Arena REIT
Appendix 4D
For the period ended 31 December 2018

Name of entity:

Arena REIT (ARF) comprising the securities of Arena REIT Limited, Arena REIT No.1 and Arena REIT No.2

ARSN:

Arena REIT No.1 (ARSN 106 891 641) Arena REIT No.2 (ARSN 101 067 878)

ACN:

Arena REIT Limited (ACN 602 365 186)

Reporting period

This report details the consolidated results of Arena REIT for the half-year ended 31 December 2018. Arena REIT is a stapled security comprising Arena REIT Limited, Arena REIT No.1 and Arena REIT No.2.

Results for announcement to the market

All comparisons are to the half-year ended 31 December 2017.

				$A'000
Total income from ordinary activities	Up	1%	to	42,526
Profit from ordinary activities after tax attributable to Arena REIT stapled group investors	Down	8%	to	34,188
Net profit for the period attributable to Arena REIT stapled group investors	Down	8%	to	34,188

Distributions

Quarter	Cents per security	Paid/Payable
September Quarter	3.3750	8 November 2018
December Quarter	3.3750	7 February 2019
Total	**6.7500**	

Net assets per security

	Consolidated	
	31 December 2018	**30 June 2018**
Net asset value per ordinary security	$2.03	$1.97

This information should be read in conjunction with the 31 December 2018 Half Year Financial Report of Arena REIT and any public announcements made during the period in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and Listing Rules.

This report is based on the Arena REIT 31 December 2018 half-year financial statements which have been reviewed by PricewaterhouseCoopers. The Independent Auditor's Review Report provided by PricewaterhouseCoopers is included in the 31 December 2018 half year financial statements.

Signed:

David Ross
Chairman
19 February 2019

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Arena REIT

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These financial statements cover Arena REIT (the 'Group') comprising Arena REIT No. 1, Arena REIT No. 2, Arena REIT Limited, and their controlled entities. The financial statements are presented in Australian currency.

The Responsible Entity of Arena REIT No.1 and Arena REIT No. 2 (the 'Trusts') is Arena REIT Management Limited (ACN 600069761, AFSL 465754). The Responsible Entity's registered office is:

Level 5, 41 Exhibition Street
Melbourne VIC 3000

Directors' report

The directors of Arena REIT Limited ('ARL') and Arena REIT Management Limited ('ARML'), the Responsible Entity of Arena REIT No. 1 and Arena REIT No. 2 (the 'Trusts'), present their report together with the financial statements of Arena REIT for the period ended 31 December 2018. The interim financial report covers ARL, Arena REIT No. 1 ('ARF1'), Arena REIT No. 2 ('ARF2'), and their controlled entities.

ARF1, ARF2 and ARL are separate entities for which the units and shares have been stapled together to enable trading as one security. The units of ARF1, ARF2 and shares of ARL cannot be traded separately. None of the stapled entities controls any of the other stapled entities, however for the purposes of statutory financial reporting the entities form a consolidated group.

Directors

The following persons held office as directors of ARL during the whole of the financial period and up to the date of this report:

David Ross (Chairman) (Independent, non-executive)
Simon Parsons (Independent, non-executive)
Dennis Wildenburg (Independent, non-executive)
Bryce Mitchelson (Executive)

The following persons held office as directors of ARML during the whole of the financial period and up to the date of this report:

David Ross (Chairman) (Independent, non-executive)
Simon Parsons (Independent, non-executive)
Dennis Wildenburg (Independent, non-executive)
Bryce Mitchelson (Executive)
Gareth Winter (Executive)

Principal activities

The Group invests in a portfolio of investment properties and is listed on the Australian Securities Exchange under the code ARF.

There were no changes in the principle activities of the Group during the period.

Distributions to securityholders

The following table details the distributions declared to securityholders during the financial period:

	31 December 2018 $'000	31 December 2017 $'000	**31 December 2018 cps**	31 December 2017 cps
September quarter	**9,138**	8,570	**3.375**	3.20
December quarter	**9,157**	8,583	**3.375**	3.20
Total distributions to securityholders	**18,295**	17,153	**6.750**	6.40

Operating and Financial Review

The Group operates with the aim of generating attractive and predictable distributions for securityholders with earnings growth prospects over the medium to long term.

