

Arena REIT

Appendix 4D

For the period ended 31 December 2019

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 2019. 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 2018.

				\$A'000
Total income from ordinary activities	Up	20%	to	48,197
Profit from ordinary activities after tax attributable to Arena REIT stapled group investors	Up	24%	to	42,248
Net profit for the period attributable to Arena REIT stapled group investors	Up	24%	to	42,248

Distributions

Quarter	Cents per security	Paid/Payable
September Quarter	3.5750	7 November 2019
December Quarter	3.5750	6 February 2020
Total	7.1500	

Net assets per security

	Consolidated	
	31 December 2019	30 June 2019
Net asset value per ordinary security	\$2.18	\$2.10

This information should be read in conjunction with the 31 December 2019 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 2019 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 2019 half year financial statements.

Signed:

A handwritten signature in black ink, appearing to read 'David Ross', is positioned above the printed name.

David Ross
Chairman
13 February 2020

Arena REIT

ARSN 106891641

Interim Report

31 December 2019

Arena REIT

ARSN 106 891 641

Interim Report 31 December 2019

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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 2019. 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 financial period and up to the date of this report:

David Ross (Chairman) (Independent, non-executive)
 Rosemary Hartnett (Independent, non-executive) (appointed 13 August 2019)
 Simon Parsons (Independent, non-executive)
 Dennis Wildenburg (Independent, non-executive)
 Rob de Vos (Executive)

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

David Ross (Chairman) (Independent, non-executive)
 Rosemary Hartnett (Independent, non-executive) (appointed 13 August 2019)
 Simon Parsons (Independent, non-executive)
 Dennis Wildenburg (Independent, non-executive)
 Rob de Vos (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 2019 \$'000	31 December 2018 \$'000	31 December 2019 cps	31 December 2018 cps
September quarter	10,694	9,138	3.575	3.375
December quarter	10,726	9,157	3.575	3.375
Total distributions to securityholders	21,420	18,295	7.150	6.750

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 2019	31 December 2018	Change
Net profit (statutory)	\$42.2 million	\$34.2 million	+ 24%
Net operating profit (distributable income)	\$21.4 million	\$18.3 million	+ 17%
Distributable income per security	7.17 cents	6.77 cents	+ 6%
Distributions per security	7.15 cents	6.75 cents	+ 6%

	31 December 2019	30 June 2019	Change
Total assets	\$890.4 million	\$825.7 million	+ 8%
Investment properties	\$853.3 million	\$798.3 million	+ 7%
Borrowings	\$207.0 million	\$188.5 million	+ 10%
Net assets	\$652.9 million	\$610.3 million	+ 7%
NAV per security	\$2.18	\$2.10	+ 4%
Gearing *	23.2%	22.8%	+ 40 bps

* Gearing calculated as Borrowings / Total Assets

31 December 2019 half-year highlights

- Half-year net statutory profit was \$42.2 million, up 24% on the previous half-year comparative period. This is primarily due to the increase in net operating profit (refer below), a higher investment property revaluation gain compared to the prior period, a revaluation gain on derivatives, and a realised profit on sale of investment properties.
- Half-year net operating profit was \$21.4 million, up 17% on the previous half-year comparative period which is primarily due to earnings from completed ELC developments, investment in operating ELC's and specialised disability accommodation properties, and periodic rent reviews;
- During the period, the property portfolio increased with the addition of nine Early Learning Centre ('ELC') development sites and three operational ELCs. One ELC development was also completed and lease commenced;
- Distributions for the period were 7.15 cents per security, up 5.9% on the previous half year comparative period;
- NAV per security at 31 December 2019 was \$2.18, an increase of 4% on 30 June 2019. This was primarily due to an increase in investment property values; and
- Gearing was 23.2% at 31 December 2019, representing an increase of 40 bps on 30 June 2019; and
- In conjunction with the Institutional Placement completed in May 2019, the Group offered a Security Purchase Plan (SPP) to eligible investors with settlement occurring 1 July 2019. \$16.37 million was raised through the issue of 6.2 million securities.

