

Dexus (ASX: DXS)

ASX release



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12 March 2019

Dexus and DWPF acquire remaining interest in MLC Centre, Sydney

Dexus and Dexus Wholesale Property Fund ("DWPF") today announced that they have entered into an agreement to jointly acquire the remaining 50% interest in the MLC Centre, 19 Martin Place, Sydney¹. Dexus and DWPF will each acquire an additional 25% interest in the property for a total price of A\$800.0 million².

The MLC Centre is a quality A-grade property comprising 66,900 square metres of office space, 10,600 square metres of retail space and 308 car spaces. Since Dexus and DWPF acquired their initial interest in the MLC Centre in July 2017, 15,763 square metres of space has been leased³ across the property at average face re-leasing spreads of 29.8% and average incentives of 13.8%. The property has achieved an unlevered total property return⁴ of 11.37% per annum since acquisition.

The rationale for the acquisition includes:

- MLC Centre occupies one of the largest freehold sites in the Sydney CBD and will directly benefit from the new Martin Place Metro Station (due for completion in 2024)
- Office tower is under-rented⁵, providing an opportunity to benefit from strong Sydney CBD office market fundamentals with circa 28,000 square metres expiring or to be leased by the end of FY21
- Ground floor retail development across 12,800 square metres provides exposure to positive rental reversion and will add further amenity for occupants of the office tower (which represents more than 86% of current NLA)
- Acquisition of the remaining interest provides Dexus with full management and operational control

Acquisition funding and Exchangeable Note issue`

Dexus is committed to maintaining a conservative and prudent capital structure. Dexus will fund its share of the acquisition through debt and will concurrently launch a fully underwritten offering of A\$425 million Guaranteed Exchangeable Notes ("Notes") due June 2026, which will be exchangeable into Dexus securities at the election of the holder anytime starting 41 days from closing until 10 days prior to maturity.

Consistent with Dexus capital management strategy, the Notes further diversify the Group's funding sources through accessing an attractively priced new source of capital.

The Notes are being offered at a coupon in the range of 2.05% to 2.30% and fixed exchange price of A\$15.05 per Dexus stapled security (subject to certain adjustments), representing a premium of approximately 20% to the Dexus closing price on 12 March 2019. The final coupon and exchange price is expected to be announced on 13 March 2019, following completion of the offer bookbuild.

The Notes will rank as unsubordinated and unsecured obligations of Dexus in line with Dexus's existing indebtedness. Holders of the Notes will have a put option⁶ at the end of five years (on 19 March 2024).

Dexus was advised by Jones Lang LaSalle in relation to the acquisition of a further interest in the MLC Centre.

Citigroup Global Markets Australia Pty Limited, J.P. Morgan Securities PLC and Merrill Lynch Equities (Australia) Limited are acting as Joint Lead Managers and Underwriters to the issue. Key terms of the Notes are outlined in Appendix A.

Given the Notes are exchangeable into Dexus securities, key risks of being a Dexus Security holder are set out in Appendix B.

Pro-forma financial impact

Post-acquisition Dexus's pro forma gearing is expected to increase by 90 basis points to 24.6%⁷. The acquisition is expected to have an immaterial impact on distributions in FY19. Dexus maintains its FY19 guidance⁸ of distribution per security growth of circa 5%.

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About Dexus

Dexus is one of Australia's leading real estate groups, proudly managing a high quality Australian property portfolio valued at \$28.9 billion. We believe that the strength and quality of our relationships is central to our success and are deeply committed to working with our customers to provide spaces that engage and inspire. We invest only in Australia, and directly own \$13.9 billion of office and industrial properties. We manage a further \$15.0 billion of office, retail, industrial and healthcare properties for third party clients. The group's \$5.2 billion development pipeline provides the opportunity to grow both portfolios and enhance future returns. With 1.7 million square metres of office workspace across 53 properties, we are Australia's preferred office partner. Dexus is a Top 50 entity by market capitalisation listed on the Australian Securities Exchange (trading code: DXS) and is supported by 27,000 investors from 19 countries. With more than 30 years of expertise in property investment, development and asset management, we have a proven track record in capital and risk management, providing service excellence to tenants and delivering superior risk-adjusted returns for investors. www.dexus.com

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Dexus Funds Management Ltd ABN 24 060 920 783, AFSL 238163, as Responsible Entity for Dexus (ASX: DXS)

Notes Offer Restrictions

This release does not constitute an offer to sell, or the solicitation of an offer to buy, any securities in the United States or to any "U.S. person" (as defined in Regulation S under the U.S. Securities Act of 1933, as amended (the Securities Act)) (U.S. Person) and may not be distributed or released in the United States or to, or for the account or benefit of, any U.S. Person. The Notes to be offered and sold have not been and will not be registered under the Securities Act, or under the securities laws of any state or other jurisdiction of the United States and may not be offered or sold, directly or indirectly, in the United States or to, or for the account of any U.S. Person, except in compliance with the registration requirements of the Securities Act and any other applicable securities laws of any state or other jurisdiction of the United States (which Dexus has no obligation to do or procure) or pursuant to an exemption from, or in a transaction exempt from or not subject to, such registration requirements and any other applicable securities laws.

