# Centro Direct Property Fund

## INVESTOR UPDATE

Centro™ Diversified Funds

**FEBRUARY 2009**

## Quarterly Distributions

The Direct Property Fund (DPF) paid a December quarter distribution of 1.13 cents per unit to all investors on 10 February 2009. This distribution was sourced from the net underlying income of the Fund and did not include any return of capital.

The increase from 0.90 cents per unit in the September quarter is related to the Centro Australia Wholesale Fund investment which declared a higher distribution for the December quarter than the September quarter.

The distribution strategy is to maximise the ongoing payment of income distributions. It is difficult to accurately forecast what future distributions will be, as they are dependent on the underlying funds and their capacity to pay distributions.

Unless there is a further marked deterioration in operating conditions, which could lead to some syndicates or wholesale funds further scaling back distributions, the Manager expects that the DPF will pay quarterly distributions of approximately 1.0 cent per unit through FY09.

**Unit Price:** $0.9776*

**Distribution:** 1.13 cents^

* Price as at 25 Feb 2009
^ Dec 2008 quarter

# Key News

## Centro Completes Documentation for Debt Stabilisation

Centro Properties Group (Centro) has completed documentation with its financiers for the long term refinancing and debt stabilisation of the Group.

**Debt Stabilisation Features**

- Three year extension on A$3.9 billion of the senior syndicated debt facility.
- A$1.05 billion Hybrid Security to improve cash flow servicing and balance sheet strength for the Group.
- Simplification of the Group's borrowing structure.
- Agreement for the extension of debt facilities for many of Centro's managed funds.
- Reduced pressure to sell property assets within Centro and its managed funds.

**Benefits to DPF Investors**

The Centro refinancing will provide a more stable environment for the DPF and the underlying Centro investment funds. It should however be noted that the DPF still has only a very small proportion of its assets in a liquid form, and the ongoing challenge will be to substantially increase its liquidity. Accordingly, the suspension of the Fund is likely to continue for the foreseeable future.

The stabilisation of Centro has had some positive impacts on DPF investors because of the following:

- Centro MCS Manager Limited continues to be the responsible entity of the DPF.
- Lenders have agreed to extend the debt maturities to December 2011 and increase the loan to value ratio covenants for 11 syndicates in which the DPF is invested, thus providing those syndicates with additional stability.
- Many of the underlying investments have taken steps to remove Centro being the primary counterparty to hedges that fix interest and foreign currency exchange rates, thus lowering the counterparty risk to Centro.
- The teams managing the underlying Centro investment funds and the teams managing the day to day shopping centre operations continue.

# Investment Portfolio Update

### Property Valuations

Centro has a policy whereby each property in its managed portfolio is revalued on a six-monthly basis. Each unlisted Centro fund then determines a unit price which factors in these valuations. Gearing within those funds amplifies any valuation change. Valuations in the December half declined both in Australia and the US due to the global financial crisis.

The valuation decreases generally resulted from an increase in the capitalisation rate used by valuers to value the shopping centres. The higher rate is reflective of a more risky and uncertain economic environment. Rental income growth has to some extent offset the impact of the increased cap rates.

### Fund Assets

Over the December 2008 quarter, the value of the Fund's total assets declined from $2.09 billion to $1.75 billion, a fall of over 16%. The main contributors to this fall were valuation decreases in the Centro Australia Wholesale Fund (CAWF), Centro Retail Investment Trust (CRIT), and Centro Direct Property Fund International (DPFI) investments. In addition, the value of the Centro MCS syndicate investments declined on average by 22% over the quarter based on provisional net asset backing unit prices.

### Retail Sales

Over recent months, retailer sales have been mixed. Discretionary categories, in particular Department Stores, have seen significant declines in comparable sales. Supermarkets, Specialty Retailers and Discount Department Stores continue to see respectable sales growth. Virtually all of Centro shopping centres in Australia are anchored by a supermarket - providing some stability in the current economic environment.

### Occupancy

The overall look through occupancy of the DPF portfolio was a healthy 95.8% as at 31 December 2008. Occupancies remain higher in Australia than the US, which has to date experienced a more severe decline in occupancy levels. Occupancy rates are expected to decline further over coming months as some retailers are expected to encounter financial difficulties leading to store closures.

### Fund Investments

CAWF remains the largest single investment of the DPF, accounting for 41% of total assets, followed by the DPFI at 19.5%. The majority of the Fund's assets are invested in unlisted direct property investments (98.5%) with only 1.5% being in a liquid form.

Over the quarter, $20 million was returned to investors as a capital distribution, partially contributing to the asset decline mentioned above.