Operating and Financial Review (continued)
31 December 2019 half-year highlights (continued)

Financial results

	31 December 2019 \$'000	31 December 2018 \$'000
Property income	26,448	23,488
Other income	293	265
Total operating income	26,741	23,753
Property expenses	(261)	(254)
Operating expenses	(1,921)	(1,853)
Finance costs	(3,133)	(3,324)
Net operating profit (distributable income) *	21,426	18,322

Non-distributable items:

Investment property revaluation and straight-lining of rent income	20,213	18,571
Profit/(loss) on sale of investment properties	871	-
Change in fair value of derivatives	296	(2,055)
Transaction costs	(65)	(112)
Amortisation of equity-based remuneration (non-cash)	(521)	(498)
Other	28	(40)
Statutory net profit	42,248	34,188

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

Financial results summary

	31 December 2019	31 December 2018
Net operating profit (distributable income) (\$'000)	21,426	18,322
Weighted average number of ordinary securities ('000)	298,912	270,518
Distributable income per security (cents)	7.17	6.77

- 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 one ELC development completed during the six months ended 31 December 2019, and the acquisition of three operational ELCs during the period; and
 - The full year effect of acquisitions and developments completed during FY19.
- Non-distributable items increased during the period primarily due to:
 - A higher investment property revaluation gain compared to the prior period;
 - Realised profit on sale of investment properties in the current period; and
 - A revaluation gain on derivatives during the period, compared to a revaluation loss on derivatives in the prior period.

Operating and Financial Review (continued)

Investment property portfolio

Key property metrics

	31 December 2019	30 June 2019
Total value of investment properties	\$853.3 million	\$798.3 million
Number of properties under lease	219	220
Development sites	14	6
Properties available for lease or sale	-	-
Total properties in portfolio	233	226
Portfolio occupancy	100%	100%
Weighted average lease expiry (WALE)	14.1 years	14.1 years

- The increase in the value of investment properties is primarily due to:
 - New ELC development expenditure and capital expenditure of \$46.7 million; and
 - A net revaluation increment to the portfolio of \$20.2 million for the period, inclusive of straight-lining of rent accrual.
- Offset by the following investment property disposals during the period:
 - Five operating ELCs were sold during the period with sale proceeds of \$10.2 million.

Capital management

Equity

- During the period, 1.80 million securities were issued at an average price of \$2.77 to raise \$5.0 million of equity pursuant to the Distribution Reinvestment Plan (DRP);
- On 1 July 2019, 6,211,244 securities were issued at a price of \$2.63625 following the completion of the Security Purchase Plan (SPP).

Bank facilities & gearing

- The Group's debt facility comprises a \$130 million facility expiring 31 March 2022 and a \$150 million facility expiring 31 March 2023, providing a remaining weighted average term of 2.8 years as at 31 December 2019;
- The Group has undrawn capacity of \$73 million to fund ELC development commitments and new investment opportunities;
- Gearing was 23.2% at 31 December 2019 (30 June 2019: 22.8%);
- The Group was fully compliant with all bank facility covenants throughout the period and as at 31 December 2019. At 31 December 2019, the Loan to Valuation Ratio was 25.9% (Covenant: 50%) and the Interest Cover Ratio was 6.4 times (Covenant: 2.0 times);
- Refer to note 5 for further information.

Interest rate management

- As at 31 December 2019, the Group has hedged 75% of borrowings for a weighted average term of 4.3 years (30 June 2019: 82% for 4.8 years). The average swap fixed rate at 31 December 2019 is 2.42% (30 June 2019: 2.42%).

Operating and Financial Review (continued)

FY20 outlook

The Group presently expects to pay a distribution of 14.3 cents per security for FY20. The FY20 distribution is comprised of the 7.15 cents per security declared by Arena REIT up until 31 December 2019 and 7.15 cents per security forecast by the Group for the period from 1 January 2020 to 30 June 2020.

