



Qualitative Fund Research

PMG Direct Office Fund

July 2018

About the Manager

Property Managers Group (PMG, the Group) own PMG Holdings Limited (incorporated in December 2016) which in turn has 100% ownership of Property Managers Limited (PML, the Manager), incorporated in 1992. PMG Holdings Limited is owned by staff or their related entities.

The Manager has a series of funds, that can differ in terms of types and composition of the properties they invest in. Fundamentally the Group strategy is to identify properties where the Manager has a long term property strategy to improve value through strategic leasing, smart and safe maintenance and finding opportunities to add value. The Manager's profile is available [here](#).

PMG's strategy is to achieve greater diversification by offering a range of both diversified and sector specific investment funds. The Group looks to establish each investment fund with multiple quality properties to produce diversity of buildings and

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.

The PMG Direct Office Fund (the Fund or DOF) is a direct property fund that invests in to physical office properties. By investing in physical assets investors are exposed to the risks of direct physical assets, being reduced liquidity, leverage, and some variation to income. Accordingly, the Fund may be suitable for investors seeking exposure to office real-estate assets who are prepared to invest for the long-term in lower volatility income streams with potential capital growth component.

From an asset class perspective this Fund is considered a satellite to a well-diversified portfolio. The Fund will generally sit within the alternative sector of a balanced portfolio, due to the low correlation to listed investments.

The Fund has been established to focus on holding a diversified portfolio of office properties. The investment objective of the Fund is to provide

tenants, to create a robust investment vehicle offering greater economies of scale, reliable cashflows, and improved liquidity.

FundSource views corporate citizenship and governance frameworks as extremely important foundations from which a manager starts to engage with the clients' experiences. The Manager takes an active [community](#) role both supporting and having the team members participate in local charities.

PMG has a series of [current investment portfolios](#), with this report focusing on the [PMG Direct Office Fund](#).

PMG has become increasingly active in the New Zealand market. Unlike the traditional portfolio manager and analyst roles, PMG's team consists of transaction, leasing and licensee, development, and property management. Individual bios for the PMG team can be found [here](#).

investors with strong and sustainable returns, whilst offering more diversification and liquidity.

This Fund is expected to have low correlation to listed investments and potentially complement and smooth the performance delivered by listed investment vehicles. The Fund is subject to market risks and movements (both positive and negative) and is suitable for investors with an investment horizon of more than five years.

The Fund is a Portfolio Investment Entity (PIE) with distributions made on a monthly basis, at the discretion of the Board. New investments and redemption requests are processed weekly.

FundSource notes that due to the Fund being a direct property fund it does not appear in the FE Analytics database. Accordingly, FundSource has provided some fund analytics on page 12 of this report.