The Group's strategy is to invest in property underpinned by relatively long leases and in sectors with supportive macro-economic trends. The Group will consider investment in sectors with the required characteristics, which may include:

- Early learning / childcare centres
- Healthcare - including medical centres, diagnostic facilities, hospitals, aged care and associated facilities
- Education - including schools, colleges and universities and associated facilities

Key financial metrics

	31 December 2018	31 December 2017	Change
Net profit (statutory)	$34.2 million	$37.1 million	- 8%
Net operating profit (distributable income)	$18.3 million	$16.8 million	+ 9%
Distributable income per security	6.77 cents	6.42 cents	+ 5%
Distributions per security	6.75 cents	6.40 cents	+ 5%

	31 December 2018	30 June 2018	Change
Total assets	$763.7 million	$726.1 million	+ 5%
Investment properties	$742.9 million	$699.4 million	+ 6%
Borrowings	$196 million	$179.5 million	+ 9%
Net assets	$551.2 million	$531.6 million	+ 4%
NAV per security	$2.03	$1.97	+ 3%
Gearing *	25.7%	24.7%	+ 100 bps

** Gearing calculated as Borrowings / Total Assets*

31 December 2018 half-year highlights

- In December 2018, the Group extended the lease term on six healthcare properties leased to Healius Limited (formerly Primary Health Care Limited) for further terms ranging from 10-14 years beyond the previous expiry date. The lease extensions have contributed to an increase in the portfolio WALE to 14.2 years as at 31 December 2018 (30 June 2018: 12.9 years);
- Half-year net statutory profit was $34.2 million, down 8% on the previous half-year comparative period. This is primarily due to a reduced uplift in investment property valuations and a higher revaluation decrement on derivatives compared to the prior period;
- Half-year net operating profit was $18.3 million, up 9% on the previous half-year comparative period which is primarily due to earnings from completed ELC developments, investment in operating ELC's and periodic rent reviews;
- During the period, the property portfolio increased with the addition of two Early Learning Centre ('ELC') development sites and two operational ELCs. Three ELC developments were also completed and leases commenced;
- Distributions for the period were 6.75 cents per security, up 5% on the previous half year comparative period;
- NAV per security at 31 December 2018 was $2.03, an increase of 3% on 30 June 2018. This was primarily due to an increase in investment property values; and
- Gearing was 25.7% at 31 December 2018, representing an increase of 100bps on 30 June 2018.

Operating and Financial Review (continued)

31 December 2018 half-year highlights (continued)

Financial results

	31 December 2018 $'000	31 December 2017 $'000
Property income	**23,729**	20,701
Other income	**265**	317
Total operating income	**23,994**	21,018
Property expenses	**(495)**	(401)
Operating expenses	**(1,853)**	(1,687)
Finance costs	**(3,324)**	(2,172)
Net operating profit (distributable income) *	**18,322**	16,758
Non-distributable items:		
Investment property revaluation and straight-lining of rent income	**18,571**	21,252
Profit/(loss) on sale of investment properties	**-**	67
Change in fair value of derivatives	**(2,055)**	(264)
Transaction costs	**(112)**	(401)
Amortisation of security-based payments (non-cash)	**(498)**	(363)
Other	**(40)**	38
Statutory net profit	**34,188**	37,087

** Net operating profit (distributable income) is not a statutory measure of profit*

Financial results summary

	31 December 2018	31 December 2017
Net operating profit (distributable income) ($'000)	**18,322**	16,758
Weighted average number of ordinary securities ('000)	**270,518**	261,013
Distributable income per security (cents)	**6.77**	6.42

- Net operating profit is the measure used to determine securityholder distributions and represents the underlying cash-based profit of the Group for the relevant period. Net operating profit excludes fair value changes from asset and derivative revaluations and items of income or expense not representative of the Group’s underlying operating earnings or cashflow.
- The increase in net operating profit during the period is primarily due to:
    - Ongoing fixed annual rent increases and market reviews on the Group's property portfolio;
    - Commencement of rental income from three ELC developments completed during the six months ended 31 December 2018, and the acquisition of two operational ELCs during the period; and
    - The full year effect of acquisitions and developments completed during FY18.
- Non-distributable items primarily decreased due to a reduced uplift in investment property valuations and a higher revaluation decrement on derivatives compared to the prior period.

Operating and Financial Review (continued)

Investment property portfolio

Key property metrics

	31 December 2018	30 June 2018
Total value of investment properties	$742.9 million	$699.4 million
Number of properties under lease	214	209
Development sites	4	5
Properties available for lease or sale	-	-
Total properties in portfolio	**218**	**214**
Portfolio occupancy	100%	100%
Weighted average lease expiry (WALE)	14.2 years	12.9 years

- The increase in the value of investment properties is primarily due to:
  - New ELC development expenditure and capital expenditure of $24.9 million; and
  - A net revaluation increment to the portfolio of $18.6 million for the period, inclusive of straight-lining of rent accrual.

