**ASX Announcement**
Arena REIT (ASX Code: ARF)

24 AUGUST 2017

# FY17 ANNUAL RESULTS

## Strategy continues to deliver strong earnings growth

FINANCIAL HIGHLIGHTS

- Net Operating Profit of $28.7 million, up 12% on the prior corresponding period (pcp)
- Statutory Net Profit of $96.8 million, up 33% on pcp
- Distributable income (earnings) per security (EPS) of 12.3 cents, up 11% on pcp
- Distributions per security (DPS) of 12.0 cents, up 10% on pcp
- Total Assets of $621.3 million, up 21% on 30 June 2016
- Net Asset Value (NAV) per security of $1.84, up 19% on 30 June 2016
- ASX total securityholder return for one year of 19.8%; three year compound average return of 31% per annum
- Return on equity of 24.7% pa
- FY18 DPS guidance of 12.8 cents per security[1], reflecting forecast growth of 6.7% on FY17

Arena REIT (Arena) has today announced a net operating profit for the year ended 30 June 2017 of $28.7 million, up 12% on the prior year.

Key contributors to the result were income growth from annual rent reviews, portfolio management initiatives and development projects completed in FY16 and FY17, as well as lower relative borrowing costs.

This result equated to distributable income (earnings) per security (EPS) of 12.3 cents, an increase of 11% over the prior year. In line with previous guidance, Arena has paid an annual distribution of 12.0 cents per security, up 10% on the prior year.

Statutory net profit for the year was $96.8 million (up 33%), as a result of both the increase in net operating profit and a $66.1 million increase in property valuations. The revaluation uplift also contributed to a $0.30 increase in Net Asset Value (NAV) per security, up 19% from $1.54 at 30 June 2016 to $1.84 at 30 June 2017.

Commenting on today's result, Arena's Managing Director Mr Bryce Mitchelson said "We have continued to build on our core strengths throughout FY17, actively working to enhance the key metrics of the existing portfolio, successfully executing on our development pipeline and identifying new opportunities for growth."

[1] *Estimated on a status quo basis assuming no new acquisitions or disposals, developments in progress are completed in line with forecast assumptions, and tenants comply with their lease obligations.*

Post financial year end, Arena completed the acquisition of a portfolio of nine early learning centre (ELC) properties in development for a total cost of $65 million. The projects are all forecast to complete in FY18, and bring the total development pipeline to 18 projects with a forecast total cost of $113 million. The unaudited financial results and position announced at the time of this acquisition are consistent with the audited financial report released today.

Following the strong 2017 result and above acquisition, Arena has provided FY18 DPS guidance of 12.8 cents per security[2], representing forecast distribution growth of 6.7% on FY17.

## ASX performance

Arena's FY17 annual total ASX securityholder return was 19.8%[3], a significant achievement when compared to the ASX 300 A-REIT sector return of -5.6% over the same period. On a longer term basis, Arena's three year annual compound average return was 31.0% per annum, which outperformed the ASX 300 A-REIT sector return of 12.2% per annum.

## PORTFOLIO HIGHLIGHTS

- Average like-for-like rental increase of 4.3% across portfolio
- Fourteen five-year lease options renewed (100% renewal rate)
- 100% occupancy maintained and 102 leases extended for an average 6.2 years
- Weighted average lease expiry (WALE) extended to 12.8 years
- Portfolio net valuation uplift of $66.1 million (+12.6%)
- Portfolio passing yield firmed to 6.76%
- Eight ELC development projects completed at a cost of $20.4 million
- Acquisition of a portfolio of nine ELC properties under development for $65 million[4]
- Total development pipeline of 18 ELC projects at a forecast cost of $113 million

## Portfolio composition

At 30 June 2017, Arena's property portfolio comprised 198 ELC properties and development sites (86% of portfolio value) and seven healthcare properties (14% of portfolio value). The portfolio is 100% occupied by 19 tenants, the largest three being Goodstart Early Learning (40% portfolio income), Primary Health Care (15% of portfolio income) and Affinity Education (15% portfolio income). The majority of Arena's portfolio is located in Australia's eastern states of Queensland (33% of portfolio value); Victoria (32% of portfolio value); and NSW (22% of portfolio value).