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 2020, the Group's syndicated debt facility limit was increased by \$50 million to \$330 million, and the remaining weighted average term of the facility was extended to 4 years.

Other than the matter identified above, no other significant events have occurred since 31 December 2019 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 85% invested in ELCs and ELC development sites and 15% 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 2019, 65% of the portfolio by income (excluding developments) is leased to the largest four tenants (Goodstart Early Learning Ltd 31%, Green Leaves Group Ltd 14%, Healius Limited 12% and Affinity Education Group 8%). 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
13 February 2020



Auditor's Independence Declaration

As lead auditor for the review of Arena REIT No. 1 for the half-year ended 31 December 2019, 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.

A handwritten signature in black ink, appearing to read 'Charles Christie'.

Charles Christie
Partner
PricewaterhouseCoopers

Melbourne
13 February 2020

Arena REIT
Consolidated statement of comprehensive income
For the half-year ended 31 December 2019

Consolidated statement of comprehensive income

	Consolidated	
	31 December	31 December
	2019	2018
Notes	\$'000	\$'000
Income		
Property income	3 29,790	26,520
Management fee income	264	136
Interest	57	90
Net gain/(loss) on change in fair value of derivative financial instruments	296	(2,055)
Realised gain/(loss) on sale of investment properties	871	-
Revaluation of investment properties	4 16,919	15,539
Total income	48,197	40,230
Expenses		
Property expenses	(309)	(254)
Management and administration expenses	(2,349)	(2,326)
Finance costs	(3,133)	(3,324)
Other expenses	(158)	(138)
Total expenses	(5,949)	(6,042)
Net profit for the half-year	42,248	34,188
Other comprehensive income	-	-
Total comprehensive income for the half-year	42,248	34,188
Total comprehensive income for the half-year is attributable to Arena REIT stapled group investors, comprising:		
Unitholders of Arena REIT No. 1	37,236	23,272
Unitholders of Arena REIT No. 2 (non-controlling interest)	5,187	11,231
Unitholders of Arena REIT Limited (non-controlling interest)	(175)	(315)
	42,248	34,188
	Cents	Cents
Earnings per security:		
Basic earnings per security in Arena REIT No. 1	12.46	8.60
Diluted earnings per security in Arena REIT No. 1	12.40	8.55
Basic earnings per security in Arena REIT Group	14.13	12.64
Diluted earnings per security in Arena REIT Group	14.07	12.56

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

Arena REIT
Consolidated balance sheet
As at 31 December 2019

Consolidated balance sheet

	31 December	Consolidated
	2019	30 June
Notes	\$'000	\$'000
Current assets		
Cash and cash equivalents	11,706	8,134
Trade and other receivables	13,663	7,711
Total current assets	25,369	15,845
Non-current assets		
Receivables	629	603
Property, plant and equipment	287	139
Investment properties	4 853,306	798,318
Intangible assets	10,816	10,816
Total non-current assets	865,038	809,876
Total assets	890,407	825,721
Current liabilities		
Trade and other payables	11,035	8,364
Distributions payable	10,726	9,832
Provisions	138	167
Lease liabilities	144	-
Total current liabilities	22,043	18,363
Non-current liabilities		
Derivative financial instruments	6 8,884	9,180
Provisions	301	278
Lease liabilities	51	-
Interest bearing liabilities	5 206,213	187,570
Total non-current liabilities	215,449	197,028
Total liabilities	237,492	215,391
Net assets	652,915	610,330
Equity		
Contributed equity - ARF1	324,319	306,368
Accumulated profit	222,756	204,155
Non-controlling interests - ARF2 and ARL	105,840	99,807
Total equity	652,915	610,330

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

Arena REIT
Consolidated statement of changes in equity
For the half-year ended 31 December 2019