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1. Dexus and DWPF each hold an existing 25% interest in the MLC Centre and have each agreed to acquire an additional 25% interest.
 2. Reflects acquisition price for remaining 50% interest and excludes acquisition costs.
 3. Includes Heads of Agreement signed post 31 December 2018.
 4. Represents unlevered total property return percent per annum from acquisition to 31 December 2018 (excluding acquisition costs).
 5. Under-rented means that current passing rent is below Dexus's assessment of current market rent.
 6. Holders of the Notes will have a put option at the end of five years (19 March 2024) allowing them to have their Notes redeemed for the outstanding principal balance together with any accrued but unpaid interest.
 7. Pro forma 31 December 2018 look-through gearing including the acquisition of the increased interest in the MLC Centre described in this announcement and the divestment of 11 Talavera Road, Macquarie Park for \$231.2 million (net sale proceeds before transactions costs).
 8. Barring unforeseen circumstances, guidance is supported by the following assumptions: Impacts of announced divestments and acquisitions; FFO per security growth of circa 3%, underlying FFO per security growth of circa 3% underpinned by Dexus office portfolio like-for-like growth of 4-5%, Dexus industrial portfolio like-for-like income growth of 2.5-3.5%, management operations FFO and cost of debt broadly in line with FY18; trading profits of \$35-40 million net of tax; maintenance capex, cash incentives, leasing costs and rent free incentives of \$155-165 million; and excluding any further transactions.

Appendix A – Key terms of the Exchangeable Notes

Issuer	Dexus Finance Pty Ltd.																		
Guarantors	The Guarantors are the same Guarantors as for Dexus's existing Australian Dollar MTNs and USPP bonds.																		
Currency	AUD																		
Issue Size	A\$425 million																		
Status	Direct, unsubordinated and unsecured obligations of the Issuer and Guarantors (pari passu with all other unsecured and unsubordinated obligations of the Issuer and the Guarantors).																		
Maturity	On or about 19 June 2026																		
Investor Put	On or about 19 March 2024																		
Coupon	2.05%-2.30% per annum, payable quarterly in arrears																		
Exchange premium	Approximately 20% premium to Dexus's closing price on 12 March 2019																		
Exchange Period	Exchangeable into Stapled Securities of Dexus (DXS AU) at the option of holders anytime starting 41 days from closing until 10 days prior to maturity																		
Distribution Protection	<p>Adjustment to the Exchange Price in the event of an Extraordinary Distribution. Extraordinary Distribution is the amount by which the total cash distribution in a financial year exceeds on a per unit of Stapled Securities basis, the following amounts:</p> <table border="1"> <thead> <tr> <th>In respect of Financial Year end</th> <th>Threshold Amount (AUD)</th> </tr> </thead> <tbody> <tr> <td>June 30, 2019</td> <td>50 cents¹</td> </tr> <tr> <td>June 30, 2020</td> <td>52 cents</td> </tr> <tr> <td>June 30, 2021</td> <td>54 cents</td> </tr> <tr> <td>June 30, 2022</td> <td>56 cents</td> </tr> <tr> <td>June 30, 2023</td> <td>59 cents</td> </tr> <tr> <td>June 30, 2024</td> <td>61 cents</td> </tr> <tr> <td>June 30, 2025</td> <td>64 cents</td> </tr> <tr> <td>June 30, 2026</td> <td>66 cents</td> </tr> </tbody> </table>	In respect of Financial Year end	Threshold Amount (AUD)	June 30, 2019	50 cents ¹	June 30, 2020	52 cents	June 30, 2021	54 cents	June 30, 2022	56 cents	June 30, 2023	59 cents	June 30, 2024	61 cents	June 30, 2025	64 cents	June 30, 2026	66 cents
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Cash Alternative Election	Yes, the Issuer may, in full or in part, elect to make payment of the Cash Alternative Amount to exchanging Noteholders in lieu of delivering Stapled Securities.																		
Covenants / Provisions	Standard provisions including negative pledge, anti-dilution protection, change of control, and cross default.																		
Listing Exchange	Application will be made to list on the Open Market segment of the Frankfurt Stock Exchange.																		

