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INDEPENDENT INVESTMENT RESEARCH

US Masters Residential Property Fund (URF)

1H16 Results – August 2016

INDEPENDENT
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US Masters Residential Property Fund (URF)

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Investment Profile	
Unit price ($) as at 30 August 2016	1.99
NAV ($) at 31 July 2016 (unaudited)	1.82
Valuation ($)	2.17
Issued capital:	
Ordinary shares (M)	292.9
Options (M)	0.0
New shares issued if capital raising fully subscribed (M)	43.6
Fully Diluted (M)	336.5
Market capitalisation ($M)	582.9
52-week low/high ($)	1.99/2.35

Board and Management

Directors

Alex MacLachlan - Managing Director, Head of Strategy

Tristan O'Connell - Finance Director

Tom Kline - Executive Director

US Management Team

Alan Dixon - Chief Executive Officer

David Orr - Chief Operating Officer

Paul Mcinerney - Joint Chief Financial Officer

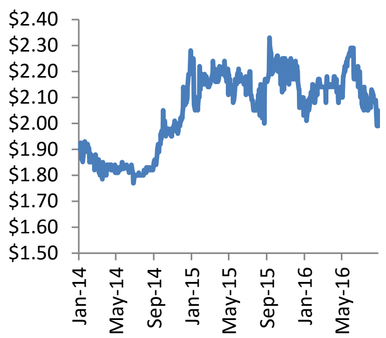
Kevin McAvey - Joint Chief Financial Officer

Ezequiel Ortiz - Director, Acquisitions

Priscilla Porter - Director, Property Management

Largest Shareholders	%
Alan Dixon	2.1
Yarraandoo Pty Ltd	0.5

Share price performance



OPERATING LOSS FOR 1H16 DRIVEN BY INCREASED INTEREST AND FOREIGN CURRENCY MOVEMENTS

1H16 Results: Revenue continued to improve in the 1H16, up 50% on the pcp, as a result of the increased number of properties leased out over the period. As the Fund continues to increase the number of properties available for rent, revenue will continue to improve. While revenue was up, the Fund reported a $12.2m operating loss. Contributing to the loss was a significant increase in interest expense and a net loss on foreign currency. The Fund had $108m cash at 30 June 2016, however we note that the $97.6m of this was proceeds from borrowings. The Fund had a current ratio of 1.4 at 30 June 2016. We expect this to improve upon the successful completion of the upcoming capital raising.

Property Spending: The Fund spent $26.6m on acquisitions and improvements to properties in 1H16. This is a 31% decline on the $38.4m spent in the pcp. The Fund acquired 17 freestanding properties. The number of properties acquired on an annual basis continues to decline. The decline is a combination of increased prices, increased competition for property and a focus on the refurbishment of properties in the portfolio.

Property Sales: The Fund completed the disposal of the multi- dwelling properties owned jointly with Excelsior Equities, LLC, during the period. The Fund received US$61m for the sale of the 14 properties, a 26% premium to the acquisition price.

Capital Raising: URF has announced a placement of up to 43.9m fully paid ordinary units at $1.95 per unit to raise up to $85.7m. The new units are expected to be issued on 23 September 2016. Based on previous capital raisings, we expect the placement to be fully subscribed. The price at which the new units will be issued are at a 5.8% discount to the share price at 21 August 2016 (the close price the day before the announcement), which will have a short-term negative impact on the share price. The proceeds from the capital raising will be used to fund property renovations and property acquisitions as well as for general business and financing purposes.

Borrowings: URF increased their debt levels during the 1H16 with the Fund securing an additional US$84.5m through two loan facilities, taking the total borrowings to USD$528.7m, including the unsecured notes issued. As a result of the additional facilities, current borrowings increased 179.7% to $68.9m at 30 June 2016.

Currency: The AUD appreciated against the USD over the half, having a negative impact on the portfolio value. While the AUD has appreciated over the short-term, the decline in AUD since the inception of URF has contributed significantly to the value of the portfolio in AUD. We note that with the AUD/USD at 0.76, new capital raised in AUD does not have the same buying power as it did a number of years ago.

Valuation: We have revised our base case value for URF down to **$2.17** from $2.41 per unit. Given the Fund's history with capital raisings, we have assumed the capital raising will be fully subscribed and as such the valuation has been diluted by a 43.9m increase in the number of units on issue. The Fund has 15% of its portfolio (based on number of properties) in the renovation phase, providing rental income growth as these properties are brought to market for lease. Whilst the Fund will continue to look for acquisition opportunities, we believe the focus will remain on the renovation of existing properties and as such do not foresee the Fund making a significant number of acquisitions over the coming 18 months. As highlighted in our previous update, the biggest risk for unit holders in the medium-term is dilution risk. The announcement of the capital raising at a discount to the unit price will result in short-term weakness in the unit price. We note that the unit price was trading at a premium to NTA prior to the announcement. While the unit price issue was at a discount to the prevailing unit price, the new units were issued at a premium to the July 2016 NTA of $1.82. We continue to view dilution risk as high with further capital raising likely with our expectation that the Fund will likely have to raise additional capital to repay the face value of the notes when they mature.

