

# **GPT**

## **GENERAL PROPERTY TRUST**

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### **General Property Trust Stock Exchange Announcement & Media Release**

### **RESPONSE TO QUESTIONS FROM MAJOR INVESTORS**

**25 May 2005**

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The Internalisation Proposal scheduled for a unitholder vote on 2 June 2005 has stimulated a number of questions from some of GPT's major investors. Attached is a collation of those questions and GPT's responses, an edited version of which has been provided to those major investors.

**ENDS**

#### **Enquiries**

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A prospectus for GPT Management Holdings Limited (**GPTCo**) shares was lodged with the Australian Securities and Investments Commission on 2 May 2005. The offers of the GPTCo shares will be made in, or accompanied by, a copy of the prospectus. Anyone wishing to acquire the GPTCo shares must be a member of General Property Trust (ARSN 090 110 357) on the record date specified in the prospectus.



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## Addressing specific questions raised by certain investors and commentators

Since receiving an unsolicited merger proposal from Lend Lease just over a year ago, GPT's independent directors and management team have been focused at all times on working for the interests of unitholders as a whole.

In the course of briefing our owners, we have addressed a number of questions concerning the information provided in the Explanatory Memorandum released to unitholders on 2 May 2005. In order to provide a comprehensive summary of the issues raised, key points are included below.

### 1. Why higher growth is desirable

In recent years, GPT has consciously sought to broaden its scope to address investor feedback that GPT needed to generate higher growth while maintaining an appropriate risk profile. As a result, GPT has diversified into investments in bulky good centres (Homemaker portfolio), hotels and master planned urban communities over the period since 2001 and is now proposing the Internalisation accompanied by the Joint Venture and Asset Sales.

As you are aware, GPT has had ongoing, frequent consultation with investors, in the period since the LLC merger proposal failed to gain GPT unitholder support. This revealed a clear consensus that enhanced growth (as well as internalisation) was a requirement for any counter proposal.

In addition, investors will recall that GPT has recently been subject to an undervalued, unsolicited takeover offer by Stockland and the Independent Directors believed it was critical to put forward a proposal that would make GPT competitive within the LPT sector on an ongoing basis and end the climate of uncertainty surrounding GPT without preventing any development of future takeover bids at appropriate values and with risk profiles commensurate with GPT's investment philosophy.

The Internalisation Proposal as a whole is estimated to create \$880m of value for unitholders in the short term, the vast majority of which is attributed to the Joint Venture and Asset Sales<sup>1</sup>. It also provides GPT with a platform from which to increase significantly the rate of growth in earnings and distributions whilst preserving GPT traditional strengths and its essential character as a vehicle at the lower end of the risk spectrum for LPTs.

### 2. Appropriate risk management mechanisms have been incorporated

While GPT has been focused on establishing a new growth platform, GPT has been equally concerned to implement appropriate risk management measures. Those measures include the following:

- the majority of the investments of the Joint Venture will be in defensive, income-producing assets (typically backed by long-term leases to creditworthy tenants), or in low volatility assets with upside potential (such as the German residential apartments with long tenant histories);
- investments must be capable of being held for up to 10 years;
- debt-funding of the Joint Venture investments will be long-term and non-recourse, appropriately hedged against interest rate and currency fluctuation;
- GPT's investment in the Joint Venture will be capped at 15% of GPT's total assets;
- GPT's investment in the Joint Venture is predominantly based around the \$700 million investment in 9% return preferred capital which ranks ahead of the Joint Venture's ordinary capital; and
- GPT will have final veto rights over any investments proposed to the Joint Venture.

### 3. Why the Joint Venture terms strike a reasonable balance

GPT rejects any suggestion that the Joint Venture terms are unfair to GPT or unduly generous to Babcock and Brown ("B&B"). GPT went to great lengths in negotiating a necessarily robust and detailed joint venture with B&B so as to create an appropriate balance between the risk/return position deemed desirable by GPT and the need to ensure that significant incentives were in place for B&B to deliver an appropriate quality and quantity of opportunities to the joint venture from its global real estate platform.

