

# Argosy Property Trust

## Appraisal Report

On the Proposed Internalisation of the management of the Trust

**and**

## Independent Report

On the Alternative Proposals presented by Unit Holders of the Trust



GRANT SAMUEL



August 2011

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# Executive Summary

**Proposed Internalisation:** Argosy Unit Holders are being asked to consider the internalisation of the management of the Trust. In Grant Samuel's opinion internalisation of the management of Argosy is in the best interests of Unit Holders. The Independent Directors are proposing an internalisation proposal that involves the Trust making a one-off payment of \$20 million to the Manager to terminate its rights to manage the Trust. **Grant Samuel is of the view that the terms and conditions of the Proposed Internalisation are fair to Argosy Unit Holders not associated with the Manager and that the Proposed Internalisation is in the best interests of Unit Holders.** The Proposed Internalisation will be put to a vote of Unit Holders at the Argosy Annual Meeting in August 2011.

The Proposed Internalisation is a robustly negotiated proposal on commercial terms that ensures an orderly transition from external management to an internally managed vehicle. The \$20 million payment to the Manager contemplated by the Proposed Internalisation is at the lower end of Grant Samuel's value range for the Management Rights of between \$19.7 million and \$23.7 million, which has been based on the estimated price a third party purchaser would pay to secure the management rights today. The value to the Trust of internalising its management is significantly greater than the \$20 million being paid due to the annual cost savings it will achieve (a net saving after interest of approximately \$2.9 million p.a.) and also due to the perpetual nature of the internalisation when compared with the risk of removal associated with external management. The Proposed Internalisation is earnings accretive to the Trust and should have a positive impact on the unit price of the Trust to the extent this has not already been factored in to the current unit price. The Proposed Internalisation will also improve the control Unit Holders have over the Trust.

Since the announcement of the Proposed Internalisation several Argosy Unit Holders have put forward other proposals, including a number of resolutions, which are to be considered at the Annual Meeting of Unit Holders in August 2011. Of the proposals put forward by other Unit Holders, only two represent alternatives to the Proposed Internalisation:

- the DNZ Property Fund Limited proposal to takeover Argosy; and
- the proposal by some Argosy Unit Holders to request that the Trustee of the Trust exercise its powers to remove the Manager from its position as manager of the Trust, with no consideration payable to the Manager.

**DNZ Proposal:** DNZ has not made a formal takeover offer for Argosy but has publicly expressed an interest in doing so. Importantly, DNZ is not proposing a cash takeover offer. Rather DNZ has indicated it would seek to takeover Argosy by issuing DNZ shares in exchange for Argosy units. However, some of the key details of the DNZ proposal have not yet been announced by DNZ. Most importantly the ratio at which DNZ proposes to exchange Argosy units for shares in DNZ, which would determine how much of the combined DNZ/Argosy entity Argosy Unit Holders would own, has not been disclosed, although a range of possible ratio premiums have been announced. DNZ also intends to internalise the management of the Trust simultaneous with the takeover but has not disclosed the payment it envisages agreeing with the Manager to acquire the Management Rights in order to achieve internalisation.

**Removal of the Manager by the Trustee:** On the surface a removal of the Manager by the Trustee is the lowest cost alternative. It is not, however a "zero cost" alternative and puts the Trust in a position of significant risk. It does not achieve immediate internalisation and a temporary external manager would need to be appointed. In the intervening period between removal and internalisation management fees would continue to be paid and additional one-off costs would be incurred. Grant Samuel is of the opinion that if the Trustee elected to remove the Manager for no consideration it would be open to a significant risk of litigation from the Manager and indeed from Unit Holders in the event the Trust suffered a loss of any kind following such a removal. Due to the provisions of the Trust Deed that indemnify the Trustee (other than where the Trustee acts in breach of its duty of care as a Trustee), the costs of such litigation would be payable by the Trust, which would ultimately be a cost to Unit Holders. It is difficult to quantify all of the possible costs associated with a removal of the Manager by the Trustee, however, Grant Samuel estimates that excluding litigation costs, business disruption, loss of tenants, and the cost of any subsequent internalisation the additional costs could be as much as \$7.9 million. The Trustee of Argosy has stated that at this stage it does not believe that there is sufficient reason to form a view that it is in the interest of Unit Holders that the Manager should be removed. The Trustee may change this view at any time.

## Glossary

| Term  | Definition   |
|---|--|
| <b>24 June Proposal</b>                     | The resolutions proposed by DNZ, ACC, Westpac/BT, Superlife and Albany Power   |
| <b>ACC</b>                                  | Accident Compensation Corporation  |
| <b>Albany Power</b>                         | Albany Power Centre Limited (in Liquidation)   |
| <b>Alternative Proposals</b>                | The Institutional Unit Holders' Proposal, the 24 June Proposal and the DNZ Proposal  |
| <b>ANO</b>                                  | AMP NZ Office Trust  |
| <b>ANZ</b>                                  | ANZ National Bank Limited  |
| <b>Argosy</b>                               | Argosy Property Trust  |
| <b>AUM</b>                                  | Assets Under Management  |
| <b>CAPM</b>                                 | Capital Asset Pricing Model  |
| <b>DNZ</b>                                  | DNZ Property Fund Limited  |
| <b>DNZ Proposal</b>                         | DNZ's proposal to undertake a merger with Argosy and internalise its management  |
| <b>GMT</b>                                  | Goodman Property Trust   |
| <b>Grant Samuel</b>                         | Grant Samuel & Associates Limited  |
| <b>ING</b>                                  | ING Property Trust Management Limited  |
| <b>Institutional Unit Holders' Proposal</b> | The resolutions proposed by ACC, NZ Super and Westpac/BT   |
| <b>KIP</b>                                  | Kiwi Income Property Trust   |
| <b>KPF</b>                                  | Kermadec Property Fund Limited   |
| <b>LVR</b>                                  | Loan to Valuation Ratio  |
| <b>Management Rights</b>                    | The rights to manage the Trust and its properties  |
| <b>Manager</b>                              | Argosy Property Management Limited   |
| <b>MFL</b>                                  | MFL Mutual Fund Limited  |
| <b>NEIL</b>                                 | North East Industrial Limited  |
| <b>New Manager</b>                          | A new manager whose shares will be held by Public Trust for the benefit of the Trust   |
| <b>NPT</b>                                  | NPT Limited  |
| <b>NTA</b>                                  | Net Tangible Assets  |
| <b>NZIFRS</b>                               | New Zealand International Financial Reporting Standards  |
| <b>NZ Super</b>                             | The Guardians of New Zealand Superannuation  |
| <b>NZSX</b>                                 | New Zealand Stock Exchange   |
| <b>OnePath</b>                              | OnePath (NZ) Limited   |
| <b>PFI</b>                                  | Property For Industry Limited  |
| <b>Property Management Agreements</b>       | Separate existing property management agreements between OnePath and the Manager dated 30 October 2002 and 9 December 2003   |
| <b>Proposed Internalisation</b>             | The proposed internalisation of the Management Rights by the Trust   |
| <b>Section 18 Resolution</b>                | A resolution under Section 18 of the Unit Trusts Act 1960 requiring approval of at least 75% of the units voted at a meeting of unit holders holding not less than 25% of the units on issue |
| <b>SIL</b>                                  | Superannuation Investments Limited   |
| <b>Superlife</b>                            | Superlife Trustees Nominees Limited  |
| <b>Termination Payment</b>                  | The payment of \$20 million to the Manager to be made if the Proposed Internalisation is approved by Unit Holders  |
| <b>Trust</b>                                | Argosy Property Trust  |
| <b>Trust Deed</b>                           | The Trust Deed dated 30 October 2002 as subsequently amended and restated  |
| <b>Trustee</b>                              | The New Zealand Guardian Trust Company Limited   |
| <b>Unit Holders</b>                         | Holder of units in Argosy  |
| <b>VHP</b>                                  | Vital Healthcare Property Trust  |
| <b>WALT</b>                                 | Weighted Average Lease Term  |
| <b>Westpac/BT</b>                           | Westpac Banking Corporation and BT Private Selection   |



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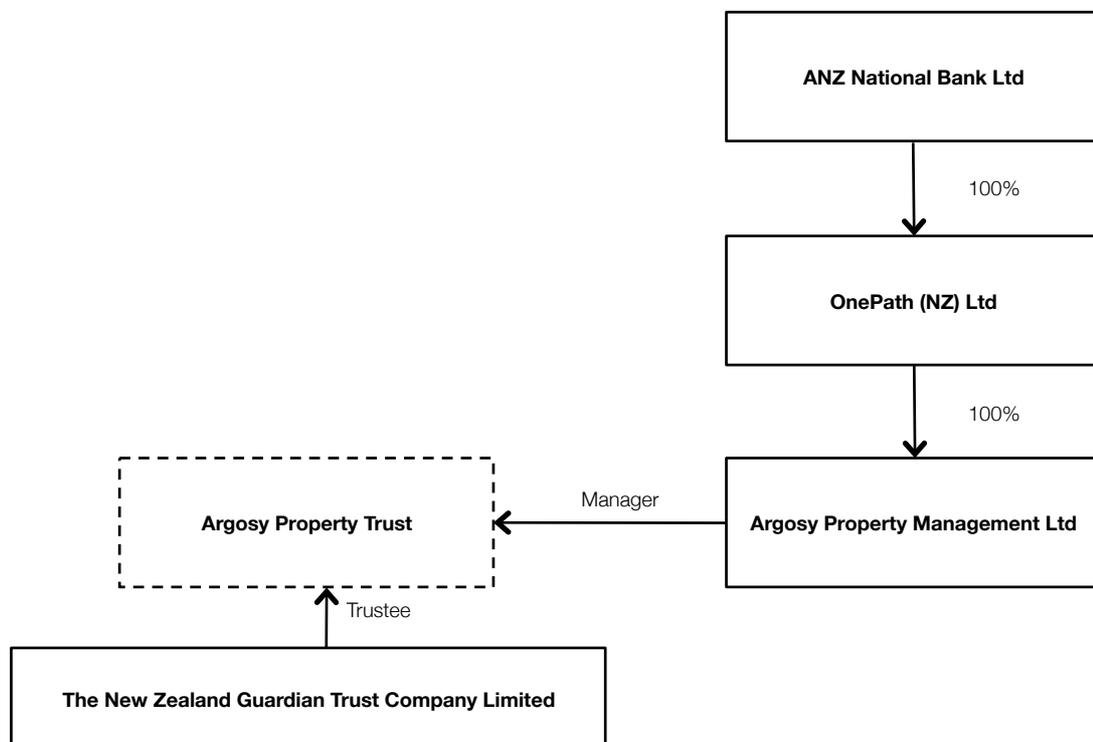
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Dear Sirs,

# 1. Introduction and Scope of the Report

## 1.1 Introduction

The Argosy Property Trust (**Argosy**) is a property trust listed on the New Zealand Stock Exchange (**NZSX**). The Trust was established under the Unit Trusts Act 1960 by way of a Trust Deed dated 30 October 2002, as subsequently amended and restated (the **Trust Deed**). The Trust's assets are held, on behalf of Argosy unit holders (the **Unit Holders**), by The New Zealand Guardian Trust Company Limited (**the Trustee**). The Trustee is responsible for ensuring that the operations of Argosy are managed in accordance with the terms of the Trust Deed. The day-to-day operations of the Trust are managed by Argosy Property Management Limited (the **Manager**), a wholly owned subsidiary of OnePath (NZ) Limited (**OnePath**) which is in turn wholly owned by ANZ National Bank Limited (**ANZ**). Argosy has no Directors. The Directors of the Manager have been appointed by OnePath in its capacity as shareholder of the Manager, with the exception of the Independent Directors (Peter Brook and Trevor Scott) who have been appointed at the direction of Unit Holders. The Independent Directors are responsible for protecting the interests of Unit Holders. The structure of the Trust is shown diagrammatically below:



The Independent Directors are proposing to put to a vote of Unit Holders a proposal to internalise the management of the Trust (the **Proposed Internalisation**) at the Trust's Annual Meeting which is scheduled for late August 2011. Over the course of the last several months a number of other proposals have also been put to the Independent Directors (the **Alternative Proposals**) and, in accordance with the provisions of the Trust Deed and the Unit Trusts Act 1960, must also be considered by Unit Holders. The Independent Directors will also put the resolutions relating to Alternative Proposals to a vote of Unit Holders at the Annual Meeting in late August 2011.

## 1.2 Requirement for a report

Under Rule 9.2.1 of the NZSX Listing Rules Argosy shall not enter into a Material Transaction if a Related Party is, or is likely to become a direct or indirect party to the Material Transaction, unless that transaction is approved at a meeting of Unit Holders by an Ordinary Resolution, the notice of meeting for which is accompanied by an Appraisal Report. The Trust and the Manager are Related Parties for the purposes of the NZSX Listing Rules.

NZX Regulation have taken the view that the appropriate threshold to apply when assessing whether the Proposed Internalisation is a "Material Transaction" for the purposes of the Listing Rules, is the threshold contained in Listing Rule 9.2.2(e), being providing or obtaining services in respect of which the actual gross cost to the Trust exceeds 1% of the average market capitalisation of the Trust. The Proposed Internalisation contemplates a payment of \$20 million being made by the Trust to the Manager (in this case being the Related Party of the Trust) to achieve internalisation (the **Termination Payment**). The Termination Payment exceeds the Listing Rule 9.2.2(e) threshold and accordingly, an Appraisal Report under Listing Rule 9.2.5 is required in respect of the Proposed Internalisation.

The Independent Directors of the Manager have asked Grant Samuel & Associates Limited (**Grant Samuel**) to prepare the Appraisal Report required to assist Argosy Unit Holders that are not associated with the Manager with their assessment of the Proposed Internalisation prior to voting on the resolutions pertaining to the Proposed Internalisation. Grant Samuel has received the approval of the NZX to provide this Appraisal Report. Pursuant to Listing Rule 1.7.2 this Appraisal Report is required to:

- (a) be addressed to the Independent Directors of the Manager;
- (b) be expressed to be for the benefit of the Unit Holders of Argosy not associated with the Manager;
- (c) state whether or not in the opinion of Grant Samuel the consideration and the terms and conditions of the Proposed Internalisation are "fair" to Argosy Unit Holders;
- (d) state whether or not in Grant Samuel's opinion the information to be provided by Argosy to the Unit Holders is sufficient to enable holders to understand all the relevant factors, and make an informed decision;
- (e) state whether Grant Samuel has obtained all information which it believes desirable for the purposes of preparing the report, including all relevant information which is or should have been known by any director of the Manager and made available to the directors;
- (f) state any material assumptions on which the Grant Samuel's opinion is based; and
- (g) state any term of reference which may have materially restricted the scope of the report.

The term "fair" has no legal definition in New Zealand either in the NZSX Listing Rules or in any other statutes dealing with securities or commercial law. However, guidance in interpreting and applying the rule can be gained both from regulatory interpretation in other jurisdictions and rulings made by the NZX.

Grant Samuel has also been engaged by the Independent Directors to assess whether or not, in its opinion the Proposed Internalisation is in the best interests of Argosy Unit Holders.

There is no requirement for a report in respect of the Alternative Proposals in any of the NZSX Listing Rules, the Takeovers Code, the Trust Deed or the Unit Trusts Act. Despite this, Grant Samuel has been engaged by the Independent Directors to prepare an independent report to assist Unit Holders in their evaluation of the Alternative Proposals. For completeness Grant Samuel has elected to combine its assessment of the Proposed Internalisation and the Alternative Proposals in the same report.

This report has been prepared to assist Argosy Unit Holders not associated with the Manager in assessing whether or not to approve the Proposed Internalisation, for the benefit of the Trustee and as an expression of Grant Samuel's opinion as to the merits of the Alternative Proposals. This report should not be used by any other person or for any other purpose. A copy of this report is to accompany the Notice of Meeting to be despatched to Argosy Unit Holders by the Manager. This report should be read in conjunction with the Qualifications, Declarations and Consents set out at Appendix C.

The decision of each Argosy Unit Holder as to whether or not to vote in favour of the Proposed Internalisation is a matter for individual Unit Holders having considered all relevant factors and their own preference either in favour of or against the Proposed Internalisation.

### 1.3 Terms of Reference for the Report

In addition to the requirements of the NZSX Listing Rules Grant Samuel's terms of reference for preparing this report were determined by both the Independent Directors of the Manager, and the Trustee of the Trust and required Grant Samuel to evaluate the following aspects of the Proposed Internalisation:

- the price to be paid to the Manager to terminate the Management Rights and facilitate the internalisation, including how that price compares with the fair value of the Management Rights;
- the impact, if any, of the release of liability of the Manager and the Manager's continuing right of indemnity by the Trust under the Proposed Internalisation;
- the one-off costs associated with implementing the Proposed Internalisation, including additional fees payable to the banking syndicate (if any), redundancy costs (if any) and the costs of establishing the trust arrangement with the Public Trust;
- the implications and risks of not having limits on the costs and expenses reimbursed from the Trust under the Proposed Internalisation, compared with paying a management fee at an agreed rate under the status quo;
- the costs associated with carrying on the management of the Trust internally, including the additional costs associated with the trust arrangement with Public Trust;
- alternatives to the Proposed Internalisation (including, among other things, an evaluation of the DNZ Property Fund Limited proposal);
- the effect of the Proposed Internalisation on the Trust's ability to enter into other, subsequent transactions involving the units of the Trust or the rights to manage the Trust;
- the governance and management of the Trust under the internalised structure, including the impact, if any, of the New Manager not having a substantial shareholder;
- the proposed changes to the Trust Deed, and the terms of the Transaction Implementation Deed and the Transitional Services Agreement; and
- whether the Proposed Internalisation is in the best interests of Unit Holders when compared with the status quo and any other potential alternatives.

Grant Samuel has not specifically commented on all of these aspects, however, they have each been considered in the preparation of this report.

## 1.4 Basis of evaluation

When evaluating whether the Proposed Internalisation is in the best interests of, and fair to, Unit Holders it is necessary to form a judgement as to whether Argosy Unit Holders are better off if the Proposed Internalisation proceeds than if it does not. To form this judgement Grant Samuel has assessed the following:

- the fairness of the proposed Termination Payment to be paid to the Manager;
- the estimated value range of the Management Rights when compared with the proposed \$20 million Termination Payment to be paid to the Manager;
- the impact of the change in the management of Argosy;
- the impact of the Proposed Internalisation on:
  - earnings per unit;
  - net tangible assets per unit;
  - gearing; and
  - distributions.
- the impact on Unit Holders' ability to control the appointment and removal of Directors;
- the impact on Unit Holders' ability to control the appointment and termination of the Manager of the Trust;
- the impact on whether and to whom the Management Rights can be sold;
- any other advantages or disadvantages of the Proposed Internalisation for the Unit Holders;
- alternatives to the Proposed Internalisation; and
- the timing and circumstances surrounding the Proposed Internalisation.

Grant Samuel's analysis required an understanding of complex legal issues and interpretation of the Trust Deed and the Unit Trusts Act 1960. Where necessary, Grant Samuel has relied on legal advice from the Trustee's and Independent Directors' respective legal counsel's (MinterEllison and Harnos Horton Lusk) to their own clients when assessing and evaluating such legal matters.

Grant Samuel's opinion is to be considered as a whole. Selecting portions of the analyses or factors considered by it, without considering all the factors and analyses together, could create a misleading view of the process underlying the opinion. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary. For the avoidance of doubt appendices A to C form part of this report.

## 2. The Proposed Internalisation

### 2.1 Background

On 29 October 2010 Argosy announced that ANZ had received expressions of interest to acquire the management rights of OnePath including both the rights to manage Argosy, and the management rights over Vital Healthcare Property Trust (**VHP**). For the purposes of this report the rights to manage Argosy and its properties are referred to as the **Management Rights**.

On 19 April 2011 Argosy announced that the Independent Directors had agreed with OnePath to progress the potential internalisation of the Management Rights. The proposal at that date included a payment of \$32.5 million to the Manager to achieve internalisation. The subsequent reaction from Argosy's Unit Holders, market commentators and listed property trust peers was that a payment of \$32.5 million was excessive and alternative proposals should be examined or a lower payment negotiated by the Independent Directors.

On 11 May 2011 DNZ Property Fund Limited (**DNZ**) announced that it had approached Argosy with a proposal to merge the two property vehicles (the **DNZ Proposal**) as an alternative to internalising the Argosy Management Rights. The DNZ Proposal is outlined in further detail at Section 3.3 of this report.

On 8 June 2011 Argosy announced that it had received a request from Accident Compensation Corporation (**ACC**), The Guardians of New Zealand Superannuation (**NZ Super**), and Westpac Banking Corporation and BT Private Selection (**Westpac/BT**) (which together at that date held 9.57% of the units in Argosy) (together the **Institutional Unit Holders**) to convene a meeting of Unit Holders to consider various resolutions relating to the Manager (the **Institutional Unit Holders' Proposal**). The Institutional Unit Holders' Proposal is outlined at Section 3.1 of this report.

On 23 June 2011 the Independent Directors announced that whilst they remained committed to progressing an internalisation of the Trust's management they were not in a position to recommend an internalisation proposal to Unit Holders that involved a payment of \$32.5 million to OnePath for the termination of the Management Rights.

On 27 June 2011 Argosy announced that it had received, on 24 June 2011, a notice requesting certain resolutions be considered by Argosy Unit Holders (the **24 June Proposal**). The notice was signed by DNZ, ACC, Westpac/BT, Superlife Trustees Nominees Limited (**Superlife**) and Albany Power Centre Limited (**Albany Power**) who collectively held 11.21% of the Argosy units on issue at the date of the request. The details of the 24 June Proposal are outlined in further detail at Section 3.2 of this report.

Over the past three months, in response to clear market sentiment that the initially proposed internalisation involving a \$32.5 million payment to the Manager was excessive, the Independent Directors have, in conjunction with their advisors First NZ Capital and Harnos Horton Lusk, renegotiated the proposed internalisation payment to OnePath from \$32.5 million to \$20 million.

The internalisation proposal put forward by the Independent Directors involves making a payment of \$20 million to the Manager (the **Termination Payment**) to terminate the Management Rights and the establishment of a new manager (the **New Manager**) to undertake the management of the Trust on a cost-recovery basis (the transaction as a whole is referred to throughout this report as the **Proposed Internalisation**). If approved by Unit Holders the settlement of the Proposed Internalisation is scheduled to occur shortly after the Unit Holders' meeting at which it is approved.

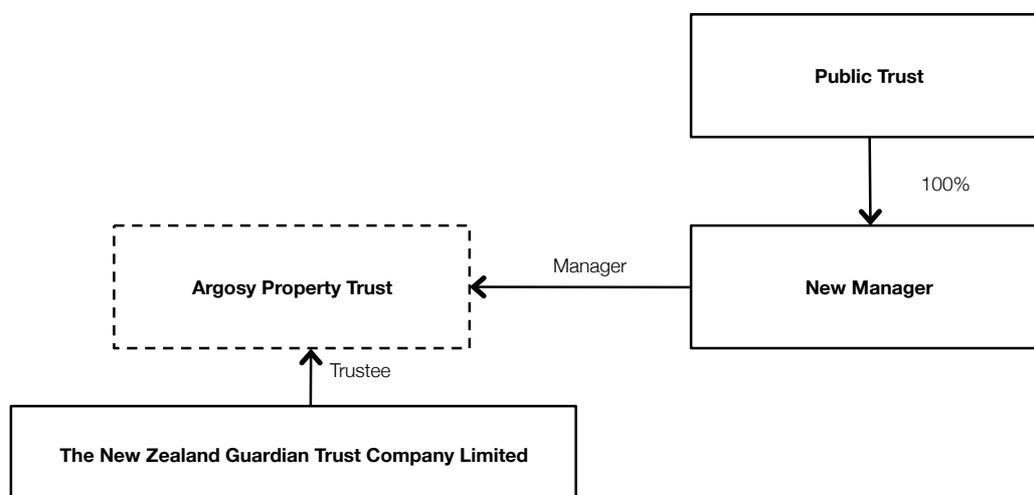
The Manager has called a meeting of Argosy Unit Holders which is scheduled to be held in late August 2011 to consider the Proposed Internalisation along with the Institutional Unit Holders' Proposal and the

24 June Proposal. The Independent Directors recommend that Argosy Unit Holders vote in favour of the Proposed Internalisation and against the Institutional Unit Holders' Proposal and the 24 June Proposal.

## 2.2 Details of the Proposed Internalisation

The Proposed Internalisation involves the following elements:

- a payment of \$20 million to the Manager to terminate the Management Rights and acquire certain assets of the Manager<sup>1</sup>, funded primarily through additional debt and ongoing proposed property sales. The total \$20 million Termination Payment will be paid to the Manager;
- the establishment of the New Manager to undertake the management of the Trust. The New Manager would offer to employ, substantially on the same terms and conditions, the majority of the staff of OnePath who are currently engaged solely in the management of the Trust (approximately 21 in total including general manager Peter Mence) as well as any additional staff required to manage the Trust;
- the appointment of the New Manager as manager of the Trust;
- the appointment of Public Trust, an independent trustee, to hold the shares in the New Manager subject to a trust arrangement. The need to engage the Public Trust to perform this shareholding role (as opposed to the New Manager being owned by the Trustee) is due to the Unit Trusts Act requirement that the Trust have a separate manager, independent of the trustee. The Public Trust will hold the shares in the New Manager on trust for a charity selected by the board of the New Manager. This will preserve the separation of the Trustee and the Manager and there will be no transfer of value to the charity unless the Unit Holders so agreed by way of a special resolution, which is highly unlikely. Voting rights in respect of the shares in the New Manager may only (subject to limited exceptions) be exercised in accordance with a direction passed by Unit Holder resolution. This proposed structure is outlined diagrammatically below:



- making various amendments to Argosy's Trust Deed to incorporate the following key changes:
  - deleting the provisions relating to the remuneration of the Manager and inserting provisions whereby the New Manager is not entitled to any fee in the nature of remuneration but is entitled to cost reimbursement and indemnification;
  - deleting the provisions under which the Manager is entitled to receive payment on cessation of office;

<sup>1</sup> Approximately \$22,000 of the Termination Payment is payment for the transfer of certain assets of the Manager

- clarification of the reimbursement of expenses provisions contained in the Trust Deed to provide that all costs, charges, disbursements and expenses incurred by the New Manager in performing its functions of, and incidental to, the management of the Trust are to be reimbursed out of Trust funds;
  - inserting provisions that require the New Manager to use its best endeavours to ensure that the Trust is operated efficiently with a view to maintaining its costs at a minimum level consistent with the effective conduct of the business, with no intention for the New Manager to operate at a profit;
  - inserting provisions that provide Unit Holders the right, by means of an ordinary resolution, to direct Public Trust as to the individuals to appoint or remove as Directors of the New Manager in the Public Trust's capacity as shareholder of the New Manager; and
  - inserting a provision giving Unit Holders the right, by means of an extraordinary resolution, to direct the Public Trust to dispose of all or any of the shares in the New Manager and to vote its shares in the New Manager.
- the cancellation of the separate property management agreements with OnePath dated 30 October 2002 and 9 December 2003 (the **Property Management Agreements**) that expire in 2012 and 2013 respectively under which OnePath performs various property management services;
  - entering into a Transaction Implementation Deed to give effect to the Proposed Internalisation. The Trustee intends to execute the Transaction Implementation Deed only after a resolution of Unit Holders has approved the Proposed Internalisation; and
  - entering into a Transitional Services Deed regarding the mechanics of the implementation of the Proposed Internalisation and the provision of services by the Manager to the New Manager for a transitional period.