Consolidated statement of changes in equity

	Consolidated	Consolidated	Consolidated	Consolidated
	Contributed equity \$'000	Accumulated profit \$'000	Non-controlling interests - ARL & ARF2 \$'000	Total equity \$'000
Notes	\$'000	\$'000	\$'000	\$'000
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 securityholders	-	(15,919)	(2,376)	(18,295)
Equity-based remuneration	-	-	467	467
Balance at 31 December 2018	262,574	197,971	90,673	551,218
Balance at 1 July 2019 (restated)	306,368	204,155	99,783	610,306
Profit for the half-year	-	37,236	5,012	42,248
Total comprehensive income for the period	-	37,236	5,012	42,248
Transactions with owners in their capacity as owners:				
Issue of securities under the DRP	4,330	-	650	4,980
Issue of securities under the Security Purchase Plan	13,621	-	2,682	16,303
Distributions to securityholders	-	(18,635)	(2,785)	(21,420)
Equity-based remuneration	-	-	498	498
Balance at 31 December 2019	324,319	222,756	105,840	652,915

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

Arena REIT
Consolidated statement of cash flows
For the half-year ended 31 December 2019

Consolidated statement of cash flows

	Consolidated	
	31 December 2019 \$'000	31 December 2018 \$'000
<i>Cash flows from operating activities</i>		
Receipts in the course of operations	30,156	26,297
Payments in the course of operations	(6,918)	(5,912)
Interest received	56	90
Finance costs paid	(3,011)	(3,161)
<i>Net cash inflow from operating activities</i>	20,283	17,314
<i>Cash flows from investing activities</i>		
Proceeds from sale of investment properties	7,152	3,535
Payments for investment properties and capital expenditure	(43,046)	(23,701)
<i>Net cash (outflow) from investing activities</i>	(35,894)	(20,166)
<i>Cash flows from financing activities</i>		
Net proceeds from issue of securities	16,276	(20)
Distributions paid to securityholders	(15,520)	(14,524)
Capital receipts from lenders	33,500	16,500
Capital payments to lenders	(15,000)	-
Finance lease payments	(73)	-
<i>Net cash inflow from financing activities</i>	19,183	1,956
<i>Net increase/(decrease) in cash and cash equivalents</i>	3,572	(896)
Cash and cash equivalents at the beginning of the financial period	8,134	8,654
<i>Cash and cash equivalents at the end of the financial period</i>	11,706	7,758

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

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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 2019 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 2019 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').

(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 2019, 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 2019:

- AASB 16 *Leases*

The impact of the adoption of this standard is summarised below:

(i) AASB 16 Leases

Effective for annual reporting periods commencing 1 January 2019, AASB 16 *Leases* replaces AASB 117 *Leases*. The new 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 across all leases. 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.

1 Summary of significant accounting policies (continued)

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

(i) AASB 16 Leases (continued)

The Group has adopted AASB 16 *Leases* using the modified retrospective approach, meaning that comparatives have not been restated as permitted under the specific transition provisions in the standard. On adoption of AASB 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of AASB 117 *Leases*. These liabilities were measured at the present value of the lease payments over the life of the leases, discounted using the lessee's incremental borrowing rate.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

On adoption of AASB 16 in the current reporting period, the Group has recognised the following opening balances as at 1 July 2019: a Lease Liability of \$263,201, a Right-of-use asset of \$239,315 (included within the 'Property, Plant and Equipment' financial statement line item), with a corresponding balancing adjustment of \$23,886 to 'Non-controlling interests (ARL's opening accumulated profit balance).

(e) New accounting standards and interpretations not yet adopted

There are no 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:

	31 December 2019	Consolidated 31 December 2018
	\$'000	\$'000
Property income	26,448	23,488
Other property income (recognised on a straight line basis)	3,342	3,032
Total property income	29,790	26,520

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 44 Early Learning Centres ('ELC') as at 31 December 2019. The board of directors has reviewed these valuations and has determined they are appropriate to adopt during the financial period ending 31 December 2019. Director valuations were performed over investment properties not independently valued.

4 Investment properties (continued)

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.