Question	What the Manager says	What FundSource think
<p>What are the Manager's assets under management - in total and in this Fund?</p>	<p>Property Managers Limited (PML) was founded in 1992 and is a member of the Property Managers Group (PMG). As at May 2018 PML has approximately \$250 million of real estate assets under management.</p> <p>PML offers investors both Retail and Wholesale investment offerings. Retail offerings include Pacific Property Fund Limited (PPF) and PMG Direct Office Fund (PMG DOF). Wholesale offerings include PMG Direct Childcare Fund and PMG Capital Fund Limited – a private equity property fund. PML also manages a number of individual property syndicates.</p> <p>PMG DOF was established in December 2016 as a Retail Managed Investment Scheme. PMG DOF owns office properties largely across the upper North Island valued at \$55 million. PMG DOF was registered as a Portfolio Investment Entity (PIE) in April 2016.</p> <p>As at 30 June 2018: Pacific Property Fund: \$127M PMG Direct Office Fund: \$ 55M</p>	<p>PMG offers both retail and wholesale property investments typically in the form of unlisted commercial property funds.</p> <p>PMG has spent the last two years restructuring its operations. This has prepared PMG to set itself for growth, and diversify its client base to include retail investors, as well as high net worth investors.</p> <p>This Fund and the Pacific Property Fund are the only products available to retail investors. PMG offer the PMG Capital Fund and PMG Direct Childcare Fund to wholesale investors only.</p> <p>PMG are looking to grow its retail offerings to a target size of \$250 million dollars. This represents an ambitious growth target for this Fund.</p>
<p>Who is accountable for managing the Fund, and how long has the investment team worked together?</p>	<p>PML was one of the first property funds managers in New Zealand to be licensed under the Financial Markets Conduct Act 2013 (FMCA) as a manager of Managed Investment Schemes, (excluding managed funds) ("schemes") which invest in, or own, real property in New Zealand.</p> <p>The property portfolio of PMG DOF is held by an independent trustee (Covenant Trustee Services Limited) and is managed by PML. Key PML personnel include the following:</p> <p>Scott McKenzie, CEO and Director of PML. Scott has 17 years of commercial, finance and leadership experience within the banking sector in New Zealand and the UK. He oversees the company's operations and is responsible for implementing PML's and PMG DOF's strategy. Scott joined PML in 2012.</p> <p>Daniel Lem, Director and Head of Investment is responsible for sourcing new investment opportunities for PML's portfolios including PMG DOF, and the re-positioning/re-development of assets. He is a real estate professional with 20 years' experience in NZ, the UK and Eastern Europe. Daniel joined PML in 2015.</p> <p>Nigel Lowe, Chief Financial Officer, is responsible for the financial reporting, compliance and capital and cashflow management for PMG DOF and PML. He is a Chartered Accountant with over 15 years' experience. Nigel joined PML in 2016.</p> <p>Matt McHardy, Head of Sales and Investment, is responsible for developing</p>	<p>Unlike traditional managed funds, the DOF is not managed under a typical portfolio manager and analyst structure. The Manager's focus is investing in large lumpy assets, rather than a target security price where the noise and information is significantly higher.</p> <p>With this in mind the team is broken down to core functions, transaction, leasing, development, and property management. For this Fund the focus is on office property, concentrating some risks as the properties are focused around a single use. These roles are completed by a team of five directly, with input from the Directors of PMG. The property management team is led by Steve Williams and Brian Berry, from a day to day perspective. Both Williams and Berry are considered to be key people, outside the executive team.</p> <p>FundSource view structure and composition of the PML investment committee favourably. FundSource notes the PMG investment committee meets on a quarterly basis or when required. Given the long lead time to identify assets for consideration, either purchase or sell assets, quarterly meetings are considered to be appropriate. As the number of assets held across the group, and as this Fund grows, the Manager may need to consider the frequency of the investment committee meetings.</p> <p>FundSource notes the Manager implemented a significant restructure of its business through 2014-2016, which included the establishment of funds and aggregation of standalone buildings into the funds where there was investor</p>

	<p>strong relationships with investors nationwide, managing capital raises and the necessary associated compliance requirements. Matt joined PML in 2015.</p> <p>Denis McMahon, is founding director of PML. Nowadays, Denis acts in a governance capacity for PML. Denis has over 35 years of property and fund management experience.</p> <p>Full profiles are available on PML's website: http://www.propertymgr.co.nz/</p> <p>All key personnel have a combined fund and property management experience of 80+ years. The team established PMG DOF in December 2016</p> <p>On establishment, the fund was valued at \$45.5m. The fund's current value is \$47.8m with cash distributions of 7.50 cents per share.</p>	<p>support. FundSource believes the Manager has a strong core skill set and is appropriately resourced for the number of current properties.</p> <p>FundSource highlights the role of the independent trustee, Covenant Trustee Services (CTS). CTS were established in 1998 and have offered trustee services since inception. This provides a layer over oversight separate to that of the Manager and the Fund. Accordingly, the independent trustee should be acting in the interests of the unit holder, not the Manager.</p>
<p>What objective is the Manager trying to achieve?</p>	<p>PMG DOF was launched in 2016 as a category-specific, quality, office building investment portfolio, with properties geographically diversified largely throughout the North Island of New Zealand. PMG DOF's goal is to grow the portfolio to \$250 million worth of assets under management over time. The properties are owned by PMG DOF and are actively managed by PML's experienced team.</p> <p>The strategy for PMG DOF is to provide sustainable returns to shareholders through strategic geographic, building, and tenant diversification, with a focus on proactive management of the properties to improve the building and tenant quality and grow long term shareholder value. PMG DOF's investment objectives are to:</p> <ul style="list-style-type: none"> (a) achieve sustainable gross distribution levels at 7.75% or above by the year ending 31 March 2019 and beyond; and (b) grow the value of the portfolio of buildings in PMG DOF. <p>PMG DOF invests in office properties which are typically valued between \$5 and \$50 million and where it is believed PML's proactive management will release unrealised value.</p>	<p>The Fund's objective is to build a geographically diversified portfolio of office properties in the North Island of New Zealand. The drivers of the office property market will be somewhat concentrated due to this geographic focus. The Fund's income is derived from the leasing of each underlying property, which in turn influences the valuation of each property.</p> <p>Property location, quality, tenant profile, lease quality and weighted average lease term (WALT) will impact the property valuation and capital expenditure requirements. FundSource notes the Manager actively looks for property assets that can benefit from tenant, floor plan, refurbishment, or purpose restructuring. PMG focus on improving assets, from low grade assets in to higher quality buildings. The portfolio comprises 6 properties at present, with >50 tenants.</p> <p>Diversification is central to the Fund's investment strategy. This is being achieved on several levels including location and tenant profiles. FundSource highlights the office building held in this portfolio are not jointly owned in other PMG vehicles. However, assets can be acquired using the PMG Capital Fund Limited, which has an opportunistic focus. Assets can be acquired by DOF or other PMG funds, when they are in a position to do so. As this Fund grows investors can expect the location of assets, and tenants, to change over time. This is updated to investors via a regular quarterly report, available directly from the Manager.</p>
<p>What does the Manager invest your money into?</p>	<p>PMG DOF is a fund which invests in high-quality office buildings which are geographically spread throughout the North Island, predominantly in Auckland, Tauranga. There are 6 properties in the fund which are leased to a total of 50 tenants, with a 90% occupancy rate and a WALT of 3.1 years (as at 31 March 2018).</p>	<p>This Fund is a single sector focused fund, providing exposure to the office sector. Accordingly, FundSource notes investors must be prepared to invest in this sector, which will concentrate its exposure to the upper region of the North Island, primarily the regional area between Tauranga and Auckland. While the underlying assets may</p>