If the Proposed Internalisation is approved by Unit Holders the Management Rights will be cancelled, effective management of the Trust will pass to the New Manager, and the Trust will cease to pay management fees.

### **Conditions**

The Proposed Internalisation is conditional, among other things, upon the following:

- a resolution under Section 18 of the Unit Trusts Act 1960 which requires the approval of at least 75% of the votes cast at the meeting from Unit Holders holding at least 25% of the units in the Trust (a **Section 18 Resolution**) authorising the Trustee to enter into the necessary transaction documents;
- Unit Holder approval by way of an extraordinary resolution in relation to amendments to the Trust Deed, requiring the approval of at least 75% of the votes cast at the meeting;
- Grant Samuel providing an independent report which states that the Proposed Internalisation is in the best interests of the Unit Holders;
- obtaining from the Financial Markets Authority an exemption from the Securities Act 1978 to enable the notice of meeting to be sent to Unit Holders;
- and the lenders to the Trust continuing to provide finance on reasonable commercial terms and approving the Proposed Internalisation as it is set out in the Transaction Implementation Deed.

## 2.3 Resolutions regarding the Proposed Internalisation

Argosy Unit Holders will be asked to vote on the following resolutions in relation to the Proposed Internalisation:

- **Resolution 1** (Section 18 resolution<sup>2</sup>):  
*That the Manager and the Trustee be authorised to do everything required to enter into and give effect to the [Proposed Internalisation], on such terms... as the Trustee and the Manager consider appropriate. The Trustee is directed... to:*
  - (a) *pay to the Manager from the Trust Fund the sum of \$20 million (plus GST); and*
  - (b) *take all steps necessary to cause the Manager to cease to be manager of the Trust and [New Manager] to be appointed as manager of the Trust; and*
  - (c) *enter into the amendments of the Trust Deed contemplated by Resolution 2 (if Resolution 2 is passed); and*
  - (d) *without limiting (a), (b) and (c), enter into, and perform its obligations under, all documents which are necessary to give effect to those transactions.*
- **Resolution 2** (Extraordinary Resolution<sup>3</sup>):  
*That pursuant to clause 30.1(c) of the Trust Deed, the Manager and the Trustee be authorised to make the amendments, additions and deletions to the Trust Deed shown in the revisions set out in Schedule [1] to [the] notice of meeting.*
- **Resolution 3** (Ordinary Resolution<sup>4</sup>):  
*That the transaction described in Resolution 1, including the payment referred to in paragraph (a) of Resolution 1, be approved for the purposes of Rule 9.2 of the NZSX Listing Rules (Transactions with Related Parties).*

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<sup>2</sup> a resolution under Section 18 of the Unit Trusts Act 1960 which requires the approval of at least 75% of the votes cast at the meeting from unit holders holding at least 25% of the units in the Trust.

<sup>3</sup> is defined at paragraph 11.1 of the Schedule to the Trust Deed and means a resolution passed at a meeting duly convened and held and carried by a majority of not less than 75% of the unit holders entitled to vote and voting thereat on a show of hands, or if a poll is duly demanded, by a majority consisting of not less than 75% of the votes given on such poll.

<sup>4</sup> An ordinary resolution is a resolution that is approved by a simple majority of votes (ie: greater than 50% of those unit holders voting, and entitled to vote, on the resolution in question).

# 3. Alternative Proposals

## 3.1 The Institutional Unit Holders' Proposal

### *Summary of the Institutional Unit Holders' Proposal*

**The Institutional Unit Holders are essentially seeking to request that the Trustee exercise the powers available to it under both the Trust Deed and the Unit Trusts Act to remove the Manager for no consideration. To do this the Trustee would have to form a view that it is in the interests of the Unit Holders that the Manager cease to hold office as manager of the Trust. Importantly Argosy Unit Holders cannot compel the Trustee to form such a view even in the event that the resolution proposed by the Institutional Unit Holders' is passed.**

### *Overview of the Institutional Unit Holders' Proposal*

On 8 June 2011 Argosy announced that the Manager had received a letter from ACC, NZ Super and Westpac/BT, three institutional investors in the Trust holding between them at that date 9.57% of the units in Argosy. The letter requisitioned a meeting of Unit Holders to vote on the following ordinary resolution:

▪ **Resolution 4:** (Ordinary Resolution)

*That:*

- (a) *the unit holders ("**Unit Holders**") of the Argosy Property Trust ("**Trust**") record their view that it is in the interests of Unit Holders that Argosy Property Management Limited cease to hold office as manager of the Trust; and*
- (b) *the Unit Holders formally request that The New Zealand Guardian Trust Company Limited, as trustee of the Trust, consider as a matter of urgency whether it is appropriate to exercise its discretion (pursuant to clause 24.1(b) of the trust deed relating to the Trust) to certify that it is in the interests of the Unit Holders that Argosy Property Management Limited cease to hold office as manager of the Trust; and*
- (c) *the Unit Holders request that the Trustee, when appointing any new temporary manager of the Trust in place of the Manager, consider requiring the new manager, as a condition of its appointment, to:*
  - i) *prepare a proposal for the management of the Trust to be undertaken internally, for consideration by the Unit Holders; and*
  - ii) *agree to assist and support the transition of the provision of management services to a person (including the Trust) that is approved by the Unit Holders."*

The Trustee has the power under Clause 24.1(b) of the Trust Deed and under section 19(2) of the Unit Trusts Act to remove the Manager if it certifies that it is in the interests of Unit Holders that the Manager should cease to hold office. Where the Manager ceases to hold office in this manner the Trust Deed does not require the Trust to pay any termination fees to the Manager. On 19 July 2011 the Trustee sent a letter to all Unit Holders stating that at this stage it does not believe that there is sufficient reason to form a view that it is in the interest of Unit Holders that the Manager should be removed.

The Manager is proposing to put this resolution to Unit Holders at the same time as the resolutions regarding the Proposed Internalisation.

A detailed analysis of the Institutional Unit Holders' Proposal is outlined at Section 8.1 of this report.

## 3.2 The 24 June Proposal

### *Summary of 24 June Proposal*

The focus of the 24 June Proposal put forward by DNZ, ACC, Westpac/BT, Superlife and Albany Power is on considering alternatives to the Proposed Internalisation. The first of the 24 June Proposal resolutions (Resolution 5) seeks to amend the Trust Deed to make Resolutions 6 to 10 binding on the Trustee and the Manager. In essence Resolutions 6 to 10 seek to:

- require the Independent Directors to consider alternative proposals and liaise with interested third parties;
- appoint an independent adviser to consider, and opine on the merits of, such alternative proposals;
- request that the independent adviser advises whether it is in the interest of Unit Holders for the Manager to cease to hold office and whether the Trustee should certify that it is in the interests of Unit Holders for the Manager to cease to hold office and, thereby, be removed from office for no consideration; and
- request various documents in relation to any exclusivity arrangements between the Manager and OnePath or any voting arrangements between the Manager and Unit Holders, and information regarding the day-to-day management of the Trust.

### *Overview of the 24 June Proposal*

On 24 June 2011 the Trust received a letter from Unit Holders holding on that date 11.21% of the Argosy units on issue requesting that a meeting of Unit Holders of Argosy be called to be held on or before 1 August 2011 to consider the following resolutions:

- **Resolution 5:** (Extraordinary Resolution)  
*Pursuant to clause 30.1(c) of the Trust Deed, that the Unit Holders resolve to amend clause 28.3 of the Trust Deed by inserting the following subclause after subclause (b):*  
*“Notwithstanding clause 28.3(b) the resolutions passed at the meeting of Unit Holders at which this subclause (c) was inserted, which resolutions were also the subject of the same requisition by Unit Holders for a meeting, shall be binding on the Trustee and the Manager.”*
- **Resolution 6:** (Extraordinary Resolution, or if not passed as such, Ordinary Resolution)  
*“That the Unit Holders request and, if Resolution 5 is passed, direct the Manager acting through its nominated independent directors, being at the date of this resolution Peter Brook and Trevor Scott, to take all reasonable steps to engage cooperatively and (where necessary) negotiate in good faith with appropriate third parties who have provided, or who provide, credible Alternative Proposals (including preparation of documentation for those proposals), and cooperate and consult with the independent adviser appointed pursuant to Resolution 7 (if Resolution 7 is passed), in order to progress Alternative Proposals which have the potential to be in Unit Holders’ best interests (including the merger proposal which DNZ has publicly notified, and the proposal to terminate the Manager which [the Institutional Unit Holders] have publicly notified.”*
- **Resolution 7:** (Section 18 Resolution, or if not passed, Ordinary Resolution)  
*“That the Unit Holders (to the extent lawful) direct, and otherwise request, the Trustee to Immediately select and appoint an independent adviser (being a suitably qualified person who is not currently and who (for the avoidance of doubt) has not at any time been engaged in relation to the Argosy Internalisation Proposal) to:*
  - (a) *determine and prepare a written report to the Trustee and the Unit Holders on the merits of the Alternative Proposals which have the potential to be in Unit Holders’ best interests (including the merger proposal which DNZ has publicly notified, and the proposal to terminate the Manager which [the Institutional Unit Holders] have publicly notified), and the Argosy Internalisation Proposal, including comparative analysis of the merits of the proposals: and*

(b) engage with the Manager, acting through its nominated independent directors, being at the date of this resolution Peter Brook and Trevor Scott, in relation to the findings of its report, with the costs of the independent adviser appointed by the Trustee in accordance with this resolution to be met by Argosy. And further that the Unit Holders request that the Trustee consider acting on any recommendations in the report to the extent that such action by the Trustee does not require a vote of Unit Holders.”

- **Resolution 8:** (Section 18 Resolution, or if not passed as such, Ordinary Resolution)  
“That the Unit Holders (to the extent lawful) direct, and otherwise request, the Trustee to Immediately select and appoint an independent adviser (being either, if Resolution 7 is passed, the adviser appointed pursuant to Resolution 7, or, if Resolution 7 is not passed, a suitably qualified person who is not currently and who (for the avoidance of doubt) has not at any time been engaged in relation to the Argosy Internalisation Proposal) to determine and prepare a report to the Trustee and the Unit Holders (to be provided to the Trustee and the Unit Holders, if Resolution 7 is passed, at the same time as the report provided pursuant to Resolution 7) advising (a) whether it is in the Interests of Unit Holders that the Manager should cease to hold office as Manager of the Trust and (b) whether the Trustee should certify pursuant to section 19(2) of the Act that it is in the interests of the Unit Holders that the Manager should cease to hold office as Manager of the Trust.”
- **Resolution 9:** (Extraordinary Resolution, or if not passed as such, Ordinary Resolution)  
“That the Unit Holders request and, if Resolution 5 is passed, direct the Manager, to refrain from convening a meeting of Unit Holders to consider the Argosy Internalisation Proposal until it can put before Unit Holders:
  - (a) Full information in relation to the Argosy Internalisation Proposal and:
    - i) Information third parties providing Alternative Proposals reasonably request be provided to Unit Holders; and
    - ii) If Resolution 6 is passed, details of the outcome of negotiations and the key terms of any agreed documentation; and
    - iii) If Resolution 7 is passed, the report of the independent adviser; and
  - (b) for their vote at the same meeting, to progress the Argosy Internalisation Proposal or to progress any such Alternative Proposals.”
- **Resolution 10:** (Extraordinary Resolution, or if not passed as such, Ordinary Resolution)  
“That the Unit Holders request and, if Resolution 5 is passed, direct the Manager to immediately disclose to Unit Holders and the Trustee:
  - (a) Full details of the exclusivity arrangements which it has entered into with OnePath (NZ) Limited, or any affiliates of OnePath (NZ) Limited, in relation to the Argosy Internalisation Proposal; and
  - (b) Full details of any voting Arrangement which the Manager or any Associated Person has entered into whether on a formal or an informal basis with any Unit Holder in relation to the Argosy Internalisation Proposal; and
  - (c) Full copies of all arrangements relating to the management of Argosy or the management of its properties and all related management or other charges.”

As the Annual Meeting is scheduled for late August 2011 the Manager has elected to put the above resolutions to Unit Holders at the same time rather than on 1 August 2011 as requested under the 24 June Proposal to avoid additional cost and inconvenience for the Unit Holders. On 14 July 2011 DNZ filed proceedings in the High Court in Auckland seeking an additional meeting at which the 24 June Proposal would be considered (prior to the Annual Meeting of Unit Holders in late August 2011) and alleging a breach of Trust for a failure of the Manager to call such an additional meeting. The High Court rejected DNZ’s case on all fronts on 29 July. DNZ subsequently announced that it is reconsidering its position with respect to a potential merger.

A detailed analysis of the 24 June Proposal is outlined at Section 8.2 of this report.

### 3.3 The DNZ Proposal

#### *Summary of the DNZ Proposal*

**In essence DNZ is proposing a takeover of Argosy as an alternative to the Proposed Internalisation. The proposed takeover would achieve internalisation by way of DNZ assuming responsibility for the day-to-day management of the Argosy properties. The DNZ Proposal would also have the effect of corporatising the Argosy trust structure as DNZ is proposing to exchange Argosy Unit Holders' units in the Trust for shares in DNZ (which is a company). Importantly, however, DNZ has not made a formal offer and without specific terms, including an actual ratio at which it would exchange Argosy units for shares in DNZ, it is difficult to evaluate the DNZ Proposal.**

#### *Overview of the DNZ Proposal*

DNZ is an NZSX listed property investment vehicle. As at 31 March 2011 DNZ's property portfolio carried a book value of \$637.7 million, consisted of 50 properties with 283 tenants, had a Weighted Average Lease Term (**WALT**) of 4.3 years and an occupancy rate of 97.9%.

On 18 May 2011 DNZ outlined the key elements of the DNZ Proposal as follows:

- Argosy would be merged into the DNZ corporate structure;
- Argosy Unit Holders would receive DNZ shares in return for selling their units to DNZ. The number of DNZ shares received by Unit Holders would be determined by a fixed exchange ratio, based on the relative value of each entity at the time of the transaction;
- the external management arrangement of Argosy would be exited as part of the transaction with the Manager receiving a compensation payment of an unspecified amount;
- DNZ would continue as the ongoing listed corporate entity, managing the combined property portfolio internally; and
- selected members of the Argosy board and management team would be offered an opportunity to join the DNZ board and management team.

DNZ has proposed that the exchange ratio be based on the relative net tangible assets (**NTA**) of Argosy and DNZ at the time of the proposed merger, with some flexibility built into the calculation to ensure both Argosy Unit Holders and DNZ shareholders achieve value accretive outcomes. DNZ's position on the exchange ratio was further clarified on 28 June 2011 when it announced that it believed "a 5-10% premium in the NTA exchange ratio could be attributed to Argosy Unit Holders if the transaction was completed at the same time as exiting the current management contract".

On 18 May 2011 DNZ stated the reasons it believed its proposal provided a better outcome for Argosy Unit Holders than an internalisation of the Management Rights for a payment of \$32.5 million. Its reasons were as follows:

- the direct synergies under the DNZ Proposal could be \$4 – \$5 million per annum greater than under the then current internalisation proposal;
- additional benefits and synergies would be available through more efficient tenant management across the complementary property portfolios;
- the incremental costs for Argosy in having to implement the infrastructure and administrative functions for internalising the management function could be avoided;
- Argosy Unit Holders would be transferred out of a trust structure into a corporate structure without incurring the costs of establishing one;
- a more stable dividend outlook would be likely; and

- the merged entity would have a better and more appropriate gearing level than the gearing level resulting for Argosy under the then current internalisation proposal.

The above conclusions were also formulated at a time when the internalisation proposal involved a payment of \$32.5 million, which is no longer the case. DNZ has stated that the implementation of its merger proposal would be conditional upon satisfactory completion of due diligence and other conditions including:

- agreement with Argosy on the terms for the exit of the Manager, and for the terms under which DNZ would assume the management of the Argosy properties;
- entry into a merger implementation agreement with Argosy. This would set out the principal terms of the merger acceptable to the DNZ Board; and
- the Board of Argosy unanimously recommending the proposal to Argosy Unit Holders, without qualification, and not withdrawing or changing that recommendation once made, subject to an independent expert concluding that the DNZ Proposal is in the best interests of Argosy Unit Holders.

On 2 June 2011 the Independent Directors issued an announcement through the NZSX that although they had an open mind to a “potential future merger with DNZ”, they did not propose progressing any takeover by DNZ at this time and that their central focus remained on the initiative to internalise the existing management contract. Their stated reasons were:

- that Argosy units trade at a smaller discount to NTA than DNZ indicating that DNZ has more to gain from an NTA based exchange ratio;
- that Argosy’s consensus forecast net yield for FY2012, based on its current unit price, was 7.1% versus DNZ’s consensus forecast net yield for FY2012 of 6.3%;
- that the Independent Directors were of the view that Argosy would have higher future earnings per unit growth than DNZ and that a NTA based merger would allow DNZ to capture some of that growth;
- that Argosy has a lower risk property portfolio, with a longer WALT and higher property yields than DNZ, with DNZ having a higher proportion of its property portfolio in more volatile regional markets;
- that any takeover should take the best parts of both entities and not be focused on DNZ taking over Argosy, particularly given Argosy is larger than DNZ;
- that the Independent Directors believed that Argosy could manage a combined Argosy/DNZ portfolio more cost effectively than DNZ manages its own portfolio alone; and
- that any takeover may see the forfeiture of tax losses, and the incurrence of transaction costs, significantly reducing overall transaction economics, particularly in the first year.

If the Proposed Internalisation is approved it would still be possible for Argosy to merge with DNZ and may make the merger easier to implement.

On 14 July 2011 DNZ filed proceedings in the High Court in Auckland seeking an additional meeting at which the 24 June Proposal would be considered (prior to the Annual Meeting of Unit Holders in late August 2011) and alleging a breach of Trust for a failure of the Manager to call such an additional meeting. The High Court rejected DNZ’s case on all fronts on 29 July. DNZ subsequently announced that it is reconsidering its position with respect to a potential merger.

An analysis of the DNZ Proposal is outlined at Section 8.3 of this report.

# 4. The Decision Confronting Unit Holders

## 4.1 Background

There has been significant press coverage of the Proposed Internalisation and the Alternative Proposals, which have created a complex array of alternatives for Unit Holders to consider. The purpose of this section is to summarise the issues confronting Unit Holders of Argosy. A detailed evaluation of the Proposed Internalisation is outlined at Section 7 of this report and a detailed evaluation of the Alternative Proposals at Section 8.

The Proposed Internalisation will give Unit Holders control over the management of Argosy for a one-off payment of \$20 million, plus one-off transaction costs of approximately \$1.8 million. The Proposed Internalisation is a robustly negotiated proposal on commercial terms that ensures an orderly transition from external management to an internally managed vehicle with the New Manager being entitled to charge on a cost-recovery basis only (ie: the New Manager would not be entitled to any management fees). The \$20 million payment to the Manager is at the lower end of Grant Samuel's value range for the Management Rights of between \$19.7 million and \$23.7 million, which has been based on the estimated price a third party purchaser would pay to secure the management rights today. The value to the Trust of internalising its management is significantly greater than the \$20 million being paid due to the significant annual cost savings it will achieve (a net after interest of approximately \$2.9 million per year) and also in part to the perpetual nature of the internalisation when compared with the risk of removal associated with external management. The Proposed Internalisation is earnings accretive to the Trust and should have a positive impact on the unit price of the Trust to the extent this has not already been factored in to the current unit price. The Proposed Internalisation will also improve the control Unit Holders have over the Trust and its day-to-day operations.

The Alternative Proposals, in essence, involve:

- A takeover of Argosy by DNZ and the simultaneous internalisation of the management of Argosy by making a payment to the Manager of an unspecified amount; and
- The removal of the Manager by the Trustee.

In Grant Samuel's opinion, at this stage the alternatives to the Proposed Internalisation contain a number of risks and uncertainties and are not superior to the Proposed Internalisation. Both alternatives risk producing potentially sub-optimal outcomes for Unit Holders. The reasons for forming this conclusion are outlined below.

## 4.2 The DNZ Proposal

DNZ has an obligation to act in its own shareholders' best interests and the DNZ Proposal should be considered in light of this. There are two aspects of the DNZ Proposal:

- a takeover of Argosy by DNZ; and
- the internalisation of the management of Argosy by making a payment of an unspecified amount to the Manager.

A merger of DNZ and Argosy may have merit. However, DNZ has only indicated a range of ratios at which it would intend to exchange Argosy units for shares in DNZ. DNZ has not made a formal takeover offer for Argosy or stated an exact exchange ratio. Without this information and detailed analysis of the likely synergies it is not possible to fully evaluate a potential merger/takeover at this time. If DNZ is serious about a takeover it needs to make public the detailed terms of its proposed takeover and make a formal takeover offer.

DNZ intends to manage Argosy itself. To achieve this DNZ would need to make a termination payment to the Manager for the cancellation of the Management Rights. DNZ has not indicated the value of the cancellation payment it intends to make to the Manager. In any event DNZ would need to negotiate with the Manager to agree the amount of the cancellation payment. There is no reason to assume that the Manager would agree any lower amount than the \$20 million negotiated by the Independent Directors. The cancellation of the Management Rights by DNZ simultaneous with a merger could possibly be more expensive than the proposed \$20 million Termination Payment but even if it were less, there is a risk that the benefits of internalisation may end up being shared between Argosy Unit Holders and DNZ shareholders, whereas under the Proposed Internalisation all of the benefits of internalisation flow to Argosy Unit Holders. The Proposed Internalisation if approved does not prevent a merger with DNZ in future, in fact it may assist and ensure Argosy Unit Holders maximise the benefits to themselves.

### 4.3 Removal of the Manager by the Trustee

*“The manager of any unit trust shall cease to hold that office if the trustee certifies that it is in the interest of unit holders that the manager should do so” - Section 19(2) of the Unit Trusts Act.*

Although the Trustee has stated that at this stage it does not believe that there is sufficient reason for it to form the view that a removal of the Manager is in the interest of Unit Holders, it may change this view.

Removal of the Manager by the Trustee is, on the face of it, the lowest cost option. It is not a “zero-cost” option and will involve a level of disruption to the business of Argosy and additional costs. As noted elsewhere in this report Grant Samuel believes internalisation is in the best interests of Unit Holders. A removal of the Manager by the Trustee will not immediately result in internalisation of the management of the Trust but may be a step to achieving internalisation over a subsequent 6 to 12 month period.

Grant Samuel has considered the costs that could be incurred under a Section 19(2) removal of the Manager by the Trustee. These may include:

- the cost of appointing of a new temporary manager for a period of 6 – 12 months;
- management fees being paid to the temporary manager as currently stipulated in the Trust Deed (no such management fees would be payable under the Proposed Internalisation);
- substantially increased legal and trustee fees during the transition from a temporary manager (supervised by the Trustee) to an internally managed vehicle;
- the costs of recruiting a new permanent management team prior to Unit Holders voting to internalise the management of the Trust and remove the temporary manager; and
- the payment of the costs and any settlement with the existing Manager if the Trustee’s decision to remove the Manager is challenged in the courts. The Trust has indemnified the Trustee for all of its costs associated with being the Trustee of the Trust, except in circumstances where the Trustee acts in breach of its duty of care as a Trustee, and accordingly such litigation costs would be payable by the Trust (other than if the Trustee acted in breach of its duty of care).

There are a number of unquantifiable consequential financial impacts that could arise as a result of the removal of the Manager by the Trustee. These include:

- loss of corporate knowledge and knowledge of the property portfolio as employees currently involved in the day-to-day management of the Trust would not necessarily leave OnePath to be employed by the temporary manager for an uncertain period of time;
- potential loss of tenants due to uncertainty as to who the manager will be in the future. It is a tenant’s market with rising vacancies and competitors and real estate agents will seek to capitalise on any uncertainty with tenants who have the option to move or renew;
- potential loss of tenants due to the failure of the temporary manager to perform. It is possible that a temporary manager could be an accounting or receivership firm rather than an experienced property manager;

- loss of revenue through failure to charge tenants for all operating and recoverable expenses which may be difficult to track without the necessary information systems;
- erosion of property values if leases not renewed or renewed at less than market rates by inexperienced managers; and
- failure to take advantage of buying, selling and development opportunities to maximise the value of the property portfolio. The temporary manager and the Trustee will likely be reluctant to make major decisions and as a result it is possible that the portfolio will not be actively managed until a transition to internal management is complete (possibly for a period of 6 – 12 months). In the 12 months to 30 June 2011 Argosy sold 6 properties with a value of \$19.7 million and acquired 2 properties with a value of \$33.1 million. In the same period capital expenditure on upgrades and extensions of \$15.2 million was committed.

A removal of the Manager by the Trustee is being proposed by a small number of large Unit Holders who have their own agendas. They may be right that the Manager can be removed at a net cost of less than \$15.2 million<sup>5</sup>. However, there is a real risk that the cost of a removal of the Manager by the Trustee could be more than \$15.2 million. Grant Samuel has estimated the costs likely to arise as a result of a removal of the Manager by the Trustee in the following table. We have not attempted to quantify the consequential financial impacts of the dismissal of the Manager but they are real risks that Unit Holders need to consider:

| <b>Costs Associated with a removal of the Manager by the Trustee</b>                        |            |
|---|------------|
|   | <b>\$m</b> |
| Compensation payable to Manager   | nil        |
| Cost of engaging a new temporary manager (one-off engagement fee)                           | 1.0        |
| Fees payable to the temporary manager <sup>6</sup>  | 3.7        |
| Costs associated with rebuilding property management database and records                   | 1.2        |
| Additional legal and Trustee fees   | 1.0        |
| Recruitment and employment costs for new management team                                    | 1.0        |
| Business disruption and loss of tenants   | Unknown    |
| Costs associated with potential litigation (assuming the Trustee has not acted negligently) | Unknown    |
| Value losses associated with portfolio mismanagement or management absenteeism              | Unknown    |
| Costs associated with subsequent internalisation  | Unknown    |
| <b>Estimated quantifiable costs of a removal of the Manager by the Trustee</b>              | <b>7.9</b> |

The estimated after tax cost of the Termination Payment to the existing Manager is \$15.2 million. The after tax cost of the items quantified in the table above is approximately \$5.7 million. The after tax difference is \$9.5 million or 1% of the total property assets of the Trust. Whilst this is a meaningful sum, this has been calculated before deducting any of the costs or losses arising from business disruption, loss of tenants, potential litigation, value lost due to portfolio mismanagement, and the costs associated with subsequent internalisation. Grant Samuel believes that the additional cost of approximately \$9.5 million for an orderly and immediate transition to self-management is likely to be a reasonable outlay to avoid the disruption and very real risks associated with a summary dismissal of the Manager by the Trustee. Argosy is a large business and potentially throwing its management into disarray albeit temporarily for that amount of money is a risk Unit Holders must consider very carefully in deciding which resolutions to support.

<sup>5</sup> Assuming the Termination Payment is tax deductible to the Trust. The calculation is outlined in Section 6 of this report.