Capital management

Equity

- During the period, 1.46 million securities were issued at an average price of $2.21 to raise $3.2 million of equity pursuant to the Distribution Re-investment Plan (DRP);

Bank facilities & gearing

- The Group's debt facility comprises an $80 million facility expiring 31 March 2022 and a $150 million facility expiring 31 March 2023 providing a remaining weighted average term of 3.9 years as at 31 December 2018;
- The Group has undrawn capacity of $34 million to fund ELC development commitments and new investment opportunities;
- Gearing was 25.7% at 31 December 2018 (30 June 2018: 24.7%);
- The Group was fully compliant with all bank facility covenants throughout the period and as at 31 December 2018. At 31 December 2018 the Loan to Valuation Ratio was 28.7% (Covenant: 50%) and the Interest Cover Ratio was 5.85 times (Covenant: 2.0 times);
- Refer to note 5 for further information.

Interest rate management

- As at 31 December 2018, the Group has hedged 79% of borrowings for a weighted average term of 5.3 years (30 June 2018: 78% for 5.9 years). The average swap fixed rate at 31 December 2018 is 2.42% (30 June 2018: 2.44%).

Operating and Financial Review (continued)

FY19 outlook

The Group presently expects to pay a distribution of 13.5 cents per security for FY19. The FY19 distribution is comprised of the 6.75 cents per security declared by Arena REIT up until 31 December 2018 and 6.75 cents per security forecast by the Group for the period from 1 January 2019 to 30 June 2019.

The distribution outlook assumes a status quo basis, with no new acquisitions or dispositions, developments in progress are completed in line with budget assumptions and tenants comply with their lease obligations.

Significant changes in state of affairs

In the opinion of the directors, other than the matters identified in this report, there were no significant changes in the state of affairs of the Group that occurred during the financial period.

Matters subsequent to the end of the financial period

In February 2019, the Group acquired three properties leased to SACARE for $24 million. Refer to the separate ASX annoucement for futher details.

In February 2019, the Group's syndicated debt facility limit was increased by $50 million to $280 million, on similar terms to the existing facility.

Other than those matters identified above, no other significant events have occurred since 31 December 2018 that have affected, or may significantly affect:

(i) the operations of the Group in future periods, or
(ii) the results of those operations in future financial periods, or
(iii) the state of affairs of the Group in future financial periods.

Likely developments and expected results of operations

The Group will continue to be managed in accordance with its existing investment objectives and guidelines.

The results of the Group's operations will be affected by a number of factors, including the performance of investment markets in which the Group invests. Investment performance is not guaranteed and future returns may differ from past returns. As investment conditions change over time, past returns should not be used to predict future returns.

Material business risks

The material business risks that could adversely affect the achievement of the Group's financial prospects are as follows. The Responsible Entity has in place a Risk Management Policy and Framework under which it identifies, assesses, monitors and manages these risks.

Concentration risk

The Group’s property portfolio is presently 87% invested in ELCs and ELC development sites and 13% in healthcare assets. Adverse events to the early learning sector or healthcare sector may result in a general deterioration of tenants' ability to meet their lease obligations and the future growth prospects of the current portfolio. As at 31 December 2018, 72% of the portfolio by income (excluding developments) is leased to the largest four tenants (Goodstart Early Learning Ltd with 33%, Green Leaves Group Ltd with 14%, Healius Limited with 13% and Affinity Education Group with 12%). Any material deterioration in the operating performance of these tenants may result in them not meeting their lease obligations which could reduce the Group's income.

Tenant risk

The Group relies on tenants to generate its revenue. Tenants may be not for profit companies limited by guarantee, private entities or listed public companies. If a tenant is affected by financial difficulties they may default on their rental or other contractual obligations which may result in loss of rental income and loss in value of the Group’s properties. Typically, tenants are required to provide an unconditional and irrevocable bank guarantee, which must not expire until at least six months after the ultimate expiry date of the lease, for an amount generally equivalent to six months' rent (plus GST) as security for their performance under the lease.

Rounding of amounts to the nearest thousand dollars

The Group is an entity of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191, relating to the 'rounding off' of amounts in the Directors' report. Amounts in the Directors' report have been rounded to the nearest thousand dollars in accordance with that Instrument, unless otherwise indicated.

Auditor's independence declaration

A copy of the Auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 8.

This report is made in accordance with a resolution of directors.

David Ross
Chairman

Melbourne
19 February 2019

Auditor's Independence Declaration

As lead auditor for the review of Arena REIT No. 1 for the half-year ended 31 December 2018, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and

(b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Arena REIT No. 1 and the entities it controlled during the period.