	<p>The investment strategy of PMG DOF is:</p> <ul style="list-style-type: none"> (a) to invest directly in office buildings largely North Island of New Zealand; and (b) to grow the value of the property portfolio by leasing the remaining vacant space, maintaining the properties and finding opportunities to add value to the properties. <p>PMG provides a matching service for buyers and sellers of units in DOF. PMG has a good track record of providing this service within a reasonable timeframe.</p>	<p>change over time, one characteristic FundSource does not expect to change is the Managers approach to property. That is acquiring properties that present opportunities for improvement, rather than growing a book of high “A Grade” lower rental growth, income streams.</p> <p>The Manager has a buy and hold investment strategy, however an investor should expect some turnover in assets, where the opportunity arises. FundSource believes the Manager actively seeks and acts on opportunities. This can include acquiring assets from other PMG managed structures managed, provided the asset meets the Funds objectives.</p> <p>At present all assets are owned by the DOF, rather than co-investing in to other funds, or investment structures. Investors should consider the Fund to be illiquid. The Manager is reviewing the ability to provide regular liquidity for the Fund, but at present the Fund is not obligated to meet redemption requests.</p>
<p>What are the inherent risks imbedded in the Fund?</p>	<p>Rental risk – the risk that a tenant may become insolvent and unable to pay rent. Where a tenant cannot meet its contractual obligations, it could impact on PMG DOF’s distribution. However, PML’s diversified and multi-property portfolio strategy, mitigates this risk.</p> <p>Capital expenditure risk – PMG DOF may be required to outlay unbudgeted capital expenditure on any properties in its portfolio for a number of reasons. PMG DOF may not be able to recover all of this expenditure from tenants, which may have an adverse effect on PMG DOF’s performance.</p> <p>Funding risk - Adverse market movements may cause property values to drop and therefore PMG DOF’s maximum loan to value ratio, set by lenders, may be exceeded. Interest rates may rise, therefore reducing operating profits.</p> <p>Property market risk - Property market conditions and fluctuations in supply and demand for properties can affect the value of the portfolio, the costs, and other underlying property fundamentals. PMG DOF is reliant on its property investments to provide it with a return and a deterioration in the New Zealand property market could result in PMG DOF not being able to deliver forecasted returns.</p> <p>Liquidity risk – Units in PMG DOF are not listed and, as such, there is no established market for units. However, PML facilitates a secondary market service whereby it actively works with any investors who may wish to exit their investments and helps them sell to other investors.</p>	<p>The risk an investor exposes themselves to in this Fund appear to be similar to those in other PIE managed funds. However, there are some important differences, including the significantly reduced liquidity. Investors should also ensure they familiarise themselves with the key risks highlighted by the Manager.</p> <p>FundSource highlights the DOF currently invests in properties ranging from >\$5 million - <\$50 million. These are smaller properties and can be within the reach of private investors. Competition for properties can be high, which may see the Fund purchase a property at a premium. There is potential for the Fund to invest in alongside PMG vehicles, as well as purchase assets for the Fund. While this can provide diversification across the assets of the Fund, there is potential to introduce liquidity risk. FundSource notes the Manager would prefer to acquire properties in full, rather than invest in other PMG investment vehicles, such as syndicated trusts.</p> <p>Geographic and concentration risk includes the assets location. Currently there is a bias to the North Island, with a particular focus on Auckland and Tauranga regions. This does not prevent the Fund from owning properties outside this region. The Manager recognises its core skillset rests within this regional area, accordingly FundSource believes this will account for a majority of the Fund’s assets, with Auckland likely to dominate over time.</p> <p>All underlying properties have some gearing. This means there is some interest rate risk, and financing risk involved. At present PMG have lending facilities with top tier banks, which helps to mitigate some of this risk. Historically banks have</p>

