Fund Update – 21 February 2022

Arrow Primary Infrastructure Fund

Dear Investor

Half-year Financials

The Fund's financial statements for the half-year to 31 December 2021 have been released and are available from our website.

- Net Profit was $18.8 million, which was up $8.2 million on the corresponding period last year.
- Normalised Earnings per Unit (EPU) for the six months was 3.71 cents.
- Distribution per Unit (DPU) for the same period was 4.00 cents.

The Fund's EPU has been dragged down over the last few years as a result of the significant capital that has been invested in the Fund's Boombera Park property near Lawrence, NSW from which no income is currently being derived, but where significant value is being created from our development. Although current distributions to investors are now slightly higher than Fund earnings, the earnings deficit is expected to be more than rectified when the decision is made to lease the Boombera Park property.

The Fund has continued to achieve strong growth over the last six months, resulting in a total investment return for the 12 months to 31 December 2021 of 36.7%.

The major growth has come from Capital growth (27.1% per annum) with Income growth representing 9.6% per annum.

Net Asset Value (NAV) at 31 December 2021 was $1.1721 per unit compared to $0.9219 a year ago. The distribution rate of 8.0 cents per annum now represents a distribution yield of 6.8% on the Fund's latest NAV.

In early 2021, together with our tenants, we made the decision to embark on a capital development program over the next two years to upgrade and expand a number of the Fund's properties. This also included lease adjustments, (e.g. term extensions and initial rent reductions), to ensure there was continuing alignment between landlord and tenant. New capital works totalling $49.7 million will be undertaken over the next 18 months, which will provide significant long-term benefits for these tenants in the form of increased profitability and for the Fund in the form of stronger tenants as well as increased future rents and longer lease terms.

The weighted average lease expiry (WALE) of the Fund's portfolio has now increased to 16.7 years as at 31 December 2021 (up from 12.6 years a year earlier) due to the above amended lease terms. This has strengthened our Fund and ensures that Arrow's long-term focus on key agricultural industries and properties is maintained.

Other key factors in the half-year result to December 2021:

- Property revaluations totalled $11.2 million, up $6.3 million on the same period last year.
- The liability for interest rate derivatives reduced by $2.7 million in the six-month period (down from $6.1 million at 30 June 2021), due to continuing increases in forward market interest rates.
- Base property rent was reduced by $0.2 million compared to last year, as a result of the above lease variations and capex commitments.
- Finance costs for the six months were $2.2 million, the same as last year.
- Administrative costs of running the Fund increased by $0.2 million to $1.8 million.
- The Fund's investment in shares in Murray River Organics Group Ltd was written down by $0.3 million to nil at 31 December 2021. These shares were received as part of the Fund's compensation when the lease of Advinco Farm was terminated in December 2019. MRO is

now in Receivership and the Fund's Advinco Farm dried fruit vineyard is now in the hands of a good operator and much improved.

- Total assets held by the Fund at 31 December 2021 were $357.9 million, which was an increase of $14.3 million in the last six months.
- The Fund's borrowing facility was increased to $170 million in anticipation of the new capex commitments. As at 31 December 2021 the facility was only drawn down to $139.5 million as funding of the above capital development works did not commence until late January 2022.
- The Fund's loan to valuation ratio ("LVR") was 39.6% at 31 December 2021 compared to 41.0% at 30 June 2021 and 44.5% at 31 December 2020.

Industry and valuations

As previously reported, extremely strong demand for Australian agricultural and horticultural properties over the last few years has significantly boosted market values. This has now flowed through to independent valuations, including properties subject to long-term leases, such as those owned by our Fund.

Valuers are now applying lower capitalisation rates to the rental income streams generated from these properties, resulting in increases in market value (subject to lease). The capitalisation rates being applied are still not as low as industrial leased properties, but they are significantly lower than where they were a few years ago.

Covid impacts

The essential need for domestic food production has been highlighted in these Covid times. It is therefore not surprising that the investment market has now upgraded its focus on, and the value attached to, the Agricultural property sector. Many of the traditional industrial fund managers and large superannuation funds have recently ventured into this renamed "Farmland" sector, with its more sustainable outlook and less volatile nature than some of the traditional property investment sectors. It is now its own investment category and certainly no longer referred to as part of "Alternative" investments.

Whilst "Covid-19" reminds us that everyone is now well into their second year of dealing with this pandemic, we are fortunate that the interruptions to our Fund have been minimal thanks to our decentralised management and systems and our geographically spread properties.