<sup>6</sup> This conservatively assumes a 6 month transition period to internalisation. Unless the Trust Deed is amended simultaneously, the new temporary manager would be entitled to the fees stipulated in the Trust Deed that are currently paid to the Manager. The property management fees under the Property Management Agreements would also continue to be payable if the Property Management Agreements survived.

# 5. Profile of the Manager

## 5.1 Background

The Manager of the Trust is a wholly owned subsidiary of OnePath (previously ING (NZ) Ltd), a provider of investment, KiwiSaver and insurance in New Zealand. OnePath is wholly owned by ANZ.

The Trust was initially managed by Symphony Group. In August 2003, the Trust announced that Symphony and ING (NZ) Limited (**ING**) had formed a partnership to manage the Trust, with ING purchasing a 50% equity interest in the Manager. In August 2004, Symphony and ING jointly acquired control of the Urbus Management Companies for \$31.5 million. In September 2005 the Trust paid the Manager \$13 million in compensation for cancelling the Urbus management contracts in order to enable the Manager's management fees to be charged on a consistent basis across the total property portfolio. Cancelling the Urbus contracts resulted in the Manager assuming responsibility for the management of all of the Trust's assets and subsidiary companies in accordance with the terms of the Trust Deed and the separate existing Property Management Agreements.

In early 2008 ING acquired Symphony's 50% shareholding in the Manager. In November 2010 the ING name was changed to OnePath.

## 5.2 Role of the Manager

The Manager's role extends to the overall strategic direction of the Trust, portfolio management, selection and review, negotiation and disposal of assets, treasury and funding management, property management, ensuring adherence to financial reporting requirements and liaison with Unit Holders in accordance with the Trust Deed. The key provisions include:

- the ability to exercise absolute discretion as to the investment of any of the Trust funds and as to how the assets and liabilities of the Trust are dealt with. These powers extend to the purchase, sale, transfer, exchange, lease, alteration of or other dealing with any of the assets from time to time except where the dealing:
  - relates to real estate or securities where the value exceeds 1% of Unit Holders' funds;
  - relates to the lease of real estate in respect of which either the annual rental exceeds an amount equivalent to 4% of the aggregate gross annual rental income of the Trust or any rent review period exceeds three years;
  - relates to capital expenditure which exceeds, in each separate instance, an amount equivalent to 1% of the Unit Holders' funds; or
  - is otherwise of a capital nature, the value of which exceeds, in each separate instance, an amount equivalent to 1% of Unit Holders' funds

unless the Manager has first prepared and delivered a submission to the Trustee and received the Trustee's acceptance of the submission;

- the requirement to have all investments valued by a qualified adviser at intervals of not more than 12 months;
- the ability to direct the Trustee on behalf of the Trust to enter into any arrangement which has the effect of granting security to a third party over all or any part of the Trust to secure any liabilities or obligations incurred or undertaken by the Manager for the purposes of the Trust;
- the requirement to insure all buildings to their full reinstatement value against fire, earthquake, storm, flood and such other risks as buildings of a similar nature are normally insured against, and against loss of rent, in each case on customary terms and with reputable insurers;

- the ability to direct the Trustee to enter into a guarantee or similar arrangement with respect to the obligations of any entity through which any of the assets of the Trust are held;
- the ability to specify and modify the distribution policy regarding distributions to the Unit Holders and the requirement to ensure such distributions are paid;
- the requirement to keep and maintain a register of the Unit Holders of the Trust;
- the ability to direct the Trustee to borrow on behalf of the Trust, up to a maximum of 50% of the Gross Value<sup>7</sup> of the Trust;
- the requirement to prepare semi annual and annual accounts for the Trust and to have the annual accounts audited and sent to the Trustee and Unit Holders;
- the requirement to prepare a quarterly report for the Trustee;
- the requirement to convene an annual meeting of Unit Holders within 6 months of the end of each financial year of the Trust; and
- the requirement to manage the Trust in a proper and efficient manner.

### 5.3 Management Fees and Property Management Fees

The Manager is entitled to a **base fee** of 0.6% of the average Gross Value of the Trust and an **incentive fee** based on quarterly Unit Holder returns<sup>8</sup>. The base fee is calculated and paid in cash monthly in arrears. The incentive fee is calculated and paid in cash quarterly in arrears. In addition the Manager is entitled to reimbursement for certain expenses incurred on the Trust's behalf including \$252,500 of annual Directors fees.

The Trust Deed also provides that the Manager is reimbursed by the Trust for all expenses, costs or liabilities incurred by the Manager in procuring property management services. The day-to-day management of the Trust's properties is carried out directly by OnePath (rather than the Manager) under the Property Management Agreements. The Property Management Agreements provide that OnePath is entitled to a property management fee as well as time-in-attendance fees at market rates for time spent on lease renewals, new leases and investigating potential property purchases. The Trust incurs **property management fees** of 2%-2.5% of gross rental income per annum.

#### **Base fee**

The Manager now receives the highest base fee payable of any of its NZSX listed peers (excluding VHP, which has publicly announced its intention to reduce its base fee from 0.75% to 0.60%). This was not the case prior to 2010 and follows the internalisation of NPT management in November 2010 and ANO reducing its base fee to 0.55% and introducing an incentive fee in the December quarter of 2010.

Based on the Gross Value of the Trust as at 31 March 2011 of \$962 million the annual base fee for FY2011 would be \$5.8 million. The base fee will fluctuate over time as the market value of the investments changes and as the Trust seeks to further reduce its debt levels to a medium term target LVR of 38%, from 43% at 31 March 2011. In order to reduce the Trust's current debt levels the Manager expects to realise approximately \$52 million from property sales in the current financial year. A reduction in Assets Under Management (**AUM**) of approximately \$52 million would lower the annual base fee by \$0.3 million. Over time the dividend reinvestment plan will increase the Gross Value of the Trust but at projected levels of less than \$5 million per annum, is not expected to materially impact the Manager's fees.

<sup>7</sup> The gross value of the Trust is the aggregate of the market value of all investments and cash forming part of the Trust fund.

<sup>8</sup> Unit holder returns means the pre-tax profit per unit (excluding unrealised revaluation gains and losses) plus the change in the unit price over that quarter.

### ***Incentive fee***

The incentive fee is calculated by reference to the returns accruing to Unit Holders. Unit Holder returns are defined as the pre-tax profit per unit for the relevant quarter (excluding unrealised revaluation movements of property assets) plus or minus the change in the market price of the units for the same period. The Manager is paid 10% of the amount by which the total Unit Holder returns exceed 10% per annum up to a maximum of 15% per annum. Where the returns exceed 15% per annum, the excess is carried forward to subsequent quarters for the next 24 months. If the Unit Holder returns are less than 10% per annum for a quarter, the deficit is also carried forward to use in calculating the incentive fee in subsequent quarters for the next 24 months.

The Manager has earned incentive fees in the past in varying amounts each year from 2003 to 2007. The pre-tax profit per unit for FY2011 is 4.85 cents per unit, which equates to a return of 6.6% on the 1 April 2010 unit price of \$0.74. The net movement in the unit price over FY2011 has been slightly negative (75 cents to 73 cents) and combined with the deficit in Unit Holder returns carried forward from FY2010 means that the Manager will not receive an incentive fee in FY2011. However, the Manager will be paid an incentive fee payment for the quarter ending 30 June 2011 of approximately \$495,000 largely as a result of the significant increase in the unit price from \$0.73 to \$0.83 following the announcement of the Proposed Internalisation.

The outlook for the New Zealand property sector would suggest that achieving a better than 10% per annum Unit Holder return after the June 2011 quarter will be challenging. The market value of investments is not expected to materially appreciate for the foreseeable future (to the extent that any unrealised revaluation gains flow through in higher unit prices) and the overhang from MFL selling units to meet its own liquidity requirements is likely to continue to put downward pressure on the Trust's unit price. Against this the proposed reduction in gearing is likely to have a positive impact on the unit price that, until the announcement of the Proposed Internalisation, was trading at a relatively large discount to NTA.

### ***Property management fees***

The Manager has contracted OnePath to manage all of the properties owned by the Trust and is reimbursed by the Trust for all expenses incurred in relation to the Property Management Agreements that set out the terms and conditions under which OnePath manages the Trust's properties on behalf of the Manager. OnePath is required to perform duties in relation to tenancy management, account management, risk management and property investigations.

The Property Management Agreements provide for an annual management fee as a percentage of gross rental income (that cannot exceed 4%) plus specific time-in-attendance fees at market rates for time spent on lease renewals, new leases and investigating potential property purchases. Property management fees have generally ranged from 2% to 2.5% per annum over the past 5 years. The proposed conditional sale of approximately \$52 million of properties is expected to reduce property management fees by approximately \$92,000 per annum (due to the loss of rental income on sold properties). Property management fees paid to OnePath are included in property expenses of the Trust.

The Property Management Agreements have a defined term of 10 years and expire in 2012 and 2013 respectively unless the term is extended by mutual agreement. The Proposed Internalisation will result in the Property Management Agreements being cancelled.

### Historical fees earned

The table below provides a summary of management fees paid to the Manager and the property management fees reimbursed by the Trust over the five years ended 31 March 2011:

| Management Fees and Property Management Fees paid by the Trust (\$ millions) |              |                |                |                |              |
|--|--------------|----------------|----------------|----------------|--------------|
| Year end 31 March  | 2007         | 2008           | 2009           | 2010           | 2011         |
| Base management fees   | 5.5          | 6.4            | 7.3            | 6.1            | 5.5          |
| Incentive fees   | 3.2          | -              | -              | -              | -            |
| Due diligence fees   | -            | 0.4            | -              | -              | -            |
| Directors fees   | 0.2          | 0.2            | 0.3            | 0.3            | 0.3          |
| <b>Total trust management fees</b>   | <b>8.9</b>   | <b>7.0</b>     | <b>7.6</b>     | <b>6.4</b>     | <b>5.8</b>   |
| <b>Average Gross Asset Value</b>   | <b>917.4</b> | <b>1,071.6</b> | <b>1,210.0</b> | <b>1,005.5</b> | <b>927.7</b> |
| <b>As a % of average Gross Asset Value</b>                                   | <b>0.97%</b> | <b>0.65%</b>   | <b>0.63%</b>   | <b>0.64%</b>   | <b>0.63%</b> |
| <b>Property Management Fees</b>  |              |                |                |                |              |
| Amounts recovered under lease from tenants                                   | 0.9          | 0.5            | 0.9            | 0.8            | 0.9          |
| Amounts paid by the Trust directly   | 0.8          | 1.3            | 1.2            | 1.5            | 0.7          |
| <b>Total property management fees</b>  | <b>1.7</b>   | <b>1.9</b>     | <b>2.1</b>     | <b>2.3</b>     | <b>1.6</b>   |
| <b>Gross property income from rentals</b>                                    | <b>80.9</b>  | <b>89.6</b>    | <b>93.3</b>    | <b>83.8</b>    | <b>79.1</b>  |
| <b>As a % of gross income from rentals</b>                                   | <b>2.1%</b>  | <b>2.1%</b>    | <b>2.3%</b>    | <b>2.7%</b>    | <b>2.0%</b>  |

#### 5.4 Term of the Management Rights

There is no defined term for the Management Rights under the Trust Deed. However, the ability to remove the manager from office by unit holder resolution is a requirement of the Unit Trusts Act 1960 and is therefore a standard feature of unit trust structures. Unit holders have the right to direct that the Manager should cease to hold office by passing a resolution under Section 18 of the Unit Trusts Act 1960. In addition, the Trustee has the ability to remove the Manager under Section 19(2) of the Unit Trusts Act if the Trustee certifies that it is in the interests of Unit Holders that the Manager should cease to hold office. If termination occurs for either of these reasons the Trust Deed states that the Manager must **immediately desist** from all activities relating to the Trust.

In the event of termination from office by way of a Section 18 resolution of Unit Holders the Manager is entitled to an additional fee (over and above any accrued fees owing under the Trust Deed up until the date of termination) equal to 1.2% of the Gross Value of the Trust (ie the equivalent of two years of base fee income) plus 10% of the available excess fees accrued under the incentive fee provisions of the Trust Deed (the **Available Excesses**). The estimated carry forward available excesses as at 30 September 2011 are \$101.1 million. The excesses are high due primarily to the unit price having increased over the last 24 months (8 quarters) from 60 cents to 83 cents per unit. Accordingly, if the Manager were removed from office in the near term by way of a Unit Holder resolution, the compensation payable would total approximately \$21.3 million, being 1.2% of the Gross Value of the Trust (\$11.2 million) plus 10% of the Available Excesses (\$10.2 million). The Available Excess are estimated to fall to zero as at 1 October 2011 which would have the effect of reducing the compensation payable from \$21.3 million to approximately \$11 million.

No compensation is payable to the Manager in the event of a Section 19(2) certification by the Trustee that it is in the interests of Unit Holders for the Manager to cease to hold office.

#### 5.5 Financial Profile

The Manager does not employ any staff or incur any costs directly other than Directors' fees and some property management fees (for which it is reimbursed by the Trust or recovered from tenants). All of the staff involved in the day-to-day management of the Trust are employees of OnePath. Accordingly, the financial statements of the Manager are of limited value in evaluating the revenues and costs associated with undertaking the management of Argosy. Historical management fees earned are shown in the table in Section 5.3 above.

# 6. The Value of the Management Rights

## 6.1 Summary

**Grant Samuel has assessed the value of the Management Rights of Argosy to be in the range of \$19.7 million to \$23.7 million.** This valuation range is an overall judgement having regard to:

- the termination provisions applicable to the Management Rights;
- the forecast net profit after tax attributable to the Management Rights on a stand alone basis; and
- multiples of Assets Under Management and Revenue implied by transactions similar to the Proposed Internalisation.

The Termination Payment, or purchase price, of \$20 million is at the lower end of our valuation range. There is a strong possibility that the Termination Payment will be tax deductible to the Trust. When the benefit of the potential tax deductibility is taken into account, the net purchase price is \$15.2<sup>9</sup> million, which is well below the bottom end of our valuation range.

## 6.2 Preferred Methodology

### Overview

Grant Samuel's valuation of the Management Rights has been estimated on the basis of fair market value as a going concern, defined as the estimated price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information.

The most reliable evidence as to the value of such rights is the price at which those rights or similar comparable rights have been bought and sold in an arm's length transaction. In the absence of direct market evidence of value, estimates of value are made using methodologies that infer value from other available evidence. There are four primary valuation methodologies commonly used for valuing businesses:

- capitalisation of earnings or cash flows;
- discounting of projected cash flows;
- industry rules of thumb; and
- estimation of the aggregate proceeds from an orderly realisation of assets.

Each of these valuation methodologies has application in different circumstances. The primary criterion for determining which methodology is appropriate is the actual practice adopted by purchasers of the type of business involved. A detailed description of each of these methodologies is outlined at Appendix B.

### Preferred Approach

Grant Samuel has adopted a capitalisation of earnings methodology to value the Management Rights and cross-checked this valuation with a discounted cash flow methodology.

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<sup>9</sup> The value of the Termination Payment net of the tax benefits accruing to the Trust in the event the Termination Payment is tax deductible, has been calculated by reducing the \$20 million Termination Payment by the Net Present Value of the tax deductions in the year in which they are applied. Due to the timing of the Proposed Internalisation, any tax deduction available for the Termination Payment will largely be realised in 2013. The Net Present Value of the tax benefit arising is therefore \$4.8 million.

### 6.3 Capitalisation of earnings

Grant Samuel has applied multiples of 2.5 to 3.0 times the estimated revenues of the Manager for FY2012 of approximately \$7.9 million. These multiples are broadly in line with multiples implied by transactions of a similar nature to the Proposed Internalisation, as outlined in Section 6.5 of this report.

Grant Samuel has estimated the Manager's revenue with reference to the following:

#### *Argosy's AUM*

The Manager's base fee has been calculated with reference to the Trust's forecast average AUM for FY2012. The forecast reflects Argosy's plan to divest approximately \$52 million of property in the current financial year to reduce debt. In addition to this Grant Samuel has assumed valuation growth for FY2012 of 1%. The resulting average forecast AUM for FY2012 is approximately \$935.0 million.

#### *Unit Holder returns*

The incentive fee component has been calculated with reference to the Trust's forecast net profit before tax for FY2012 and a 2.0% growth in Argosy's unit price. Grant Samuel has assumed an incentive fee for FY2012 of \$495,000.

#### *Gross rental income*

Property management fees have been calculated based on the Trust's forecast gross rental income for FY2012, which has been determined on a property-by-property basis with reference to the terms of the underlying lease agreements. Total property management fees have been estimated at \$1.5 million for FY2012. An additional \$300,000 of time and attendance fees has also been assumed.

### 6.4 Discounted cash flow analysis

Grant Samuel has cross-checked its capitalisation of earnings valuation with a discounted cash flow valuation of the cash flows from the current Management Rights net of the costs incurred in generating these cash flows. The discounted cash flows are very sensitive to changes in the assumptions regarding the Trust's AUM (which drive base fee estimates) and the costs associated with undertaking the management of the Trust. Grant Samuel's discounted cash flow analysis yields the following valuation range:

| Discounted Cash Flow Analysis                    |                 |             |
|--|-----------------|-------------|
| \$ million unless otherwise stated               | Valuation Range |             |
|  | Low             | High        |
| Discount rate                                    | 14.0%           | 12.0%       |
| Value of the cash flows of the Management Rights | 16.4            | 17.7        |
| Discounted termination payment                   | 4.1             | 4.9         |
| <b>Total Discounted Cash Flow valuation</b>      | <b>20.5</b>     | <b>22.6</b> |

Due to the risk of removal for an external manager Grant Samuel's discounted cash flow valuation has assumed a 10 year term for the Management Rights at which time the Manager would receive a termination payment equivalent to 1.2% of the Gross Value of the Trust in that year (Year 10), which is the compensation to which the Manager would be entitled to under the Trust Deed if Unit Holders voted to remove the Manager.

Grant Samuel's assessment of the key valuation drivers is outlined below, together with other factors that have an impact on the outcome of the discounted cash flow analysis:

### Assumed AUM for the Trust

As stated above Argosy is planning to divest approximately \$52 million of property in the current financial year to reduce debt. Grant Samuel has assumed annual valuation growth of 1% rising to 2.5% per annum over five years, and annual capital expenditure on new and existing properties of \$16 million to maintain a debt/total assets ratio remains at approximately 40%. Grant Samuel has made no allowance for any increases in the units on issue by way of a rights issue or other means. Distributions have been held constant at 6 cents per unit.

### Cost associated with operating the Management Rights

Historical operating costs for the Manager are difficult to ascertain as the vast majority of the costs associated with managing the Trust are currently incurred by OnePath, which employs all of the staff involved in the day-to-day management of the Trust and incurs the costs associated with fulfilling its obligations under the Property Management Agreements. It is difficult to separate the costs relating to Argosy from OnePath's other operating costs for its broader investment, KiwiSaver and insurance business. Accordingly, Argosy's management and the Independent Directors have forecast the operating costs of Argosy at approximately \$4.1 million per annum. Grant Samuel has reviewed the cost estimates and adopted them as they represent the best available estimate of the ongoing costs of undertaking the management of the Trust.

### Discount rate

Selection of the appropriate discount rate to apply to forecast cash flows of any business enterprise is fundamentally a matter of judgement. The capital asset pricing model (**CAPM**) is probably the most widely accepted and used methodology for determining the cost of equity capital. While the theory underlying CAPM is rigorous, the practical application is subject to very substantial shortcomings and limitations. There is a tendency to regard the discount rates calculated using CAPM as inviolate. However, a mechanistic application of formulae derived from that theory can obscure the reality that there is no "correct" discount rate. Valuation is an estimate of what real world buyers and sellers of assets would pay and must therefore reflect criteria that will be applied in practice. For the purposes of valuing the Management Rights Grant Samuel has adopted discount rates of 12% to 14%. The discount rate reflects the difficulty in gearing the Management Rights and is, in effect, a proxy for the return on equity that a third party acquirer would apply.

## 6.5 Assessment of Implied Multiples

Grant Samuel estimates the value of the Management Rights to be in the range of \$19.7 million to \$23.7 million. This range implies the following multiples of the Manager's forecast pro-forma earnings for the year ending 31 March 2012:

|  | Management Rights - Implied Multiples |      |
|--|---------------------------------------|------|
|  | Valuation Range                       |      |
|  | Low                                   | High |
| Multiple of Revenue                      | 2.5                                   | 3.0  |
| Valuation as a percentage of average AUM | 2.2%                                  | 2.6% |

The above multiples are broadly in line with multiples implied by transactions involving management rights similar to the Argosy Management Rights. The table below outlines the multiples implied by two recent New Zealand internalisation transactions:

| Recent Transaction Evidence |                         |                 |                          |                |                         |                  |
|-----------------------------|-------------------------|-----------------|--------------------------|----------------|-------------------------|------------------|
| Date                        | Target                  | Transaction     | Consideration (millions) | AUM (billions) | Consideration / AUM (%) | Revenue Multiple |
| Oct-10                      | National Property Trust | Internalisation | NZ\$2.5                  | NZ\$0.2        | 1.4%                    | 1.8 x            |
| Jul-10                      | DNZ                     | Internalisation | NZ\$35.0                 | NZ\$0.7        | 4.0%                    | 3.5 x            |

Each of the above transactions had specific circumstances that affected the value outcome. In particular the National Property Trust transaction involved a distressed sale by the manager who was in liquidation at the time. Conversely the DNZ transaction reflected the fact that the manager of the DNZ assets could not be removed from office due to the nature of its shareholding in DNZ. Further transaction evidence is outlined at Appendix A of this report together with a description of each of the above transactions.

## 6.6 Range of Value Outcomes

The range of possible value outcomes is broad ranging from a value of nil in the event the Manager is removed from office by the Trustee certifying that such removal is in the interests of Unit Holders, to the value to the Trust in the event the Termination Payment is fully tax deductible.

The possibility that the Management Rights could be terminated with or without compensation makes the assessment of value problematic. The risk of removal either by the Unit Holders or the Trustee is a risk every external manager of a unit trust in New Zealand faces. At the other end of the value spectrum is the net cash flow benefit to the Trust of internalising the management.

The table below outlines the full range of value outcomes considered by Grant Samuel in determining the value of the Management Rights:

| Summary – Range of value outcomes (\$ million)                                      |             |             |
|---|-------------|-------------|
|   | Low         | High        |
| Grant Samuel capitalisation of earnings valuation (see Section 6.3)                 | 19.7        | 23.7        |
| Grant Samuel discounted cash flow analysis (see Section 6.4)                        | 20.5        | 22.6        |
| Value to the Trust if Termination Payment not tax deductible (see discussion below) | 37.4        | 42.6        |
| Value to the Trust if Termination Payment tax deductible (see discussion below)     | 42.2        | 47.5        |
| <b>Proposed Termination Payment if tax deductible / not tax deductible</b>          | <b>15.2</b> | <b>20.0</b> |
| Value based on removal by Unit Holders (pre/post 30 Sept 2011)                      | 11.0        | 21.3        |
| Value based on removal of the Manager by the Trustee                                | -           | -           |

The range of value outcomes is discussed in turn below.

### *Value of the Proposed Internalisation to the Trust*

From the Trust's perspective it could reasonably be expected to apply a lower discount rate to projected cash flows in perpetuity than a prospective external purchaser of the Management Rights. This will derive higher net present values (all other factors being the same) for the benefit of internalising management, because an internalised management structure does not have the same exposure to being removed from office by a majority of Unit Holders that an external manager has under the Trust Deed. For the purposes of determining the value of the Management Rights to the Trust Grant Samuel has adopted a discount rate range of 9% to 10%. The lower discount rates adopted for the Trust as opposed to a third party reflect the Trust's weighted average cost of capital and are primarily a function of assuming a level of gearing of 40%.

On the basis that the Termination Payment is fully deductible to the Trust for taxation purposes, Grant Samuel has assessed the Net Present Value of the Proposed Internalisation to the Trust<sup>10</sup> to be in the range of \$20.4 million to \$25.7 million:

<sup>10</sup> Based on a Net Present Value of the Management Rights to the Trust of between \$42.2 and \$47.5 million

| Value of the Management Rights to the Trust (\$ million)                  |             |             |
|---|-------------|-------------|
|   | Low         | High        |
| Discount rate   | 10.0%       | 9.0%        |
| Value of 10 year cash flows   | 24.1        | 25.0        |
| Terminal value  | 18.1        | 22.5        |
| <b>Total value of the Management Rights to the Trust</b>                  | <b>42.2</b> | <b>47.5</b> |
| Less cost of implementing the Proposed Internalisation <sup>11</sup>      | (21.8)      | (21.8)      |
| <b>Net Present Value if Termination Payment tax deductible</b>            | <b>20.4</b> | <b>25.7</b> |
| <b>Net Present Value if Termination Payment <u>not</u> tax deductible</b> | <b>15.6</b> | <b>20.8</b> |

In Grant Samuel's opinion it is not appropriate to assess the fair market value of the Management Rights on this basis given that these circumstances are unique to the Trust and no third party would be likely to pay this price for the Management Rights.

The differences between the value to the Trust and the value of the management rights on a standalone basis are:

- the potential tax deductibility of the termination payment;
- lower discount rates; and
- significantly larger terminal value as the benefit is assumed to continue into perpetuity.

#### Value based on removal by Unit Holders

Unit Holders may elect to pass a Section 18 Resolution to remove the Manager, in which case the Manager would be entitled to compensation of 1.2% of the Gross Value of the Trust (ie the equivalent of two years of base fee income) plus 10% of Available Excesses. The Available Excesses fluctuate from time to time but coincidentally will reach their highest point at 30 September 2011. Accordingly, the compensation payable to the Manager in the event of a removal by way of a Section 18 Resolution varies greatly depending on whether the Section 18 Resolution to remove the Manager occurs on or before 30 September 2011 or after 30 September 2011. The calculation of the compensation payable in each instance is shown in the table below:

| Compensation Payable to Manager Under Section 18 Resolution (\$ millions) |            |  |  |
|---|------------|--|--|
|   |            | Resolution on or before<br>30 September 2011 | Resolution on or after<br>1 October 2011 |
| Estimated Gross Value of the Trust  | (A)        | 933.9  | 913.8                                    |
| Estimated Available Excesses  | (B)        | 101.1  | -  |
| 1.2% of the Gross Value of the Trust                                      | (1.2% x A) | 11.2   | 11.0                                     |
| Plus: 10% of Available Excesses   | (10% x B)  | 10.1   | -  |
| <b>Total compensation payable to Manager</b>                              |            | <b>21.3</b>                                  | <b>11.0</b>                              |

The significant difference between the pre and post 30 September 2011 compensation payable is a result of the manner in which the Available Excesses are calculated. On 30 September 2011 a large proportion of Available Excesses will expire, reducing that component of the compensation significantly. The above values do not reflect the costs associated with a removal of the Manager by way of a Section 18 Resolution of Unit Holders, which are significantly greater and discussed on page 41 of this report.

#### Value based on removal of the Manager by the Trustee

In the event that the Trustee certified that a removal of the Manager was in the interests of Unit Holders, no compensation would be payable. Importantly, this does not reflect the actual cost associated with a removal of the Manager by the Trustee, which are significant and discussed in detail at Section 4.3.

