.0
Gearing (net debt / equity) (%)	0	0
Gearing (net debt/assets) (%)	0	0

Table vii

### 3.7 Disclosure

Disclosure is assessed in two parts, the public disclosure which the investment offer documents give to the public and the level and quality of disclosure given to PIR during the evaluation process.

The offer document available to the public appears broadly consistent with meeting the obligations of a Product Disclosure Statement although the ultimate authority on this matter is ASIC. Greater clarity in the disclosure of the absolute value of initial portfolio, details regarding debt arrangements, specific investment of proceeds from Park Hyatt sale and details (if any) of the management of foreign currency risk are notable areas which could be improved although it is noted that the nature of the offering makes this task difficult.

Disclosure to PIR during the evaluation process was thought generally sufficient and in many respects comparable to similar investment ratings undertaken.

## 4. Property and Location Analysis (Direct Assets)

### 4.1 416 – 420 Collins Street, Melbourne

416 – 420 Collins Street, Melbourne, Victoria				5.36% of Portfolio	
Ownership	50%*		Vacancy	Nil	
Title	Strata titled units		Major Tenants	Singapore Airlines	
Type	Office and retail		Lease Terms	Commence 12 July 2007, Expiry 11 July 2009, \$175/m <sup>2</sup>	
Location	Melbourne CBD, VIC		Rent Reviews	12 July 2008	
Completion Date	Refurbished circa 1980s		% Area	49.4%	
Purchase Price	\$6,250,000		% Rental	47%	
Gross Lettable Area	1485.97m <sup>2</sup>		Major Tenants	Rivers Pty Ltd	
Total Site Area	584.8m <sup>2</sup>		Lease Terms	Holding over, \$462.74/m <sup>2</sup>	
Net Passing Income	Contract	\$272,549	Rent Reviews	N/A	
	Market	\$409,861	% Area	50.6%	
	\$/m <sup>2</sup>	Retail \$628m <sup>2</sup> ; Office \$175m <sup>2</sup> ; Basement \$128m <sup>2</sup>	% Rental	53%	
Valuation Date	15 May 2007		Value	\$5.3m	
Valuer	M3 Property Strategists Limited		Passing Yield (%)	5.62% on passing rents	
Cap rate (%)	Lvl 1 & 2 - 7.25%; Retail (Ground level) – 6.75%; Basement – 8.5%		\$/m <sup>2</sup>	Lvl 1 & 2 - \$2,400; Retail (Ground level) - \$8,000; Basement - \$1,650	

50% interest in the property and operating partner (JV)

Table ix

#### 4.1.1 Property Commentary

- ◆ The property comprises two strata titled units which form part of a 12 storey B grade office building. One strata unit is a basement area of 381.5 square metres, a ground floor area (currently utilised as retail space) of 370.3 square metres and Level 1 office area of 358.1 square metres. The other strata unit is Level 2 office area of 376 square metres.
- ◆ The property is well located on the northern side of Collins Street in Melbourne's CBD between Queen and William Streets, opposite the northern end of Market Street.
- ◆ The building is currently occupied by 2 tenants: Singapore Airlines on Levels 1 and 2; and Rivers Pty Ltd on Ground and Basement levels. The Rivers lease has expired and occupation is on a "holding over" basis.
- ◆ The Manager's strategy for the property is to significantly increase the rental income and then to sell the property with a forecast sale in financial year ending June 2010.
- ◆ The Manager has indicated that the building is expected to undergo a foyer and façade upgrade. The Manager is also negotiating with the Owners Corporation in relation to acquiring part of the common area in the foyer to add to the ground floor retail area. The SPV joint venture partners anticipated share of the cost is in the vicinity of \$340,000 for both foyer and façade refurbishment and separation of tenancy and shopfront refurbishment works.

#### 4.1.2 Market Commentary

The Melbourne CBD is Victoria's largest retail precinct with approximately 496,000 square metres equating to some 5.15% of all CBD floor space. Overall shopfront retail vacancy in the CBD is less than 2% with tight supply conditions and an increasing CBD residential population and workforce. The Melbourne office suite market is likely to have limited new supply in the short to medium term and is characterised by prices ranging from \$2,000 - \$5,000 per square metre depending on size, quality and location. The valuer notes that owner occupiers are among the most active purchasers of strata suites. Source: M3 Property Strategists.

## 5. Research and Investigation

PIR was engaged by **Real Estate Capital Partners Managed Investments Limited** to undertake this investment evaluation for a fixed fee established prior to commencement of work on the investment evaluation. Property Investment Research Pty Ltd (PIR) advises that in the compilation of this report, a full due diligence on this offer has **not** been conducted. Investors should consult the offer document, conduct their own inquiries, and obtain their own professional advice.

This evaluation is based on the information as reviewed at the time of review. Events subsequent to this point in time, either inside or outside the control of the Product Issuer may have a beneficial or detrimental impact on the performance of this investment product. A scientifically-based financial evaluation model cannot inherently assume that market circumstances or sentiment will change sufficiently to undermine the viability of an operation, despite the possibility that this can and does on occasion happen – which would then result in practically all higher risk products receiving a rating less than investment grade. A report with its associated rating is predicated on the basis of the merits of the metrics of the investment at the time of evaluation, which while pointing out risks inherent in that investment, can only assume all else being equal in the wider market place going forward. PIR also cautions that the risk return parameters of any investment may not be suitable for all investors.