### Syndicate Investor Meetings

Over the past few months, two of the syndicates in which the DPF is invested called investor meetings to consider a number of resolutions:

*Centro MCS 9*

In October 2008, Centro MCS 9 (the DPF holds 10.2% of the Syndicate's units) asked investors to consider extending the term of the Syndicate for a period of up to three years (until November 2011). Centro MCS 9 held five properties, however its gearing had reached 69% and needed to be reduced to enable a rollover of this financing which matured in late 2008. All of the assets in the Syndicate were marketed for sale, however acceptable offers were received for only two of the properties. Without an extension to the Syndicate term, Centro MCS 9 would have been forced to sell the remaining properties at prices considerably lower than the book value. After due consideration, the DPF voted in favour of the constitutional changes and the extension of the Syndicate term. Over 95% of investors who voted supported the resolutions. On 20 January 2009, Centro MCS 9 announced the finalisation of the sale of Hamilton Central and Raintrees Shopping Centre. All of the net proceeds were used to retire Syndicate debt. Syndicate debt has also subsequently been extended until 15 December 2011.

*Centro MCS 15*

In January 2009, Centro MCS 15 (the DPF holds 24.1% of the Syndicate's units) asked investors to consider extending the term of the Syndicate for a period of up to three years (until April 2012). Centro MCS 15 held two properties, however its gearing had reached 53% and needed to be reduced to enable a rollover of this financing which matures in December 2009. The existing financier had indicated it was unwilling to refinance on maturity. Both of the assets in the Syndicate were marketed for sale, however only Centro Ringwood received an acceptable offer. Without an extension to the Syndicate term, Centro MCS 15 would have been forced to sell the remaining property (Centro Meadow Mews in Launceston) at a price considerably lower than book value. This action would have likely resulted in a further drop of at least 28% to the Syndicate net asset backing. After due consideration, the DPF voted in favour of the constitutional changes and the extension of the Syndicate term. Over 97% of investors who voted supported the resolutions. All of the net proceeds from the sale of Centro Ringwood will be used to retire Syndicate debt.

In both of the above situations, the DPF considered the following choices:

- Vote against the Syndicate extension, leading to a sale of all Syndicate properties and the wind up of the Syndicate, with net proceeds distributed to investors; and
- Vote for the extension, allowing the Syndicate to continue and sell further properties at some time in the future when market conditions are hopefully more favourable.

The Responsible Entity of the DPF deemed that it was better to seek to preserve capital values where possible, rather than the opportunity to access some liquidity but with a significantly diminished capital value.

**Fund Investment – December 2008**

| Investment | $ Million | % Portfolio |
|---|---|---|
| Centro Australia Wholesale Fund | 718.6 | 41.0% |
| Centro DPF International | 341.8 | 19.5% |
| Centro Retail Investment Trust – Domestic Pools | 200.2 | 11.4% |
| Centro MCS 28 | 64.1 | 3.7% |
| Centro MCS 21 | 43.2 | 2.5% |
| Centro MCS 33 | 40.6 | 2.3% |
| Centro MCS 25 | 27.7 | 1.6% |
| Centro MCS 37 | 26.0 | 1.5% |
| Non-Centro Direct Property Funds | 23.6 | 1.3% |
| Other Centro MCS Property Funds | 238.5 | 13.7% |
| **Total Unlisted Property Investments** | **1,724.3** | **98.5%** |
| Centro Retail Trust (Listed) | 2.8 | 0.2% |
| Centro Properties Group (Listed) | 0.4 | 0% |
| Outsourced LPT Portfolio | 1.0 | 0.1% |
| Cash & Other Assets | 22.0 | 1.2% |
| **TOTAL ASSETS** | **1,750.5** | **100%** |

# Fund Performance

As a result of the significant decreases in the value of the Fund's investments over the quarter, the unit price declined by 16% for the December quarter. As illustrated in the table below, the DPF generated a negative return of 20.7% for the year ended December 2008, which was comprised of a negative capital return of 24.2% offset by a distribution return of 3.5%.

In anticipation of some of the underlying investment declines, the Manager adjusted the unit prices in the weeks leading up to 31 December. Since December 2008, the unit price of the DPF has decreased further in response to further falls in the value of some of the underlying investments. The unit price at 25 February 2009 had declined to $0.9776, representing a further fall of 8.1% since 31 December.

Some of the funds have only recently finalised their December unit prices, and in some cases, the decrease was more significant than anticipated. This was particularly the case with the CAWF and CRIT investments. The further decline in the CRIT value also impacted the value of the DPF's investment in the Centro DPF International which had 28.5% of its assets invested in CRIT at 31 December 2008. Unit pricing for Centro MCS Syndicate investments is based on provisional net asset backing unit prices with final unit pricing expected to be published mid March 2009.

