

Challenger Hybrid Property Fund

Fund report and commentary – 30 June 2010

Performance						
	Quarter (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	10 years (%) p.a.	Inception (%) p.a.
Challenger Hybrid Property Fund	1.74	11.93	-8.41	0.14	5.04	6.98
Growth return	-1.05	6.90	-11.57	-6.05	-3.26	-1.13
Distribution return	2.80	5.03	3.16	6.19	8.29	8.10
Mercer/S&P Property Composite Index ¹	0.31	12.47	-11.29	0.36	6.36	7.75
Challenger Wholesale Hybrid Property Fund	1.98	13.02	-7.55	1.23	6.08	8.50
Growth return	-1.07	6.95	-11.23	-5.93	-3.07	-0.76
Distribution return	3.05	6.07	3.68	7.15	9.15	9.26
Mercer/S&P Property Composite Index ¹	0.31	12.47	-11.29	0.36	6.36	7.70

Returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax. Past performance is not a reliable indicator of future performance.

¹For the period to 1 July 2007 the benchmark for the Fund was the InTech Property Composite Index with a 50% weighting to the InTech Weighted Direct Property Index and a 50% weighting to the S&P/ASX 200 Property Trust Accumulation Index.

Investment objective

The Fund aims to outperform its benchmark, a 50% weighting to Mercer's Australian Unlisted Property Index and a 50% weighting to the S&P/ASX 300 A-REIT Accumulation Index (formerly known as the S&P/ASX 300 Property Accumulation Index), over rolling three-year periods, while providing capital growth and some income over the medium to long term (at least five years).

Investment manager

Challenger Managed Investments Limited

Investment strategy

The investment strategy is to identify the major trends in the economy, and look at how these trends will influence financial and property markets. By analysing both global and domestic economic prospects, we aim to position investment portfolios to take advantage of future economic developments.

The Fund uses an investment mix of direct property and listed property securities. Macroeconomic analysis assists in determining the weighting of the portfolio to listed property securities and direct property. It also assists in identifying sectors that have the potential to deliver superior performance. For property securities we employ a 'top-down' macroeconomic and 'bottom-up' company specific research and analysis approach.

Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

Asset allocation

	Current (\$M)	Current (%)	Range (%)
Listed property	137.2	48	30-100
Direct/unlisted property	141.7	50	0-70
Cash	4.4	2	N/A

Top five listed positions as at 31 May 2010

	Fund weight (%)
Westfield Group	21.10
Stockland Trust Group	7.19
Goodman Group	4.26
Mirvac Group	3.48
DEXUS Property Group	3.34

Fund facts

	Hybrid Property Fund	Wholesale Hybrid Property Fund
Inception date	30/09/1994	31/10/1994
Fund size (\$M)	31.1	156.4
APIR code	HBC0002AU	HBC0013AU

Fees

	Hybrid Property Fund	Wholesale Hybrid Property Fund
Entry fee	Up to 4%	Nil
2008/09 ICR	1.75%	0.82%
Management fee	1.75% p.a.	0.768% p.a.
Performance fee	Nil	Nil
Buy/sell spread	+0.87%/-0.87%	+0.87%/-0.87%

Important note: The Challenger Hybrid Property Fund and the Challenger Wholesale Hybrid Property Fund have been temporarily closed for withdrawals and investments, including the reinvestment of distributions.

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Direct property holdings as at 30 June 2010

	State	Building type	NLA (m2)	Current book value (\$ million)	Occupancy (%)
330 Collins Street	VIC	Commercial	18,439	100.0	98.3%
Kings Cross Centre - Retail	NSW	Retail	4,434	26.0	95.9%
Kings Cross Centre - Commercial	NSW	Commercial	2,543	10.4	100.0%

Commentary

The Challenger Hybrid Property Fund outperformed the benchmark during the quarter. Performance was primarily driven by positive property revaluations. The Fund has continued to maintain its asset allocation close to the benchmark weightings of 50% listed property securities and 50% unlisted property assets/direct real property during the period.

The Australian Real Estate Investment Trust (REIT) market finished down 1.54% (S&P/ASX 300 A-REIT Accumulation Index), outperforming the S&P/ASX 300 Accumulation Index by 9.65% during the quarter. Large cap A-REITs performed especially well as investors were driven to their defensive characteristics, as concerns around European credit risk grew. With the market chasing defensive stocks, the perceived 'beta' plays (smaller caps, development REITs etc.) suffered both in absolute and relative terms.

In economic news, investors had to contend with further tightening of monetary policy by the Reserve Bank of Australia (RBA), with the Official Cash Rate rising to 4.50%. However, the rate of increases is expected to slow as interest rates have moved to a more neutral setting. Australia's economy expanded for the sixth straight quarter, with March quarter GDP at 0.5% quarter-on-quarter. Consumer spending was subdued in the face of rising interest rates and ongoing caution. New housing construction contracted by 4.3%, despite a near 50% rise in private building approvals in the year to March as workers were apparently diverted to building school halls and libraries. A survey by National Australia Bank showed business confidence falling for the third consecutive month. The Westpac-Melbourne Institute Consumer Sentiment Index also fell by 5.7% in June from 108.0 in May to 101.9 in June.

Overall, Australia continues to deliver growth well above other developed nations globally. However in recent months there has been a clear slowdown in activity, with retail sales in particular coming off the boil as the Federal Government stimulus package is unwound and tighter monetary policy starts to bite into private consumption. Aiding the slowdown in retail spending was consumer confidence deteriorating whilst markets fell on concerns over Europe, the global economy and Resource Super Profit Tax negotiations. We expect the RBA to remain on hold in the near term, allowing the full effect of recent tightening to be seen in the data flow.

Direct property exposure

330 Collins Street, Melbourne, VIC

The property is located on the corner of Collins Street and Elizabeth Street within the Melbourne CBD. A major refurbishment was completed in 2003. Accommodation comprises basement level car parking and storage, ground floor retail and entrance foyer and 16 upper levels of office space. The property has an average lease duration of approximately 4.2 years. The major tenants include National Australia Bank, Legal Services Board and Chubb Insurance. To ensure that the property remains competitive within the leasing market a lift upgrade is currently underway. The lift upgrade will result in a new lift control system, refurbished car interiors and improved lift response times. The property was valued as at June 2010 at \$100m. This was an increase of \$5.5m over the previous valuation.

Kings Cross Centre, Sydney, NSW

Kings Cross Centre, Potts Point, NSW (Retail Lot) – The property is located approximately 1.5 kilometres east of the Sydney Central Business District and has exposure to William Street which is a link between Sydney's west, CBD, and the eastern suburbs. The Centre was refurbished in 2007 and comprises approximately 23 speciality shops located on the ground level and a two level Coles supermarket located on lower ground levels 1 and 2. The gross lettable area of the Centre is approximately 4,443m², with the major tenant, Coles, occupying approximately 58% of the floor area. The lease to Coles expires in 2022. The property was valued as at June 2010 at \$26m. This valuation was a \$0.35m increase over the previous valuation.

Kings Cross Centre, Potts Point, NSW (Commercial Lot) – The commercial lot is located over floors 2 – 4 and is fully occupied by Fitness First gym. The lease to Fitness First expires in 2022. The property was revalued in June 2010 at \$10.4m, resulting in a \$0.2m increase over the previous valuation.

Update on temporary closure

The Fund continues to be closed to withdrawals and investments. Until there is a notable improvement in liquidity in the direct property market for assets similar to the Fund's major asset and further asset sales are completed, we expect the Fund to remain closed to investments and withdrawals. We believe the Fund's closure continues to be the best course of action to preserve unitholder value in the current market environment.

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