PIR has relied upon information contained in the Product Disclosure Statement dated 30 November 2007. PIR has carried out its own inquiries by:

- ◆ inspecting the properties;
- ◆ having discussions with representatives of the Responsible Entity;
- ◆ reviewing the offer document dated 30 November 2007; and
- ◆ conducting a compliance review of the RE on 27 November 2007.

PIR has received copies of the valuations, tenancy schedules as well as the PDS and the RE's electronic financial analysis. PIR has received copies of the Trust Constitution and the Compliance Plan which have been registered by the Australian Securities and Investment Commission (ASIC).

As part of the compliance review, documents sighted by PIR included the following:

- ◆ Australian Financial Services Licence No. 299074 and a new draft AFSL
- ◆ Constitution of the Scheme
- ◆ Compliance Plan of the Scheme
- ◆ Draft PDSs of the Scheme
- ◆ Compliance Manual (including provisions on Code of Conduct and dealing with Conflicts)
- ◆ RE's Breach Register
- ◆ RE's Training Register
- ◆ RE's Complaints Register
- ◆ RE's Conflicts Register
- ◆ Responsible Officers Register
- ◆ Compliance Manager Checklists
- ◆ Compliance Manager's Reports to the Compliance Committee
- ◆ Fund Manager Checklists
- ◆ AFS Licence Checklist
- ◆ RE's Annual Report of the RE for the year ended 30 June 2007, including Financial Statements, audited by Ed Psaltis of Ernst & Young
- ◆ Compliance Committee Minutes and Agendas (for last 2 Meetings)
- ◆ D&O and PI Insurance certificate (\$5 million cover with AIG)
- ◆ CVs of Board
- ◆ Compliance Manager's Job Description
- ◆ NTA Calculation
- ◆ RE's monthly cash flow to February 2008
- ◆ FICs membership certificate
- ◆ Original Deeds of Subordination, including ASIC signatures
- ◆ Compliance Committee Member Services Agreements
- ◆ Compliance Committee Charter
- ◆ 3 pages on Complaints Handling

## 6. Ratings Definitions - Unlisted Funds

**AAA:** risk-adjusted returns are highly likely to exceed the stated investment objectives. The anticipated out-performance against the relevant PIR benchmarks for its peers signals best-of breed. The Fund is highly likely to effectively manage endogenous and, to the extent that it can, exogenous risk factors with industry best practice standards.

**AA+:** expectation that risk-adjusted returns will exceed the stated investment objectives and should significantly out-perform the relevant PIR benchmarks for its peers. The Fund's management of endogenous and, to the extent that it can, exogenous risk factors is of a high calibre.

**AA:** expectation that risk-adjusted returns can exceed the stated investment objectives and should out-perform the relevant PIR benchmarks for its peers. The Fund should be in a position to effectively manage endogenous and, to the extent that it can, exogenous risk factors and these should result in returns being reflective of the expected level of up-side and down-side risk.

**AA-:** should be able to consistently generate risk-adjusted returns in-line with stated investment objectives and should marginally out-perform the relevant PIR benchmarks for its peers. Although the Fund may have exposure to endogenous and exogenous risks, it should not suffer substantial performance volatility.

**A+:** should be able to generate risk-adjusted returns in-line with stated investment objectives and the relevant PIR benchmarks for its peers, although key risk factors may result in some performance volatility.

**A:** potentially able to generate risk-adjusted returns in-line with stated investment objectives, however the Fund has potential to under-perform the relevant PIR benchmarks for its peer investment products. Several key risk factors may result in greater than anticipated performance volatility, with risks concentrated on the down-side.

**A-:** while this product may be marginally investment grade for some investors with suitable risk and investment tolerances, this investment is likely to under-perform the relevant PIR benchmarks for its peer investment products. Investment performance may be somewhat volatile with significant and substantial risks concentrated on the down-side

**B+:** below the minimum standard to be considered Investment Grade. Funds in this category are unlikely to generate investment returns to compensate for the likely risks and variability in performance. The risk-adjusted returns do not enable favourable comparison to PIR benchmarks or its peers and its investment objectives may be optimistic.

**B:** below the minimum rating to be considered Investment Grade. Funds in this category are considered to contain high risks which are not reflected by the projected return. PIR benchmark comparison is unfavourable and performance volatility, particularly on the down-side is likely.

### Key Issues Relating to Production of PIR Reports

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Investments in equity and debt securitised property based products are not necessarily directly comparable and should be considered as different components of an investor's individual portfolio as they offer different risk, return and investment characteristics. Weighting investment to one product or another will not necessarily ameliorate overall investment risk.

A Fund is evaluated on a point in time basis predicated on the information available and the merits of the metrics of the investment at that time. The nature of the product and its management, its investment environment, political and economic conditions and market sentiment along with many other unpredictable variables can materially affect the basis upon which a rating has previously been issued. PIR does not assume an obligation to update a report or rating once it is issued, regardless of changed circumstances in either the product itself or the investment environment in which it operates.

A research report and product rating is an expression of opinion, not a statement of fact or a recommendation to transact or not to transact securities. The report and rating should not be construed as full due diligence or an exhaustive audit and should only be one part of the investment process. Portfolio diversification is an imperative, especially when investing in higher risk products.

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Established in 1989, PIR is Australia's leading independent specialist research group on property related investments. PIR is the major supplier of independent property research to Investment Managers and Financial Advisers. As required by section 945A(1)(b) of the Corporations Act 2001, Financial Advisers must research properly the financial products they recommend and PIR's independent property research assists in this area by providing information on investment promoters, the investment market and the risks involved.

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Richard Cruickshank, Managing Director.

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