		<p>made decisions to exit parts of the property market, notably in times of stress, which can exacerbate portfolio risks. The timing of refinancing can impact the Manager and the Fund, as was the case for several Australian direct property fund managers in the global financial crisis (GFC).</p> <p>The Manager is aware of the broad range of risks and is mindful of them when constructing and managing the portfolio. Selecting and blending the properties takes a great deal of skill, knowledge, understanding and insight, which is developed over many years. FundSource is impressed by the PMG investment philosophy, and believes the team has appropriate experience and insight to improve a property, leading to higher rental income, and better capital expenditure management. This type of Fund is not readily replicable by an individual investor.</p>
<p>Why does the Manager believe the future prices of the Fund's investments will vary?</p>	<p>Successful direct investment in commercial property is largely driven by the Manager's skill at identifying good properties and effectively managing those properties. In this respect, PML works hard to firstly sustain and then increase value for its investors. Undertaking proactive property management practices and strategically refurbishing and re-leasing existing buildings where appropriate, are key ways in which PML works to increase the value of properties owned by PMG DOF.</p> <p>PML believes the future prices of PMG DOF's investments will vary, due to changes, over time, in the underlying assets of the portfolio. These changes include acquisitions and/or divestments, growth in rental income from existing and/or new tenants and capitalisation rate compression through fluctuations in the property market.</p>	<p>The Manager's due diligence process sees each individual property modelled, the current tenant and lease profiles are evaluated so the Manager can accurately determine the capital expenditure. As the Manager focuses on acquiring lower grade assets and refurbishing them, there is some potential for increased capital expenditure and usage risk. This is evident in the Short Street offices, where the Manager has undergone a deliberate refurbishment program, which remains ongoing. FundSource notes this has been completed on a lease by lease and floor by floor approach. The PMG Auckland office fit out acts as a showpiece for new and existing tenants to consider.</p> <p>FundSource believes the Short Street property is a good example of how the Manager looks at its properties, and the best use for that property. FundSource notes the Short Street refurbishment adds to the tenant, leasing profile, development and refurbishment risks, but shows the Manager's innovative thinking around the Fund's properties.</p> <p>FundSource is aware the leasing profile for this Fund is significantly shorter than that of the PMG managed Pacific Property Fund Limited, at 3.3 years and 7.5 years respectively, at the date of this report. This provides opportunities for the Manager to refurbish and/ or repurpose the buildings. Correspondingly the reduced WALT presents some uncertainty around the rental income. FundSource notes the Manager has a strong track record in managing this type of asset and will look to improve the WALT over time. FundSource believes the current tenant mix is well diversified and will provide opportunities for the DOF to grow the overall portfolio valuations.</p> <p>FundSource note that valuations are an important part of operating the Fund, underpinning investor expectations.</p>