<sup>11</sup> including \$1.8 million of one-off transaction costs associated with the Proposed Internalisation and which are detailed at Section 7.3

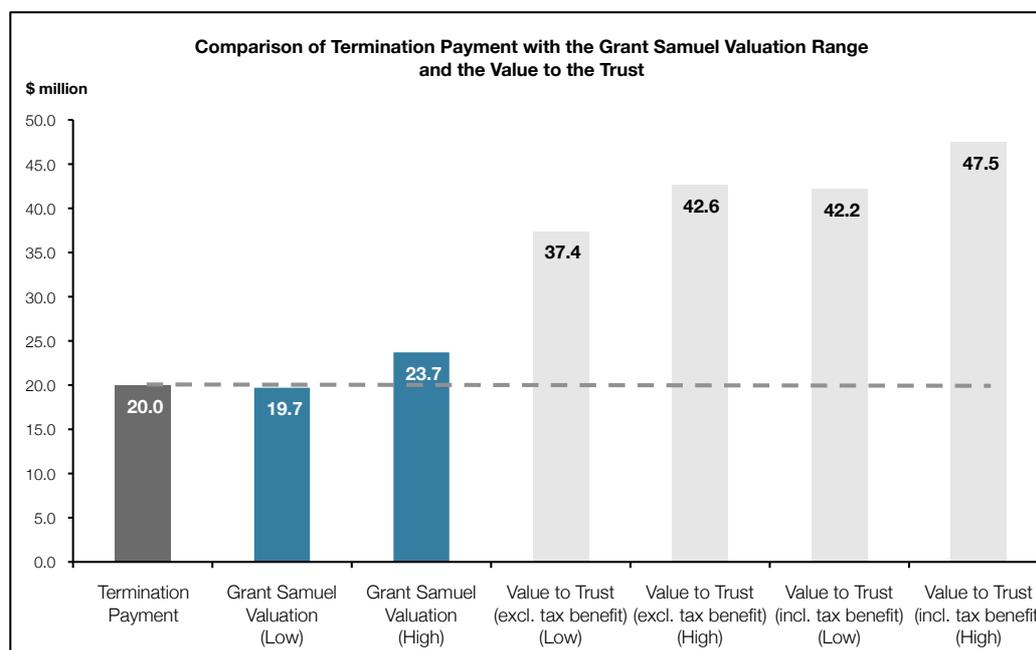
# 7. Evaluation of the Proposed Internalisation (Resolutions 1, 2 and 3)

## 7.1 Rationale for the Proposed Internalisation

- The Proposed Internalisation came about as a result of expressions of interest received by ANZ from third parties in relation to the acquisition of the Management Rights. As a result of these approaches ANZ indicated that it would pursue a formal sale process for the Management Rights.
- There is a strong international trend towards internal management of listed property vehicles. The reasons for this current trend include:
  - the removal of the potential for a conflict of interest between the manager and the managed entity. An argument often advanced is that under most external management fee structures the manager is incentivised to grow AUM to maximise management fees without regard for the consequences of increasing the level of debt of the managed entity. Argosy is relatively highly geared and the Manager has commenced selling investment properties with the primary purpose of reducing debt;
  - likely lower management costs under internal management. External management fees will usually exceed the cost of internal management as the shareholders of an external manager require a profit over and above the costs of managing the listed property vehicle. This is particularly the case with larger entities where there can be significant benefits arising from economies of scale which, under a flat fee structure, the manager benefits from at the expense of the managed entity. In the case of Argosy the operating cost saving arising if the Proposed Internalisation proceeds has been estimated at \$3.8 million per annum. This is before the additional interest expense arising from the acquisition of the Management Rights which is estimated to be \$0.9 million per annum and additional expenses associated with the Public Trust shareholding structure of \$15,000 per annum plus \$300 per hour for time and attendance and excludes one off transaction costs;
  - the suppression of unit prices of externally managed listed property vehicles due to the fact that external management contracts can act as an impediment to a takeover or merger. As a result, internationally listed property vehicles with external management generally exhibit higher discounts to NTA than internally managed vehicles;
  - the desire to retain and develop key management personnel in-house rather than being exposed to the potential loss of knowledge in the event an external manager were removed; and
  - the removal of the risk that the shareholders of an external manager can elect to divest the manager without unit holder approval. Changes in the control of management companies result in the value of the management rights, and any increase in the value of management entities, being captured by the shareholders of the external manager rather than by the Unit Holders.
- The Proposed Internalisation also provides the Trust with the opportunity to select the appropriate management team to undertake the ongoing management of the Trust.

## 7.2 The Fairness of the Termination Payment to Unit Holders

- Grant Samuel's assessment of the value of the Management Rights.** In Grant Samuel's opinion the fair market value of the Management Rights is in the range of \$19.7 million to \$23.7 million as set out in Section 6. The value is the price a person or entity could be expected to pay to acquire the Management Rights. By comparison the proposed Termination Payment is \$20 million, which is at the lower end of Grant Samuel's valuation range. It is possible, but not certain, that the Termination Payment may be tax deductible to the Trust. Due to the timing of the Proposed Internalisation it is likely that the majority of the tax benefit would not be derived before 2013 resulting in a net Termination Payment of \$15.2 million (when taking into account the Net Present Value of the future tax benefits). Importantly the potential tax benefit would only be available to the Trust and not to any other third party purchaser of the Management Rights and there is no reason for the Trust to pay away this benefit to OnePath to secure the Management Rights. The chart below compares Termination Payment with the Grant Samuel valuation range and the value of the Proposed Internalisation to the Trust (both excluding and including the benefit of any potential tax deductibility):



The chart above clearly shows that the acquisition of the Management Rights for \$20 million is a value-adding transaction for the Unit Holders. In other words, the value of internalising the management of the Trust is greater than the cost of making the Termination Payment. Grant Samuel estimates that the net present value (that is, the present day benefit) to the Trust is between \$15.6 million (if the Termination Payment is not tax deductible) and \$25.7 million (if the Termination Payment is tax deductible) even after taking into account the \$1.8 million of associated one-off transaction costs. The Trust is the highest value owner of the Management Rights. Put another way, the Trust benefits to the greatest extent from controlling the management of its assets and undertakings as internalisation represents significant immediate cost savings (in the form of a cost only management structure and the removal of external management fees) and the ability for the Unit Holders to control any future takeover premium for the Trust with no value leakage to the Manager;

- comparable company and comparable transaction data.** The Proposed Internalisation implies the following multiples:

| Multiples Implied by the Proposed Internalisation     |                                 |  |
|---|---------------------------------|--|
|   | % of forecast AUM for<br>FY2012 | Multiple of forecast<br>Revenue for FY2012 |
| Termination Payment (excluding any tax benefit)       | 2.2%                            | 2.5 x                                      |
| Termination Payment (including potential tax benefit) | 1.7%                            | 1.9 x                                      |

Grant Samuel's analysis suggests these multiples are in line with multiples paid for management rights of similar entities (excluding any potential tax benefit). Although the multiples implied by the Proposed Internalisation are below those implied by the recent internalisation of the DNZ management contract it is important to note that the DNZ internalisation differed substantially from the Proposed Internalisation in that the manager of the DNZ assets could not be removed from office due to the nature of its shareholding in DNZ. The risk of removal for the Manager of Argosy is substantially greater;

- at present the commercial, industrial and retail property sectors are flat with only little prospect of any meaningful increase in value in the medium term. If past cycles are an indicator of the future, property prices can be expected to eventually increase. To the extent this eventuates, it will result in the payment of higher fees to the Manager. Internalisation at a low point in the cycle is likely to be achieved at a better price than when property prices are firming, as the Manager arguably does not need to be compensated for lost incentive fees; and
- an alternative way of evaluating the Proposed Internalisation is to assess the benefit to the Trust of investing the Termination Payment in additional properties instead of acquiring the Management Rights. For Argosy an investment in property of \$20 million would on average yield net annual income of approximately \$1.4 million based on the Trust's average passing yield of 8.28%, non-recoverable property expenses of approximately 8.5% of rental income and management fees of 0.6% of AUM. This compares with net annual cost savings under the Proposed Internalisation of \$2.9 million (after additional interest costs and Public Trust expenses). The Trust is better off under the Proposed Internalisation than it would be investing \$20 million in additional property.

### 7.3 The cost of implementing the Proposed Internalisation

The costs involved in implementing the Proposed Internalisation include:

| <b>Costs of Implementing the Proposed Internalisation</b>  |                   |
|--|-------------------|
|  | <b>\$ million</b> |
| Termination Payment  | 20.0              |
| Advisory and legal fees  | 1.2               |
| Public Trust establishment fees (\$3,000) and relocation costs for transferring staff to new premises (\$75,000) | 0.1               |
| Additional banking fees*   | 0.6               |
| <b>Total cost of implementing the Proposed Internalisation</b>   | <b>21.8</b>       |

\* On 30 May 2011 Argosy's banking syndicate comprising ANZ (as Facility Agent, Security Trustee, Arranger and Lead Manager), BNZ and HSBC, agreed to increase Argosy's Loan to Valuation Ratio<sup>12</sup> (**LVR**) covenant from 45% to 50%, along with other minor variations to the loan facility agreement. As part of the amendments Argosy agreed to pay the Facility Agent on 30 September 2011 an arrangement fee of 0.075% of the facility limit (or \$337,500). However, as the Proposed Internalisation involves a change of Manager thereby triggering an "event of review" under the banking facility, Argosy has agreed to pay the Facility Agent an increased arrangement fee of 0.20% if the Proposed Internalisation proceeds (or \$900,000 rather than the 0.075% which applies if the Proposed Internalisation does not eventuate), an additional one-off expense of \$562,500.

<sup>12</sup> The ratio of net debt to the market value of the Trust's properties.

## 7.4 The Financial Impact of Proposed Internalisation

- The forecast earnings for the Trust for the financial year ending 31 March 2012 are set out below together with a pro-forma post Proposed Internalisation forecast. The forecast is based on the following assumptions:
  - the sale of approximately \$52 million of property during the course of the financial year;
  - stand alone operating expenses based on management’s forecasts;
  - a marginal borrowing cost of 4%; and
  - in the “Post Proposed Internalisation” case the payment of the \$20 million Termination Payment.

Grant Samuel has not reflected the benefit of the potential tax deductibility of the Termination Payment or the payment of the \$1.8 million one-off transaction costs in the table below:

| Trust – Financial Profile pre and post Proposed Internalisation (\$000s) |  |                          |
|--|--|--------------------------|
| Year ending 31 March 2012  | Forecast                                   | Pro-Forma Post           |
|  | Pre-Proposed Internalisation <sup>13</sup> | Proposed Internalisation |
| Gross rental income  | 77.1                                       | 77.1                     |
| Net property expenses  | (4.4)                                      | (2.8)                    |
| <b>Net property income</b>   | <b>72.7</b>                                | <b>74.3</b>              |
| Operating expenditure  | (8.4)                                      | (6.2)                    |
| <b>Operating profit</b>  | <b>64.3</b>                                | <b>68.1</b>              |
| Net interest expense   | (30.3)                                     | (31.1)                   |
| <b>Earnings Before Tax<sup>14</sup></b>                                  | <b>34.0</b>                                | <b>37.0</b>              |
| <b>Earnings per unit (cents)</b>   | <b>6.2</b>                                 | <b>6.7</b>               |
| Net tangible assets  | 513.4                                      | 493.4                    |
| <b>NTA per unit (cents)</b>  | <b>93.1</b>                                | <b>89.4</b>              |
| <b>LVR %</b>   | <b>39.3%</b>                               | <b>41.5%</b>             |

- **impact on earnings per unit.** The Proposed Internalisation of the Management Rights results in an increase of 0.5 of a cent in earnings per unit from 6.2 cents per unit to 6.7 cents per unit;
- **impact on NTA per unit.** The Termination Payment will result in a decrease in the NTA of the Trust of approximately 3.75 cents per unit from 93.1 cents to 89.4 cents; and
- **impact on LVR.** If the Proposed Internalisation proceeds, gearing will increase from 39.3% to 41.5%, an increase of 2.2%.

<sup>13</sup> Latest management forecast as at 20 July 2011 for the year ending 31 March 2012

<sup>14</sup> Excluding abnormal one off expense of the \$20 million Termination Payment and \$1.8 million of one off transaction costs

## 7.5 Implications if the Proposed Internalisation proceeds

### *Advantages for Unit Holders*

- **No further management fees will be payable.** The Manager currently receives the following management fees:
  - a base fee of 0.60% of the Gross Value of the Trust per annum; plus
  - property management fees paid to OnePath; plus
  - an incentive fee based on quarterly Unit Holder returns.

If the Proposed Internalisation is approved by Unit Holders by passing Resolutions 1, 2 and 3 no further fees will be payable to the Manager. The New Manager will be appointed and will instead be entitled to the recovery of its costs by way of reimbursement out of the Trust fund. The total fees payable by the Trust to the Manager for the year ended 31 March 2011 were \$7.4 million. The internalisation is expected to yield significant cost savings for the Trust both initially and over time, approximately \$3.8 million per annum. The reduction in management costs should enhance Unit Holder returns provided adequate controls on the costs are put in place;

- **enhanced governance structure with greater control available to Unit Holders.** The current role of the Manager is to manage the Trust in accordance with the Trust Deed and the law. Ultimate responsibility for corporate governance of the Trust currently resides with the Board of Directors of the Manager. Both the Manager's Constitution and the Trust Deed govern the Board's actions and conduct. OnePath, in its capacity as shareholder of the Manager, appoints the Board of Directors with two representatives (of the total of 5) being appointed at the direction of Unit Holders. The establishment of a New Manager with the shares held by Public Trust will result in a material improvement in Unit Holders' control over the day-to-day management of the affairs of the Trust. If the Proposed Internalisation proceeds, Unit Holders will be responsible for the appointment of all of the Directors of the New Manager. The Public Trust will give effect to directions given by the Unit Holders. If the Proposed Internalisation is successful the Directors of the New Manager will set the strategic direction of the Trust and manage it as they see fit. The Board will have the power to remunerate and appoint the senior executive team and to determine the cost structure of the New Manager;
- **retention of operational knowledge.** The Proposed Internalisation envisages the direct employment by the New Manager of the majority of the current OnePath employees involved in the day-to-day management of the Trust and its assets, together with entering into various transitional arrangements between OnePath and the Manager for systems and support. An advantage of this proposal when compared with removing the Manager and appointing a temporary manager is the retention of management knowledge, systems, records and files which will ensure a smooth transition from external management to an internal management model. In addition, the Proposed Internalisation affords the Trust the ability to optimise its management team to ensure that the Trust is managed and operated in the most efficient way possible. OnePath will bear the cost of any redundancy obligations arising in relation to any staff that are not transferring to the New Manager;
- **improvement in the unit price of the Trust.** If the Proposed Internalisation proceeds it is possible that the unit price of Argosy will be re-rated (to the extent this has not already occurred due to the announcement of the Proposed Internalisation) and the discount to NTA at which Argosy units trade may narrow. Argosy will become a more attractive takeover target in the event the Proposed Internalisation proceeds. The internalisation of the Management Rights ensures that any potential acquirer of the Trust is guaranteed to secure control over the Management Rights also, which would not be the case under an externally managed model where the owner of the manager would be able to control if, and to whom, the Management Rights were sold. As a result the Trust should also attract a greater takeover premium if the Proposed Internalisation proceeds (if such a takeover eventuated). In addition, the Proposed Internalisation is earnings accretive to the Trust (improving

annual earnings per unit by 0.5 of a cent) which should also have a positive influence on the unit price; and

- **greater control over the future management of the Trust.** The existing management structure allows the Manager to determine whether and to whom the Management Rights are sold, with the Trustee and Unit Holders having certain rights to remove the Manager. A consequence of the structure of the Proposed Internalisation when compared to other similar transactions in New Zealand is that the Unit Holders of Argosy will obtain control over the Management Rights and will have the ability to direct the Public Trust to terminate the New Manager and appoint another manager in the unlikely event this were desirable. If the Proposed Internalisation proceeds the Unit Holders will determine whether and to whom the Management Rights are sold.

### **Risks for Unit Holders**

- **Cost escalation risk.** A key focus of the Board of Directors will be ensuring that sufficient controls exist on the management costs of the Trust following the implementation of the Proposed Internalisation. Unlike the external management model, there is no fee cap on the manager and no explicit incentive to ensure that costs are minimised. This is because, in the case of internal management, all costs are on-charged to the Trust and the New Manager is not expected to generate a profit. However there are several important mitigating factors to this perceived risk:
  - the Trust Deed provides that “The Manager shall use its best endeavours to ensure that the Trust is carried on in a proper and efficient manner”. The amendments to the Trust Deed provide further clarity to this requirement stating that “The Manager shall operate its own business efficiently, with a view to maintaining its costs at a minimum level consistent with the effective conduct of its business with no intention for the Manager to operate at a profit over the course of any Financial Year”;
  - if the Proposed Internalisation proceeds there will be no incentive to act in anything other than the best interests of the Trust as the Directors of the New Manager will be appointed at the discretion of the Unit Holders of the Trust (rather than by investors in the management company);
  - in the event serious concerns arise regarding either the conduct of the New Manager or the costs being incurred by the New Manager in managing the Trust, the Trustee and the Unit Holders will retain their right to remove the New Manager; and
  - the Directors of the New Manager intend to regularly benchmark the operating costs of the New Manager against other industry participants to ensure it is operated in as cost efficient manner as practicable. Under the terms of the revised Trust Deed the New Manager will have the responsibility for approving such costs.
- **Gearing risk.** The Trust will need to borrow additional funds, at least in the short term, to terminate the Management Rights (\$21.8 million additional borrowings in total being the Termination Payment plus one-off costs associated with the Proposed Internalisation). This is estimated to increase borrowing costs by \$0.9 million per annum assuming the Trust’s marginal cost of funding of 4%. The additional borrowings will be reduced by property sales, the proceeds of which will be used to repay debt in order to lower the gearing level of the Trust. This will have the effect of reducing rental income over time. The Trust is already relatively highly geared. The gearing of the Trust is forecast to increase by 2.2% (to 41.5%) if the Proposed Internalisation proceeds. The Proposed Internalisation will limit Argosy’s ability to make property acquisitions or fund development expenditure with debt. If any significant expenditure is required or desirable following the Proposed Internalisation, Argosy may need to consider an equity raising;
- **Reduction in NTA.** The Proposed Internalisation will result in the payment of \$20 million to the Manager which will have a direct impact on the Trust’s NTA. The reduction in NTA per unit if the Termination Payment is made will, be approximately 3.75 cents per unit. This may have an impact on the acquisition price per unit achievable by Unit Holders in the event of a takeover offer or merger; and

- **Performance of OnePath employees.** The Proposed Internalisation involves the employment of substantially all of the OnePath employees currently involved in the day-to-day management of the Trust, including general manager Peter Mence. In the event Unit Holders do not believe the Manager has been performing to an appropriate standard, the Proposed Internalisation is unlikely to result in a significant enhancement in the performance of the individual management team members. Unit Holders will be able to control the appointment of the Directors of the New Manager who in turn will monitor the performance of the New Manager's employees. In the first instance the Directors of the New Manager will be the current Directors of the Manager.

#### **Other implications**

- **The Trust will remain listed.** If the Proposed Internalisation proceeds the Trust will continue to be a unit trust listed on the NZSX with substantially the same Unit Holder base;
- **No impact on the Trust's strategy going forward.** Following the Proposed Internalisation Argosy will continue to progress the sale of investment properties in order to reduce its gearing. The day-to-day strategy and operation of the Trust are unlikely to change materially; and
- **No impact on ability to merge or corporatise.** The implementation of the Proposed Internalisation will not restrict the Trust's ability to merge with DNZ or any other party. In fact it may enhance the opportunities for a takeover or merger. Ultimately the decision on whether or not to pursue a merger is for all of the Unit Holders of the Trust. One of the potential consequences the Proposed Internalisation will have on a potential merger is the impact that the Termination Payment has on the NTA of Argosy for the purposes of establishing an appropriate exchange ratio for Argosy units if NTA is the basis of a transaction. Although the Proposed Internalisation does not contemplate a corporatisation of the trust structure of Argosy, the Proposed Internalisation does not restrict Argosy's ability to corporatise at a later date.

## 7.6 Alternatives to the Proposed Internalisation

Grant Samuel has considered the following alternatives to the Proposed Internalisation:

- Internalise and corporatise simultaneously;
- Third party ownership of the Management Rights;
- Retention of the status quo;
- Unit Holders voting to remove the Manager; and
- The Trustee certifying that it is in the interests of Unit Holders that the Manager cease to hold office.

In addition to the above alternatives are the alternatives contemplated under the Alternative Proposals. These are considered in detail at Section 8 of this report.

### *Internalise and corporatise simultaneously*

- **The Proposed Internalisation does not involve corporatisation.** The only two New Zealand listed property vehicles that have internalised management structures – NPT Limited (**NPT**) and DNZ – are both corporatised entities. The Proposed Internalisation does not involve the corporatisation of the trust structure simultaneous with the acquisition of the Management Rights (although it also does not preclude corporatisation occurring at a later date);
- **Two options available for internalisation.** As discussed elsewhere in this report the Trust is required under the Unit Trusts Act 1960 to have a trustee that is separate from the manager of the Trust. As a result, the two options available to the Trust in order to acquire the Management Rights are corporatisation of the Trust and a termination or purchase of the Management Rights by the newly created company, thereby avoiding the Unit Trusts Act requirement by becoming a company rather than a unit trust, or the adoption of the Public Trust shareholding structure contemplated by the Proposed Internalisation; and
- **Retention of trust structure a function of potential competitive process.** The rationale behind the retention of the trust structure was to enable the Trust to participate in a timely and efficient manner in the competitive sale process being proposed by OnePath in relation to the Management Rights. The Trust did not wish to disadvantage itself in the competitive process by proposing a potentially lengthy corporatisation proposal.

The benefits and disadvantages of the structure contemplated as part of the Proposed Internalisation include:

- **Lower establishment costs but higher ongoing costs.** The establishment costs under the Proposed Internalisation are lower than establishing a corporate structure. Importantly however, the ongoing Trustee fees of \$0.3 million per annum will continue to be incurred and an additional \$15,000 per annum (plus time incurred on an hourly basis for extra attendances) will be paid to Public Trust. No such fees would be required if the Trust were corporatised;
- **Greater control over the future of the New Manager.** Unlike a corporate structure where shareholders can influence only the appointment and removal of Directors, under the Proposed Internalisation the Unit Holders of the Trust will have the right to direct the appointment and removal of the Directors of the New Manager and to direct the Public Trust to sell some or all of the shares in the New Manager. The Proposed Internalisation enables Unit Holders to retain control over the manner in which the Trust is managed and whether and to whom the Management Rights are sold. Under a corporate structure the separation of the management rights from the company would be an unlikely outcome;
- **Retention of Trustee.** The retention of the trust structure under the Proposed Internalisation also has the effect of retaining the oversight of the Trust's affairs by the Trustee which Unit Holders may see value in; and

- **No protection from the rules of Takeovers Code as a trust.** A disadvantage of a unit trust structure when compared with a corporate structure is that the provisions of the Takeovers Code do not cover unit trusts. This may have negative implications for minority Unit Holders in the event a takeover or merger proposal (such as the DNZ Proposal) is made, as the provisions of the Takeovers Code are more comprehensive than the takeover provisions of the NZSX Listing Rules that only apply to listed trusts.

#### **Third Party ownership of the Management Rights**

In the event the Proposed Internalisation does not proceed, it would be reasonable to expect that the existing Management Rights may be sold to a third party. Third party ownership of the Manager may produce several outcomes for Unit Holders:

- **No control over who acquires Management Rights.** The Unit Holders would have no ability to control which third party the Management Rights were sold to and accordingly, would have to accept whichever third party purchaser was successful. This third party may or may not produce higher Unit Holder returns or manage the Trust's affairs in a more efficient manner;
- **Loss of continuity.** There is the risk that, depending on which third party secured the Management Rights, a loss of continuity of knowledge could occur if employees currently managing the Trust were not employed by the third party; and
- **Disadvantages of external management continue to apply.** All of the disadvantages of external management (ie: higher costs, lack of control over the direction of the Trust, lack of transparency, impediments to takeover and lack of control over whether or to whom the Management Rights are on-sold) will remain.

#### **Retention of the status quo**

Another alternative if the Proposed Internalisation does not proceed is that the status quo prevails. If this occurs the Manager will continue to manage the Trust under the existing Trust Deed and Property Management Agreements and to receive the management fees prescribed under these arrangements. The Trust will continue to operate under an external management model with all of the attendant risks and disadvantages, principally the risk that the Manager could, at any time, elect to sell the Management Rights to whomever it decides. Given the attention the internalisation of Argosy is receiving and the actions taken by some Unit Holders to request the Trustee terminate the Management Rights and consider the Alternative Proposals it is highly unlikely, in Grant Samuel's opinion, that the status quo will remain for long.