1. Inclusive of A\$0.272 already paid.

Appendix B – Risk Factors

An investment in Dexus has a number of risks. Key risks relating to this investment are summarised in the table below. This is a non-exhaustive list of risks. Dexus stapled security holders (“**Stapled Security holders**”) and prospective investors should seek their own professional tax, financial and legal advice about the risks that may be associated with an investment in Dexus.

Dexus specific risks

<p>Acquisition and business opportunities</p>	<p>At any time, Dexus may be undertaking due diligence on a number of potential acquisition opportunities both on its own account and with joint venture parties. When Dexus proceeds with any opportunity, it is possible that Dexus may not uncover issues that may later have an adverse impact on Dexus. Risks which may arise in pursuing new opportunities or acquisitions which may adversely affect Dexus’s future value or profitability, include:</p> <ul style="list-style-type: none"> • any of the acquisition or business opportunities performing below expectations; • capital expenditure required in any of the acquisition or business opportunities being greater than expected; • a breakdown in the relationship with a joint venture partner; or • a downturn in the relevant local market conditions.
<p>Development activities</p>	<p>Dexus has several development projects underway. Under certain contracts entered into under these development projects, the contractors assume the financial risks relating to completion delays and cost overruns except for tenant and owner requested contract variations. Dexus has also obtained performance guarantees from its contractors. However, there can be no assurance that Dexus will not be adversely impacted by the failure of a contractor to deliver the project as agreed. Where certain development projects are only partially leased, there is no income guarantee on any remaining vacancies at practical completion.</p> <p>Dexus has entered into several tenancy agreements for certain development projects. While Dexus believes that it will be able to secure tenants for the remaining vacancies, there can be no guarantee that Dexus will be able to do so.</p> <p>The earnings, cash flows and valuations of certain development projects are impacted by a number of factors including construction costs, scheduled completion dates, assumed post-completion occupancy, assumed rentals achieved and the ability of tenants to meet rental obligations. Dexus has a pipeline of future and prospective development projects which have not yet commenced and in some instances, which have not yet secured necessary authority approvals and consents. There is no certainty that these approvals will be secured or that the projects will be activated.</p>
<p>Refinancing requirements</p>	<p>Dexus is exposed to risks relating to the refinancing of existing debt instruments and facilities.</p> <p>Dexus has \$350 million of debt maturing in the 12 months from the date of this notice (including Dexus’s share of repayment obligations from its 50% ownership in Dexus Office Trust Australia, on a look-through basis). It may be difficult for Dexus to refinance all or some of these and other debt maturities.</p> <p>Further, if some or all of these debt maturities can be refinanced, these may be on less favourable terms than is currently the case.</p>

Availability of capital (including debt finance)	<p>Real estate investment and development is highly capital intensive.</p> <p>Dexus's ability to raise funds in the future (including obtaining additional debt finance to fund acquisitions and ensuring sufficient debt funding headroom is retained within its capital management policies) on favourable terms depends on a number of factors including general economic conditions, political, capital and credit market conditions and the reputation, performance and financial strength of Dexus's business. Many of these factors are outside Dexus's control and may increase the cost and availability of capital.</p> <p>Dexus holds an investment grade credit rating from Standard & Poor's of A-(Stable) and holds an investment grade credit rating of A3 from Moody's. Any downgrade to Dexus's credit rating may impact access to capital.</p>
Impact of financing covenants	<p>Dexus's financiers require Dexus to maintain certain gearing and other ratios under various debt covenants. As at the date of this notice, Dexus was in compliance with all covenants under its debt facilities. In the event that these covenants are breached, financiers may seek to exercise enforcement rights under debt documentation.</p> <p>No financiers' rights under Dexus's current debt facilities are triggered as a result of adverse market capitalisation movements.</p>
Impact of interest rates	<p>Dexus's interest cost on floating rate debt will increase if benchmark interest rates increase. This would reduce earnings and cash flow available for distribution to Stapled Securityholders.</p> <p>Dexus manages its exposure to adverse fluctuations in floating interest rates by entering into interest rate hedge instruments, however the impact of interest rate hedging may be negative, depending on the extent, timing or direction of movements in underlying rates.</p>
Financial forecasts and forward looking statements	<p>There is no guarantee that the assumptions contained within forward-looking statements or estimates (including as to Dexus's future earnings and earnings guidance) released to the market will ultimately prove to be accurate. The forward-looking statements and forecasts depend on a variety of factors, many of which are beyond Dexus's control.</p>