| | | Returns (1 Year Rolling) | | | | |
|---|---|---|---|---|---|---|
| Period Ended | Distribution (cents per unit) | Distribution | Growth | Total | Unit Price^ | Tax Advantage |
| 30 Jun 03 Yr | 8.16 | 8.7% | 6.5% | 15.2% | 1.0650 | 68% |
| 30 Jun 04 Yr | 8.23 | 8.0% | 2.0% | 10.0% | 1.0867 | 73% |
| 30 Jun 05 Yr | 8.54 | 8.4% | 12.8% | 21.2% | 1.2256 | 70% |
| 30 Jun 06 Yr | 8.78 | 7.7% | 10.5% | 18.2% | 1.3553 | 58% |
| 30 Jun 07 Yr | 9.23 | 7.2% | 9.4% | 16.6% | 1.4821 | 100% |
| 30 Jun 08 Yr | 4.64 | 2.9% | -12.5% | -9.6% | 1.2968 | 89% |
| 30 Sep 08 Qtr | 1.40* | 2.8% | -14.4% | -11.6% | 1.2647 | N/A |
| 31 Dec 08 Qtr | 1.88** | 3.5% | -24.2% | -20.7% | 1.0641 | N/A |

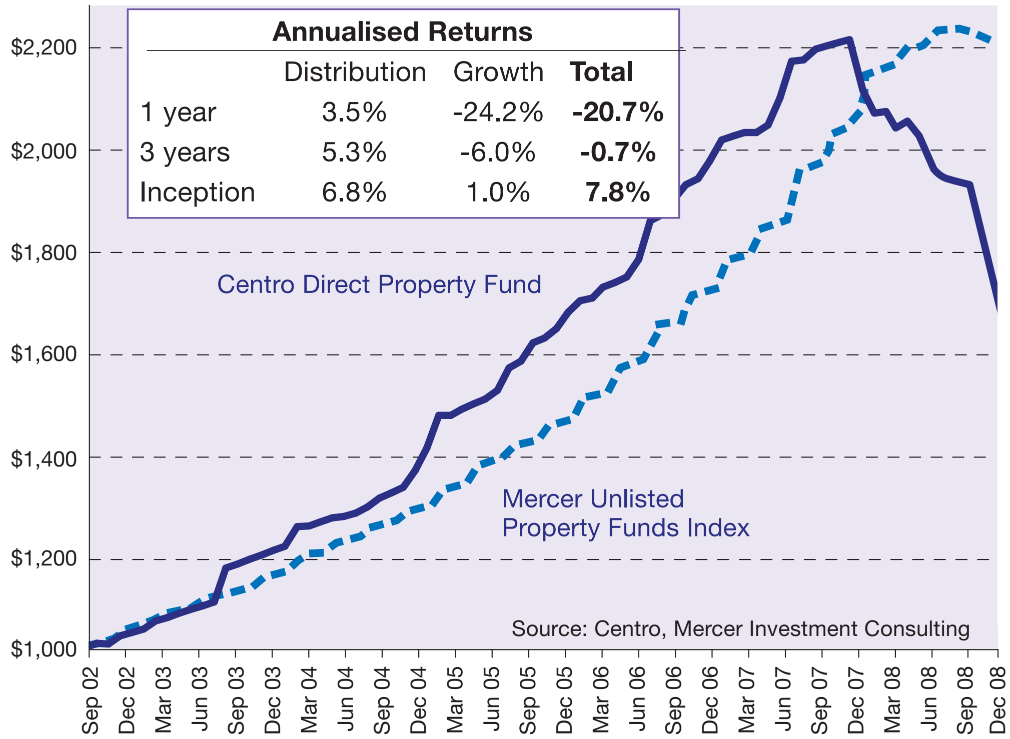
^ Ex Distribution

* In addition to the 0.90 cents income distribution for the September quarter, investors received 0.50 cents as a capital distribution, resulting in a total distribution of 1.40 cents for the quarter.

** In addition to the 1.13 cents income distribution for the December quarter, investors received 0.75 cents as a capital distribution, resulting in a total distribution of 1.88 cents for the quarter

**Total Fund Returns**

(Since Inception July 2002 – December 2008)




The chart at left illustrates the performance of the DPF has fallen sharply since December 2007. After performing well in excess of the Mercer benchmark up to that point, the DPF's performance over the past 12 months has been considerably lower than benchmark. It should be noted that the Mercer benchmark comprises a group of wholesale Australian property funds invested across the retail, office and industrial sectors, some of which only revalue their properties annually. The Manager expects that there will be further downward revisions in their valuations which be reflected in the Mercer benchmark, on a lagged basis.

The chart illustrates some levelling off and decline in the Mercer performance over the past three months.

## Fund at a Glance

(all figures as at December 2008)

| | |
|---|---|
| Fund Size | $1.75 billion |
| Total Annual Return to December | -20.7% |
| Management Expense Ratio (MER)* | 0.74% |
| Benchmark | Mercer Unlisted Property Funds Index |
| Distribution Payments | Quarterly, usually within 45 days after the end of the calendar quarter |
| Distribution Reinvestment | Suspended |

* The management expense ratio for the 2009 financial year is expected to be 0.62% while the fund remains suspended

## Look-through Portfolio Information

*Look-through* refers to the information in relation to the underlying property investments held by the Fund.

| | |
|---|---|
| Gearing (the DPF does not have any borrowings of its own) | 50.2% |
| Number of properties | 746 |
| Weighted average portfolio occupancy | 95.8% |
| Weighted average lease term (by income) | 4.96 years |

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