		<p>Valuation only become real on the completion of a transition to sell or buy an asset. Understanding the property market conditions (the macro backdrop for property) impact investor returns and potential for capital gains, as much as the income stream from rent.</p>
<p>Why does the Manager believe you should give them your money rather than to someone else or to an inexpensive index fund?</p>	<p>PML has over 25 years' experience in property investment management. PML's team of experienced professionals care deeply about what they do and about increasing the wealth of their clients. A culture-driven business, PML lives and operates by its values of Trusted; Integrity; Proactive; Honest and Available. This coupled with PML's long history of delivering solid returns to investors makes it a highly trusted and approachable property and funds manager.</p> <p>PML takes its responsibility seriously and aims to deliver stable monthly cash distributions for PMG DOF investors and growth in value over time. Since PMG DOF was established, PML has delivered to investors distribution returns at or over forecasted returns.</p> <p>Many of PML's investors have been invested with us from day one (for 25 years) and so are a number of their children and grandchildren. PML is a trusted investment partner for all of our investors and PML directors invest alongside its clients (have 'skin in the game') ensuring we have our client's best interests at heart.</p> <p>Being an unlisted property fund, PMG DOF, unlike indexed funds, is not subject to share market fluctuations that are not directly associated with the quality, value and return from the properties within the portfolio.</p>	<p>FundSource view the direct property market as a specialist area, where the Manager's ability to manage the assets becomes critical to investor outcomes. FundSource believe the PMG team have appropriate skills and for the number of properties at present, on-ground resources, to deliver strong investor outcomes, in line with their stated objectives. As the number of properties increases FundSource believes there is an opportunity to add to this team and look to develop some succession planning for the Manager.</p> <p>Since the Funds inception in December 2016 there has been material allocation to Auckland, which represents ~75% of the portfolio. As the demographic focus has been on Auckland's growth it is expected this will be a higher allocation in the Fund. The Manager's expertise lies in acquiring lower quality assets, refurbishing and/ or repurposing the assets to improve the asset quality, which underpins rental income and property valuations. Some performance analytics have been provided on page 12 of this report.</p> <p>FundSource believes the Manager will have significant opportunities to source new properties. The key will lie in the Managers ability to acquire the property at the right price. In addition, the Fund must carry the property while undergoing an incremental refurbishing and/ or repurposing of the property. This must be achieved without detrimentally affecting the rental income, until completion. The Manager has been able to achieve this today</p> <p>FundSource highlights the DOF investment structure is not new. During the 2008 global financial crisis (GFC) several Australian direct property fund structures materially changed their underlying asset quality, tenancy profile and WALT. Having commenced in the mid 2000's with A and B grade buildings, with strong tenants and long WALTs. This resulted in the failure of these Funds. PMG has successfully navigated several market cycles, since commencing operations in 1992.</p> <p>FundSource highlights PMG is changing its distribution model and is actively engaging with the intermediary market.</p> <p>FundSource believes the DOF offers potential investors a fund that mixes relatively diversified leasing profile, with some refurbishment, improvement and potential repurposing opportunities, and corresponding risks. These are all intended</p>

		to improve leasing profiles for each property, and the valuation as well.
<p>How does the Manager decide to buy or sell investments?</p>	<p>The investment committee of Denis McMahon, Scott McKenzie, Daniel Lem, Nigel Lowe, Steve Williams and Matt McHardy (which includes all the directors of PML) regularly reviews the performance of the portfolio and makes recommendations to the board, including investment/divestment decisions.</p> <p>Each month, at the PMGDOF board meeting, all recommendations from the investment committee are considered.</p> <p>Acquisition and divestment decisions are made taking into account the following factors:</p> <ul style="list-style-type: none"> • Is any major capital expenditure on the property required? • What is the lease (s) expiry date and is the lease (s) likely to be renewed? • What is the weighted average lease term (WALT) of the overall portfolio? • What is the Internal Rate of Return? • What are the current and forecasted property market conditions and valuations? Risks? • What is the forecasted net income? Risks? • What is the forecast compliance with banking covenants? <p>If the decision to sell or acquire a property is made, a report to the fund's board is prepared for its consideration. If approved, PML endeavours to sell or acquire the property.</p>	<p>The Manager typically takes a long-term, greater than 10-year view on the properties it acquires. FundSource notes this is typical for direct property managers. This doesn't prevent properties from being sold in a shorter timeframe, subject to an appropriate offer being made. Notably the time taken to acquire a property can vary from a couple of months to over 12 months. The due diligence conducted is extensive, every property is comprehensively modelled internally by PMG, and subject to the investment committee review, prior to the PMG Board providing final approval.</p> <p>While the due diligence process underpins acquisitions, the Manager actively seeks opportunities, and has been able to structure transactions around multiple properties to coincide around similar timeframes. FundSource believes this is a function of PMG's approach to capital management and enabling the Fund to acquire higher cost assets for the Fund. This is also reflected in the Managers responsible approach to managing debt facilities from an asset and fund perspective.</p> <p>The requirement for all transactions to be approved by the investment committee, prior to being escalated to the PMG Board viewed positively. The size of each transaction varies and is considered to be relatively small. This increases the pool of potential buyers as properties of this size sit within the reach of high net worth investors. FundSource doesn't believe the investment committee or board process delays or hampers the Manager's ability to operate the Fund in an efficient manner and is a positive risk management tool.</p> <p>Potential investors should consider the Fund to be illiquid, as selling a real property asset quickly is unusual or involves large discounts. The Manager will onboard investors who may have a need to sell along with investors who are looking to buy in to the fund. The Fund does provide an annual redemption facility which is available in July each year subject to investor demand and board approval.</p>
<p>Has the CIO/ Portfolio Manager personally invested in the Fund? If so, paying the same fees as other investors?</p>	<p>The directors of PML and certain senior employees and/or their associated entities own units in the fund. The directors and associated entities all pay the same fees as all other investors within the Fund.</p>	<p>FundSource believes that the interests of investment personnel are better aligned to those of the investors, when investment personnel are significantly invested, and at the same fees.</p> <p>On a positive note, a number of the executive team, and employees have invested in PMG products, which may include this Fund. Importantly they pay the same fees as investors. FundSource believes this improves investor alignment, and all investors share the same experiences and outcomes.</p>