Charles Christie
Partner
PricewaterhouseCoopers

Melbourne
19 February 2019

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Consolidated statement of comprehensive income

	Notes	**Consolidated** **31 December 2018 $'000**	31 December 2017 $'000
Income			
Property income	3	**26,761**	22,740
Management fee income		**136**	220
Interest		**90**	136
Revaluation of investment properties	4	**15,539**	19,213
Total income		**42,526**	42,309
Expenses			
Property expenses		**(495)**	(401)
Management and administration expenses		**(2,326)**	(2,026)
Finance costs		**(3,324)**	(2,472)
Net (loss)/gain on change in fair value of derivative financial instruments		**(2,055)**	(264)
Other expenses		**(138)**	(59)
Total expenses		**(8,338)**	(5,222)
Net profit for the half-year		**34,188**	37,087
Other comprehensive income		**-**	-
Total comprehensive income for the half-year		**34,188**	37,087
Total comprehensive income for the half-year is attributable to Arena REIT stapled group investors, comprising:			
Unitholders of Arena REIT No. 1		**23,272**	34,748
Unitholders of Arena REIT No. 2 (non-controlling interest)		**11,231**	2,481
Unitholders of Arena REIT Limited (non-controlling interest)		**(315)**	(142)
		34,188	37,087
		Cents	Cents
Earnings per security:			
Basic earnings per security in Arena REIT No. 1		**8.60**	13.31
Diluted earnings per security in Arena REIT No. 1		**8.55**	13.23
Basic earnings per security in Arena REIT Group		**12.64**	14.21
Diluted earnings per security in Arena REIT Group		**12.56**	14.12

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Consolidated balance sheet

	Notes	Consolidated 31 December 2018 $'000	Consolidated 30 June 2018 $'000
Current assets			
Cash and cash equivalents		**7,758**	8,654
Trade and other receivables		**1,509**	6,386
Total current assets		**9,267**	15,040
Non-current assets			
Receivables		**630**	668
Property, plant and equipment		**132**	154
Investment properties	4	**742,853**	699,409
Intangible assets		**10,816**	10,816
Total non-current assets		**754,431**	711,047
Total assets		**763,698**	726,087
Current liabilities			
Trade and other payables		**4,946**	6,127
Distributions payable		**9,157**	8,619
Provisions		**312**	312
Total current liabilities		**14,415**	15,058
Non-current liabilities			
Derivative financial instruments	6	**2,617**	561
Provisions		**341**	334
Interest bearing liabilities	5	**195,107**	178,491
Total non-current liabilities		**198,065**	179,386
Total liabilities		**212,480**	194,444
Net assets		**551,218**	531,643
Equity			
Contributed equity - ARF1	7	**262,574**	259,780
Accumulated profit	8	**197,971**	190,618
Non-controlling interests - ARF2 and ARL	9	**90,673**	81,245
Total equity		**551,218**	531,643

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

Consolidated statement of changes in equity

	Consolidated			
	Contributed equity $'000	Accumulated profit $'000	Non-controlling interests - ARL & ARF2 $'000	Total equity $'000
Balance at 1 July 2017	202,179	161,929	68,368	432,476
Profit for the half-year	-	34,748	2,339	37,087
Total comprehensive income for the period	**-**	**34,748**	**2,339**	**37,087**
Transactions with owners in their capacity as owners:				
Issue of securities under the DRP	1,610	-	242	1,852
Issue of securities under the Institutional Placement	45,478	-	8,544	54,022
Issue of securities under the Security Purchase Plan	8,350	-	1,564	9,914
Distributions to unitholders	-	(14,923)	(2,230)	(17,153)
Security-based benefits	-	-	343	343
Balance at 31 December 2017	**257,617**	**181,754**	**79,170**	**518,541**
Balance at 1 July 2018	259,780	190,618	81,245	531,643
Profit for the half-year	-	23,272	10,916	34,188
Total comprehensive income for the period	**-**	**23,272**	**10,916**	**34,188**
Transactions with owners in their capacity as owners:				
Issue of securities under the DRP	2,794	-	421	3,215
Distributions to unitholders	-	(15,919)	(2,376)	(18,295)
Security-based benefits	-	-	467	467
Balance at 31 December 2018	**262,574**	**197,971**	**90,673**	**551,218**