Australian Real Estate Investment Trust ("A-REIT") sector risks

Illiquid assets	<p>Property assets are by their nature illiquid investments. If property assets are required to be disposed in order to raise liquidity, it may not be possible to dispose of assets in a timely manner or at an optimal price. This may affect net tangible assets or the market price of Dexus stapled securities.</p>
Returns from investments	<p>The value, expectations of capital growth, and returns from Dexus's property assets will fluctuate depending on property market conditions. Rental and occupancy levels may change as a result of changes in the property market and general economic conditions (including conditions relating to retail, office, logistics and business park and development assets), and this may affect the distributions paid by Dexus and the market price of Dexus stapled securities.</p> <p>The ability to procure tenants (including timing and rental paid), demand for property from investors and the expenses in operating, refurbishing and maintaining properties, may influence the value of Dexus's assets. The supply of competing buildings, both existing and new, may also affect the ability to secure lease renewals, retain existing tenants or obtain new tenants. If Dexus cannot negotiate lease renewals or maintain existing lease terms, income and book values may be adversely impacted.</p>
Changing investor demand for property investments	<p>The demand for property and listed property securities may change as investor preferences for particular sectors and asset classes change.</p> <p>The demand for property as an asset class changes over time and can be influenced by general economic factors such as interest rates, stock market cycles and exchange rates.</p>

Asset and land values	<p>Asset values are affected by many factors including prevailing market conditions, risk appetite, volume of sales, the ability to procure tenants, contracted rental returns, operating, maintenance and refurbishment expenses and the funding environment.</p> <p>From time to time unanticipated events occur that affect the value of land or development costs which may in turn affect the financial returns from property investment, projects and property related business.</p>
Time delays	<p>Development approvals, slow decision making by counterparties, complex construction specifications and changes to design briefs, legal issues and other documentation changes may give rise to delays in completion of projects, loss of revenue and cost overruns. Additionally, delays in completion of projects may in turn, result in liquidated damages and termination of lease agreements and pre-sale agreements.</p> <p>Other time delays which may arise in relation to construction and development projects include supply of labour, scarcity of construction materials, lower than expected productivity levels, inclement weather conditions, land contamination, difficult site access or industrial relations issues.</p> <p>Objections raised by community interest groups, environmental groups and neighbours may also delay the granting or planning approvals or the overall progress of a project motion. Major infrastructure requirements or unanticipated environmental issues may affect financial returns.</p>
Property leasing	<p>There is a risk that tenants default on their rent or other obligations under leases, leading to capital losses or a reduction in income from those assets. This risk can be greater where there is a higher tenant concentration.</p> <p>There is also a risk that it may not be possible to negotiate lease renewals or maintain existing lease terms. If this occurs, income and book values may be adversely impacted.</p>
Counterparty / credit risk	<p>A-REITs are exposed to the risk that third parties, such as tenants, developers, service providers and financial counterparties (including in relation to debt and foreign exchange and interest rate hedging instruments) and other contracts may not be willing or able to perform their obligations.</p>
Fixed nature of costs	<p>Many costs associated with the ownership and management of property assets are fixed in nature. The value of assets may be adversely affected if the income from the asset declines and these fixed costs remain unchanged.</p>
Capital expenditure	<p>A-REITs are exposed to the risk of unforeseen capital expenditure requirements in order to maintain the quality of the buildings and tenants.</p>
Environmental matters	<p>A-REITs are exposed to a range of environmental risks which may result in project delays or additional expenditure. In such situations, they may be required to undertake remedial works and potentially be exposed to third party liability claims and/or environmental liabilities such as penalties and fines.</p>
Insurance	<p>A-REITs purchase insurance, customarily carried by property owners, managers, developers and construction entities that provides a degree of protection for its assets, liabilities and people. Such policies include material damage of assets, contract works, business interruption, general and professional liability and workers compensation. There are however certain risks that are uninsurable (e.g. nuclear, chemical or biological incidents) or risks where the insurance coverage is reduced (e.g. cyclone, earthquake).</p> <p>A-REITs may face risk associated with the financial strength of their insurers to meet indemnity obligations when called upon which could have an adverse impact on earnings.</p> <p>Further, insurance may be materially detrimentally affected by economic conditions so that insurance becomes more expensive or in some cases, unavailable.</p>