Our tenants have continued to do an excellent job in operating and maintaining the Fund's properties, all of which remain in full production and good condition.

The timing of the development works being undertaken on a number of the Fund's properties is being challenged by the difficult logistics and increased costs caused by Covid, however, we remain confident that all works will be completed professionally and within budget. The Fund has limited risk exposure as it only reimburses a tenant once agreed stages of capital works are completed, and property rent is increased from the date that each Capex payment is made by the Fund.

Capex and Development

Significant improvements have been made to the irrigation system and general operation of the Advinco Farm property, which is leased by the Scalzo Foods Group. To assist with capital improvements, the Fund is contributing $1.650 million in capex for this property in FY2022. We remain confident that our tenant's Farm management team are on track to return this property to benchmark yields over the next 2 years.

Planting of all macadamia trees at the Fund's Boombera Park property near Lawrence, NSW is now complete, with a total planted area of 795 hectares now confirmed. All dams on the property, with a holding capacity of approximately1,600 megalitres, are now full. Rain in December and January has thankfully been significantly less than last year's deluge – this year 337 mm compared to last year's 658 mm, with a further 420 mm in February 2021.

It is expected that the balance of development works will be completed this financial year, with the exception of a de-husking plant and on-site nut storage. Discussions with potential tenants have been interrupted by Covid, however, it has not been sensible to progress these until the tree planting and major development works have been completed. Although there is a small quantity of nuts on the oldest trees this year, commercial yields won't commence until 2024. Discussions with potential tenants are expected to re-commence in March/April this year.

DRP

During the half-year there were 2.5 million new units issued by the Fund; all issued under the Fund's Distribution Reinvestment Plan (DRP). The number of units participating in the DRP has risen to 42% compared with 35% this time last year.

The DRP continues to be a highly efficient source of capital, with the Fund raising $1.5 million in new equity from DRP participants on 31 January 2022 from the December quarter's distribution.

Outlook

There are many changes happening in our investment sector. As predicted by many, inflation and interest rates which have been running at historically low levels for many years are now on the rise. The economy is learning to live with Covid, which shows little sign of disappearing, and if it does is likely to reappear in another mutation. Agricultural trade with China is showing some signs of improvement, but exporters are likely to lessen their exposure to that market. Significant cost increases in agricultural inputs and freight are being experienced throughout Australia together with a slow-down in movement and availability of goods and plant & equipment, due to logistics problems.

Whilst the above outlook may appear somewhat uncertain, our Fund's operations and those of our tenants should continue to do well. A number of factors in our favour include:

- The Australian agricultural and horticultural sectors have experienced another excellent growing season and production forecasts for 2022 are good.
- Production levels at all of our properties are at least at pre-pandemic levels.
- The Fund's leases all include an annual increase, most of which are CPI linked (to a maximum of 2.5%).
- Approximately 55% of the Fund's exposure to interest rate rises is currently hedged. This has been good insurance against future interest rate rises even though it has increased the Fund's borrowing costs. Throughout 2022 we will be drawing down on the Fund's increased borrowing facility to fund future capex commitments, and we will continue to constantly monitor the Fund's exposure to future interest rates so that hedging cover remains in the range of 50% - 75%.
- Our tenants' businesses and our properties are classified as "essential services", thereby ensuring that they remain open whenever possible, and our properties are staffed by relatively low numbers of personnel.
- With the exception of almonds, the majority of product from our Fund's properties is produced for the domestic food market. The almond industry has sought to reduce its exposure to the Chinese market.

Our focus remains on the industries in which we are currently invested. As we have done in the last two years, our best investment returns have been achieved by working closely with our tenants to improve the quality, profitability and longevity of our Fund's existing property assets and extending our lease terms. Whilst we continue to regularly consider and undertake due diligence on potential new acquisitions, we are cognisant that Agricultural property prices are currently in a heated environment driven by ambitious new entrants. Our experienced team will continue to work with our existing tenants and network, where we can add value to the acquisition process and long term lease relationship.

Our plan remains to lease the Boombera Park property when we believe we will achieve the optimal balance of de-risking the asset, achieving development profit uplifts and receiving rental income. We will keep investors informed as we progress down that path.

Please refer to our website for the latest news and information on the Fund.

Thank you for your continued support.

Regards

ANDREW ASHBOLT
MANAGING DIRECTOR