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

Consolidated statement of cash flows

	Consolidated	
	31 December 2018	31 December 2017
	$'000	$'000
Cash flows from operating activities		
Receipts in the course of operations	**26,297**	23,529
Payments in the course of operations	**(5,912)**	(6,385)
Interest received	**90**	121
Finance costs paid	**(3,161)**	(2,089)
Net cash inflow from operating activities	**17,314**	15,176
Cash flows from investing activities		
Proceeds from sale of investment properties	**3,535**	3,987
Payments for investment properties and capital expenditure	**(23,701)**	(66,185)
Net cash (outflow) from investing activities	**(20,166)**	(62,198)
Cash flows from financing activities		
Net proceeds from issue of securities	**(20)**	63,924
Distributions paid to securityholders	**(14,524)**	(13,928)
Capital receipts from lenders	**16,500**	13,000
Capital payments to lenders	**-**	(16,030)
Net cash inflow from financing activities	**1,956**	46,966
Net (decrease)/increase in cash and cash equivalents	**(896)**	(56)
Cash and cash equivalents at the beginning of the financial period	**8,654**	9,082
Cash and cash equivalents at the end of the financial period	**7,758**	9,026

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Contents of the notes to the financial statements

1 Summary of significant accounting policies

(a) Basis of preparation of half-year financial report

This condensed consolidated interim financial report for the half-year reporting period ended 31 December 2018 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001.*

This condensed consolidated interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2018 and any public announcements made by the Group during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001.*

The Arena REIT Stapled Group (the 'Group') comprises Arena REIT No. 1 ('ARF1'), Arena REIT No. 2 ('ARF2') and Arena REIT Limited ('ARL'). The Responsible Entity of ARF1 and ARF2 is Arena REIT Management Limited (the 'Responsible Entity').

(i) Going concern - Net working capital deficiency

At 31 December 2018, the Group had a net working capital deficiency of $5.15 million. This deficiency is due to working capital management within the Group, and the difference in the timing of the drawdowns from the Group's debt facility and the timing of capital expenditure on developments. As at the date of this report the Group has in excess of $50 million of unused debt facility which can be drawn to fund cashflow requirements.

After taking into account all available information, the directors of the Group have concluded that there are reasonable grounds to believe:

- The Group will be able to pay its debts as and when they fall due; and
- The basis of preparation of the financial report on a going concern basis is appropriate.

(b) Principles of consolidation

The units of ARF1, ARF2 and the shares of ARL are combined and issued as stapled securities in the Arena REIT Stapled Group. The units of ARF1, ARF2 and shares of ARL cannot be traded separately and can only be traded as a stapled security. This interim financial report consists of the consolidated financial statements of the Arena REIT Stapled Group, which comprises ARF1, ARF2, and ARL and its controlled entities.

AASB 3 Business Combinations requires one of the stapled entities in a stapling structure to be identified as the parent entity for the purpose of preparing consolidated financial reports. In accordance with this requirement, ARF1 has been identified as the parent entity in relation to the stapling with ARF2 and ARL.

The consolidated financial statements of the Group incorporate the assets and liabilities of the entities controlled by ARF1 at 31 December 2018, including those deemed to be controlled by ARF1 by identifying it as the parent of the Group, and the results of those controlled entities for the year then ended. The effects of all transactions between entities in the consolidated entity are eliminated in full. Non-controlling interests in the results and equity are shown separately in the Statement of Comprehensive Income and Statement of Financial Position respectively. Non-controlling interests are those interests in ARF2 and ARL which are not held directly or indirectly by ARF1.

(c) Presentation of members interests in ARF2 and ARL

As ARF1 has been assessed as the parent of the Group, the securityholders interests in ARF2 and ARL are included in equity as "non-controlling interests" relating to the stapled entity. Securityholders interests in ARF2 and ARL are not presented as attributable to owners of the parent reflecting the fact that ARF2 and ARL are not owned by ARF1, but by the securityholders of the stapled group.

(d) New and amended standards adopted by the group

The Group has applied the following standards and amendments for the first time in the current reporting period commencing 1 July 2018:

- AASB 9 *Financial Instruments*
- AASB 15 *Revenue from Contracts with Customers*

1 Summary of significant accounting policies (continued)

(d) New and amended standards adopted by the group (continued)

The impact of the adoption of these standards is summarised below:

(i) AASB 9 Financial instruments

The revised AASB 9 *Financial Instruments* addresses the classification, measurement and derecognition of financial instruments and introduces new rules for hedge accounting. As the Group classifies its investments at fair value through profit or loss and does not apply hedge accounting, there is no impact to the Group due to the adoption of this standard.

In December 2014, the AASB also introduced a new impairment model (an expected credit loss model). As the impairment requirements of AASB 9 do not apply to financial assets at fair value through profit or loss and the Group also has a history of recovering all trade debtors, there is no impact on the financial statements due to the adoption of this standard.

(ii) AASB 15 Revenue from Contracts with Customers

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer - so the notion of control replaces the previous notion of risk and reward.

The Group's primary source of income is rent from investment properties, which is excluded from the scope of AASB 15 as it falls within the scope of AASB 140 *Investment Property.*

The Group has assessed the impact of the application of AASB 15 and concludes that it does not have any material revenue streams within the scope of AASB 15. Therefore the adoption of this standard has no material impact on the financial statements.