### **Unit Holders voting to remove the Manager**

- **Voting to remove the Manager will not achieve internalisation.** An alternative to the Proposed Internalisation could be to call a meeting of Unit Holders and propose a vote to remove the Manager under Section 18 of the Unit Trusts Act 1960. If 75% of units voted on the resolution (held by the holders of at least 25% of the units in the Trust) were in favour of the resolution the resolution would be passed and the Manager would be required to immediately desist from all activities regarding the Trust. The Unit Trusts Act requires a unit trust to have a manager at all times and the Trustee would be required to appoint a new temporary manager immediately following the vote to remove the Manager. Assuming the underlying reason for wishing to remove the Manager is to internalise the management functions within the Trust, a Section 18 Resolution would not achieve the desired outcome;
- **Removing the Manager by way of a Section 18 Resolution would be disruptive.** It is unlikely that the existing Manager would cooperate in any transition to a new temporary manager in the event it was removed by way of a Section 18 Resolution. The Manager can be required under the terms of the Trust Deed to provide the Trustee with any information relating to the operation of the Trust at the request of the Trustee. However, to obtain the necessary records the Trustee would need to make such a request prior to the passing of the Section 18 Resolution to remove the Manager. The management of a property portfolio requires established corporate knowledge of the portfolio, access to documents and records, and to a degree relies on established relationships between the tenant and the manager. The risks associated with a dismissal of the Manager include the potential disruption likely to be caused to the day-to-day operation of the Trust's business, the lack of internal systems and management available to operate the Trust and the potential loss of knowledge and information regarding the property portfolio. Any temporary manager would need to undertake various operational tasks in a very short time frame, such as hiring staff, reviewing operational processes, establishing systems, purchasing software and preparing financial reports. Tenants seeking renewals, extensions or to renegotiate their leases may find it difficult to do so whilst the temporary manager is coming to terms with the portfolio and the requirements of its day-to-day operation. The cost of transitioning to a temporary manager and any subsequent internalisation of the management will be a cost to the Trust. Removing the existing Manager by way of such a vote of Unit Holders, appointing a new transitional manager, and transitioning to an internalised management structure would be an expensive and disruptive process, even more so without the cooperation of the existing Manager;
- **The situation regarding the Property Management Agreements is unclear.** Certain aspects of the management of the Trust's property are carried out directly by OnePath under separate Property Management Agreements with OnePath which cannot be terminated (absent a breach or liquidation type event) unless mutually agreed, and are not due to expire until late 2012 and 2013 respectively. However the counterpart to the Property Management Agreements is the Manager (on behalf of the Trust). If the Manager were removed it is unclear whether these agreements would survive the dismissal of the Manager or whether OnePath would be able to cancel the Agreements. If the Property Management Agreements remained in force the Trust would be obliged to reimburse OnePath for all ongoing expenses incurred in relation to the Property Management Agreements for the next 1.5 to 2.5 years adding a further cost of approximately \$1.6 million per annum (assuming that the current property management fees were not increased). The corollary is that OnePath would remain contractually bound to continue in the role of property manager until the end of the term of the contract. If the Property Management Agreements were to survive, and the property management services continued to be carried out adequately by OnePath, the extent of the disruption would be reduced. The Property Management Agreements do not appear to contemplate a situation where the Manager is dismissed by a vote of Unit Holders. The uncertainty arising from the potential dismissal of the Manager is an unsatisfactory situation which Unit Holders will need to factor into their decision making;
- **Cost of removing the Manager by way of a Section 18 Resolution of Unit Holders.** In the event a Section 18 Resolution to remove the Manager is passed, the Trust Deed requires a payment

to be made to the Manager of 1.2% of the Gross Value of the Trust plus 10% of the Available Excesses. This cancellation payment is currently estimated at \$21.3 million, which is higher than the proposed Termination Payment. Due to the way in which the Available Excesses are calculated, the cancellation payment falls to an estimated \$11 million in the event the Section 18 Resolution is passed after 30 September 2011. It is possible that the lower cancellation payment and costs of appointing a new temporary manager could be less than the \$20 million Termination Payment but the risk of disruption and unknown variables would need to be considered carefully. Additional costs would also be incurred subsequently if Unit Holders wished to internalise the management of the Trust following the appointment of a temporary manager. Grant Samuel, in conjunction with the Independent Directors, has estimated the costs involved in passing a Section 18 Resolution to remove the Manager to be as follows:

| <b>Costs Associated with Removing the Manager by Section 18 Resolution (\$m)</b> |  |   |
|--|--|---|
|  | <b>Resolution pre<br/>30 Sept 2011</b> | <b>Resolution post<br/>30 Sept 2011</b> |
| Compensation payable to Manager  | 21.3                                   | 11.0                                    |
| Cost of engaging a new temporary manager (one-off engagement fee)                | 1.0                                    | 1.0                                     |
| Fees payable to temporary manager <sup>15</sup>                                  | 3.7                                    | 3.7                                     |
| Costs associated with rebuilding property management database and records        | 1.2                                    | 1.2                                     |
| Additional legal and Trustee fees  | 1.0                                    | 1.0                                     |
| Recruitment and employment costs for new management team                         | 1.0                                    | 1.0                                     |
| Business disruption, loss of tenants and additional costs                        | Unknown                                | Unknown                                 |
| Value losses associated with portfolio mismanagement/management absenteeism      | Unknown                                | Unknown                                 |
| Costs associated with subsequent internalisation                                 | Unknown                                | Unknown                                 |
| <b>Estimated costs of removing the Manager by Section 18 Resolution</b>          | <b>29.2</b>                            | <b>18.9</b>                             |

It is possible that these costs could be significantly more or less. Importantly, the above table does not take into account the additional costs associated with business disruption, loss of tenants, value lost due to portfolio mismanagement and the costs associated with internalising the management following the termination of the Manager and the appointment of a temporary manager;

- **Argosy may need to be refinanced.** A change in the manager, or a change in the control of the Manager, is an event of review under Argosy's loan facility agreement which provides the Trust's lenders with certain powers to renegotiate the facility. A removal of the Manager by a Section 18 Resolution could also be an event of default under Argosy's loan facility agreement in certain circumstances. In Grant Samuel's opinion it is possible that the removal of the Manager by Unit Holder vote will influence the manner in which ANZ, as both the ultimate shareholder of the Manager and the primary lender in Argosy's banking syndicate, views Argosy's credit profile; and
- **OnePath has limited ability to control the outcome of a Section 18 Resolution.** There are a number of examples of managers of unit trusts holding significant stakes in the listed vehicles they manage in order to prevent the passing of a Section 18 Resolution to remove them from office. In the case of Argosy, any resolution to remove the Manager from office would require the support or abstention of MFL Mutual Fund Limited (**MFL**) and Superannuation Investments Limited (**SIL**) (who are both managed by OnePath) and who together hold 26.4% of the units in Argosy. OnePath, as manager of MFL and SIL, could theoretically prevent a Section 18 Resolution from being passed. However, OnePath must at all times act in the best interest of the MFL and SIL investors, and a resolution to internalise management may well be in the best interests of all Argosy Unit Holders (including MFL and SIL). In addition, Grant Samuel understands that the independent directors of MFL and SIL have the power to direct OnePath regarding the manner in which it votes on such resolutions in its capacity as manager of MFL and SIL, which Grant Samuel understands has been exercised in the past.

<sup>15</sup> This conservatively assumes a 6 month transition period to internalisation. Unless the Trust Deed is amended simultaneously, the new temporary manager would be entitled to the fees stipulated in the Trust Deed that are currently paid to the Manager. The property management fees under the Property Management Agreements would also continue to be payable if the Property Management Agreements survived.

## **Removal of the Manager by the Trustee**

Section 19(2) of the Unit Trusts Act 1960 provides the Trustee with the power to remove the Manager if the Trustee certifies that it is in the interests of Unit Holders that the Manager should cease to hold office. This alternative is being proposed as part of the Institutional Unit Holders' Proposal. The merits of a Section 19(2) removal of the Manager by the Trustee are similar to those outlined in the above section "Unit Holders voting to remove the Manager". Specifically:

- **A Section 19(2) removal of the Manager by the Trustee does not achieve internalisation.** As with a Section 18 Resolution the Manager would, immediately upon the Trustee making its certification, cease to hold office and a temporary manager would need to be appointed. Assuming the underlying reason for wishing to remove the Manager is to internalise the management functions within the Trust, a Section 19(2) Resolution would not achieve the desired outcome;
- **A removal of the Manager by the Trustee would be disruptive.** It is unlikely that the existing Manager would cooperate in any transition to a new temporary manager in the event it were removed by way of a Section 19(2) certification by the Trustee. The Manager can be required under the terms of the Trust Deed to provide the Trustee with any information relating to the operation of the Trust at the request of the Trustee. However, to obtain the necessary records the Trustee would need to make such a request prior to making its certification under Section 19(2). The management of a property portfolio requires established corporate knowledge of the portfolio, access to documents and records, and to a degree relies on established relationships between the tenant and the property manager. The risks associated with a dismissal of the Manager include the potential disruption likely to be caused to the day-to-day operation of the Trust's business, the lack of internal systems and management available to operate the Trust and the potential loss of knowledge and information regarding the property portfolio. Any temporary manager would need to undertake various operational tasks in a very short time frame, such as hiring staff, reviewing operational processes, establishing systems, purchasing software and preparing financial reports. Tenants seeking renewals, extensions or to renegotiate their leases may find it difficult to do so whilst the temporary manager is coming to terms with the portfolio and the requirements of its day-to-day operation. The cost of transitioning to a temporary manager and any subsequent internalisation of the management would be a cost to the Trust. A removal of the existing Manager by the Trustee, appointing a new transitional manager, and transitioning to an internalised management structure would be an expensive and potentially disruptive process, even more so without the cooperation of the existing Manager;
- **The situation regarding the Property Management Agreements is unclear.** Certain aspects of the management of the Trust's property are carried out directly by OnePath under separate Property Management Agreements with OnePath which cannot be terminated (absent a breach or liquidation type event) unless mutually agreed, and are not due to expire until late 2012 and 2013 respectively. However the counterpart to the Property Management Agreements is the Manager (on behalf of the Trust). If the Manager were removed it is unclear whether these agreements would survive the dismissal of the Manager or whether OnePath would be able to cancel the Agreements. If the Property Management Agreements remained in force the Trust would be obliged to reimburse OnePath for all ongoing expenses incurred in relation to the Property Management Agreements for the next 1.5 to 2.5 years adding a further cost of approximately \$1.6 million per annum (assuming that the current property management fees were not increased). The corollary is that OnePath would remain contractually bound to continue in the role of property manager until the end of the term of the contract. If the Property Management Agreements were to survive, and the property management services continued to be carried out adequately by OnePath, the extent of the disruption would be reduced. The Property Management Agreements do not appear to contemplate a situation where the Manager is dismissed by the Trustee. The uncertainty arising from the potential dismissal of the Manager is an unsatisfactory situation which Unit Holders will need to factor into their decision making;

- **Removal of the Manager by the Trustee for no consideration would still result in costs being incurred.** A detailed discussion of these potential costs is outlined at Section 4 of this report. Grant Samuel estimates the quantifiable costs could be as much as \$7.9 million. Further costs may also be incurred as a result of business disruption, loss of tenants, potential litigation, and the subsequent internalisation of management. Unit Holders should have regard to Section 4 when considering the merits of a removal of the Manager by the Trustee;
- **Removal of the Manager by the Trustee may result in litigation.** In Grant Samuel's opinion the litigation risk associated with a removal of the Manager by the Trustee is significant on the basis that it would be difficult to point to a sound commercial reason for such a removal given the already negotiated cancellation of the Management Rights. In all likelihood the Manager would seek, as a minimum, the compensation to which it would have been entitled had a Section 18 Resolution to remove the Manager been passed. Due to the provisions of the Trust Deed that indemnify the Trustee for all costs, other than those incurred where the Trustee acts in breach of its duty of care as a Trustee, the costs of such litigation and any settlement would be paid by the Trust which would ultimately be a cost to Unit Holders;
- **Argosy may need to be refinanced.** A change in the manager, or a change in the control of the Manager, is an event of review under Argosy's loan facility agreement which provides the Trust's lenders with certain powers to renegotiate the facility. In Grant Samuel's opinion it is possible that the removal of the Manager by Unit Holder vote will influence the manner in which ANZ, as both the ultimate shareholder of the Manager and the primary lender in Argosy's banking syndicate, views Argosy's credit profile; and
- **Likelihood of the Trustee removing the Manager.** Grant Samuel is not aware of any instance where a Trustee in similar circumstances has exercised its discretion under Section 19(2) of the Unit Trusts Act and believes that the Trustee may find it difficult to form the opinion that termination is in the interests of Unit Holders. In its letter to Unit Holders dated 19 July 2011 the Trustee has stated that at this stage it does not believe that there is sufficient reason to form a view that it is in the interest of Unit Holders that the Manager be removed. The Trustee may change this view at any time.

## 7.7 Implications if the Proposed Internalisation does not proceed

If the Proposed Internalisation does not proceed there are five potential outcomes:

- **Maintenance of the status quo.** In Grant Samuel's opinion the status quo is unlikely to continue given OnePath's desire to sell the Management Rights and moves by some Unit Holders to remove the Manager. However, if the status quo prevails:
  - the Trust will continue to be managed by the Manager;
  - the Manager will still be at risk of being removed by way of a Section 18 Resolution of Unit Holders or by the Trustee;
  - OnePath will control if and to whom the Management Rights are sold (in the event Unit Holders do not pass a Section 18 Resolution to remove the Manager);
  - no Termination Payment will be made, but the majority of the one-off costs associated with the Proposed Internalisation will still be incurred (other than the additional banking fees of \$0.6 million);
  - there is likely to be little noticeable difference in the operation of the Trust; and
  - the Trust's units are likely to continue to trade at a discount to NTA.
- **OnePath sells the Management Rights to an unknown third party.** If this occurs, management fees will continue to be payable to the third party under the terms of the Trust Deed. Property management fees would also continue to be payable by the Trust to either OnePath or the third party (for at least the next three years). There is no certainty regarding the operational performance of a third party owner of the Management Rights who may carry out the management of the Trust more effectively or less effectively than the current Manager. Under this scenario, all of the benefits of internalisation are lost, and all of the disadvantages of the external management model (as described above) will continue to apply;
- **Unit Holders vote to remove the Manager.** As described above, if this were to occur the Trustee would need to appoint an interim manager to satisfy the requirement of the Unit Trusts Act for the Trust to have a manager at all times. Ultimately internalisation may be able to be effected, but as previously noted, the Property Management Agreements with OnePath are likely to remain in full force. Voting to remove the Manager may result in lower costs being incurred (provided such a Unit Holder vote took place after 30 September 2011), however, the incidental costs associated with appointing an interim manager and establishing the necessary staff and systems to subsequently internalise the management of the Trust are unknown and could be significant;
- **Trustee certifying that it is in the interests of Unit Holders that the Manager cease to hold office.** If this were to occur the Trustee would need to appoint an interim manager to satisfy the requirement of the Unit Trusts Act for the Trust to have a manager at all times. Ultimately internalisation may be able to be effected but it is unclear how long this would take and what cost would be involved. If the Trustee removes the Manager no compensation is payable to the Manager, however the risk of litigation against the Trustee by the Manager or Unit Holders is significant. Due to the provisions of the Trust Deed that indemnify the Trustee for all costs, other than those incurred as a result of breach of trust, the costs of such litigation would be a cost to the Trust which would ultimately be a cost to Unit Holders. Grant Samuel estimates that excluding litigation costs, business disruption, loss of tenants, and the cost of any subsequent internalisation the additional costs could be as much as \$7.9 million; or
- **The DNZ Proposal is pursued.** If the Proposed Internalisation does not proceed it is possible that the DNZ Proposal will be progressed. The Alternative Proposals, including the DNZ Proposal, are discussed in detail at Section 8 below.

## 7.8 Voting in favour of or against the Proposed Internalisation

Voting in favour of or against the Proposed Internalisation is a matter for individual Unit Holders based on their own view of the merits of the Proposed Internalisation when compared to the alternatives. Unit Holders will need to consider the merits outlined in this report and the Notice of Meeting and, if appropriate, consult their own professional adviser(s). Unit Holders wishing to vote for the Proposed Internalisation should vote in favour of Resolutions 1, 2 and 3 and against Resolutions 4 to 10.

## 7.9 Conclusion

**In Grant Samuel's opinion the terms and conditions of the Proposed Internalisation are fair to Unit Holders not associated with OnePath and the Proposed Internalisation is in the best interests of Unit Holders.**

The Proposed Internalisation is a robustly negotiated proposal on commercial terms that ensures an orderly transition from external management to an internally managed business documented by a legal agreement binding on both parties. The Proposed Internalisation ensures a transfer of systems and records and OnePath employees engaged in the management of the Trust's properties would be offered continued employment with the New Manager.

The \$20 million payment to the Manager contemplated by the Proposed Internalisation is at the lower end of Grant Samuel's value range for the Management Rights of between \$19.7 million and \$23.7 million, which has been based on the estimated price a third party purchaser would pay to secure the management rights today. The value to the Trust of internalising its management is significantly greater than the \$20 million being paid due to the annual cost savings it will achieve (a net after interest of approximately \$2.9 million per year) and also in part to the perpetual nature of the internalisation when compared with the risk of removal associated with external management.

The Proposed Internalisation is earnings accretive to the Trust and should have a positive impact on the unit price of the Trust to the extent this has not already been factored in to the current unit price. The Proposed Internalisation will also improve the control Unit Holders have over the Trust and its day-to-day operations.

Internalisation of the management of the Trust is in the best interests of Unit Holders. Proposals that do not achieve internalisation are, in Grant Samuel's opinion, sub-optimal.

The alternatives to the Proposed Internalisation do not achieve an orderly transition and, in all likelihood, could be more expensive to the Trust than the proposed Termination Payment of \$20 million (or \$15.2 million if the present value of the potential tax benefit is taken into consideration). The risks associated with the various unknowns such as business disruption in the case of a Section 18 Resolution to remove the Manager or a removal of the Manager by the Trustee, and the cost of potential litigation in the latter case, are potentially significant. The extent and cost of the business disruption or litigation is difficult, if not impossible, to determine and due to the provisions of the Trust Deed that indemnify the Trustee for costs incurred, the cost of any litigation would ultimately be a cost to the Trust.

In almost all of the alternatives to the Proposed Internalisation, including the Alternative Proposals, a temporary manager would need to be appointed even in the event internalisation was still considered a desirable outcome and the costs of achieving internalisation would be incurred a second time as a significant proportion of the one-off transaction costs regarding the Proposed Internalisation have already been incurred.

# 8. Evaluation of Alternative Proposals

## 8.1 Evaluation of the Institutional Unit Holders' Proposal (Resolution 4)

- **Effect of Resolution 4.** ACC, NZ Super and Westpac/BT have required the Manager to put resolutions to a meeting of Unit Holders that, in summary, have the following effect:
  - that Unit Holders record that it is their view that the Manager ceasing to hold office would be in Unit Holders interests;
  - that Unit Holders request the Trustee to consider, as a matter of urgency, exercising its discretion to certify that it is in the interests of Unit Holders that the Manager cease to hold office; and
  - that the Trustee appoint a new manager conditional on that new manager preparing a proposal for the internalisation of management for consideration by Unit Holders and agree to assist and support a transition from the new manager to an internally managed model.
- **Trustee not obliged to act on Resolution 4.** If Unit Holders pass this resolution the Trustee is not obliged to follow Unit Holders' wishes. Section 19(2) of the Unit Trusts Act (which gives the Trustee the power to remove the Manager if it certifies that such a removal is in the interests of Unit Holders) does not require Unit Holders to vote on the matter. Rather, the Trustee must exercise its discretion to determine whether the Manager ceasing to hold office is in the interests of Unit Holders;
- **Resolution 4 does not achieve internalisation immediately.** The merits of a removal of the Manager by the Trustee are discussed in detail on page 42 of this report under the heading "Removal of the Manager by the Trustee" and should be read by Unit Holders when considering how to vote in respect of Resolution 4. No compensation is payable to the Manager if the Trustee certifies that it is in the interests of Unit Holders that the Manager cease to hold office. Importantly, however, a removal of the Manager by the Trustee is not a "zero-cost" option and Grant Samuel estimates that excluding litigation costs, business disruption, loss of tenants, and the cost of any subsequent internalisation the additional costs could be as much as \$7.9 million. The removal of the Manager by the Trustee under Section 19(2) of the Unit Trusts Act places a significant responsibility on the Trustee requiring, as it does, the removal of the existing Manager for no compensation and the appointment of a temporary manager. It could open the Trustee to legal action from the Manager and potentially from Unit Holders if there is a loss in value in the Trust for whatever reason following the removal of the existing Manager. By virtue of the Trust indemnifying the Trustee for all costs incurred in its capacity as Trustee of the Trust (other than those incurred where the Trustee acts in breach of its duty of care as a Trustee), the cost of any such litigation would be a cost to the Trust;
- **The Trustee has indicated it does not believe there is a reason for it to dismiss the Manager at this stage.** The Trustee in a letter to Unit Holders on 19 July 2011 stated:

*"At this stage we do not believe that there is reason to form a view that the Manager should be removed. In reaching this conclusion, we took into account all factors known to us to date, including:*

  - *The potential impact on the investors who have chosen the Trust as an investment over other property trusts presumably based on the identity of the Manager and its track record;*
  - *The fact that we are not aware of the Manager being in breach of any of its obligations under the Trust Deed nor has it failed to carry out its duties to the satisfaction of the Trustee; and*
  - *The substantial direct and indirect costs of terminating the Manager, such as identifying and appointing an alternative temporary manager, transitioning between the two, and subsequently selecting, appointing and transitioning to a new permanent manager, as well as a significant degree of disruption that is likely to arise if the Manager were not to co-operate with the transition following its removal."*

The Trustee may change this view at any stage.

***Voting in favour of or against the Institutional Unit Holders' Proposal***

Voting in favour of or against the Institutional Unit Holders' Proposal is a matter for individual Unit Holders based on their own view of the merits of the Institutional Unit Holders' Proposal when compared to the Proposed Internalisation and the 24 June Proposal. Unit holders will need to consider the merits outlined in this report and the Notice of Meeting and, if appropriate, consult their own professional adviser(s). Unit Holders wishing to vote for the Institutional Unit Holders' Proposal should vote in favour of Resolution 4.

## 8.2 Evaluation of the 24 June Proposal (Resolutions 5-10)

The resolutions proposed by a group of Unit Holders (including DNZ, ACC, Westpac/BT, Albany Power and Superlife) on 24 June 2011 are discussed below:

### Resolution 5

- **Purpose of Resolution 5.** Resolution 5 seeks to amend the Trust Deed to make resolutions 6 to 10 (discussed below), if passed, binding on the Manager and the Trustee.
- **Resolution 5 will have no effect.** Under clause 30 of the Trust Deed an amendment to the Trust Deed can only be made if the Manager and the Trustee so agree. The Manager has advised that it believes Resolutions 6 to 10 (outlined below) are misconceived and will not agree to the amendment to the Trust Deed outlined in Resolution 5. Similarly the Trustee has indicated that the effect of Resolution 5 would be to alter the Trust Deed to impose obligations upon the Trustee in relation to ordinary resolutions which is “contrary to the principles inherent in the Trust Deed and the Unit Trusts Act”. The Trustee has also determined that it will not agree to amend the Trust Deed as envisaged by Resolution 5, even if it is passed. As a result of the decisions of the Manager and the Trustee even if Resolution 5 is passed it will have no effect.

### Resolution 6

- **Purpose of Resolution 6.** Resolution 6 seeks to request the Manager to take all reasonable steps to engage with parties who have provided credible Alternative Proposals which have the potential to be in the Unit Holders’ best interests and to appoint an independent adviser to evaluate the merits of any such proposals including the Argosy Internalisation Proposal (which is the subject of Resolutions 1, 2 and 3) and provide a comparative analysis of the merits; and
- **Only two Alternative Proposals have been received and these have already been considered by the Manager.** In Grant Samuel’s opinion the only alternatives that have been put forward are the DNZ Proposal (which is evaluated at Section 8.3 of this report), and the moves by some Unit Holders to request that the Trustee consider exercising its power under Section 19(2) of the Unit Trusts Act to remove the Manager for no consideration (which is evaluated at Section 8.1 of this report). The Manager has indicated that it has already considered alternatives to the Proposed Internalisation and that they will continue to consider and deal with any other reasonable proposals that are made in respect of the Trust, its ownership or management.

### Resolutions 7 and 8

- **Purpose of Resolutions 7 and 8.** These resolutions seek to direct and otherwise request the Trustee to appoint an independent adviser to simultaneously prepare two reports for the Trustee and Unit Holders to:
  - evaluate any Alternative Proposal as referred to in Resolution 6; and
  - determine whether it is in the interests of Unit Holders that the Manager cease to hold office and whether the Trustee should certify pursuant to Section 19(2) of the Unit Trust Act 1960 that it is in the interests of Unit Holders that the Manager should cease to hold office.
- **No liability for Trustee in following the direction of Unit Holders under Resolutions 7 and 8 if passed by the majority required by Section 18 of the Unit Trusts Act.** If Resolution 7 and/or 8 is passed by the majority required by Section 18 of the Unit Trusts Act, they will be directions to the Trustee for the purposes of that section. The Unit Trusts Act provides that if the Trustee complies with any such direction, it shall not be liable for anything done or omitted by the Trustee by reason of following that direction. However, if the Trustee believes that the direction conflicts with any rule of law or is otherwise objectionable it may apply to the High Court for direction on the matter. The Trustee has determined that if Resolutions 7 and 8 are passed as Section 18

Resolutions it will act in accordance with Resolutions 7 and 8 and seek to give effect to them which the Trustee believes may result in the need for it to consider applying to the Court for directions;

- **Alternative Proposals already evaluated in this Independent Report.** The Alternative Proposals as they are currently known have been evaluated in this Independent Report and it is not clear what further evaluation a subsequent independent report may yield unless further details of the DNZ Proposal were forthcoming or new and subsequent alternative proposals put forward; and
- **Regardless of the conclusions reached in such a report, the Manager and the Trustee would not be bound to act.** The merits of a removal of the Manager by the Trustee are outlined on page 42 of this report. Regardless of what the independent adviser determines, the Trustee is not obliged to exercise its powers to remove the Manager under Section 19(2) unless it believes it is in the interests of Unit Holders to do so. The Trustee has indicated that it currently does not believe there is a reason to form the view that the Manager should be removed and would not utilise Section 19(2) of the Act to remove the Manager. However, the Trustee may change this view at any stage.

### Resolution 9

- **Purpose of Resolution 9.** Resolution 9 seeks to prevent the Proposed Internalisation being put to Unit Holders at the Annual Meeting, which is currently scheduled to be held in late August 2011. The Unit Holders that proposed Resolutions 5 to 10 requested a separate meeting of Unit Holders prior to the Annual Meeting in order to prevent the Proposed Internalisation being considered at the time of the Annual Meeting. The Independent Directors have elected to combine the consideration of the 24 June Proposal with the consideration of the Proposed Internalisation at the Annual Meeting; and
- **Resolution 9 even if passed, will have no effect.** Despite recent submissions to the High Court by DNZ to attempt to force an earlier meeting, the Independent Directors believe that in the interests of avoiding additional cost and inconvenience for Unit Holders it is in the interests of Unit Holders that the 24 June Proposal is considered at the same meeting as the Proposed Internalisation. The High Court supported the Independent Directors' position and rejected DNZ's submission. As the Proposed Internalisation (Resolutions 1, 2 and 3) will be put to Unit Holders at the same time Resolution 9 that seeks to prevent the Proposed Internalisation being put to Unit Holders, Resolution 9, even if passed, will have no effect.

### Resolution 10

- **Purpose of Resolution 10.** Resolution 10 requests the Manager to disclose to Unit Holders and the Trustee:
  - details of any exclusivity arrangements which the Manager has entered into with OnePath (or any of its affiliates) in respect of the Proposed Internalisation;
  - details of any voting arrangements with any Unit Holder in relation to the Proposed Internalisation; and
  - full copies of all arrangements relating to the management of the Trust or the management of its properties and all related management or other charges.
- **Resolution 10 is not binding on the Manager.** However, the Manager has indicated that where the resolutions request the Manager to act in a certain way, the Manager will have regard to those requests if passed;
- **No formally documented exclusivity arrangements.** Grant Samuel understands that the exclusivity arrangements entered into with OnePath in respect of the Proposed Internalisation were not formally documented but the understanding between the parties was that OnePath would cease all discussions with third parties and not approach any other party with a view to selling the Management Rights;

- Grant Samuel is not aware of any voting arrangements between the Manager and any Unit Holders in relation to the Proposed Internalisation; and
- The Trust Deed requires the Manager to provide to the Trustee any documents relating to the management of the Trust and its properties on the request of the Trustee. Resolution 10 is seeking to request the Manager to provide such information to the Trustee and the Unit Holders. Although the Manager has indicated that it will have regard to resolutions that request the Manager to act in a certain way (if passed), it is unlikely that the Manager would disclose such confidential and commercially sensitive documents regarding the day-to-day operations of the Trust to the wider pool of Unit Holders.

### **Summary**

Resolutions 5 to 10 are seeking three outcomes:

- to prevent the Proposed Internalisation being considered at the time of the Annual Meeting;
- to direct the Manager and the Trustee to fully evaluate any Alternative Proposals; and
- to terminate the Manager without payment.

***The Proposed Internalisation should be evaluated by Unit Holders.*** In Grant Samuel's opinion all Unit Holders should have the option of evaluating the Proposed Internalisation developed by the Independent Directors. Unit Holders can vote in favour of or against the Proposed Internalisation. Alternative Proposals such as the DNZ Proposal or the Institutional Unit Holders' Proposal can be considered either simultaneously, or subsequent to, a consideration of the Proposed Internalisation.