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<sup>1</sup> Implied value creation based on internalisation uplift of 13 cents per GPT unit and joint venture/asset sales uplift of 31 cents per GPT unit being the mid-point of the ranges determined by the independent expert, Grant Samuel & Associates, report dated 2 May 2005.

Our solution requires B&B to commit \$100m of equity capital to a joint venture rather than act as a traditional external fund manager earning base management and performance fees.

B&B's disproportionate ordinary equity interest (equivalent to a one-off 17% goodwill factor) in the joint venture has attracted attention. Again the appropriate equity investment was the subject of careful consideration by the Independent Directors, GPT management and their advisors. In summary it recognises and compensates B&B for:

- providing GPT with a 5 month option over the initial portfolio of c.\$1.4 billion of assets
- agreeing to sell assets to the joint venture at a \$35m discount to independent assessed valuation
- providing a first right to the joint venture to provide equity capital for any property acquisition identified by B&B across the globe, where B&B is raising third party Australian capital from listed or wholesale investors
- access to B&B's real estate expertise and deal sourcing capability around the world – without any obligation to contribute to the overheads of that business
- providing world class expertise in structuring and financing real estate transactions which enhance the joint venture's investments by mitigating risks and/or improving returns
- underwriting the delivery of an acquisition pipeline which is intended to see the joint venture fully invested by 31 December 2006 and generate an uplift in distributions of 1.0cpu in CY2005 and 2.75cpu in CY2006

After working closely with the B&B team for over six months, we are confident that the joint venture will exceed our expectations and endure over the long term because it offers strong strategic and financial benefits to both parties. In addition, GPT procured protections for unitholders in the form of rights to terminate the joint venture after three years in the event that GPT has not received a required weighted average minimum total return of 10% across its preferred capital and ordinary equity investment in the joint venture. If under such circumstances GPT chose to terminate the joint venture, B&B may forfeit its "uplift" in the ordinary equity on a winding up.

We also note that it has been suggested that these termination provisions can be characterised as a "poison pill" however in fact these provisions are designed to protect GPT unitholders' capital and take effect at market value.

#### **4. Fees potentially payable by the Joint Venture to B&B are comparable with accepted LPT standards**

The basic principle enshrined in the joint venture agreement is that both parties will be remunerated at market rates for genuine third party transaction related services. There is no fee leakage to either party for ongoing asset or property management.

The most contentious and misunderstood component of the fee arrangements is the maximum 5% cap on advisory fees. The key points to note here are:

- this cap was put in place to incentivise B&B (or GPT) to source acquisitions at or below independently assessed market value
- GPT will select and instruct independent valuers in all cases – as was the case with the initial portfolio of assets. GPT will also be strengthening its management platform with key appointments in both Australia and Europe to assess, in conjunction with B&B, investment opportunities and determine the ongoing strategic direction of the Joint Venture
- where acquisitions are acquired at market value, fees payable to B&B will be limited to a 1% fixed advisory fee and a debt arranging fee at market rates (typically 40 to 50 BP on debt arranged) where these services are performed by B&B. Unlike most externally managed LPTs there will not be additional leakage in the form of base management fees, sponsor's fees etc
- where acquisitions are acquired below market value, the 5% cap will be inclusive of all fees for services provided by B&B. Our review of standard fees charged by externally managed vehicles, indicates that over say a three year period total fee leakage suffered would typically amount to between 3 and 4% of total asset value<sup>2</sup>. On this basis, if the maximum cap is applicable the effective mark-up to B&B is, in fact, between 1 and 2%

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<sup>2</sup> Assuming standard fees charged by external LPT managers, eg sponsors fees of 80BP at IPO, acquisition and due diligence fees of 100BP and 25BP, respectively, on all asset acquisitions, annual base management fees of 45BP and debt arranging fees of 50BP.