(e) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2018 reporting periods. The Group has not early adopted these standards/interpretations. The Group's assessment of the impact of these new standards and interpretations is set out below:

Standard / Interpretation	Impact	Effective annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
IFRS 16 Leases	In February 2016, the AASB issued AASB 16 Leases. The standard provides a single lessee accounting model, requiring lessees to recognise an asset (the right to use the leased item) and a financial liability to pay rentals. The only exemptions are where the lease term is 12 months or less, or the underlying asset has a low value. Lessor accounting is substantially unchanged under AASB 16. Management has assessed the effects of applying the new standard on the Group's financial statements and has determined that as of 1 January 2019, the impact is not expected to be material.	1 January 2019	30 June 2020

There are no other standards that are not yet effective and that are expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

2 Segment information

The Group operates as one business segment being investment in real estate, and in one geographic segment being Australia. The Group's segments are based on reports used by the Board (as the Chief Operating Decision Maker) in making strategic decisions about the Group, assessing the financial performance and financial position of the Group, determining the allocation of resources and risk management.

3 Property income

The following table details the property income earned by the Group during the period:

	Consolidated	
	31 December 2018	31 December 2017
	$'000	$'000
Property income	**23,729**	20,701
Other property income (recognised on a straight line basis)	**3,032**	2,039
Total property income	**26,761**	22,740

4 Investment properties

Arena has adopted a valuation program that provides for each property to be independently valued by suitably qualified valuers at least once every three years. Changes in market conditions may necessitate more frequent independent revaluations of properties.

Independent valuations were performed over 40 Early Learning Centres ('ELC') as at 31 December 2018. The board of directors has reviewed these valuations and has determined they are appropriate to adopt during the financial period ending 31 December 2018. Director valuations were performed over investment properties not independently valued.

The key inputs into valuations are:

- Passing rent;
- Market rents;
- Capitalisation rates;
- Lease terms;
- Discount rates (healthcare properties); and
- Capital expenditure and vacancy contingencies (healthcare properties).

The key inputs into the valuation are based on market information for comparable properties. The majority of ELC and healthcare properties are located in markets with evidence to support valuation inputs and methodology. The independent valuers have experience in valuing similar assets and have access to market evidence to support their conclusions. Comparable assets are considered those in similar markets and condition.

Investment properties have been classified as Level 2 in the fair value hierarchy.

There have been no transfers between the levels in the fair value hierarchy during the financial period.

4 Investment properties (continued)

(i) Key assumptions - ELCs

	31 December 2018	30 June 2018
Market rent per licenced place	**$1,500 to $5,400**	$1,500 to $5,000
Capitalisation rates	**5.0% to 8.5%**	5.0% to 8.5%
Passing yields	**4.5% to 9.0%**	4.0% to 9.0%

(ii) Key assumptions - Healthcare properties

	31 December 2018	30 June 2018
Capitalisation rates	**5.75% to 6.75%**	6.0% to 7.0%
Passing yields	**5.75% to 6.75%**	6.0% to 7.75%

(iii) Movements during the financial period

	Consolidated	
	31 December 2018	30 June 2018
	$'000	$'000
At fair value		
Opening balance	**699,409**	591,712
Property acquisitions and capital expenditure	**24,869**	80,498
Disposals	**-**	(4,402)
Revaluations	**15,539**	26,479
Other IFRS revaluation adjustments	**3,036**	5,122
Closing balance	**742,853**	699,409

5 Interest bearing liabilities

	Consolidated	
	31 December 2018	30 June 2018
	$'000	$'000
Non-current		
Secured		
Syndicated facility	**196,000**	179,500
Unamortised transaction costs	**(893)**	(1,009)
Total non-current interest bearing liabilities	**195,107**	178,491

The Group has an $80 million facility expiring 31 March 2022 and a $150 million facility expiring 31 March 2023 providing a remaining weighted average term of 3.9 years as at 31 December 2018.

Either Trust can draw on the facility and the assets of the Trusts are held as security under the facility.

5 Interest bearing liabilities (continued)

The Group was compliant with all facility covenants throughout the period and at 31 December 2018.

6 Derivative financial instruments

	31 December 2018	30 June 2018
	$'000	$'000
Non-current liabilities		
Interest rate swaps	**2,617**	561
	2,617	561

The Group has entered into interest rate swap contracts under which they receive interest at variable rates to reduce the exposure of interest bearing liabilities to changes in interest rates.