***To date there are only two Alternative Proposals, both of which have been considered in this report*** – the DNZ Proposal and the proposal by certain Unit Holders to request that the Trustee consider exercising its powers under Section 19(2) of the Unit Trusts Act to remove the Manager for no consideration. The DNZ Proposal will be much easier to implement without disruption and potential loss of value, if internalisation has taken place and, as noted elsewhere in this report, the Trustee has stated that at this stage it does not believe that there is sufficient reason to form a view that it is in the interest of Unit Holders that the Manager should be removed.

### **Voting in favour of or against of the 24 June Proposal**

Voting in favour of or against the 24 June Proposal is a matter for individual Unit Holders based on their own view of the merits of the 24 June Proposal when compared to the alternatives, in particular the Proposed Internalisation. Unit holders will need to consider the merits outlined in this report and the Notice of Meeting and, if appropriate, consult their own professional adviser(s). Unit Holders wishing to vote for the 24 June Proposal should vote in favour of Resolutions 5 to 10 and against Resolutions 1, 2 and 3.

### 8.3 Evaluation of the DNZ Proposal

The DNZ Proposal was announced to the market on 11 May 2011. The DNZ Proposal has two major components – the removal of the Manager including making a “compensation payment” to the Manager, and the merger of Argosy into the DNZ corporate structure. In its current form, there is insufficient available information on which to form any substantive conclusions regarding the merger of Argosy and DNZ as DNZ has not stated the ratio at which it intends to exchange Argosy units for shares in DNZ. However, it has stated that it envisages determining an exchange ratio on an NTA basis and believes a 5% – 10% premium in the NTA merger exchange ratio could be attributed to Argosy Unit Holders if the merger transaction was completed at the same time as exiting the current management contract.

In May 2011 DNZ indicated an interest in merging Argosy and DNZ by way of DNZ taking over Argosy, subject to undertaking due diligence on Argosy. Since that time it has had available to it the opportunity to make a full takeover offer for Argosy under Section 4 of the NZSX Listing Rules (Trusts are not covered by the Takeovers Code). DNZ has instead sought to place a number of resolutions before Unit Holders requiring, among other things, that Argosy investigate a merger with DNZ. The takeover provisions of the NZSX Listing Rules provide for this outcome. Under a takeover offer DNZ must put its best foot forward and the Argosy Directors are required to fully evaluate the takeover and, if DNZ has undertaken due diligence, to commission an Appraisal Report, which must:

*“state whether or not in the opinion of the reporter the consideration and terms and conditions of the relevant proposed issue or other transaction are fair to the holders of Equity Securities other than those associated with the relevant Associated Persons (DNZ), and the grounds for that opinion”.*

The reluctance of DNZ to make a full takeover offer and its desire to stall the Proposed Internalisation has not been explained. DNZ may believe that it will achieve a better outcome for DNZ shareholders if there is a negotiated merger. Grant Samuel believes there is likely to be merit in Argosy merging with another listed property vehicle, potentially DNZ, but as a first step an orderly transition to internal management, as recommended by Independent Directors, is in the best interests of Argosy unit holders.

Grant Samuel also makes the following observations:

- **DNZ has not disclosed the value of the compensation payment it envisages making to the Manager** in the event the DNZ Proposal proceeds. DNZ intends to manage Argosy itself. To achieve this DNZ would need to make a termination payment to the Manager for the cancellation of the Management Rights. DNZ has not indicated the value of the cancellation payment it intends to make to the Manager. In any event DNZ would need to negotiate with the Manager to agree the amount of the cancellation payment. There is no reason to assume that the Manager would agree any lower amount than the \$20 million negotiated by the Independent Directors. The cancellation of the Management Rights by DNZ simultaneous with a merger could possibly be more expensive than the proposed \$20 million Termination Payment but even if it were less, there is a risk that the benefits of internalisation may end up being shared between Argosy Unit Holders and DNZ shareholders, whereas under the Proposed Internalisation all of the benefits of internalisation flow to Argosy Unit Holders. The Proposed Internalisation if approved does not prevent a merger with DNZ in future, in fact it may assist and ensure Argosy Unit Holders maximise the benefits to themselves;
- **it is unclear why DNZ is concerned with the internalisation of the Argosy Management Rights as part of its takeover proposal** in any event. The decision regarding whether to implement the Proposed Internalisation is a matter for Argosy Unit Holders and should not concern DNZ (other than in its capacity as a Unit Holder of Argosy). Argosy Unit Holders should be the sole beneficiaries of any decision to internalise the management of the Trust and the benefits should not be shared with DNZ shareholders. The only impact on DNZ shareholders in the event the Proposed Internalisation proceeds prior to any merger or takeover, is the reduction in Argosy’s NTA the Termination Payment would have for the purposes of calculating an exchange ratio (the ratio at which Argosy units may be exchanged for shares in DNZ). By combining a merger with

internalisation the financial benefits of the internalisation will potentially be shared with DNZ shareholders;

- **DNZ's Management Expense Ratio (the ratio of operating costs to average total assets) is the highest in the listed property sector** at 1.4%. By contrast Argosy's Management Expense Ratio is 0.9%. Significant management cost savings may be achieved with a merger, however, it may be preferable for the management of the combined vehicle to be undertaken by Argosy;
- **Argosy trades at a lower discount to NTA than DNZ** (13% compared with DNZ at 21%). The size of the discount is a direct reflection of the market's assessment of the two property portfolios and their respective management although the Argosy discount is, to some extent, currently distorted due to the increase in its unit price as a result of announcing the Proposed Internalisation. DNZ has indicated that it would envisage the merger being based on a premium of 5% - 10% over Argosy's NTA adjusted for the Termination Payment. Using the mid-point of this range of premiums of 7.5% to determine the exchange ratio result in Argosy Unit Holders holding 58.3% of the merged company and DNZ shareholders 41.7%. This produces a similar outcome to that arising if the merger was based on current market prices. Based on current prices Argosy Unit Holders would hold approximately 60% of the merged company and DNZ shareholders 40%. Any merger terms would need to address not just NTA but also Earnings Per Unit/Share, forecast earnings and an overall assessment of the attributes of the respective property portfolios. The NTA per share of the combined entity would be \$1.53 (assuming DNZ took over Argosy) or the equivalent of 96 cents per existing Argosy Unit. A result of paying Argosy Unit Holders a premium over Argosy's NTA per unit is that DNZ shareholders would experience a reduction in their own NTA per share;
- **DNZ has not undertaken any form of due diligence review of Argosy.** The proposal it has put forward is based on publicly available information, and is conditional upon due diligence being carried out. In the event DNZ is given access to the Trust to undertake due diligence it is possible that changes could be made to the proposal or, indeed, that the proposal could be withdrawn;
- **Carry forward tax losses would be lost.** A merger of DNZ and Argosy may result in tax losses in DNZ being lost. Certain Argosy tax losses would also be lost. Grant Samuel understands that the tax benefit lost could be approximately \$6 million to a combined entity;
- **Both DNZ shareholders and Argosy Unit Holders should benefit from any merger.** A merger between DNZ and Argosy should benefit security holders in both entities depending on the exchange ratio used to calculate the rate at which Argosy units would be swapped for DNZ shares. If a merger between DNZ and Argosy eventuated, the combined vehicle would be the second largest listed property vehicle in New Zealand by asset value but would also have the highest level of debt of any of the listed property vehicles. The merger would produce synergy benefits that would be shared by all shareholders in the merged company. In addition a merger would significantly increase the overall index position on both the NZX50 and the Property Index. This would increase liquidity and in all likelihood have a positive impact on the share price. At this stage insufficient analysis has been undertaken by either Argosy or DNZ to form anything other than a high level view on a merger. The Independent Directors have stated that their central focus remains on achieving the Proposed Internalisation first;
- **DNZ Directors are pursuing a takeover of the Trust as they must believe it is in the best interests of DNZ shareholders.** The DNZ Directors are pursuing the takeover aggressively through the media and the Courts despite having not put a formal takeover proposal before Unit Holders at the date of this report. DNZ appears anxious to stop the Proposed Internalisation proceeding and one could conclude that it believes it can do a better deal for DNZ shareholders before the Trust's management is internalised. The Termination Payment of \$20 million will not prevent a takeover and as it will be value accretive to the Trust, should result in a marginally superior outcome to Unit Holders in any subsequent takeover/merger;
- **A merger proposal could be considered after the Proposed Internalisation is implemented.** There is no reason why a merger would not be considered by Argosy after the Proposed Internalisation has been implemented, or indeed, in the event Unit Holders do not approve the

Proposed Internalisation. Statements from the Independent Directors of the Manager in response to the release of the DNZ Proposal indicate that they have an open mind towards a detailed consideration of a merger with DNZ or another party in due course; and

- ***In Grant Samuel's opinion there are significant benefits to be gained from merging the Trust with another New Zealand listed property vehicle.*** Argosy is a larger listed entity than DNZ and may, once management has been internalised, appeal to a number of parties other than DNZ. It is likely to be in the best interests of Argosy Unit Holders to undertake the internalisation process first, then determine if a merger with DNZ or another party is a desirable outcome. In this way the full benefits of internalisation are captured by the existing Unit Holders of the Trust. Based on the information provided to date there appears to be no reason to conclude whether DNZ is, or is not, the ideal merger partner or if, indeed, a merger is desirable. From Argosy Unit Holders' perspective, achieving the internalisation on the best terms should be the current priority. There is no time pressure on the Trust to merge at this time.

# 9. The Property Investment Sector

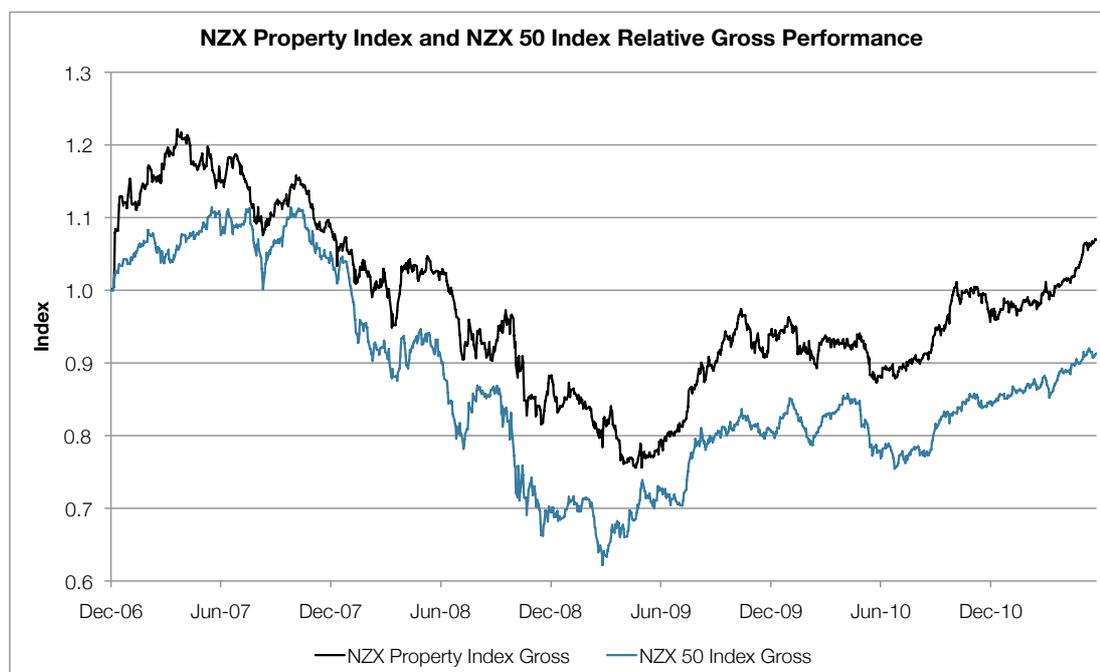
## 9.1 Overview

The table below summarises the key metrics of the main listed property entities (**LPEs**) on the NZSX:

| NZSX Listed Property Investment Vehicles      |         |                                |                                |
|---|---------|--------------------------------|--------------------------------|
| Entity  | Type    | Sector                         | Market Cap (\$m) <sup>16</sup> |
| Kiwi Income Property Trust ( <b>KIP</b> )     | Trust   | Retail, Commercial             | 934                            |
| Goodman Property Trust ( <b>GMT</b> )         | Trust   | Industrial Commercial          | 915                            |
| AMP NZ Office Limited ( <b>ANO</b> )          | Company | Commercial Office              | 798                            |
| Argosy Property Trust                         | Trust   | Retail, Industrial, Commercial | 430                            |
| Vital Healthcare Property Trust               | Trust   | Health                         | 313                            |
| DNZ Property Fund Limited                     | Company | Retail, Industrial, Commercial | 300                            |
| Property for Industry Limited ( <b>PFI</b> )  | Company | Industrial                     | 253                            |
| NPT Limited                                   | Company | Retail, Industrial, Commercial | 81                             |
| Kernadec Property Fund Limited ( <b>KPF</b> ) | Company | Retail, Industrial, Commercial | 49                             |

Following the relatively recent corporatisation of both ANO and NPT the majority of LPEs are now structured as limited liability companies rather than unit trusts, as was historically the norm. Corporate structures have the advantage of allowing investors a higher level of influence over the governance of an LPE, through the appointment of board members. Corporate structures also benefit from the protections offered under the Takeovers Code, the rules of which do not extend to cover unit trusts. Further discussion on the differences between a company structure and the unit trust model are discussed later in this report.

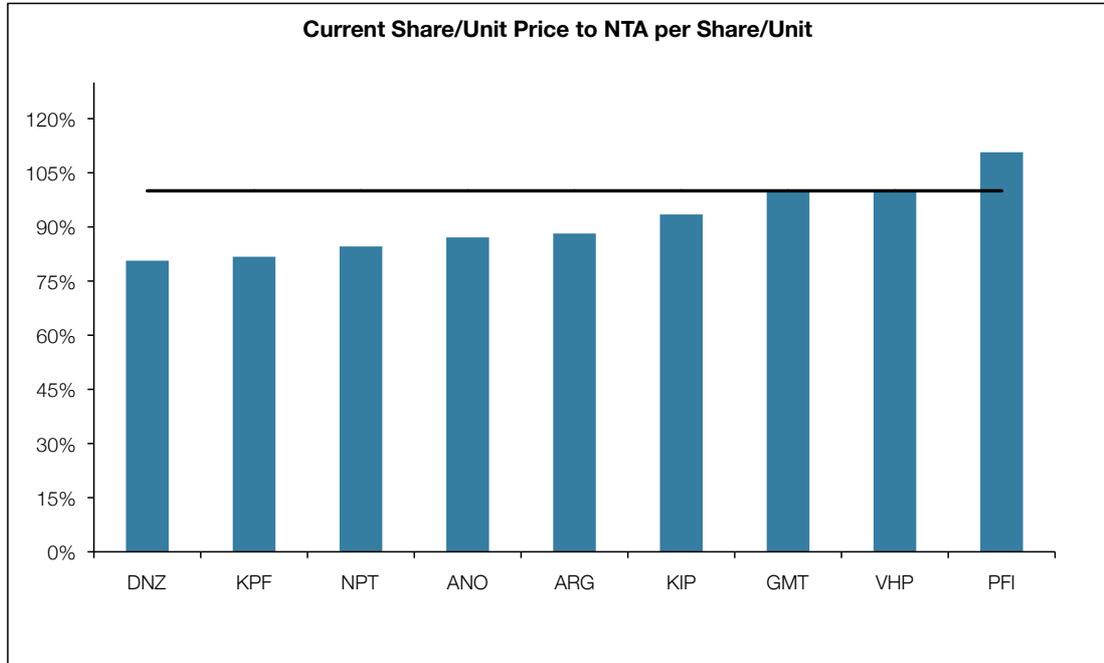
The performance of each LPE from a share or unit holder perspective must be considered in the context of total or gross returns, being both the change in share or unit value and the level of distributions made. The chart below illustrates the performance of the LPE sector as a whole relative to the NZX 50 index (on a gross basis i.e. assuming dividends are reinvested) over the period since December 2006:



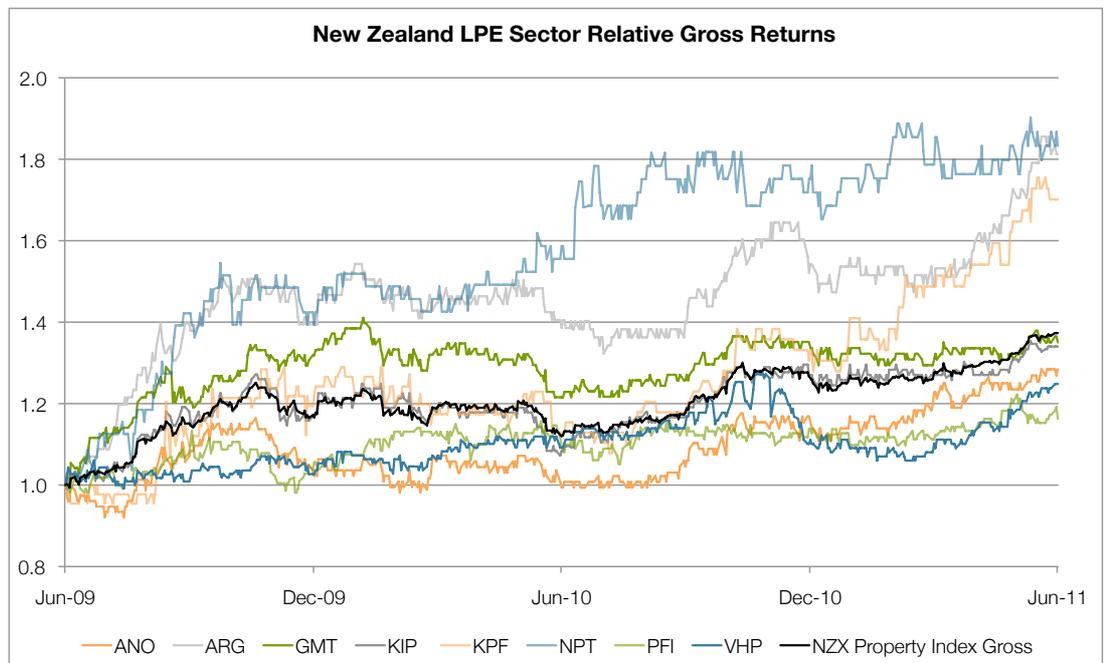
Source: Bloomberg, Grant Samuel analysis

<sup>16</sup> Market capitalisation as at 5 August 2011

The performance of the LPE sector suffered in the wake of the global financial crisis and still faces challenges due to the slow recovery of the domestic economy and the impact of recent earthquakes on property values in the Christchurch area. It is interesting to note that the positive performance recorded above since 2009 has been achieved in a climate of reducing property values and is a result of a narrowing in the discount between share/unit prices and NTA per share/unit, which peaked at the height of the financial crisis. The majority of the LPEs in New Zealand are still trading at a discount to NTA per unit or share as at 5 August 2011, as shown in the chart below:



Some of the LPEs trading at the highest discounts to NTA are the better performers in the sector as shown in the chart below:



Source: Bloomberg, Grant Samuel analysis

## 9.2 Management Structures

There are two major styles of management of LPEs – external management and internal management. Externally managed entities generally have no staff of their own and appoint a third party to undertake the management of the property portfolio in return for a management fee. Internally managed entities undertake responsibility for the management of property portfolios in-house. The Unit Trusts Act requirement for trusts to have a manager that is separate from the trustee means that historically it has been common for property trusts to have an external management model. The New Zealand LPE sector has recently seen a number of internalisation and restructuring proposals:

- in July 2010 DNZ entered into an agreement to acquire its management contract. DNZ listed on the NZSX in August 2010, raising \$45 million, \$35 million of which was applied to the purchase of the management contract from related party owners. The high price paid (3.5 times revenue) to internalise the management contract was in part a function of the lack of dismissal rights available and the nature of the control the manager of DNZ exercised over the fund (where the manager held a separate class of shares in DNZ which gave it disproportionate influence);
- in October 2010 ANO unit holders voted to corporatise the trust structure but elected to retain an external manager (a wholly owned entity within the AMP group) thereby entrenching the incumbent manager by leaving ANO shareholders with limited ability to remove the manager only in circumstances such as a material breach of contract; and
- in November 2010 NPT simultaneously internalised its management and corporatised its unit trust structure.

Internationally there is a strong trend towards internal management of LPEs and pressure for New Zealand LPEs to internalise their management is increasing. The underlying reasons for this current trend are outlined in Section 7.1 of this report. The only internally managed New Zealand LPEs at the date of this report are DNZ and NPT.

## 9.3 External Management Fees

The table below summarises the management fees paid by the externally managed LPEs:

| Externally Managed New Zealand LPEs – Fee Structures |  |  |   |  |             |                |
|--|--|--|---|--|-------------|----------------|
| Entity   | Base fee                               |  | Fee basis   | Performance fee  |             |                |
|  | Rate                                   | Based on                                 |   | Threshold/cap  | Carried fwd | Paid in        |
| KIP  | 0.55%                                  | Average gross assets                     | 10% of unit holder return above threshold                         | Total unit holder return of 10%, capped at 0.15% of average gross assets | 2 years     | Units          |
| GMT  | 0.5% up to \$0.5bn<br>0.4% thereafter  | Total assets less cash and trade debtors | 10% of unit holder return above threshold                         | NZ LPE Index (ex. GMT), capped at 5% above index                         | Yes         | Units          |
| ANO  | 0.55% up to \$1bn<br>0.45% thereafter  | Investment properties                    | 10% of shareholder return above threshold                         | NZ LPE Index (ex. ANO), capped at 5% above index                         | 2 years     | Cash           |
| Argosy   | 0.60%                                  | Average gross assets                     | 10% of unit holder return above threshold                         | Total unit holder return of 10% but under 15%                            | 2 years     | Cash           |
| VHP  | 0.75%                                  | Average gross assets                     | 10% of average annual increase in gross assets over prior 3 years | capped at 1% of gross assets   | Yes         | Units          |
| PFI  | 0.70% up to \$175m<br>0.35% thereafter | Average gross assets                     | 10% of shareholder return above threshold                         | Total shareholder return of 10% but under 15%                            | 2 years     | Cash           |
| KPF  | 0.55%                                  | Gross asset value                        | 10% of shareholder return above threshold                         | Total shareholder return of 10% but under 15%                            | 3 years     | Cash or shares |

\* Total other fees as a percentage of base plus performance fees

In all cases fee structures comprise both a base and performance fee component. However, comparison of fees between LPEs is complicated by the often significant additional fees charged by managers over and above the base and performance components, which are typically levied on a transactional or time in attendance basis and not always appropriately disclosed.

### Base fees

Base fees are generally perceived to cover the core costs of managing the entity such as fund, capital and strategic management. In all cases the base fee is determined as a percentage of the value of either total assets (i.e. some structures allow for a fee on cash balances etc) or investment properties. The base fees charged range from 0.50% (GMT) to 0.75% (VHP). There has been widespread criticism of base fees as it can be argued that they incentivise management to grow the asset base of an entity without regard for asset quality or the risks associated with higher levels of debt, and also do not recognise the economies of scale that a larger portfolio of assets generates. PFI has, for many years, operated a tiered base fee structure with a reducing percentage fee for incremental assets over a set threshold. More recently GMT and ANO have introduced similar tiered structures, but with much higher thresholds for lower fees. In the case of ANO lower fees are only charged on incremental assets over \$1 billion.

### Performance fees

In general performance fees are structured based on either absolute shareholder returns (i.e. 10% of unit/shareholder returns between a set minimum threshold and maximum cap, in most cases 10% of shareholder returns between 10% and 15%) or based on shareholder returns relative to the performance of the LPE sector as a whole.

The “absolute” performance fee structure allows a manager to benefit from movements in the market as a whole regardless of whether the LPE in question is actually underperforming relative to its peers. The 10% threshold for shareholder returns adopted by the market is somewhat arbitrary and does not reflect the material differences between portfolio composition and the capitalisation rates applicable to the various LPEs. For example, higher yields on industrial and health portfolios make it easier for LPEs with higher weightings in these sectors to meet unit/shareholder return thresholds. The table below summarises the weighted average capitalisation rates by sector based on the latest portfolio valuations of the LPEs in New Zealand:

| LPE Sector - Weighted Average Capitalisation Rates |              |                                      |
|--|--------------|--------------------------------------|
| Sector   | Value (\$m)  | Weighted Average Capitalisation Rate |
| Retail   | 1,874        | 7.97%                                |
| Commercial   | 3,130        | 8.52%                                |
| Industrial   | 1,777        | 8.54%                                |
| Health   | 514          | 9.30%                                |
| <b>Total Market</b>                                | <b>7,295</b> | <b>8.44%</b>                         |

Relative performance fee structures mean that a manager is only rewarded if it outperforms the market. They do however mean that managers can achieve a performance fee even if shareholder returns are low at an absolute level.

The carry forward of over or under performance should effectively lag and smooth performance fee payments to managers and should incentivise managers to focus on longer term performance strategies. Underperformance will result in a manager having to overachieve in the subsequent financial period(s) to claw back to a neutral position where performance fees can again be earned. In most cases NZSX LPEs have a carry forward period of 2 years, which, for example, prevents a significant underperformance impacting future fees for many years and potentially rendering a performance fee unobtainable for the foreseeable future. Such circumstances may cause the manager to solely focus on increasing base fees through portfolio growth. Both VHP and GMT have indefinite carry forward periods. The advantage of a

longer/indefinite carry forward period is that it discourages the manager from pursuing short-term strategies for performance.

Three of the LPEs pay performance fees in units or shares and three pay fees in cash. In the case of KPF the independent directors may elect to pay half the performance fee in shares and half in cash subject to various conditions. The payment of performance fees in shares or units further aligns the interests of security holders in the LPE and the manager.

### **Additional Fees**

LPE managers charge additional fees for a range of services that may include some or all of the following:

- property and facilities management (generally recoverable from tenants);
- leasing fees;
- renewal fees;
- rent review fees;
- acquisition/sale fees;
- development; and
- project management fees.

The fees charged by some LPE managers for some of the “additional” services are higher than market rates. For example, in the case of GMT the leasing services that the manager contracts to external agents attracts a 25% “override levy”. In other cases the fees are below market rates for some services and in the case of PFI no fees are charged over and above the base and performance fees.

Comparison of additional fees, and therefore total fees paid to LPE managers, is problematic as managers do not typically provide the same set of services, with some managers electing to outsource certain activities (e.g. ANO outsources all property management services). Also the level of fees charged for particular services is not well disclosed, nor is the level of tenant cost recovery.

## **9.4 Outlook**

As a result of the global financial crisis, the collapse of the finance company sector in New Zealand and the subsequent decline in commercial and industrial property values, the New Zealand LPE sector in general has focused on reducing debt, diversifying heavily concentrated portfolios, improving liquidity and managing development risk. Each sector of the property market in New Zealand has its own challenges and opportunities.