PROFIT AND LOSS					
Y/E December	2013A	2014A	2015A	2016F	2017F
Rental Income	10.2	13.8	22.0	28.7	34.5
Other Income	1.0	0.5	1.5	0.4	0.8
Total Revenue	11.2	14.4	23.4	29.1	35.3
Fair Value Movement	27.3	31.7	40.8	27.2	27.2
Share of JV Profits	5.0	-0.4	13.7	7.6	7.6
Property Expenses	6.2	8.8	13.8	14.9	18.0
Other Expenses	15.2	25.4	38.8	52.0	52.0
Total Costs	21.4	34.2	52.5	66.9	71.1
PBT	22.2	11.5	25.4	-3.0	-1.0
Tax Expense	14.0	15.4	25.3	10.9	9.3
PAT	8.2	-3.9	0.1	-13.9	-10.2

BALANCE SHEET ($M)					
Y/E December	2013A	2014A	2015A	2016F	2017F
Cash	42.8	191.3	133.6	258.1	179.3
Receivables	0.3	0.6	0.6	28.7	34.5
Prepayments	1.3	0.8	0.3	0.0	0.0
Other	5.5	21.5	24.9	0.0	0.0
Current Assets	49.9	214.2	159.3	286.8	213.8
Investment Properties	349.0	543.1	862.5	907.2	907.2
Non-Current Assets	380.4	604.6	948.0	957.8	957.8
Total Assets	430.3	818.7	1107.3	1244.6	1171.6
Payables	16.7	37.2	30.6	36.3	17.3
Borrowings	1.3	0.8	24.7	68.9	34.5
Current Liabilities	18.0	38.7	55.3	105.2	51.8
Borrowings	45.5	282.8	450.8	513.9	479.3
Deferred Tax Liabilities	17.5	35.3	65.9	72.6	61.7
Other	0.1	0.2	0.2	0.0	0.0
Non-Current Liabilities	63.1	318.3	516.9	586.5	541.0
Total Liabilities	81.1	357.0	572.2	691.7	592.8
Net Assets	349.2	461.7	535.1	552.9	578.8
Contributed Equity	307.0	382.0	388.7	481.8	481.8
Reserves	42.3	83.6	150.3	88.9	125.0
Retained Earnings	0.0	-3.9	-3.9	-17.8	-28.0
Shareholders' Equity	349.2	461.7	535.1	552.9	578.8
Minorities	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Total Equity	349.2	461.7	535.1	552.9	578.8
Units on Issue	211.7	268.5	285.5	336.8	336.8
Options Outstanding	0.0	0.0	0.0	0.0	0.0
Fully Diluted	211.7	268.5	289.3	336.8	336.8

CASHFLOW ($M)					
Y/E December	2013A	2014A	2015A	2016F	2017F
Receipts from Customers	10.4	13.9	22.7	28.7	34.5
Payments to Suppliers	-17.9	-20.0	-44.8	-29.8	-35.9
Net Interest	0.1	0.4	-8.6	-29.5	-29.5
Other	0.4	0.0	0.1	0.0	0.0
Operating Activities	-7.0	-5.7	-30.6	-30.6	-30.9
Property Deposits	-1.6	-1.6	-3.3	0.0	0.0
Asset Sales/(Acquisitions)	-173.3	-125.7	-183.4	16.3	0.0
Investment in JV's	-8.8	-22.6	-1.8	0.0	0.0
Other	3.6	-1.0	-19.4	0.0	0.0
Investment Activities	-180.1	-150.9	-208.0	16.3	0.0
Share Issues/(Buybacks)	67.4	86.7	19.5	93.1	0.0
Debt Drawdown/(Repaid)	38.6	228.4	183.5	63.1	-34.5
Dividends Paid	-7.7	-8.9	-11.9	-13.5	-13.5
Other	-2.3	-3.0	-20.5	-3.7	0.0
Financing Activities	96.1	303.2	170.5	138.9	-48.0
Net Increase/(Decrease) in cash	-91.0	146.6	-68.1	124.6	-78.9
Cash at Beginning	122.9	42.8	191.3	133.6	258.1
FX Impact	10.9	1.9	10.4	0.0	0.0
Cash at End	42.8	191.3	133.6	258.1	179.3