		<p>FundSource notes that due to the illiquid nature of a direct property fund, it is unreasonable to expect PMG employees to have significant wealth invested. Diversification across assets classes and the liquidity profile of the portfolio needs to align to an employee's or investor's risk profile.</p>
<p>How much latitude does the Manager have to deviate from the weightings of the Benchmark portfolio?</p>	<p>The investments PMG DOF is authorised to purchase and hold assets to include:</p> <ul style="list-style-type: none"> • Asset Classes: Commercial property • Sectors: Office • Geographical Location: New Zealand - upper North Island <p>Target Asset Allocation is as follows:</p> <ul style="list-style-type: none"> • Direct investments in commercial property: 70-100% • Interest rate swap agreements: 0% -10% • Other assets associated with property ownership: 0%-10% • Cash: 0%-10% 	<p>Since 2016 the Fund has been relatively stable in the location of the properties. Despite the sector and regional changes, the Manager's intention is to hold assets over the long term. This can be seen in the tables on page 12 of this report.</p> <p>Auckland dominates the asset allocation of the Fund. FundSource highlights the Short Street property is representative of the Managers ability to add value to a property. The Fund intends to be fully invested, with cash usually building up post sale or pre-acquisition of a property.</p> <p>As the Fund's funds under management grows investors can expect the asset allocation on a regional basis to change accordingly. FundSource will continue to review any significant changes in property locations, with a view to ensure that assets do not become centralised around Auckland.</p> <p>Managing a portfolio of direct property assets is expensive, and there are many components the Manager is looking to optimise to generate a return for investors. This isn't limited to the physical assets themselves, it extends to debt management, and risk management, hence the use of derivatives, such as interest rate swaps, to protect against interest rate movements.</p>
<p>On what basis does the Manager believe the fees they charge are justified?</p>	<p>PML believes the fees charged to PMG DOF are fair and in line with the market. The fees represent the combined-experience of PML's directors in the industry, which is over 80 years. They also reflect the proactive, personalised property management services PML provides PMG DOF via its in-house, expert property management team, which is essential for direct property investments. PML's directors select and analyse all investments to ensure they are suitable and represent a great opportunity to grow the value and returns of the portfolio.</p> <p>PML's fees are also directly linked to the performance of the portfolio. Property management fees are based on the gross rental income collected (i.e. exclusive of vacant space, if any). Therefore, the performance of the overall portfolio is based on the performance of the underlying assets.</p> <p>Below is the list of PML's fees:</p> <ul style="list-style-type: none"> • Acquisition Fee: New property investments, 1% of the purchase price 	<p>FundSource believes the Manager is transparent from a fee perspective, noting the administration and underlying manager fees are disclosed in the PMG Direct Office Fund Product Disclosure Statement (PDS)</p> <p>FundSource note the DOF is a unique offering in the New Zealand market. Its closest peers are Australian Unit Trusts (AUT) that are available for New Zealand investors to invest in. Therefore, there is no direct comparison available. Needless to say, most components of the fee structure are in line with direct property AUTs.</p> <p>The performance fee hurdle rate is not market linked, however there are no specific New Zealand direct property indices for the Manager to point to. The performance hurdle rate is fixed at 10%, while this reduces variability, strong asset valuation growth can see the total return exceed 10%. While most Australian direct property fund managers use a cash+ or consumer price index + (CPI+) basis to calculate performance fees, FundSource notes in periods of historically low interest</p>