Swaps in place cover 79% (30 June 2018: 78%) of drawn debt. The weighted average fixed interest swap rate at 31 December 2018 was 2.42% (30 June 2018: 2.44%) and the weighted average term was 5.3 years (30 June 2018: 5.9 years).

Periodic swap settlements match the period for which interest is payable on the underlying debt, and are settled on a net basis.

7 Contributed equity

(a) Units

	31 December 2018 Securities '000	30 June 2018 Securities '000	**31 December 2018 $'000**	30 June 2018 $'000
Ordinary Stapled Securities				
Fully paid	**271,322**	269,351	**262,574**	259,780

Other contributed equity attributable to securityholders of the Group relating to ARF2 and ARL of $52.5 million is included within Non-controlling interests - ARF2 and ARL (30 June 2018: $51.6 million).

(b) Movement in ordinary stapled units

Date	**Details**	**Number of securities '000**	**$'000**
1 July 2017	Opening balance	234,843	202,179
	Issue of securities under the DRP (i)	2,022	3,773
3 August 2017	Issue of securities under the Institutional Placement (ii)	27,094	45,478
5 September 2017	Issue of securities under the Security Purchase Plan (iii)	4,925	8,350
	Vesting of security-based benefits (iv)	467	-
30 June 2018	Closing balance	269,351	259,780
1 July 2018	Opening balance	**269,351**	**259,780**
	Issue of securities under the DRP (i)	**1,461**	**2,794**
	Vesting of security-based benefits (iv)	**510**	**-**
31 December 2018	Closing balance	**271,322**	**262,574**

7 Contributed equity (continued)

(b) Movement in ordinary stapled units (continued)

(i) Distribution Re-investment Plan (DRP)

The Group has a Distribution Re-investment Plan (DRP) under which securityholders may elect to have all or part of their distribution entitlements satisfied by the issue of new securities rather than being paid in cash.

(ii) Institutional Placement

The Group completed a fully underwritten placement to institutional and professional investors in July 2017 which raised $55 million through the issue of 27,093,596 stapled securities at a price of $2.03 per stapled security. Settlement of the new stapled securities under the placement occurred on 3 August 2017.

(iii) Security Purchase Plan (SPP)

In conjunction with the Institutional Placement, the Group offered a Security Purchase Plan (SPP) to eligible investors in August 2017. $10 million was raised through the issue of 4,925,032 stapled securities at a price of $2.03 per stapled security. Settlement of the new stapled securities under the SPP occurred on 5 September 2017.

(iv) Security-based payments

In September 2018, 509,999 performance rights granted to employees of an associate of the Responsible Entity in FY16 vested as a result of performance conditions being fulfilled.

8 Accumulated profit

Movement in accumulated profit was as follows:

	31 December 2018 $'000	30 June 2018 $'000
Opening accumulated profit	**190,618**	161,929
Net profit for the half-year/year attributable to ARF1	**23,272**	58,593
Distribution paid or payable attributable to ARF1	**(15,919)**	(29,904)
Closing accumulated profit	**197,971**	190,618

(i) Distributions paid or payable to securityholders

The following table details the distributions to securityholders during the financial period on a consolidated basis, including distributions declared by ARF2 (classified as a non-controlling interest) of $2.4 million (31 December 2017: $2.2 million).

	31 December 2018 $'000	31 December 2017 $'000	**31 December 2018 cps**	31 December 2017 cps
September quarter	**9,138**	8,570	**3.375**	3.20
December quarter	**9,157**	8,583	**3.375**	3.20
Total distributions to securityholders	**18,295**	17,153	**6.750**	6.40

9 Non-controlling interest

The financial statements reflect the consolidation of ARF1, ARF2 and ARL. For financial reporting purposes, one entity in the stapled group must be identified as the acquirer or parent entity of the others. ARF1 has been identified as the acquirer of ARF2 and ARL, resulting in ARF2 and ARL being disclosed as Non-controlling interests.

Movements in non-controlling interests were as follows:

	ARF2 30 June 2018	**ARL 30 June 2018**	**Total 30 June 2018**
Opening balance - 1 July 2017	54,305	14,063	68,368
Issue of securities under the DRP	568	-	568
Issue of securities under the Institutional Placement	6,787	1,757	8,544
Issue of securities under the Security Purchase Plan	1,242	322	1,564
Vesting of security-based benefits	-	487	487
Net profit/(loss) for the period attributable to non-controlling interests	6,287	(448)	5,839
Distributions paid or payable attributable to non-controlling interests	(4,468)	-	(4,468)
Increase/(decrease) in reserves (i)	-	343	343
Closing balance - 30 June 2018	64,721	16,524	81,245