- unlike most externally managed LPTs with offshore assets which typically acquire assets via public auctions or from their joint venture partners, the joint venture expects to benefit from sourcing acquisitions off-market and via established local relationships providing it with real potential to acquire assets at below independent, open market value
- ultimately all acquisitions will be subject to due diligence and a right of veto in favour of GPT. Where GPT does not believe the acquisition terms net of proposed fees are sufficiently attractive, it has the capacity to seek improved terms by seeking lower fees or to reject the opportunity.

## **5. Quality of Joint Venture properties and use of 'financial engineering'**

Certain commentators have suggested that the yields of the Joint Venture properties are 'unremarkable' and that the EPU uplift is derived from 'financial engineering' such as the positive borrowing spread and the conversion of Australian dollar debt to Euro denominated debt.

GPT believes these criticisms are misplaced and re-states that the yields quoted in the Explanatory Memorandum are net of outgoings, repairs and maintenance and (in the case of the residential assets) discretionary, earnings accretive modernisation capex and the yields are in fact significantly higher than comparable yields available on Australian properties.

These are strong investments, with long term stable cash flows with net yields well above the cost of debt in Europe. This is in fact a desirable characteristic for any property investment rather than a "financially engineered" outcome. In addition, GPT intends to match its investment in the joint venture with Euro denominated debt to minimise A\$ NTA volatility for our investors.

## **6. GPT considered a broad range of alternative strategies and partners**

Since May 2004, GPT has constantly reviewed its alternatives. This involved consideration of a broad range of alternative strategies and partners. As disclosed in section 2.4 of the Explanatory Memorandum, GPT had discussions with several parties, including Lend Lease.

The Independent Directors have unanimously recommended the current proposal in light of all likely alternatives. We believe the recommended proposal strikes a sensible balance between the desire for higher growth and taking on additional risk whilst offering the potential both independently (and via the joint venture) to develop a broader platform and expertise in funds and asset management within Australia and overseas. This will benefit GPT as an organisation over the long term and permits significant opportunities and benefits to be realised.

## **7. Information on ADFML (New RE)**

The Explanatory Memorandum set out considerable information on ADFML. In substance, as the new responsible entity of GPT, ADFML (which will become GPT RE Ltd) will have the same Board of Directors, the same senior management team (led by Nic Lyons), the same "responsible officers" and the same resources as the current responsible entity (GPTML) has. GPT conducted appropriate due diligence on ADFML and satisfied itself that this is an appropriate vehicle to become the new responsible entity. ASIC has made an offer to grant a license which is conditional on unitholder approval of the Internalisation Proposal.

## **8. Impact of the transaction on GPT's gearing**

GPT's gearing at December 2004 was 29.7%. On a pro forma basis, this will increase marginally to 31.5% if the proposal is implemented, which remains at the lower end of GPT's stated target gearing range.

There has been much discussion concerning the "see through" gearing of GPT following the transaction. GPT has disclosed gearing on a "see through" basis in the interests of transparency, however we do not believe it represents the most appropriate measure of GPT's financial risk given:

- underlying asset level debt in the Joint Venture properties is non-recourse and asset specific (ie. it is not cross collateralised to other joint venture assets)

- the gearing of the joint venture when measured in terms of interest cover is more closely comparable to GPT's core Australian portfolio given the very significant spread between asset yields and the cost of Euro denominated debt
- asset level debt will typically be fixed rate or be swapped into fixed rates
- GPT holds the majority of its investment in the joint venture via preferred capital which ranks ahead of ordinary equity.

## 9. Structure of resolutions

GPT has been criticised for the way in which the resolutions have been structured. We make the following points:

- unitholder approval is not required for the Joint Venture and Asset Sales either by law or ASX listing rules – in fact GPT could have chosen to enter into these arrangements without unitholder approval
- in the interests of transparency and unitholder choice, GPT's Independent Directors wanted to clarify that while the resolutions pertained to the Internalisation, a 'yes' vote would result in the Joint Venture and Asset Sales also being implemented
- the package of the internalisation, joint venture and assets sales was the outcome of a robust, drawn out commercial negotiation between the relevant parties. This package has been unanimously recommended by GPT's Independent Directors and endorsed by the independent expert as being in the interests of GPT unitholders taking into account all other alternatives.