	<p>(until the carrying value of the Company's property portfolio exceeds \$250,000,000.</p> <ul style="list-style-type: none"> • Disposal Fee: 1% of the sale price of each property which is sold by the Company. • Fund Management Fee: 0.50% of the total carrying value of the properties under management. • Property Management Fee: 2.0% of gross annual rental collected from the properties under management. • Project Management Fee: 5% of the total development/project costs incurred (which exceed \$100,000). • Performance fee: 20% of the total return exceeding 10% per annum. • Secondary Market Fee: 1.5% of the secondary transfer amount from one investor to another. <p>All fees are stated as exclusive of GST.</p>	<p>rates, the cash + or CPI+ performance hurdle rate can dip below 10%. The quantum of the performance fee is in line with New Zealand and Australian direct property funds, typically 15-20%.</p>
<p>How would you describe the quality of your organisational and investment governance processes?</p>	<p>PML's governance and compliance is of the highest possible standard and structured to ensure PML always operates in the best interests of its investors. PML's governance structure covers the management of assets, acquisitions, the investment process, staff code of conduct and ethics.</p> <p>Regulatory compliance is a key focus for PML and a compliance assurance plan covering all aspects of the business has been put in place.</p> <p>The primary governance responsibility for PML sits with the PML Board which is guided by independent director, Dr Wayne Beilby, who has a Doctorate in Governance. He is joined by co-founder and director Denis McMahon.</p> <p>Governance for PMG DOF sits with the PML board which includes Dr Wayne Beilby; Denis McMahon; Scott McKenzie; Daniel Lem and Nigel Lowe (all directors of PML) and Steve Williams, head of asset management for PML.</p> <p>PML is licensed under the Financial Markets Conduct Act 2013 (FMCA) as a manager of Managed Investment Schemes, (excluding managed funds) ("schemes") which invest in, or own, real property in New Zealand. As a Licensed manager PML is overseen by an independent supervisor, Covenant Trustee Services Limited.</p> <p>Additionally, all investment decisions are governed and subject to approval by the investment committee. Please see answer to the above question: "How does the Manager decide to buy or sell investments."</p> <p>From a compliance perspective, PML has invested heavily in strengthening its in-house risk and compliance team and has developed a robust process to ensure it meets all regulatory compliance</p>	<p>FundSource notes that the PMG Board and investment committee consists of executive members. However, at the Board level, the 2017 appointment of Wayne Beilby as an independent director is viewed positively. This is in addition to co-founder Denis McMahon remaining engaged with PMG, since its inception in 1992</p> <p>FundSource believe there may be some benefits to including a non-executive member to the investment committee, to add some diversity of views in the overall investment decision making process.</p> <p>FundSource would prefer to see compliance functions report directly to the Board, separating the function away from the investment team. Compliance and risk management is a growing aspect of funds management and requires appropriate resourcing. As the Fund grows FundSource expects to see additional compliance resources be added.</p> <p>FundSource highlights the PMG structure has changed markedly over the five years, which has resulted in some mergers and acquisitions. Some of this activity was to bring key people in to PMG on a full-time basis. This is also reflected in PMG seeking to engage with financial advisers and grow the property funds business. Funds management is newer for PMG, accordingly, FundSource believe the addition of a funds management specialist as a Board or investment committee member could be beneficial. In saying that FundSource does not view the current PMG structure negatively.</p>

	<p>requirements. PML uses technology to streamline the onsite regulatory and operational efficiency.</p>	
<p>Is there alignment of interests through; ownership of the Manager, and remuneration of the investment team?</p>	<p>A portion of the remuneration of all PML executive directors and the Chairman are linked to the overall performance of the Manager company (PML).</p> <p>As Manager, PML's fees are linked to the performance of each of its investment portfolios. The investment team is involved in the day to day management of PMG DOFs portfolio and is incentivised to ensure the underlying assets continue to perform and therefore maximise returns to investors.</p>	<p>To preserve capital and generate a long-term positive return for investors, the Manager must remain operational. PMG has been operating since 1992, surviving natural and financial market issues since inception. PMG's long history, and more recent diversification of capital sources, should see PMG remain a sustainable business.</p> <p>The remuneration structures are as expected for a business of this size. This being predominantly base salary, with a variable component. Key director and executive positions being held by shareholders and investors in PMG funds is considered to be a strong alignment with investors. The equity ownership of PMG CEO, Scott McKenzie, and other Directors and executives is considered a strong positive.</p>

FundSource notes that additional performance details for this Fund can be requested from the Manager via their [website](#) Data as at 30 March 2018.

PMG Direct Office Fund	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18
Monthly returns																
Cash distribution to investors	89,570	163,333	163,333	163,333	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000
Capital return annualised	289,814	528,480	528,480	528,480	157,551	157,551	157,551	157,551	157,551	157,551	157,551	157,551	157,551	157,551	157,551	157,551
Total return	379,384	691,813	691,813	691,813	332,551	332,551	332,551	332,551	332,551	332,551	332,551	332,551	332,551	332,551	332,551	332,551
Monthly return cents per unit																
Income return cpu	0.3199	0.5833	0.5833	0.5833	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250	0.6250
Capital return cpu	1.0351	1.8874	1.8874	1.8874	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627	0.5627
Total return cpu	1.3550	2.4708	2.4708	2.4708	1.1877											
Portfolio holdings by region																
Tauranga	21.04%	21.03%	20.97%	22.11%	22.08%	22.04%	22.01%	22.22%	22.24%	22.35%	22.31%	22.29%	22.40%	22.55%	22.61%	23.21%
Rotorua	3.66%	3.66%	3.65%	3.61%	3.60%	3.60%	3.59%	3.58%	3.58%	3.58%	3.58%	3.57%	3.56%	3.55%	3.54%	3.69%
Auckland	75.29%	75.31%	75.38%	74.28%	74.32%	74.36%	74.40%	74.20%	74.19%	74.07%	74.11%	74.14%	74.04%	73.90%	73.85%	73.10%
Total	100.00%															
Portfolio Holdings by sector																
Office	100%	100%	100%	100%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