Regulatory issues	Changes in relevant laws, accounting standards, other legal, legislative and administrative regimes, and government policies (including Government fiscal, monetary and regulatory policies), may have an adverse effect on the assets, operations and ultimately, the financial performance of Dexus. These factors may ultimately affect Dexus's financial position and performance and the market price of Dexus stapled securities.
Taxation	<p>Changes in tax law (including goods and services taxes and stamp duties), or changes in the way taxation laws are interpreted may impact the future tax liabilities of Dexus and/or Stapled Security holders. Under current income tax legislation, Dexus's "flow-through" trusts are generally not liable for Australian income tax, including capital gains tax. Should the actions or activities of one of Dexus's "flow-through" trusts (or their controlled entities) cause the relevant trust to fall within the operative provisions of Division 6C of Part III of the <i>Income Tax Assessment Act 1936</i> (Cth), the relevant trust may be taxed on its (taxable) income at a rate which is currently equivalent to the corporate income tax rate of 30%.</p> <p>Dexus's "flow-through" trusts currently qualify as withholding managed investment trusts such that the taxable part of the distributions to non-residents in certain jurisdictions, are subject to a withholding tax rate of 15%. Some requirements to qualify as a withholding managed investment trust are outside of Dexus's control, including the requirement that no non-resident individual has a 10% or greater stake in the group. Although Dexus does not expect this to occur, if Dexus's "flow-through" trusts cease to qualify as withholding managed investment trusts then the rate of tax imposed on non-resident Stapled Securityholders could increase.</p> <p>The attribution managed investment trusts ("AMITs") regime under the <i>Income Tax Assessment Act 1997</i> (Cth) is intended to improve the operation of the taxation law for AMITs by increasing certainty, allowing greater flexibility and reducing compliance costs. Dexus's "flow-through" trusts elected to be AMITs on and from 1 July 2016.</p> <p>Under the AMIT regime it is not a requirement that security holders be presently entitled to all of the income of a trust in order to prevent the trustee of the AMIT being subject to tax. The AMIT regime imposes the liability for income tax upon Stapled Securityholders by reference to fair and reasonable allocations made by the trustee of the AMIT and continues to treat such trusts as "flow-through" trusts. The AMIT regime also includes provisions which can impose tax on the trustee of an AMIT, including in respect of certain non-arm's length income or where the trustee fails to fully attribute the determined trusts components of the AMIT to Stapled Securityholders.</p>

Other general risks

Inflation	Higher than expected inflation rates generally or specific to the property sector could be expected to increase operating costs and development costs.
Litigation and disputes	Disputes and litigation may arise from time to time in the course of business activities. There is a risk that material or costly disputes or litigation could adversely affect financial performance and security value.
Competition	<p>Dexus faces competition from other property groups active in Australia. Such competition could lead to the following adverse outcomes:</p> <ul style="list-style-type: none"> • loss of tenants to competitors; • a reduction in rents; and • an inability to secure new tenants resulting in an oversupply of space.
Reliance on key personnel	Dexus is reliant on a number of key personnel. Loss of such personnel, or inability to attract suitably qualified personnel, may have a material adverse impact on Dexus's performance.

Work safety	Poor work safety practices by Dexus or a failure to comply with the necessary work safety regulatory requirements across the jurisdictions in which Dexus operates could result in fines, penalties and compensation for damages as well as reputational damage and poor staff morale and industrial action.
Market risks	<p>Investors should be aware that the market price of Dexus stapled securities and future distributions made to security holders will be influenced by a number of factors that are common to most listed investments. At any point in time, these may include:</p> <ul style="list-style-type: none"> • the Australian and international economic outlook; • movements in the general level of prices on international and local equity and credit markets; • changes in economic conditions including inflation, recessions and interest rates; • changes in market regulators' policies and practice in relation to regulatory legislation; • changes in Government, fiscal, monetary and regulatory policies; and • the demand for Dexus stapled securities.
General economic and business conditions	Dexus's operating and financial performance is influenced by a variety of general economic and business conditions, including the level of inflation, interest rates, commodity prices, ability to access funding, supply and demand conditions and government fiscal, monetary and regulatory policies. Prolonged deterioration in these conditions, including an increase in interest rates, an increase in the cost of capital or a decrease in consumer demand, could have a material adverse impact on Dexus's operating and financial performance.
Equity market conditions	The market price of Dexus's stapled securities will be affected by the financial performance of Dexus and also varied and often unpredictable factors influencing equity and credit markets generally. These factors include international stock markets, interest rates, domestic and international economic conditions, domestic and international political stability, investor sentiment, and the demand for equities generally.
Other factors	Other factors may impact on an entity's performance including changes or disruptions to political, regulatory, legal or economic conditions or to the national or international financial markets including as a result of terrorist attack or war.