# 10. Profile of Argosy

## 10.1 Background

Argosy was established as Paramount Property Trust under the Unit Trusts Act 1960 by a Trust Deed dated 30 October 2002 (as subsequently amended). Paramount Property Trust was first listed on the NZSX in December 2002. At that time it owned only two properties and was managed by Paramount Property Trust Management Limited (a member of the Symphony Group). In August 2003 ING acquired 50% of Paramount Property Trust Management Limited and renamed it ING Property Trust Management Limited and the Trust, ING Property Trust. In November 2003, ING Property Trust undertook a \$283 million acquisition of 71 properties from MFL and SIL, partially funded by a \$182 million capital raising.

During 2005 the Manager of the ING Property Trust successfully acquired Urbus Properties Limited and in 2006, acquired the manager of the Calan Healthcare Property Trust. In the two years ended 31 March 2010, as a result of the global financial crisis and a general downturn in the New Zealand property market, ING Property Trust sold 31 properties.

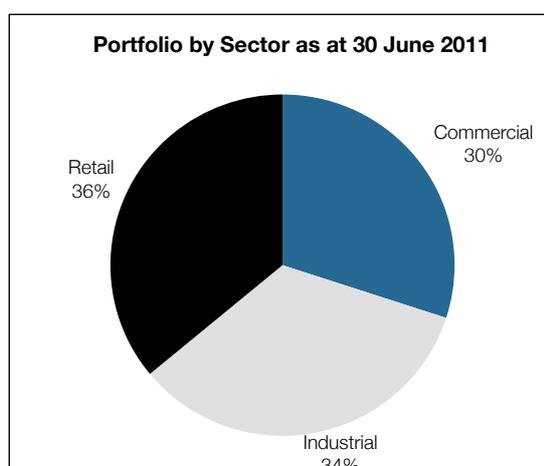
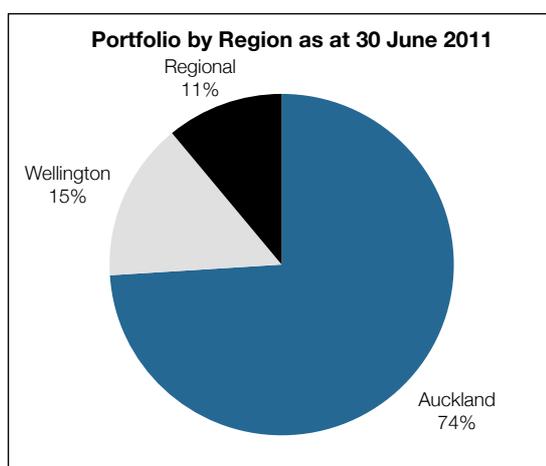
In November 2009 the Manager of ING Property Trust was wholly acquired by ANZ. The Trust was renamed Argosy Property Trust in late 2010. Argosy is now the fourth largest NZSX listed property trust by market capitalisation.

## 10.2 Operations

Argosy's assets currently comprise 74 properties leased to 294 separate tenants with a WALT of 4.92 years. The Trust's property portfolio is comprised as follows:

| Argosy Property Portfolio Overview |            |            |         |                  |
|------------------------------------|------------|------------|---------|------------------|
|                                    | Commercial | Industrial | Retail  | Total Properties |
| Number of buildings                | 17         | 38         | 19      | 74               |
| Market value of assets (\$m)       | \$262.6    | \$341.2    | \$344.8 | \$948.7*         |
| Net lettable area (sqm)            | 86,027     | 264,495    | 152,058 | 502,580          |
| Vacancy factor (sqm)               | 5.33%      | 3.83%      | 0.93%   | 3.25%            |
| WALT (years)                       | 3.92       | 5.01       | 5.71    | 4.92             |
| Passing yield                      | 9.23%      | 7.83%      | 8.00%   | 8.28%            |

\* excludes properties held for sale



A detailed table showing each of the Trust's properties is included at Section 10.3 of this report.

The Trust is currently pursuing a long-term strategy involving:

- **Risk Mitigation.** Managing tenant relationships to ensure potential problems are identified and addressed as early as possible and ensuring that the correct investment management decisions are made to preserve and enhance the value of individual properties. Management is focused on longer weighted average lease terms and occupancy rates;
- **Debt Reduction (capital management).** Targeting lower gearing ratios (41% by the year ending 31 March 2012 and 38% over the medium term) by pursuing a strategic asset sales programme. The Trust has also renegotiated its banking ratios to enable a maximum LVR of 50% for the period from 31 March 2011 to 30 June 2012, which is in line with the maximum gearing permitted under the Trust Deed; and
- **Portfolio Structuring for the future.** The long-term investment strategy of the trust is to invest in well located properties that meet the potential future wants and needs of tenants in the target market.

### 10.3 Property Portfolio

Argosy's property portfolio as at 31 March 2011 is outlined in detail below:

| Argosy Property Portfolio as at 31 March 2011 |                         |                    |                            |
|---|-------------------------|--------------------|----------------------------|
| Property Address                              | Net lettable area (sqm) | Vacant space (sqm) | Major tenant               |
| <b>Retail Portfolio</b>                       |                         |                    |                            |
| 320 Ti Rakau Drive, East Tamaki               | 26,628                  | -                  | Bunnings Limited           |
| Homemakers Centre, Albany                     | 24,933                  | 1,543              | Mitre 10 New Zealand Ltd   |
| Albany Mega Centre, Albany                    | 24,502                  | -                  | Farmers Trading Co Ltd     |
| Waitakere Mega Centre, Henderson              | 18,027                  | 196                | Coles Myer (NZ) Holdings   |
| 39 Cavendish Drive, Manukau City              | 8,171                   | -                  | The Warehouse Ltd          |
| Cnr Taniwha & Paora Hape Streets Taupo        | 7,525                   | -                  | The Warehouse Ltd          |
| 7 Wagener Place, St Lukes                     | 7,056                   | -                  | The Warehouse Ltd          |
| 2-10 Semple Street, Porirua                   | 6,540                   | -                  | Smith City (Southern) (NZ) |
| 180-202 Hutt Road, Kaiwharawhara              | 6,019                   | -                  | Fletcher Distribution Ltd  |
| 5 Tutu Place, Porirua                         | 3,781                   | -                  | Inland Revenue             |
| Spotlight, 9 Tutu Place, Porirua              | 3,727                   | -                  | Spotlight Stores (NZ) Ltd  |
| 501 Ti Rakau Drive, East Tamaki               | 3,083                   | -                  | Danske Mobler              |
| 28-30 Catherine Street, Henderson             | 2,427                   | -                  | Appliance Shed             |
| Briscoes, Main Street, Palm. North            | 2,340                   | -                  | Briscoes (NZ) Ltd          |
| Stewart Dawsons Corner, Wellington            | 1,752                   | -                  | Rodd & Gunn (NZ) Ltd       |
| Placemakers, 3 Semple Street, Porirua         | 1,470                   | -                  | Placemakers                |
| Rebel Sports, Main Street, Palmerston North   | 1,467                   | -                  | The Sports Authority Ltd   |
| 7 Maui Street, Hamilton                       | 1,410                   | -                  | Redpaths (NZ) Ltd          |
| 10 Tutu Place, Porirua                        | 1,200                   | -                  | Team Capital Ltd           |
| <b>Total retail portfolio</b>                 | <b>152,058</b>          | <b>1,739</b>       |                            |
| <b>Commercial Portfolio</b>                   |                         |                    |                            |
| 39 Market Place, Auckland                     | 10,738                  | 690                | NIWA                       |
| 23 Customs Street East, Auckland              | 9,594                   | 601                | Citibank Group/US Embassy  |
| 46 Waring Taylor Street, Wellington           | 9,015                   | -                  | Internal Affairs           |
| 143 Lambton Quay, Wellington                  | 6,216                   | -                  | Te Puni Kokiri             |
| 82 Wyndham Street, Auckland                   | 6,154                   | 426                | IBM New Zealand Ltd        |
| 107 Carlton Gore Road, Newmarket              | 6,136                   | -                  | ANZ                        |
| 105 Carlton Gore Road, Newmarket              | 5,367                   | -                  | Tonkin & Taylor Ltd        |
| 8-14 Willis Street, Wellington                | 5,232                   | 559                | Pagani Clothing Ltd        |
| 56 Cawley Street, Ellerslie                   | 5,442                   | 1,156              | James & Wells              |
| 25 College Hill, Ponsonby                     | 4,240                   | -                  | Gentrack Ltd               |
| 8 Pacific Rise, Mt Wellington                 | 3,640                   | 400                | AsureQuality Ltd           |

### Argosy Property Portfolio as at 31 March 2011

| Property Address                               | Net lettable area (sqm) | Vacant space (sqm) | Major tenant                  |
|--|-------------------------|--------------------|-------------------------------|
| 25 Nugent Street, Grafton                      | 3,029                   | -                  | Schindler Lifts (NZ) Ltd      |
| 626 Great South Road, Ellerslie                | 2,647                   | 483                | International Accreditation   |
| 65 Upper Queen Street, Auckland                | 2,655                   | 1,396              | Chester Grey                  |
| 99-107 Khyber Pass Road, Newmarket             | 2,463                   | 931                | Franklin Plumbers & Builders  |
| 302 Great South Road, Greenlane                | 1,890                   | -                  | McDonalds Restaurants (NZ)    |
| 308 Great South Road, Greenlane                | 1,571                   | -                  | Pacific Brands                |
| <b>Total Commercial Portfolio</b>              | <b>86,029</b>           | <b>6,642</b>       |                               |
| <b>Industrial Portfolio</b>                    |                         |                    |                               |
| Ezibuy, Palmerston North                       | 24,658                  | -                  | Ezibuy Ltd                    |
| 1 Pandora Road, Napier                         | 18,431                  | -                  | Fonterra Cooperative Group    |
| 211 Albany Highway, Albany                     | 15,764                  | -                  | HP Industries (NZ) Ltd        |
| 12-16 Bell Avenue, Penrose                     | 15,179                  | -                  | One Source Group              |
| Mayo Road, Wiri, Auckland                      | 13,351                  | -                  | DSE (NZ) Ltd                  |
| 8 Foundry Drive, Woolston, Christchurch        | 11,360                  | 1,127              | Polarcold Stores Ltd          |
| Rewarewa Road, Whangarei                       | 11,011                  | -                  | Toll Holdings Ltd             |
| 10 Transport Place, East Tamaki                | 10,818                  | -                  | Easy Logistics Ltd            |
| 1 Rothwell Ave, Albany                         | 10,761                  | 3,340              | Complete Entertainment        |
| 4 Henderson Place, Onehunga                    | 10,475                  | 400                | Redeal Ltd                    |
| 80 Springs Rd, East Tamaki                     | 9,865                   | -                  | Fisher & Paykel Appliances    |
| 9 Ride Way, Albany                             | 9,764                   | -                  | Amcor Packaging (NZ) Ltd      |
| 18-20 Bell Avenue, Penrose                     | 8,947                   | -                  | Peter Baker Transport         |
| 32 Bell Ave, Penrose                           | 8,639                   | -                  | Peter Baker Transport Ltd     |
| 1478 Omaha Road, Hastings                      | 8,515                   | -                  | Crasborn Coolstores Ltd       |
| William Pickering Dr & Rothwell Ave, Albany    | 7,074                   | -                  | Electrix Ltd                  |
| 1-3 Unity Drive, Albany                        | 6,204                   | -                  | Alto Packaging Ltd            |
| Wagener Place                                  | 5,320                   | -                  | Wagener Storage Units         |
| William Pickering Dr & Bush Rd, Albany         | 4,862                   | 1,470              | Dick Smith Electronics        |
| Forge Way, Panmure                             | 4,231                   | -                  | Truck Leasing Ltd (Esanda)    |
| 2 Carmont Place, Mt Wellington                 | 4,103                   | -                  | Downer EDI Engineering Ltd    |
| 106 Springs Rd, East Tamaki                    | 3,986                   | -                  | Henkel New Zealand Ltd        |
| 90-104 Springs Rd, East Tamaki                 | 3,875                   | -                  | Goodyear & Dunlop Tyres       |
| Leisureplex, Palmerston North                  | 3,829                   | -                  | Valor Ideal Ltd               |
| 67 Dalgety Drive, Manukau City                 | 3,698                   | -                  | RLA Polymers Pty Ltd          |
| 960 Great South Rd, Penrose                    | 3,676                   | -                  | Gough Gough & Hamer           |
| 19 Richard Pearse Dr & 26 Ascot Ave, Auckland  | 3,640                   | 1,644              | NZ Food Safety Authority      |
| Cnr Wakefield, Taranaki & Cable St, Wellington | 3,307                   | -                  | BP Oil (NZ) Ltd               |
| 5 Unity Drive, Albany                          | 3,046                   | -                  | Sealegs International Ltd     |
| 2 Allens Rd, East Tamaki                       | 2,920                   | -                  | Henkel New Zealand Ltd        |
| 5 Allens Rd, East Tamaki                       | 2,664                   | -                  | Thermo Fisher Scientific (NZ) |
| 12 Allens Rd, East Tamaki                      | 2,373                   | 2,373              | Transpacific Tech. Services   |
| 1 Allens Rd, East Tamaki                       | 1,806                   | -                  | Bayleys Real Estate Ltd       |
| Fonterra, Palmerston North                     | 1,780                   | -                  | Fonterra Co-op Group Ltd      |
| Vestas (xKeegans), Palmerston North            | 1,780                   | -                  | Vestas NZ Wind Technology     |
| 205-221 Wakefield St, Wellington               | 1,460                   | -                  | General Distributors          |
| Budget Plastics, Palmerston North              | 1,325                   | -                  | Budget Plastics Ltd           |
| <b>Total industrial portfolio</b>              | <b>264,497</b>          | <b>10,354</b>      |                               |
| <b>TOTAL PORTFOLIO</b>                         | <b>502,584</b>          | <b>18,735</b>      |                               |

## 10.4 Financial Performance

The financial performance of Argosy for the years ended 31 March 2009 (**FY2009**), 2010 (**FY2010**) and 2011 (**FY2011**) is outlined in the table below:

| <b>Argosy Financial Performance (NZ\$ millions)</b>                      |               |               |             |
|--|---------------|---------------|-------------|
| <b>Year end 31 March</b>   | <b>2009</b>   | <b>2010</b>   | <b>2011</b> |
| Gross rental income  | 93.3          | 83.8          | 79.1        |
| Net property expenses (after expense recoveries)                         | (5.5)         | (5.9)         | (6.8)       |
| <b>Property income</b>   | <b>87.8</b>   | <b>77.9</b>   | <b>72.3</b> |
| Other income   | 1.1           | 0.5           | 0.6         |
| Administration expenses  | (11.4)        | (10.2)        | (9.1)       |
| Other expenses   | (13.4)        | -             | -           |
| <b>EBIT before revaluations and movements in cash flow hedge reserve</b> | <b>64.1</b>   | <b>68.2</b>   | <b>63.8</b> |
| Revaluation gains/(losses) on investment property                        | (89.9)        | (82.8)        | 2.1         |
| Movement in cash flow hedge reserve                                      | (26.3)        | 13.5          | 0.6         |
| <b>EBIT</b>  | <b>(52.1)</b> | <b>(1.1)</b>  | <b>66.5</b> |
| Net interest   | (38.6)        | (41.8)        | (37.2)      |
| Tax (expense)/credit   | 1.3           | (2.7)         | (2.0)       |
| <b>Profit after tax</b>  | <b>(89.4)</b> | <b>(45.6)</b> | <b>27.3</b> |

The following points should be taken into consideration when reviewing the table above:

- Gross rental income declined significantly between FY2009 and FY2010 largely as a result of a significant decline in Argosy's property portfolio rental revenue arising from property sales, vacancy rates of more than 10% of the commercial portfolio and lower rental rates. Commercial office space in the Auckland and Wellington CBDs has very high levels of vacancy due to decreased demand and, particularly for Auckland, increasing future supply. Further rental income declines were experienced for FY2011 as a result of additional property sales;
- Other income includes gains on the disposal of investment properties and a distribution received from an available-for-sale investment;
- Administration expenses principally comprise management fees paid to the Manager, the amortisation of management contract cancellation costs (arising from the cancellation of the Urbus management contract in 2005) and also include Trustee fees of approximately \$300,000 per annum;
- Other expenses in FY2009 include the loss on disposal of investment property and investments;
- Argosy's valuation policy is to engage independent valuers to value the Trust's investment properties at least once a year. In accordance with NZ International Financial Reporting Standards (**NZIFRS**) any increase or decrease in the investment property portfolio year on year is required to be included in the statement of financial performance. As can be seen in the table above the Trust has experienced negative valuation movements of \$89.9 million in FY2009 and \$82.8 million in FY2010. This has impacted on the Trust's LVR which was required to be kept below 45% at all times under the terms of the Trust's banking arrangements. The Trust has recently renegotiated this covenant with its financiers to increase the covenanted LVR from 45% to 50% for the period from 31 March 2011 to 30 June 2012 in line with the maximum gearing level permitted under the Trust Deed. In FY2011 the value of Argosy's industrial property portfolio increased by more than \$8 million, offset by declines of more than \$3 million for each of the commercial and retail portfolios resulting in a slight overall valuation gain of \$2.1 million; and
- Hedging reserves represent hedging gains and losses recognised on the effective portion of cash flow hedges. Any gain or loss on the hedge is required by NZIFRS to be recognised in other comprehensive income and accumulated in equity. Any ineffective portions are recognised immediately in profit and loss.

## 10.5 Financial Position

The financial position of Argosy as at 31 March 2009, 31 March 2010 and 31 March 2011 is outlined in the table below:

| Argosy – Financial Position (NZ\$ millions)    |                |              |              |
|--|----------------|--------------|--------------|
| As at 31 March                                 | 2009           | 2010         | 2011         |
| Investment properties                          | 963.7          | 925.9        | 948.7        |
| Investment properties under construction       | 87.9           | -            | -            |
| Other non-current assets                       | 8.7            | 7.6          | 6.1          |
| <b>Non-current assets</b>                      | <b>1,060.3</b> | <b>933.5</b> | <b>954.8</b> |
| Cash and cash equivalents                      | 1.1            | 1.2          | 1.3          |
| Trade and other receivables                    | 3.6            | 7.2          | 3.5          |
| Other current assets                           | 9.0            | 1.4          | 3.7          |
| Non-current assets classified as held for sale | 7.8            | 6.7          | 11.9         |
| <b>Current Assets</b>                          | <b>21.5</b>    | <b>16.5</b>  | <b>20.4</b>  |
| <b>Total assets</b>                            | <b>1,081.8</b> | <b>950.0</b> | <b>975.2</b> |
| Borrowings – term loans                        | 410.8          | -            | 410.9        |
| Derivative financial instruments               | 35.3           | 19.2         | 26.8         |
| Deferred tax                                   | 5.7            | 11.4         | 15.4         |
| <b>Non-current liabilities</b>                 | <b>451.8</b>   | <b>30.6</b>  | <b>453.1</b> |
| Borrowings                                     | 18.2           | 380.9        | -            |
| Trade and other payables                       | 11.4           | 9.0          | 8.7          |
| Other current liabilities                      | 6.6            | 2.8          | 1.7          |
| <b>Current liabilities</b>                     | <b>36.2</b>    | <b>392.7</b> | <b>10.4</b>  |
| Units on issue                                 | 531.6          | 538.3        | 545.1        |
| Hedging reserves                               | (23.0)         | (9.5)        | (9.0)        |
| Retained earnings/(accumulated losses)         | 85.2           | (13.8)       | (24.4)       |
| Minority interest                              | -              | 11.7         | -            |
| <b>Unit holders' funds</b>                     | <b>593.8</b>   | <b>526.7</b> | <b>511.7</b> |
| <b>Total liabilities and equity</b>            | <b>1,081.8</b> | <b>950.0</b> | <b>975.2</b> |

The following points are relevant when considering the above table:

- The decline in Argosy's investment property balance between FY2009 and FY2010 is a combination of the sale of 15 investment properties and a decrease in the fair value of investment properties. This was partially offset by the commencement in FY2010 of the Trust consolidating 100% of North East Industrial Limited (**NEIL**), which was accounted for as a joint venture in FY2009. The uplift in investment properties for FY2011 largely reflects the acquisition of Freehold Albany Block E and 2/7 Wagener Place, St Lukes, offset by the disposal of Lot 20 El Prado Dr, Palmerston North, 308 Port Hills Road, Woolston and 792 Great South Road, Manukau;
- Investment properties under construction were completed and transferred to investment properties in FY2010;
- Other non-current assets include the capitalised cost of taking over and terminating the Urbus management contracts. The termination cost is being amortised over 10 years; and
- As at 31 March 2010 Argosy had a revolving credit facility with ANZ of \$500.1 million secured by way of a mortgage over the investment properties of the Trust and a \$40 million committed cash advance facility from BNZ to NEIL secured by way of mortgage over the NEIL properties. Drawn borrowings are shown as a current liability at FY2010 due to the term of the loan expiring within 12 months. On 17 May 2010 the Trust entered into a new 3 year, \$400 million syndicated loan facility with ANZ, BNZ and HSBC expiring on 30 June 2013. The facility limit was subsequently increased

to \$450 million on 23 December 2010. The Trust has also negotiated an amendment to its LVR covenant, increasing it from 45% to 50% for the period from 31 March 2011 to 30 June 2012.

## 10.6 Cash Flow

The cash flows for Argosy for the years ended 31 March 2009, 2010 and 2011 are shown in the table below:

| <b>Argosy – Statement of Cash Flows (NZ\$ millions)</b> |               |                |               |
|---|---------------|----------------|---------------|
| <b>Year end 31 March</b>                                | <b>2009</b>   | <b>2010</b>    | <b>2011</b>   |
| Property income   | 109.4         | 91.8           | 90.8          |
| Interest and distributions received                     | 1.5           | 0.4            | 0.3           |
| Property expenses                                       | (21.7)        | (21.1)         | (17.5)        |
| Management and Trustee fees                             | (7.6)         | (6.5)          | (5.8)         |
| Interest paid   | (38.9)        | (26.8)         | (28.9)        |
| Close of swaps contracts                                | -             | (12.3)         | (2.3)         |
| Tax paid  | (7.3)         | (4.8)          | (1.5)         |
| Other trust expenses                                    | (2.0)         | (2.0)          | (1.7)         |
| <b>Cash flow from operations</b>                        | <b>33.4</b>   | <b>18.7</b>    | <b>33.4</b>   |
| Sale of properties                                      | 107.9         | 101.5          | 18.0          |
| Sale of units in ING Medical Properties Trust           | 16.5          | -              | -             |
| Repayment of advance from related party                 | 0.7           | -              | -             |
| Loan to North East Industrial Limited                   | (1.8)         | (0.3)          | -             |
| Capital additions on investment properties              | (13.3)        | (19.1)         | (15.6)        |
| Purchase of properties                                  | (51.1)        | -              | (33.1)        |
| Purchase of property, plant and equipment               | (29.9)        | -              | -             |
| <b>Cash flow from investing activities</b>              | <b>29.0</b>   | <b>82.1</b>    | <b>(30.7)</b> |
| Debt drawn  | 96.7          | 54.8           | 429.3         |
| Issue of units (net of issue costs)                     | 8.8           | -              | -             |
| Repayment of debt                                       | (124.4)       | (122.2)        | (398.0)       |
| Distributions to Unit Holders                           | (38.5)        | (33.4)         | (31.9)        |
| Buyback of units  | (4.6)         | -              | -             |
| Facility refinancing fee                                | -             | -              | (2.0)         |
| <b>Cash flow from financing activities</b>              | <b>(62.0)</b> | <b>(100.8)</b> | <b>(2.6)</b>  |
| <b>Net increase/(decrease) in cash</b>                  | <b>0.4</b>    | <b>-</b>       | <b>0.1</b>    |
| Cash and cash equivalents through business combination  | -             | 0.1            | -             |
| Cash and cash equivalents at the beginning of the year  | 0.7           | 1.1            | 1.2           |
| <b>Cash and cash equivalents at the end of the year</b> | <b>1.1</b>    | <b>1.2</b>     | <b>1.3</b>    |

During FY2009 and FY2010 Argosy sold several investment properties resulting in cash inflows in excess of \$100 million in each year. Substantially all of the cash generated from the sale of investment properties was applied to the purchase of new investment properties, distributions to Unit Holders and a repayment of debt in FY2010 (which was subsequently redrawn in FY2011).