Key Model Assumptions	
Freestanding Properties	
Long-term Net Rental Yield (p.a)	4.5%
Average Purchase Price (US$)	$1,207,290
Long-term Vacancy Rate	5%
Multi-dwelling Properties	
Net Rental Yield (p.a)	4.5%
Long-term Vacancy Rate	5%
Other	
AUD/USD	0.70
WACC	8%

1H16 RESULTS

- The Fund continued to generate increased rental income over the 1H16, with rental income up 57.9% on the pcp to $14.7m. We expect rental income to continue to increase as more properties are made available for lease due to the completion of renovations.
- The Fund reported an operating loss of $12.2m, a significant decline on the $12m operating profit in the pcp. Contributing to the loss was increased interest payments resulting from the increased debt levels. Interest payments increased from $2.3m in 1H15 to $10.6m in 1H16. The foreign currency movements over the period adversely impacted the results with the AUD appreciating against the USD over the period. The profits from joint ventures also declined significantly with the completion of the disposal of all the multi-dwelling properties owned as part of the Excelsior JV. The Fund received a total of US$61m for the sale of the 14 properties, a 26% premium to the acquisition price.
- Investment property expenses were down to 50.4% of rental income in 1H16 from 67.6% in the pcp. The Fund continues to complete renovations and bring additional properties to market for lease. Renovations on a further 52 freestanding properties was completed during 1H16 and were made available for lease. At 30 June 2016, there were 89 properties in the renovation pipeline, 15% of the total number of freestanding properties in the portfolio. Rental income will continue to improve as more properties are brought to market. In conjunction with this, costs will decline as the renovation pipeline is reduced.
- The Fund secured an additional US$84.5m in debt facilities in 1H16, taking the total debt levels to US$528.7m - US$292.4 loans and US$236.3 unsecured notes. The additional debt saw interest payments increase significantly in 1H16 on the pcp. Net gearing is at 63.9% based on debt levels at 30 June 2016. We note, the net gearing ratio will decline if the upcoming unit placement is fully subscribed.
- The Fund continues to operate with an operating cash outflow with the rental income still only covering half of the operating cash outflow to suppliers. A significant increase in interest payments on the pcp also contributed to the increasing operating cash outflow. We expect the Fund to continue to have a negative operating cashflow while they refurbish properties before leasing them out. At 30 June 2016, 15% of the property portfolio was in the renovation pipeline.
- The AUD increased 1.6% over the period, having a negative impact on the Fund's financials. The foreign currency environment is very uncertain at the moment with a high degree of uncertainty regarding the short-term future of the interest rate differential of Australia compared to the US. A continued appreciation of the AUD against the USD will negatively impact the Fund's financials, however, we note that the initial capital raising when the Fund was established has benefited greatly from the depreciation of the AUD.

Movement in Key Inputs

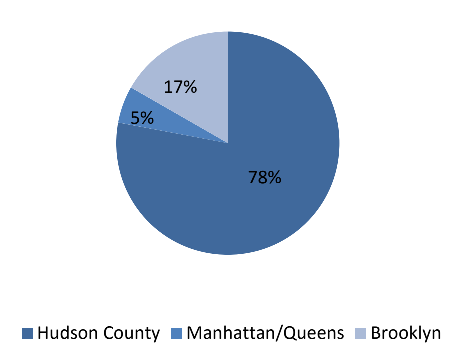
$m	1H15	1H16	% Change
Investment Property Income	9.3	14.7	+57.9
Fair Value Movement in Property Portfolio	34.8	22.5	-35.3
Investment Property Expenses	6.3	7.4	+17.5
Investment Property Expenses/Rental Income	67.6%	50.4%	-17.2
Number of Freestanding Properties	543	581	+7.0
Freestanding Property Portfolio Value	718.7	944.8	+31.5
Non-Current Borrowings	285.8	459.8	+60.9
Net Assets	499.9	501.0	+0.2
Cash	110.1	108.0	-1.9
Operating Cashflow	-17.6	-24.2	na
DPS (cents)	5.0	5.0	0.0

PROPERTY PORTFOLIO

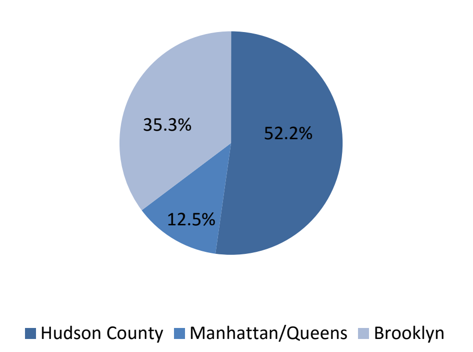
FREESTANDING PROPERTIES

- At 30 June 2016, the Fund owned 581 freestanding properties, up from the 565 at the end of 2015. During the half, the Fund acquired just 17 properties and sold one property. The rate of acquisition has slowed considerably as the Fund transitions properties to market.
- The average property price remained steady in 1H16, with an average purchase price in 1H16 of US$1.56m, compared to US$1.6m for the pcp.
- The Fund delivered US$ 24.2m of renovations across 52 properties. This is on top of the 154 properties being brought to market in CY15. At 30 June 2016, there were 89 properties being renovated or in the pipeline for renovation.
- The majority of the properties are located in Hudson County, with 76% of the properties located in this area. However, these properties only make up 52% of the portfolio by value. On average, the properties in the Manhattan/Queens district are the highest value properties with an average value of $2.9m, while the Hudson County properties having an average value of $0.8m.