## Average annual rental growth of 4.3%

Annual rent reviews across the portfolio have recorded an average like-for-like rental increase of 4.3%. Key contributors to this result were the completion of 31 market rent reviews (average increase

[2] *Estimated on a status quo basis assuming no new acquisitions or disposals, all developments in progress are completed in line with forecast assumptions, and tenants comply with their lease obligations.*
[3] *UBS Australian REIT Month in Review, June 2017.*
[4] *Announced to the ASX on 28 July 2017.*

of 6.8%)[5]; the renegotiation of 12 leases in the first half of FY17 for new 20 year terms at market rents; and the completion of FY17 annual fixed, CPI and CPI ratchet reviews.[6]

The four ELC market rent reviews due in FY18 have also now been completed, with an average increase of 6.3% achieved.

### WALE extended to 12.8 years

Throughout the year, occupancy was maintained at 100% and the portfolio's weighted average lease expiry (WALE) was extended from 9.7 years at 30 June 2016 to 12.8 years at 30 June 2017. Key drivers of this outcome were:

- the negotiation of extensions on 102 leases by an average of 6.2 years;
- the renewal of 14 five-year lease options (100% renewal rate);
- new leases commencing at eight completed developments for an average 23 year term; and
- renegotiation of 12 existing leases in 1HFY17 on new 20 year terms.

Arena's Head of Property, Mr Robert de Vos said "Throughout FY17 we have worked in partnership with our tenants to secure opportunities to enhance both the long term value of their businesses and the growth and predictability of Arena's rental income stream."

Arena's 100% lease renewal rate over the past three years has resulted in a favourable lease expiry profile, with only 3.2% of portfolio income subject to expiry over the next six years.

### Revaluation uplift of $66.1 million

A revaluation uplift of $66.1 million was recorded across Arena's portfolio, equivalent to an increase of 12.6%. The portfolio's passing yield firmed 54 basis points to 6.76%, as a result of further tightening in transaction yields in the direct property market and portfolio management initiatives.

| | Valuation | | | Weighted average passing yield | |
|---|---|---|---|---|---|
| | 30 June 2017 $m | Change $m | % | 30 June 2017 % | Change (bps) |
| Early Learning | 507.6 | 60.3 | 13.5 | 6.73 | (58) |
| Healthcare | 84.1 | 5.8 | 7.4 | 6.92 | (33) |
| **Total Portfolio** | 591.7 | 66.1 | 12.6 | 6.76 | (54) |

### Development completions

A record of eight ELC development projects were completed during FY17, for a total cost of $20.4 million. The projects, which are predominantly located in high population growth areas of Victoria, were completed on an attractive initial yield on cost of 8.6%.

The average size of the completed centres is 101 childcare places, and the weighted average lease term is 23 years. Five of the projects were completed as part of the relationship with the State of Victoria to deliver early learning centres alongside new primary schools. These centres are operated by YMCA, a new not-for-profit tenant to the Arena portfolio.

[5] *Includes 18 FY16 market rent reviews completed in FY17.*

[6] *CPI ratchet reviews are defined as reviews that are the greater of either 2.5% or CPI.*

## ELC development portfolio acquisition in July 2017

Post financial year end, Arena acquired a portfolio of nine ELC properties in development for a total cost of $65 million[7]. The properties are expected to be completed on a progressive basis over the next 12 months and were acquired on a fund through basis[8], with Arena earning a yield on total cost of 6.25%.

The new portfolio was independently valued (on completion) at $66.8 million, reflecting a 6.0% passing yield. The property purchase price represents a 5.2% discount to independent valuation (on completion), and once completed the portfolio will improve Arena's WALE, further diversify the tenant mix and enhance the rent review profile.

## Development pipeline increased to $113 million

Following the above acquisition, the ELC development pipeline now comprises 18 projects with a forecast total cost of $113 million and an initial yield on cost of 6.6%. Seventeen projects are due for completion in FY18, with one further project due for completion in FY19.

The development pipeline now comprises a mix of Arena originated projects and fund through projects, whereby Arena receives a lower relative initial yield on cost but reduces its risks associated with the project.

The composition of the development pipeline is as follows:

| | Arena originates site, secures tenant and constructs | Fund through structure[8] | Total pipeline |
|---|---|---|---|
| Number of projects | 6 | 12 | 18 |
| Forecast total cost | $31m | $82m | $113m |
| Initial yield on cost | 7.7% | 6.3% | 6.6% |
| Amount outstanding | $9m | $40m | $49m |

Mr de Vos said "By undertaking projects with a range of development structures and risk and return profiles we are able to deliver earnings growth, manage our exposure to development risk and deliver assets that enhance the overall quality of the portfolio."