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Conclusion and Rating

Overall, FundSource believes the Manager is filling a gap in the New Zealand market place, not only from an asset allocation perspective, but also providing an opportunity to diversify an investor's exposure to a focused pool of New Zealand domiciled physical office sector property assets. Investors should have a longer-term view and time horizon, due to the reduced liquidity of this Fund. FundSource highlights the Manager provides a matching service for buyers and sellers of units but is not obligated to meet withdrawal or redemption requests.

The team has strong industry experience relevant to the asset class, with roles such as valuers, leasing managers, and property managers, that are not common in typical equity, fixed interest, and listed property funds management, other than where physical investments are core to the portfolio. This is due to investing in physical assets, dealing directly with tenants, managing maintenance, refurbishment, and fit out programs. FundSource highlights the team's alignment to investors through shareholding and/ or investment in the Fund is viewed positively.

The Fund performance, on page 12, shows how on a quarterly basis the results can vary. While historical performance is not a reliable predictor of future performance, it can provide insights as to how the Manager reacts to market change, and how the Fund reacts to asset purchases or sales.

The Fund directly and wholly owns each property at present. This Fund carries refurbishment and repurposing risk, as the Manager seeks to optimise the opportunity for each property. Accordingly, this may create some variance in income and capital growth. As the Fund's FUM grows additional property acquisitions should smooth short term income or valuation fluctuations. Asset location is a significant risk, with the portfolio heavily biased to Auckland. FundSource will continue to review the asset mix over time, to ensure there the current quality and strength of the Fund maintains its current property, tenants, WALE, and team quality.

The Funds' fees are in line Australian direct property funds. This includes the calculation methodology of performance fees. The Fund is unique in a New Zealand context, therefore direct comparison to a New Zealand peer is not possible.

FundSource recommends that investors carefully consider that the Manager's approach to investing in direct property, and the liquidity profile of the Fund meets their investment needs and objectives. A direct property fund is typically allocated to the Property or Alternatives asset classes in a diversified portfolio.

FundSource Rating: **AA**

Fund ratings are current as at the date of publication of this report. FundSource reserve the right to review and update fund ratings from time to time

Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score
Corporate & Investment Governance	15%	4.00 / 5
Investment Philosophy & Process	20%	4.40 / 5
People	25%	4.00 / 5
Portfolio Construction & Implementation	15%	3.33 / 5
Risk Management	15%	4.40 / 5
Investment Fees	10%	3.43 / 5
Overall Average Score:		3.98 / 5

FundSource Rating Guide

The qualitative rating of a fund is a function of the FundSource Research Factor Weighting process, which is built around the six core qualitative research process categories. The weighted scores result in an overall score, out of five, which is then matched to the following rating:



AAA: Highly Recommended

Funds that have superior average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, significantly experienced and stable senior personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management company will also have established effective controls to maintain that philosophy.

AA: Recommended

Funds that have strong average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced and stable personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management philosophy must be coherent and consistent with existing portfolios and processes.

A: Investment Grade

Funds that have good average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced personnel, a sound track record a defined investment philosophy and process, and a portfolio consistent with that philosophy and process.

FW: Fund Watch

There has been a material change with either the manager, this may include, but is not limited to, departures, new hires, process changes, changes to the investment philosophy. This is considered to be an interim measure, to enable further investigation, re-evaluation and an appropriate course of action to be determined.

S: Sell

This category covers previously recommended funds that are no longer recommended because of some material change. Removal from recommended status might be for a variety of reasons such as a fundamental change in the fund management company or in the manager's investment strategy, or because a fund did not meet its original expectations. The implications for ongoing service are that the fund should be reviewed on an individual client basis to ensure it still matches their original investment objective.

NR: Not Rated – Screened/ Not Rated

Funds in the Not Rated – Screened category have provided information and/or FundSource has conducted an initial analysis of the fund, but has chosen not to provide a recommendation at this stage. FOR Not Rated funds the manager may have provided information, but no review meeting has been conducted

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