## 10.7 Capital Structure and Ownership

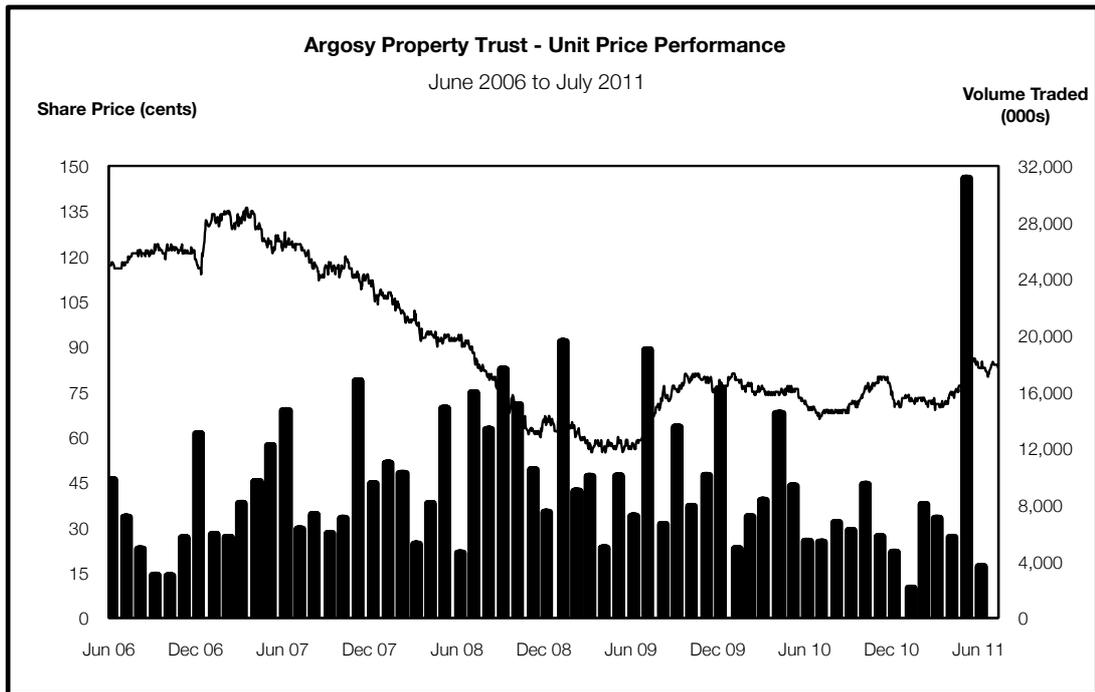
As at 22 July 2011 Argosy had 551,754,265 units on issue held by approximately 7,500 Unit Holders. The Trust's top 20 Unit Holders are shown in the table below:

| Argosy – Top 20 Unit Holders as at 22 July 2011  |                |              |
|--|----------------|--------------|
| Unit holder                                      | Units (000s)   | %            |
| MFL Mutual Fund Limited                          | 122,759        | 22.3         |
| Accident Compensation Corporation                | 38,580         | 7.0          |
| HSBC Nominees (NZ) Limited (a/c State Street)    | 23,851         | 4.3          |
| OnePath Wholesale Property Securities            | 22,604         | 4.1          |
| Investment Custodial Services Limited            | 22,475         | 4.1          |
| BT NZ Trust Nominees Limited                     | 16,350         | 3.0          |
| FNZ Custodians Limited                           | 7,571          | 1.4          |
| Forsyth Barr Custodians Limited (1-33)           | 7,204          | 1.3          |
| Forsyth Barr Custodians Limited (1-17.5)         | 6,263          | 1.1          |
| HSBC Nominees (NZ) Limited                       | 5,645          | 1.0          |
| Mint Nominees Limited                            | 5,272          | 1.0          |
| Citibank Nominees (New Zealand) Limited          | 5,020          | 0.9          |
| New Zealand Superannuation Fund Nominees Limited | 4,529          | 0.8          |
| NZ Guardian Trust Investment Nominees Limited    | 4,297          | 0.8          |
| James & Christine Mansell and Douglas Tony Brown | 4,160          | 0.8          |
| Peter & Janet Whiting & Wayne Derek Anderson     | 3,799          | 0.7          |
| Lynwalsh Holdings Limited                        | 3,500          | 0.6          |
| University of Otago Foundation Trust             | 3,500          | 0.6          |
| Tea Custodians Limited                           | 3,468          | 0.6          |
| Cogent Nominees (NZ) Limited                     | 3,438          | 0.6          |
| <b>Top 20 Unit Holders</b>                       | <b>314,285</b> | <b>57.0</b>  |
| <b>Other Unit Holders</b>                        | <b>237,469</b> | <b>43.0</b>  |
| <b>Total</b>                                     | <b>551,754</b> | <b>100.0</b> |

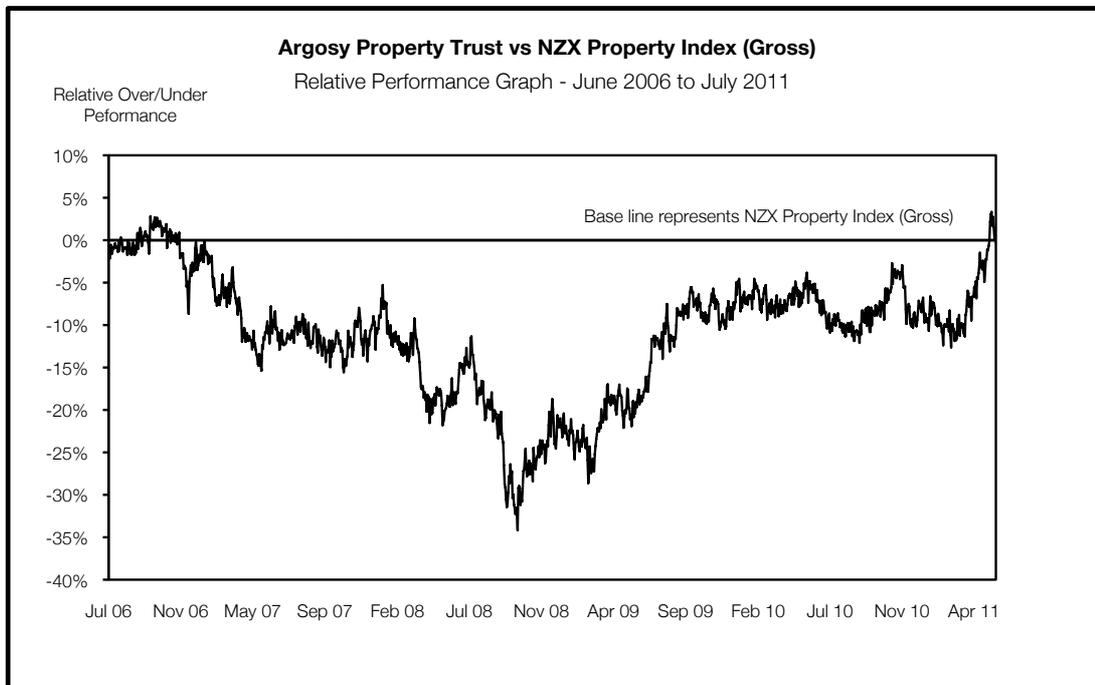
The units held by MFL and OnePath Wholesale Property Securities (on behalf of SIL) are managed by OnePath as Manager of MFL and SIL and comprise 26.4% of the units on issue.

## 10.8 Unit Price Performance

The unit price and trading volume history of Argosy units is depicted graphically below.



Argosy's unit price has declined substantially over the past five years and, as can be seen in the chart above, was particularly depressed during the height of the global financial crisis. Following the announcement of the Proposed Internalisation significant volumes of Argosy units have been traded. Argosy's unit price against the NZX Property Index (as though all dividends and distributions have been reinvested in units/shares) is shown in the graph below:



Using June 2006 as a reference point Argosy has underperformed against the NZX Property Index since late 2006. Importantly, however, if June 2009 were used as a base, Argosy has largely outperformed the NZX Property Index over the past 2 years.

GRANT SAMUEL & ASSOCIATES LIMITED

8 August 2011

*Grant Samuel + Associates*

## Appendix A

### Recent Transaction Evidence

The valuation of the Management Rights has been considered having regard to the multiples implied by the price at which broadly comparable companies and businesses have changed hands. A selection of relevant transactions is set out below:

| Recent Transaction Evidence |                                |   |   |                   |                            |                     |
|-----------------------------|--------------------------------|---|---|-------------------|----------------------------|---------------------|
| Date                        | Target                         | Transaction   | Consideration <sup>17</sup><br>(millions) | AUM<br>(billions) | Consideration /<br>AUM (%) | Revenue<br>Multiple |
| Oct-10                      | National Property Trust        | Internalisation   | NZ\$2.5                                   | NZ\$0.2           | 1.4%                       | 1.8 x               |
| Jul-10                      | DNZ                            | Internalisation   | NZ\$35.0                                  | NZ\$0.7           | 4.0%                       | 3.5 x               |
| Aug 09                      | Ardent Leisure                 | Internalisation   | A\$17.0                                   | A\$0.8            | 2.0%                       | 5.0 x               |
| July 09                     | MacArthur Cook                 | Acquisition of Manager<br>by AIMS Financial             | A\$14.2                                   | A\$1.3            | 1.1%                       | 1.1 x               |
| Jun-09                      | Macquarie Airports             | Internalisation   | A\$345.0                                  | A\$13.0           | 2.7%                       | 7.9 x               |
| Apr-09                      | Macquarie<br>Communications    | Acquisition of Fund and<br>Manager by CPP               | A\$96.5                                   | A\$7.6            | 1.3%                       | 2.4 x               |
| Dec-07                      | ING Property<br>Management     | Acquisition of 50%<br>stake from Symphony<br>Group      | NZ\$77.6                                  | NZ\$1.1           | 6.9%                       | 8.3 x               |
| Dec-07                      | Rubicon Holdings (Aust)<br>Ltd | Acquisition of 79.6% by<br>Allco Finance                | A\$328                                    | A\$5.1            | 6.4%                       | na                  |
| Jul-07                      | Macquarie Pro Logis            | Acquisition of Fund &<br>50% of Manager by Pro<br>Logis | US\$22.0                                  | US\$1.8           | 2.5%                       | 5.5 x               |
| Jun-07                      | Scarborough                    | Acquisition by Valad                                    | A\$865.0                                  | A\$10.2           | 8.5%                       | na                  |
| Jun-07                      | Halverson Real Estate          | Acquisition of 75% by<br>GPT Group                      | A\$125.0                                  | A\$2.2            | 5.7%                       | na                  |
| Jun-07                      | Multiplex Capital              | Takeover by Brookfield                                  | A\$375.0                                  | A\$5.8            | 6.5%                       | na                  |
| Jul-04                      | Urbus Property<br>Management   | ING Property<br>Management                              | NZ\$31.5                                  | NZ\$0.4           | 7.9%                       | 5.0 x               |
| <b>Average</b>              |                                |   |   |                   | <b>4.4%</b>                | <b>4.5 x</b>        |

Each transaction has its own unique set of circumstances. As such it is often very difficult to identify trends or draw any meaningful conclusions. In interpreting and evaluating such data it is necessary to recognise that:

- acquisition multiples from comparable transactions are usually seen as a good guide when valuing 100% of a business (or in this case the Management Rights) but the data tends to be less transparent and information on forecast earnings is often unavailable;
- the analysis will give a range of outcomes from which averages or medians can be determined but it is not appropriate to simply apply such measures to the company being valued. The most important part of valuation is to evaluate the attributes of the specific transaction and to distinguish it from other transactions so as to form a judgement as to where on the spectrum it belongs;
- acquisition multiples are a product of the economic and other circumstances at the time of the transaction. Each transaction will be the product of a unique combination of factors, including:

<sup>17</sup> Implied value if 100% of company or business had been acquired

- economic factors (e.g. economic growth, inflation, interest rates) affecting the markets in which the company operates;
  - strategic attractions of the business – its particular strengths and weaknesses, market position of the business, strength of competition and barriers to entry;
  - the business’s own performance and growth trajectory;
  - rationalisation or synergy benefits available to the acquirer;
  - the structural and regulatory framework;
  - investment conditions at the time; and
  - the number of competing buyers for a business;
- acquisitions in different countries can be analysed for comparative purposes, but it is necessary to give consideration to differences in economic factors (economic growth, inflation, interest rates), market structure (competition etc) and the regulatory framework. However, it is not appropriate to adjust multiples in a mechanistic way for differences in such factors; and
  - acquisition multiples are based on the target business’ earnings but the price paid normally reflects the fact that there were cost reduction opportunities or synergies available to the acquirer. If the target’s earnings were adjusted for these cost reductions and/or synergies the effective multiple paid by the acquirer would be lower than that calculated on the target’s earnings.

A brief description of these transactions follows:

#### ***National Property Trust***

As part of a significant restructure of National Property Trust that converted it into a limited liability company, the Trust’s manager (National Property Trust Limited) ceased to hold office. It was paid \$2.5 million to relinquish its management contract and related assets, with the management duties being internalised. At the time the Trust held a portfolio of diversified commercial properties valued at \$187 million.

#### ***DNZ Property Fund***

As part of restructuring arrangements leading to DNZ Property Fund obtaining a stock exchange listing, the Fund internalised its management function through acquiring the existing management contracts from DNZ Management for \$35 million. \$10 million of this amount was reinvested back into the Fund by persons associated with DNZ Management. The Fund holds a diversified portfolio of commercial office, retail and industrial properties throughout New Zealand valued at \$660 million.

#### ***Ardent Leisure Group***

Ardent Leisure Group (formerly Macquarie Leisure Trust Group) internalised its asset management function through the acquisition of all the shares in Macquarie Leisure Management Limited in August 2009. Ardent Leisure is a leading owner and operator of Australian leisure assets including Dreamworld, White Water World, Goodlife Health Clubs and AMF and Kingpin Bowling. An independent expert valued Macquarie Leisure Management at A\$18.8 million against Ardent Leisure’s acquisition cost of A\$17 million. The internalisation formed part of a package of measures designed to enhance alignment between investors and management and a repositioning of the business for a growth phase.

#### ***MacArthurCook***

MacArthurCook, an international property fund management company, was acquired by AIMS Financial Services in August 2009. AIMS is a non-bank financial services and investment group and includes funds management in its product group. The acquisition was made by way of a takeover offer to acquire the 15% shares that AIMS did not already own. MacArthurCook was listed on the Australian Stock Exchange and at the time of the offer had funds under management of approximately A\$1.5 billion.

### ***Macquarie Airports***

Macquarie Airports internalised its management arrangements by terminating Macquarie Group Limited's management rights and paying A\$345 million in Macquarie Airports securities as compensation in September 2009. An independent expert valued the management rights in the range of A\$321million – A\$401 million. Macquarie Airports is one of the world's largest private airport owners with a majority ownership of three major airports – Sydney, Copenhagen and Brussels. It is listed on the ASX and has a market capitalisation of approximately A\$5.7 billion.

### ***Macquarie Communications***

The Canadian Pension Plan Investment Board (**CPP**) agreed to acquire 100% of Macquarie Communications Infrastructure Group (**MCG**) for A\$1.37 billion in April 2009. By way of a separate inter-conditional offer CPP also acquired MCG's manager, Macquarie Communications Infrastructure Management Limited (**MCIML**), for A\$96.5 million. MCIML itself held 18.4% of MCG. MCG had three primary assets located in the UK and Australia. These are a 48% stake in Arqiva, the leading broadcast transmission provider and communication infrastructure; a 50% stake in Airwave, the sole national of communications solutions to UK's emergency and public safety businesses; and 100% of Broadcast Australia, the leading broadcast transmission provider in Australia.

### ***Rubicon Holdings***

In December 2007, Allco Finance acquired the remaining 79.6% of Rubicon Holdings it did not already hold. Allco Finance was a fully integrated global financial services business listed on the ASX. It offered structured asset finance, funds management, and debt and equity funding. It was placed in liquidation in 2009 following fallout from the global financial crisis. Rubicon Holdings was the manager of three publicly listed traded real estate investment trusts.

### ***Macquarie ProLogis Trust (MPT)***

In July 2009 the unit holders in MPT approved a proposal for New York based ProLogis to acquire units in the Trust. Included in the proposal was the purchase of MPT's 50% shareholding in its Manager, Macquarie ProLogis Management Limited. ProLogis is the leading global provider of distribution facilities with operations in markets all across North America, Europe and Asia. MPT invests in industrial properties in the USA, Mexico, and Australia, with an emphasis on warehouse and distribution centres.

### ***Scarborough***

In June 2007 Scarborough, a property management company headquartered in the UK, was acquired by Australia's Valad Property Group. Scarborough had A\$10.2 billion in AUM, including direct property ownership, fund management and development operations in Britain and Europe. Valad undertakes real estate management in Australia and Europe, and real estate ownership primarily in Australia and New Zealand. It manages approximately A\$9 billion in property assets.

### ***Halverton Real Estate***

In June 2007, GPT Group took steps to acquire the 75% of UK based Halverton Real Estate (**HRE**) that it did not already directly or indirectly control. GPT is a diversified Australian based property group with a A\$9.5 billion portfolio of real estate assets across the retail, office and industrial/business park sectors. HRE was a pan European investment and asset management company with AUM of approximately A\$2.2 billion. Halverton managed the A\$1.4 billion light industrial property portfolio that was held by a joint venture between HPT and Babcock & Brown.

### ***Multiplex Capital***

The Canadian private equity fund, Brookfield Asset Management Limited, gained control of the Perth based Multiplex Group in June 2007 in a transaction valued at A\$4.2 billion. Included in the transaction was the

purchase of Multiplex Capital, a funds manager with property funds situated in Europe, Australia, North America and New Zealand. At the time Multiplex Capital managed funds with an asset value of approximately A\$5.8 billion. Brookfield Asset Management is based in Toronto and manages a global portfolio of assets valued at over US\$100 billion. The firm's assets are concentrated in office property, hydroelectric generation and forestry.

### ***Urbus Property Management***

In July 2004 ING purchased the management rights for Urbus Properties for \$31.5 million from interests associated with the Hodge family. At the time Urbus Properties controlled diversified property assets valued at approximately \$410 million.

## Appendix B

### Valuation Methodology Descriptions

#### *Capitalisation of Earnings*

Capitalisation of earnings or cash flows is most appropriate for businesses with a substantial operating history and a consistent earnings trend that is sufficiently stable to be indicative of ongoing earnings potential. This methodology is not particularly suitable for start-up businesses, businesses with an erratic earnings pattern or businesses that have unusual expenditure requirements. This methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the stream of income that it generates. These multiples can be applied to a number of different earnings or cash flow measures including EBITDA<sup>18</sup>, EBITA<sup>19</sup>, EBIT<sup>20</sup> or net profit after tax. These are referred to respectively as EBITDA multiples, EBITA multiples, EBIT multiples and price earnings multiples. Price earnings multiples are commonly used in the context of the share market. EBITDA, EBITA and EBIT multiples are more commonly used in valuing whole businesses for acquisition purposes where gearing is in the control of the acquirer.

Where an ongoing business with relatively stable and predictable earnings is being valued Grant Samuel uses capitalised earnings or operating cash flows as a primary reference point. Application of this valuation methodology involves:

- estimation of earnings or cash flow levels that a purchaser would utilise for valuation purposes having regard to historical and forecast operating results, non-recurring items of income and expenditure and known factors likely to impact on operating performance; and
- consideration of an appropriate capitalisation multiple having regard to the market rating of comparable businesses, the extent and nature of competition, the time period of earnings used, the quality of earnings, growth prospects and relative business risk.

The choice between the parameters is usually not critical and should give a similar result. All are commonly used in the valuation of industrial businesses. EBITDA can be preferable if depreciation or non-cash charges distort earnings or make comparisons between companies difficult but care needs to be exercised to ensure that proper account is taken of factors such as the level of capital expenditure needed for the business and whether or not any amortisation costs also relate to ongoing cash costs. EBITA avoids the distortions of goodwill amortisation. EBIT can better adjust for differences in relative capital intensity.

Determination of the appropriate earnings multiple is usually the most judgemental element of a valuation. Definitive or even indicative offers for a particular asset or business can provide the most reliable support for selection of an appropriate earnings multiple. In the absence of meaningful offers, it is necessary to infer the appropriate multiple from other evidence.

The usual approach is to determine the multiple that other buyers have been prepared to pay for similar businesses in the recent past. However, each transaction will be the product of a unique combination of factors. A pattern may emerge from transactions involving similar businesses with sales typically taking place at prices corresponding to earnings multiples within a particular range. This range will generally reflect the growth prospects and risks of those businesses. Mature, low growth businesses will, in the absence of other factors, attract lower multiples than those businesses with potential for significant growth in earnings.

An alternative approach used in valuing businesses is to review the multiples at which units in listed companies in the same industry sector trade on the share market. This gives an indication of the price levels

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<sup>18</sup> Earnings before interest, tax, depreciation and amortisation

<sup>19</sup> Earnings before interest, tax and amortisation

<sup>20</sup> Earnings before interest and tax

at which portfolio investors are prepared to invest in these businesses. Share prices reflect trades in small parcels of units (portfolio interests) rather than whole companies and it is necessary to adjust for this factor.

The analysis of comparable transactions and share market prices for comparable companies will not always lead to an obvious conclusion as to which multiple or range of multiples will apply. There will often be a wide spread of multiples and the application of judgement becomes critical. Moreover, it is necessary to consider the particular attributes of the business being valued and decide whether it warrants a higher or lower multiple than the comparable companies. This assessment is essentially a judgement.

### ***Discounted Cash flow***

Discounting of projected cash flows has a strong theoretical basis. It is the most commonly used method for valuation in a number of industries, and for the valuation of start-up projects where earnings during the first few years can be negative. DCF valuations involve calculating the net present value of projected cash flows. This methodology is able to explicitly capture the effect of a turnaround in the business, the ramp up to maturity or significant changes expected in capital expenditure patterns. The cash flows are discounted using a discount rate, which reflects the risk associated with the cash flow stream. Considerable judgement is required in estimating future cash flows and it is generally necessary to place great reliance on medium to long-term projections prepared by management. The discount rate is also not an observable number and must be inferred from other data (usually only historical). None of this data is particularly reliable so estimates of the discount rate necessity involve a substantial element of judgment. In addition, even where cash flow forecasts are available the terminal or continuing value is usually a high proportion of value. Accordingly, the multiple used in assessing this terminal value becomes the critical determinant in the valuation (i.e. it is a “de facto” cash flow capitalisation valuation). The net present value is typically extremely sensitive to relatively small changes in underlying assumptions, few of which are capable of being predicted with accuracy, particularly beyond the first two or three years. The arbitrary assumptions that need to be made and the width of any value range mean the results are often not meaningful or reliable. Notwithstanding these limitations, DCF valuations are commonly used and can at least play a role in providing a check on alternative methodologies, not least because explicit and relatively detailed assumptions need to be made as to the expected future performance of the business operations.

### ***Realisation of Assets***

Valuations based on an estimate of the aggregate proceeds from an orderly realisation of assets are commonly applied to businesses that are not going concerns. They effectively reflect liquidation values and typically attribute no value to any goodwill associated with ongoing trading. Such an approach is not appropriate in the case of the Management Rights.

### ***Industry Rules of Thumb***

Industry rules of thumb are commonly used in some industries. These are generally used by a valuer as a “cross check” of the result determined by a capitalised earnings valuation or by discounting cash flows, but in some industries rules of thumb can be the primary basis on which buyers determine prices. In the property management industry multiples of revenue and percentages of AUM are commonly used metrics with which to perform cross checks. However, it should be recognised that rules of thumb are usually relatively crude and prone to misinterpretation.

## Appendix C

### Qualifications, Declarations and Consents

#### **Qualifications**

The Grant Samuel group of companies provides corporate advisory services (in relation to mergers and acquisitions, capital raisings, corporate restructuring and financial matters generally), property advisory services and manages private equity and property development funds. One of the primary activities of Grant Samuel is the preparation of corporate and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since inception in 1988, Grant Samuel and its related companies have prepared more than 400 public expert and appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Michael Lorimer, BCA and Alexa Preston, BBus, CA. Each has a significant number of years of experience in relevant corporate advisory matters.

#### **Limitations and Reliance on Information**

Grant Samuel's opinion is based on economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time. The report is based upon financial and other information provided by the directors, management and advisers of Argosy. Grant Samuel has considered and relied upon this information. Grant Samuel believes that the information provided was reliable, complete and not misleading and has no reason to believe that any material facts have been withheld.

The information provided has been evaluated through analysis, enquiry, and review for the purposes of forming an opinion as to the underlying value of Argosy. However in such assignments time is limited and Grant Samuel does not warrant that these inquiries have identified or verified all of the matters which an audit, extensive examination or "due diligence" investigation might disclose.

An analysis of the merits of the Proposed Internalisation is in the nature of an overall opinion rather than an audit or detailed investigation. Grant Samuel has not undertaken a due diligence investigation of Argosy. In addition, preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of Argosy. It is understood that, where appropriate, the accounting information provided to Grant Samuel was prepared in accordance with generally accepted accounting practice and in a manner consistent with methods of accounting used in previous years.

An important part of the information base used in forming an opinion of the kind expressed in this report is the opinions and judgement of the management of the relevant enterprise. That information was also evaluated through analysis, enquiry and review to the extent practicable. However, it must be recognised that such information is not always capable of external verification or validation.

The information provided to Grant Samuel included projections of future revenues, expenditures, profits and cash flows of the Manager and Argosy prepared by the Manager. Grant Samuel has used these projections for the purpose of its analysis. Grant Samuel has assumed that these projections were prepared accurately, fairly and honestly based on information available to management at the time and within the practical constraints and limitations of such projections. It is assumed that the projections do not reflect any material bias, either positive or negative. Grant Samuel has no reason to believe otherwise.

However, Grant Samuel in no way guarantees or otherwise warrants the achievability of the projections of future profits and cash flows for the Manager or Argosy. Projections are inherently uncertain. Projections are predictions of future events that cannot be assured and are necessarily based on assumptions, many of

which are beyond the control of management. The actual future results may be significantly more or less favourable.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue. In forming its opinion, Grant Samuel has assumed, except as specifically advised to it, that:

- the title to all such assets, properties, or business interests purportedly owned by Argosy and the Manager are good and marketable in all material respects, and there are no material adverse interests, encumbrances, engineering, environmental, zoning, planning or related issues associated with these interests, and that the subject assets, properties, or business interests are free and clear of any and all material liens, encumbrances or encroachments;
- there is compliance in all material respects with all applicable national and local regulations and laws, as well as the policies of all applicable regulators other than as publicly disclosed, and that all required licences, rights, consents, or legislative or administrative authorities from any government, private entity, regulatory agency or organisation have been or can be obtained or renewed for the operation of the business of Argosy and the Manager, other than as publicly disclosed;
- various contracts in place and their respective contractual terms will continue and will not be materially and adversely influenced by potential changes in control; and
- there are no material legal proceedings regarding the business, assets or affairs of Argosy or the Manager, other than as publicly disclosed.

### **Disclaimers**

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion as to the merits of the Proposed Internalisation and the Alternative Proposals. Grant Samuel expressly disclaims any liability to any Argosy Unit Holder and the Trustee in the event they rely or purport to rely on the report for any other purpose and to any other party who relies or purports to rely on the report for any purpose whatsoever.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

Grant Samuel has had no involvement in the preparation of the Notice of Meeting issued by the Manager and has not verified or approved any of the contents of the Notice of Meeting. Grant Samuel does not accept any responsibility for the contents of the Notice of Meeting (except for this report).

### **Independence**

Grant Samuel and its related entities do not have any shareholding in or other relationship or conflict of interest with Argosy or the Manager that could affect its ability to provide an unbiased opinion in relation to the Proposed Internalisation. Grant Samuel had no part in the formulation of the Proposed Internalisation. Its only role has been the preparation of this report. Grant Samuel will receive a fixed fee for the preparation of this report. This fee is not contingent on the outcome of the Proposed Internalisation. Grant Samuel will receive no other benefit for the preparation of this report. Grant Samuel confirms that it is independent of the Manager and the Trustee.

## **Information**

Grant Samuel has obtained all the information that it believes is desirable for the purposes of preparing this report, including all relevant information which is or should have been known to any Director of the Manager and made available to the Directors. Grant Samuel confirms that in its opinion the information provided by the Manager and contained within this report is sufficient to enable Argosy Unit Holders to understand all relevant factors and make an informed decision in respect of the Proposed Internalisation. The following information was used and relied upon in preparing this report:

### **Publicly Available Information**

- the Trust's annual and interim reports for the years ended 31 March 2007, 2008, 2009, 2010 and 2011;
- the Trust Deed (including various amendments);
- information on the Trust's website;
- the Manager's financial statements for the years ended 31 March 2005, 2006, 2007, 2008, 2009 and the nine month period ended 30 September 2010;
- various presentations and announcements released by the Trust to the NZX;
- various presentations and announcements released by DNZ to the NZX;
- the Unit Trusts Act 1960; and
- other information on the property industry and publicly listed companies with operations broadly comparable to Argosy and the Manager including annual reports, interim financial results, press reports, industry studies and information regarding the prospective financial performance of such companies.

### **Non Public Information**

- the Trust's five year financial forecast for the period from 1 April 2011 to 31 March 2016;
- recent board papers of the Trust;
- a review of the stand alone operating costs of the Manager prepared by McGrath Nichol in February 2011;
- drafts of the transaction documents including the Transaction Implementation Deed, the Transitional Services Deed and the Termination Letter;
- stand alone cost estimates prepared by the Independent Directors and the Manager; and
- other confidential correspondence, reports and agreements as provided by the Manager.

## **Declarations**

The Manager has agreed that it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity will not apply in respect of the proportion of any liability found by a Court to be primarily caused by any conduct involving gross negligence or misconduct by Grant Samuel. The Manager has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person. Where Grant Samuel or its employees and officers are found to have been grossly negligent or engaged in misconduct Grant Samuel shall bear the proportion of such costs caused by its action. Any claims by the Manager are limited to an amount equal to the fees paid to Grant Samuel.

Advance drafts of this report were provided to the directors and executive management of the Manager. Certain changes were made to the drafting of the report as a result of the circulation of the draft report. There was no alteration to the methodology, evaluation or conclusions as a result of issuing the drafts.

### **Consents**

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the Notice of Meeting to be sent to security holders of Argosy. Neither the whole nor any part of this report nor any reference thereto may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.