## 10. Sale of assets to Westfield

Prior to negotiating the joint venture with B&B and the asset sales to Westfield, GPT's Independent Directors faced two developments that they judged to be sub-optimal for the interests of GPT's unitholders. The first development was the undervalued bid by Stockland creating an unacceptable risk profile. The second was GPT's awareness of market speculation concerning negotiations, initiated by Lend Lease with Westfield, to assist Lend Lease to make a further bid for GPT under which if Lend Lease gained control of GPT, it would sell assets to Westfield.

The Board of GPT believed that its primary task should be to develop a proposal for GPT that was viable in its own right over the long term so as to optimise the GPT unit price. This led to negotiations with B&B – part of which required engagement with Westfield and resulted in the joint venture proposal with B&B and the asset sales to Westfield subject to unitholder approval of the Internalisation Proposal.

It had the clear benefit of:

- 1) providing a market benchmark with the existing Stockland proposal and creating 'market tension' for any other possibilities under consideration by third parties; and
- 2) not precluding the development of any superior offer for the whole GPT entity.

As GPT has outlined in the Explanatory Memorandum, GPT required a funding source for their investment in the Joint Venture and chose to sell partial interests in 3 retail assets to address this issue. Additional debt would have lifted GPT's gearing to an unacceptable level and issuing \$900m of equity would have been dilutive to existing unitholders and totally impractical given the prevailing uncertainty surrounding GPT's future.

Agreeing the Asset Sales with Westfield allowed GPT to maintain moderate gearing by re-directing the proceeds to a higher yielding investment in the form of the Joint Venture.

In the course of negotiating the proposed asset sales to Westfield, Westfield formally advised that, these negotiations were totally independent from its investment in GPT, and that they reserved their right to vote, as they thought fit, on resolutions, relating to the Internalisation Proposal.

## 11. The LLC alternative

As the Directors have previously announced to the market, GPT does not believe that the LLC alternative is a genuine proposal as the intended form and structure of the LLC alternative remains unclear. It raises numerous unanswered questions about the ongoing Board and management structure of GPT and lacks a clear strategy for

growth. For example, the possibility of an inherent conflict of interest between the interests GPT and LLC investors in this respect concerns GPT's independent directors. In combination, these factors raise concerns about instability going forward for GPT.

Finally, GPT's independent directors consider the LLC alternative is inferior in value terms, a fact supported by the opinion of the Independent Expert, which has concluded that the Joint Venture and Asset Sales add value of approximately 31 cents per unit which would not be available to unitholders under the LLC alternative<sup>3</sup>.

### **The Future**

GPT's Independent Directors unanimously re-affirm their support for the proposed internalisation because it creates a viable stand-alone entity for the future that will significantly increase value, provide a clear strategy for growth and ensure long term stability of Board and Management. I encourage you to vote 'yes' at the GPT unitholder meeting to be held on June 2, 2005. A supportive vote will herald a new, re-invigorated and rewarding era for GPT with a highly motivated Board, and talented management and staff exclusively committed to looking after your interests.

The new GPT will have a fundamental commitment to adding Value by providing attractive risk-adjusted returns for its owners while at the same time respecting and applying the inclusive Values which will underpin its dealings with all its stakeholders, be they owners, management and staff, partners and all the communities we serve.

We hope your trust will be the result.

Please don't hesitate to contact Nic or myself if you wish to discuss this letter of any aspect of the Proposal.

Yours sincerely,



**Peter Joseph**  
Chairman

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<sup>3</sup> Based on the mid-point of the ranges determined by the independent expert, Grant Samuel & Associates, report dated 2 May 2005.