(i) Key assumptions - ELCs

	31 December 2019	30 June 2019
Market rent per licenced place	\$1,600 to \$5,000	\$1,600 to \$5,000
Capitalisation rates	5.0% to 7.75%	5.0% to 8.25%
Passing yields	4.5% to 7.75%	4.5% to 9.0%

(ii) Key assumptions - Healthcare properties

	31 December 2019	30 June 2019
Capitalisation rates	5.25% to 6.25%	5.25% to 6.50%
Passing yields	5.50% to 6.75%	5.50% to 6.75%

(iii) Movements during the financial period

	Consolidated	
	31 December 2019	30 June 2019
	\$'000	\$'000
At fair value		
Opening balance	798,318	699,409
Property acquisitions and capital expenditure	46,655	70,936
Disposals	(11,930)	(4,455)
Revaluations	16,919	25,964
Other IFRS revaluation adjustments	3,344	6,464
Closing balance	853,306	798,318

5 Interest bearing liabilities

	Consolidated	
	31 December	30 June
	2019	2019
	\$'000	\$'000
Non-current		
Secured		
Syndicated facility	207,000	188,500
Unamortised transaction costs	(787)	(930)
Total non-current interest bearing liabilities	206,213	187,570

The Group has a \$130 million facility expiring 31 March 2022 and a \$150 million facility expiring 31 March 2023, providing a remaining weighted average term of 2.8 years as at 31 December 2019.

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

The Group was compliant with all facility covenants throughout the period and at 31 December 2019.

6 Derivative financial instruments

	31 December	30 June
	2019	2019
	\$'000	\$'000
Non-current liabilities		
Interest rate swaps	8,884	9,180
	8,884	9,180

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 75% (30 June 2019: 82%) of drawn debt. The weighted average fixed interest swap rate at 31 December 2019 was 2.42% (30 June 2019: 2.42%) and the weighted average term was 4.3 years (30 June 2019: 4.8 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	30 June	31 December	30 June
	2019	2019	2019	2019
	Securities '000	Securities '000	\$'000	\$'000
Ordinary Stapled Securities				
Fully paid	300,024	291,325	324,319	306,368

Other contributed equity attributable to securityholders of the Group relating to ARF2 and ARL of \$66.8 million is included within Non-controlling interests - ARF2 and ARL (30 June 2019: \$61.0 million).

7 Contributed equity (continued)

(b) Movement in ordinary stapled units

Date	Details	Number of securities '000	\$'000
1 July 2018	Opening balance	269,351	259,780
	Issue of securities under the DRP (i)	2,738	5,640
	Vesting of equity-based remuneration (ii)	510	-
27 May 2019	Issue of securities under the Institutional Placement (iii)	18,726	40,948
30 June 2019	Closing balance	<u>291,325</u>	<u>306,368</u>
1 July 2019	Opening balance	291,325	306,368
1 July 2019	Issue of securities under the Security Purchase Plan (iv)	6,211	13,621
	Issue of securities under the DRP (i)	1,805	4,330
	Vesting of equity-based remuneration (ii)	683	-
31 December 2019	Closing balance	<u>300,024</u>	<u>324,319</u>

(i) Distribution Reinvestment Plan (DRP)

The Group has a Distribution Reinvestment 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) Equity-based remuneration

In September 2019, 502,698 performance rights granted to employees of an associate of the Responsible Entity in FY17 vested as a result of performance conditions being fulfilled. In addition, 180,405 deferred short-term incentive rights granted to employees of an associate of the Responsible Entity in FY18 vested.

(iii) Institutional Placement

The Group completed a fully underwritten placement to institutional and professional investors in May 2019 which raised \$50 million through the issue of 18,726,592 stapled securities at a price of \$2.67 per stapled security. Settlement of the new stapled securities under the placement occurred on 27 May 2019.

(iv) Security Purchase Plan (SPP)

In conjunction with the Institutional Placement in May 2019, the Group offered a Security Purchase Plan (SPP) to eligible investors in June 2019. \$16.37 million was raised through the issue of 6,211,244 stapled securities at a price of \$2.63625 per stapled security. Settlement of the new stapled securities under the SPP occurred on 1 July 2019.