## CAPITAL MANAGEMENT HIGHLIGHTS

- Gearing 27.5%, up slightly from 26.8% at 30 June 2016
- Additional $30 million borrowing facility secured to fund the development pipeline
- Institutional placement of $55 million completed in July 2017; Security Purchase Plan currently open to raise a further $5-$10 million
- Weighted average cost of debt 3.75% pa, down from 3.85% pa at 30 June 2016
- 79% of borrowings hedged with a weighted average hedge term of 4.3 years

[7] *Total cost includes property purchase price and project costs of $63.3 million plus stamp duty and associated transaction costs.*
[8] *A fund through acquisition involves the acquisition of land and progressive payment of development costs on which a return is derived.*

## Capital management summary

- **Borrowings** – in January 2017 Arena secured additional borrowing capacity of $30 million, bringing the total facility to $205 million. At 30 June 2017, total borrowings were $171 million, up from $138 million at 30 June 2016. The additional borrowings were used to fund acquisitions and development capital expenditure. At 30 June 2017, gearing was 27.5%.
- **Borrowing cost** – Arena's cost of debt was 3.75% at 30 June 2017. This was lower than the previous year, and reflected the positive impact of the December 2015 refinancing, together with lower market interest rates.
- **Borrowing facility term** – the average facility term is 2.5 years, with the next expiry of $102.5 million to occur in December 2018.
- **Hedging** – The proportion of hedged debt has increased to 79% of drawn debt to accommodate upcoming hedge expiries and increased borrowings to fund development capex in FY18.
- **Equity raising** – on 28 July 2017 Arena completed a $55 million institutional placement to partially fund the July 2017 ELC portfolio acquisition. A $5-$10 million non-underwritten security purchase plan is currently open.
- **Distribution Reinvestment Plan (DRP)** – the DRP remains in operation, having contributed $5 million in new equity during FY17.

## Market outlook

Demand for high quality and well located ELC and healthcare property continues to be underpinned by growing community demand and supportive demographic trends. Capitalisation rates have continued to firm in both sectors over FY17.

In the early learning sector, some operators have experienced pressure on centre occupancies as the non-indexation of current childcare subsidy arrangements has negatively impacted on childcare affordability, particularly in the latter half of the financial year. The new 'Jobs for Families' package was approved by the Federal parliament in April 2017, and once introduced on 1 July 2018 will provide funding of $37 billion to the sector over the next four years.

Growth in net new supply of ELCs has accelerated, with federal government data indicating a 4% increase in the total number of centres in the year to 30 September 2016 (up from 2.3% in the prior corresponding period)[9].

Planning approval data indicates an increase in the number of ELC projects with planning approval, however more competitive operating conditions in some markets may reduce the number of projects that reach completion. As the number of centres increases and competition intensifies, it is expected that well located, newer, more efficient centres will be less vulnerable to occupancy pressures.

In this environment, ongoing detailed analysis of demand and supply in individual micro-markets remains critical to assessing long-term sustainable investment. Arena continually reviews its portfolio, recycling assets where appropriate and reinvesting in its development pipeline.

[9] *Australian Government 'Early Childhood and Child Care in Summary' Reports 2016-2017*

## FY18 distribution guidance of 12.8 cents per security[10]

Arena has provided FY18 DPS guidance of 12.8 cents per security. This reflects growth of 6.7% over FY17, and forecast FY14 – FY18 compound average growth in DPS of 9.3% per annum.

– ENDS –

**INVESTOR CONFERENCE CALL**

Arena will be hosting a conference call at 11.30am today to present the FY17 annual results. The annual results presentation has also been lodged with the ASX and is available on Arena's website (www.arena.com.au). To participate in the investor teleconference, please click here to register.

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## About Arena REIT

Arena REIT is an ASX300 listed property group that owns, manages and develops specialised real estate assets across Australia. Our current portfolio of social infrastructure assets is leased to a diversified tenant base in the growing early learning and healthcare sectors. To find out more, please visit www.arena.com.au

[10] *Estimated on a status quo basis assuming no new acquisitions or disposals, developments in progress are completed in line with forecast assumptions, and tenants comply with their lease obligations.*

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