Property Location (By Number)



Property Location (By Value)



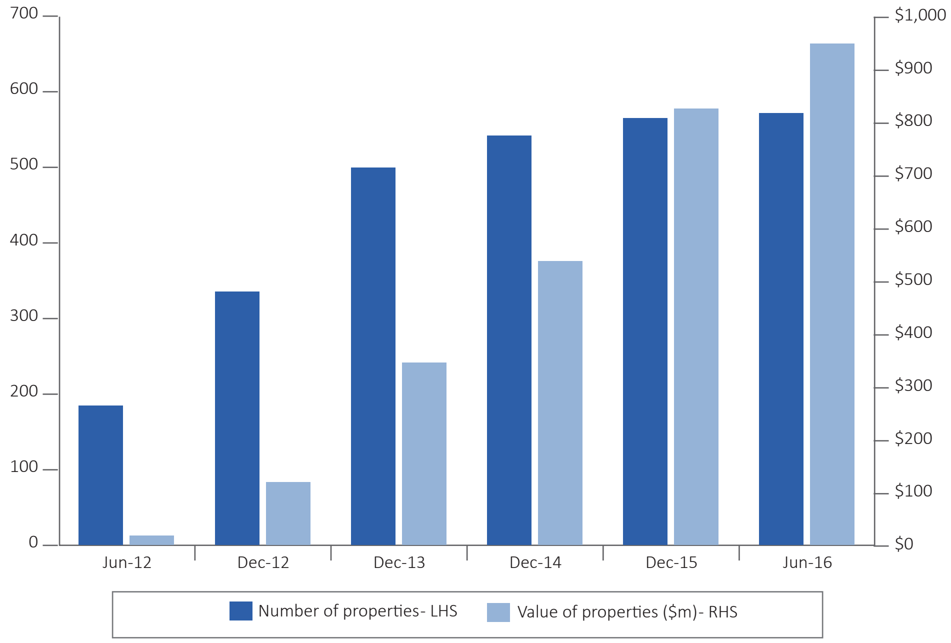
MULTI-DWELLING PROPERTIES

- Management completed the sale of all the multi-dwelling properties acquired with the joint venture partner Excelsior Equities, a total of 14 properties. The Fund received a total of US$61m for the sale of the properties, a 26% premium to the acquisition price.
- There remains 3 multi-dwelling properties in the portfolio, with a total of 508 units. The carrying value of the remaining multi-dwelling properties at 30 June 2016 was $49.6m, a 31% improvement on the acquisition cost.

PROPERTY PORTFOLIO GROWTH

- Since listing in July 2012, URF has grown the freestanding property portfolio from 187 properties valued at AUD$18.7m to 581 valued at AUD$944.8m at 30 June 2016, as highlighted in the below chart.
- We note that the AUD has declined 29.5% in value against the USD from 31 July 2012 to 30 June 2016, contributing to the value uplift reported for the property portfolio.

Freestanding Property Portfolio Growth



VALUATION & INVESTMENT VIEW

- While the Fund is actively seeking to acquire additional properties, there is a focus on renovating properties in the portfolio to get them ready for lease. In the 1H16, the Fund completed $24.2m of renovations on 52 properties, with 89 properties remaining in the renovation pipeline at 30 June 2016. Bringing these properties to market and leasing them will continue to grow the rental income stream of the Fund.
- We expect the Fund to be able to continue to successfully raise capital to have enough cash to continue to expand the portfolio while turning around properties. If fully subscribed, the capital raising will result in the Fund having in excess of AUD$180m cash.
- Dilution risk remains a key risk of the Fund. The capital raising announced is at a discount to the share price at the time of the announcement and will therefore have a negative short-term impact on the share price. We expect further capital raising in the future, with the Fund likely having to raise further capital to make the repayments of the notes when they mature.
- The Fund continues to show its ability to acquire properties and add value through renovations. This is highlighted by the continued revaluation uplift of the property portfolio. We have revised our valuation to incorporate the increased debt levels, the expected cash injection and issue of units from the announced capital raising. The valuation has been revised down from $2.41 to **$2.17** per unit.

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