

23 April 2010

Mr Tim Storey  
Chairman  
DNZ Property Fund Limited  
PO Box 6320  
Wellesley Street  
**AUCKLAND 1036**

Dear Tim

## **DNZ Management Rights – Summary of Valuation**

The independent directors of DNZ Property Fund Limited (“DNZPF”) engaged Deloitte to provide advice in relation to:

- i. the current value of the management agreement between DNZPF and DNZ Management Limited (“DNZM”) (the “DNZ Management Agreement”);
- ii. the current value of the management agreement between Diversified NZ Property Fund Limited (“DPF”) and Diversified Management Limited (“DML”) (the “Diversified Management Agreement”); and
- iii. the financial merits of the proposed internalisation of the management agreements and the impact on DNZPF shareholders.

Our instructions were set out in an engagement letter dated 11 February 2010. The valuations were to assist the independent directors in assessing the consideration to be paid to DNZM under a proposal for DNZPF to internalise the DNZ Management Agreement and acquire the Diversified Management Agreement. We provided our final report to the independent directors of DNZPF in March 2010.

The purpose of this letter is to summarise our valuation. We consent to this letter being provided to the shareholders of DNZPF, subject to the terms and conditions contained in the engagement letter.

## **Background**

DNZPF is managed by DNZM under the DNZ Management Agreement. DML holds the management agreement for DPF, however it has subcontracted its management role to DNZM. Effectively, therefore, DNZM manages both DNZPF and DPF, and it is these managements rights which were the subject of our valuation report.

DNZPF has two classes of equity securities, Group A and Group B shares. The DNZPF Group B shares are owned by DNZ Property Group Limited. DNZ Property Group Limited also owns all of the shares in DNZM, which has the rights to manage DNZPF. DNZPF’s constitution gives the Group B shares the right to appoint up to four of the six directors of DNZPF, and the ability to veto a shareholders’ resolution. Because of this control provided by the DNZPF Group B shares, we consider DNZM’s management rights in relation to DNZPF to be very secure. DNZM can continue as the manager under the current contract and fee arrangements for a further 19 years, even though we

believe these fee arrangements are above current market norms for a portfolio of this size and asset mix. Thereafter, the Group B shares effectively entrench DNZM as the manager, albeit at fees negotiated by DNZPF's directors acting in good faith and in the best interests of the company (which we have taken to mean at estimated market rates for such services).

Due to the level of entrenchment of DNZM as manager of DNZPF (created by the Group B shares), it is necessary to value as one combined package the DNZ Management Agreement and the Group B shares. Treating the two as a bundled asset is also consistent with the internalisation proposal, which would require not only the purchase of the management rights, but also the cooperation of the Group B shareholders.

The Diversified Agreement is effectively a perpetual contract. However the management fees are able to be renegotiated between DML and DPF, with approval by a special resolution (requiring a 75% majority) of the mandatory convertible noteholders and the ordinary shareholders of DPF. Accordingly, DML is entrenched as the manager of DPF with management fees at market rates.

Under the proposal to internalise the DNZ Management Agreement and acquire the Diversified Management Agreement, DNZPF would save the fees it would otherwise pay to DNZM and receive the fees paid by DPF, but would itself incur the cost of running the management team. The net effect of this is that DNZPF would capture the profit that would otherwise be earned by DNZM. To achieve this benefit, DNZPF must acquire the DNZPF and DPF management rights from DNZM.

## Valuation Approach

We have assessed the fair value of the DNZ Management Agreement (and the associated B shares) and the Diversified Management Agreement. We interpret fair value in this context to mean that, based on reasonable forecasts of future cash flows and the risks associated with these cash flows, the manager should be indifferent between receiving an upfront payment or continuing to receive payments as the manager. In valuation terms, we are assessing the present value of the forecast free cash flows associated with the management contracts.

The forecast free cash flows we valued are those that are expected to result from a continuation of the status quo (i.e. what cash profits DNZM would expect to receive if it continued under the current arrangements). Our valuation scenario must therefore take into account the constraints and prospects of the manager and funds in their current situation and the expected economic conditions. We have therefore assumed there are no future equity capital raisings, and no growth in the property portfolio through acquisitions until the debt level reduces to a more sustainable level of 40% (through property price appreciation). This is a relatively low growth scenario.

## Valuation Conclusion

The following table shows our valuation as at 31 March 2010, based on the assumptions and methodology detailed in our full report.

Valuation Conclusion		
\$ million	Low	High
DNZ Management Agreement (including Group B Shares)	\$47.4	\$50.9
Diversified Management Agreement	\$4.6	\$5.0
<b>Total</b>	<b>\$52.0</b>	<b>\$55.9</b>

We assessed the reasonableness of our valuation by comparing the multiples implied by our valuation (i.e. the value/EBIT multiple and the value as a percentage of funds under management) with the equivalent multiples derived from transactions involving property fund managers in New Zealand and Australia. We concluded that the multiples implied by our valuation are consistent with (and in the middle of the range of) the valuation multiples observed in these transactions.

## Internalisation Impact and Merits

If our status quo forecasts were to eventuate, then from a purely financial point of view the Group A shareholders of DNZPF should be indifferent between paying fair value to internalise the management contracts and remove the Group B shares, or keeping the current arrangements in place. If the contracts and the Group B shares were to be acquired at a price below our assessment of fair value, then this would represent a value gain to DNZPF.

Under the status quo scenario, we have estimated that the after-tax benefits of internalisation (before acquisition funding costs) to DNZPF over the next few years would average approximately \$3.5 million per annum. We expect the benefit would grow over time even in our status quo forecasts, and the benefits are potentially greater if listing and raising capital enables the fund to grow faster. In addition, if the internalisation of the management contracts allows the company to list on the NZX and raise additional capital, then we anticipate further benefits to shareholders such as greater liquidity (which may have a positive impact on the share price), and economies of scale.

## Important Notice

We confirm that this letter is consistent with, and is a fair summary of, our full report dated March 2010.

Our full report and this letter have been prepared with care and diligence and the statements and conclusions are given in good faith and in the belief, on reasonable grounds, that such statements and conclusions are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial positions of DNZPF, DPF, DNZM or DML will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of DNZPF, DPF, DNZM and DML. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

Yours sincerely

**DELOITTE**



**Chas Cable**  
Partner