8 Accumulated profit

Movement in accumulated profit was as follows:

	31 December 2019 \$'000	30 June 2019 \$'000
Opening accumulated profit	204,155	190,618
Net profit for the half-year/year attributable to ARF1	37,236	45,995
Distribution paid or payable attributable to ARF1	<u>(18,635)</u>	<u>(32,458)</u>
Closing accumulated profit	<u>222,756</u>	<u>204,155</u>

8 Accumulated profit (continued)

(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 \$2.8 million (31 December 2018: \$2.4 million).

	31 December 2019 \$'000	31 December 2018 \$'000	31 December 2019 cps	31 December 2018 cps
September quarter	10,694	9,138	3.575	3.375
December quarter	10,726	9,157	3.575	3.375
Total distributions to securityholders	21,420	18,295	7.150	6.750

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 2019 \$'000	ARL 30 June 2019 \$'000	Total 30 June 2019 \$'000
Opening balance - 1 July 2018	64,721	16,524	81,245
Issue of securities under the DRP	849	-	849
Issue of securities under the Institutional Placement	6,577	1,487	8,064
Vesting of equity-based remuneration	-	505	505
Net profit/(loss) for the period attributable to non-controlling interests	14,404	(1,076)	13,328
Distributions paid or payable attributable to non-controlling interests	(4,848)	-	(4,848)
Increase/(decrease) in reserves (i)	-	664	664
Closing balance - 30 June 2019	81,703	18,104	99,807

9 Non-controlling interest (continued)

		ARF2 31 December 2019 \$'000	ARL 31 December 2019 \$'000	Total 31 December 2019 \$'000
Opening balance - 1 July 2019 (restated)	1(d)	81,703	18,080	99,783
Issue of securities under the DRP		650	-	650
Issue of securities under the Security Purchase Plan		2,188	494	2,682
Vesting of equity-based remuneration		-	1,049	1,049
Net profit/(loss) for the period attributable to non-controlling interests		5,187	(175)	5,012
Distributions paid or payable attributable to non-controlling interests		(2,785)	-	(2,785)
Increase/(decrease) in reserves (i)		-	(551)	(551)
Closing balance - 31 December 2019		<u>86,943</u>	<u>18,897</u>	<u>105,840</u>

(i) Reserves

	31 December 2019 \$'000	30 June 2019 \$'000
Opening balance	2,030	1,366
Vesting of equity-based remuneration	(1,049)	(505)
Equity-based remuneration expense	498	1,169
Closing balance	<u>1,479</u>	<u>2,030</u>

The equity-based remuneration 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)

10 Fair value measurement of financial instruments (continued)

(a) Fair value hierarchy (continued)

- 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.

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 2019 and 30 June 2019.

Consolidated

31 December 2019

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial liabilities				
Interest rate swaps	-	8,884	-	8,884
Total	-	8,884	-	8,884

Consolidated

30 June 2019

	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial liabilities				
Interest rate swaps	-	9,180	-	9,180
Total	-	9,180	-	9,180

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 2019.

10 Fair value measurement of financial instruments (continued)

(a) Fair value hierarchy (continued)

(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 2019 and 30 June 2019.

12 Events occurring after the reporting period

In February 2020, the Group's syndicated debt facility limit was increased by \$50 million to \$330 million, and the remaining weighted average term of the facility was extended to 4 years.

Other than the matter 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 2019 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 22 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 2019 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
13 February 2020



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 and its controlled entities (together the Group or Arena REIT), which comprises the consolidated balance sheet as at 31 December 2019, 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 Directors' declaration.

Directors' responsibility for the half-year financial report

The Directors of the 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 Directors determine is necessary to enable the preparation of the half-year financial report that gives a true and fair view and 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 2019 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

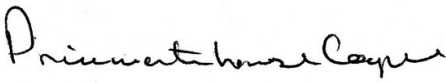
In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.



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 2019 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
13 February 2020