	ARF2 31 December 2018	**ARL 31 December 2018**	**Total 31 December 2018**
Opening balance - 1 July 2018	**64,721**	**16,524**	**81,245**
Issue of securities under the DRP	**421**	**-**	**421**
Vesting of security-based benefits to employees	**-**	**505**	**505**
Net profit/(loss) for the period attributable to non-controlling interests	**11,231**	**(315)**	**10,916**
Distributions paid or payable attributable to non-controlling interests	**(2,376)**	**-**	**(2,376)**
Increase/(decrease) in reserves (i)	**-**	**(38)**	**(38)**
Closing balance - 31 December 2018	**73,997**	**16,676**	**90,673**

9 Non-controlling interest (continued)

(i) Reserves

	31 December 2018 $'000	30 June 2018 $'000
Opening balance	**1,366**	1,023
Vesting of security-based benefits	**(505)**	(487)
Security-based benefits expense	**467**	830
Closing balance	**1,328**	1,366

The security-based benefits reserve is used to recognise the fair value of rights issued under the Group's Deferred Short Term and Long Term Incentive Plan.

10 Fair value measurement of financial instruments

The carrying amounts of the Group's assets and liabilities at the end of each reporting period approximate their fair values.

Financial assets and liabilities held at fair value through profit or loss are measured initially at fair value excluding any transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately. Subsequent to initial recognition, all instruments held at fair value through profit or loss are measured at fair value with changes in their fair value recognised in profit or loss.

(a) Fair value hierarchy

(i) Classification of financial assets and financial liabilities

AASB 13 requires disclosure of fair value measurements by level of fair value hierarchy. The fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

The determination of what constitutes 'observable' requires significant judgement by the Responsible Entity. The Responsible Entity considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

10 Fair value measurement of financial instruments (continued)

(a) Fair value hierarchy (continued)

The tables below set out the Group's financial assets and financial liabilities (by class) measured at fair value according to the fair value hierarchy at 31 December 2018 and 30 June 2018.

Consolidated

31 December 2018

	Level 1	**Level 2**	**Level 3**	**Total**
	$'000	**$'000**	**$'000**	**$'000**
Financial liabilities				
Interest rate swaps	**-**	**2,617**	**-**	**2,617**
Total	**-**	**2,617**	**-**	**2,617**

Consolidated

30 June 2018

	Level 1	Level 2	Level 3	Total
	$'000	$'000	$'000	$'000
Financial liabilities				
Interest rate swaps	-	561	-	561
Total	-	561	-	561

The Group's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period. There were no transfers between levels during the period.

The Group did not measure any financial assets or financial liabilities at fair value on a non-recurring basis as at 31 December 2018.

(ii) Valuation techniques used to derive level 2 and level 3 values

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves, taking into account any material credit risk.

11 Contingent assets and liabilities

There are no material contingent assets or liabilities as at 31 December 2018 and 30 June 2018.

12 Events occurring after the reporting period

In February 2019, the Group acquired three properties leased to SACARE for $24 million. Refer to the separate ASX annoucement for futher details.

In February 2019, the Group's syndicated debt facility limit was increased by $50 million to $280 million, on similar terms to the existing facility.

Other than those matters identified above, no other significant events have occurred since the end of the reporting period which would impact on the financial position of the Group disclosed in the consolidated balance sheet as at 31 December 2018 or on the results and cash flows of the Group for the period ended on that date.

Directors' declaration

In the opinion of the directors of the Responsible Entity:

(a) the financial statements and notes set out on pages 9 to 23 are in accordance with the *Corporations Act 2001*, including:

(i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements, and

(ii) giving a true and fair view of the Group's financial position as at 31 December 2018 and of its performance for the financial period ended on that date, and

(b) there are reasonable grounds to believe that the Group will be able to pay their debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.

David Ross
Chairman

Melbourne
19 February 2019

Independent auditor's review report to the security holders of Arena REIT No.1

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Arena REIT No. 1 (ARF 1) and its controlled entities (together the Group or Arena REIT), which comprises the consolidated balance sheet as at 31 December 2018, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, selected other explanatory notes and the Director's declaration for Arena REIT. The consolidated entity comprises of Arena REIT No. 1, Arena REIT No. 2, Arena REIT Limited and the entities it controlled during that half-year.

Directors' responsibility for the half-year financial report

The directors of Arena REIT Limited and Arena REIT Management Limited are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the director determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including giving a true and fair view of the Group's financial position as at 31 December 2018 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Arena REIT, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Arena REIT is not in accordance with the *Corporations Act 2001* including:

1. giving a true and fair view of the Group's financial position as at 31 December 2018 and of its performance for the half-year ended on that date;

2. complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

PricewaterhouseCoopers

Charles Christie
Partner

Melbourne
19 February 2019