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Investa Office Fund (ASX:IOF)

Continued strong results for financial year 2017

Investa Office Fund (IOF or the Fund) today announced its results for the financial year 2017, delivering strong returns for Unitholders underpinned by significant and accretive leasing activity, continued positive valuation uplifts and favourable office market conditions.

The Fund generated an 18.0% Return on Equity (increase in Net Tangible Assets (NTA) plus distributions) over the financial year, supported by a strong unlevered portfolio total return of 15.7%.

Funds From Operations (FFO)[1] increased 4.0% to $182.6 million, with higher occupancy in the Brisbane portfolio and improving effective rents in Sydney, partially offset by the divestment of two assets and the withdrawal of 151 Clarence Street, Sydney for redevelopment. The result equates to FFO of 29.7 cents per unit (cpu), which is above revised guidance of 29.5 cpu and an increase of 4.0% over financial year 2016. Distributions subsequently increased by 3.1% over financial year 2016 to 20.2 cpu.

Statutory Net Profit was $471.6 million, 4.5% lower than the previous corresponding period (pcp), due to the combined fair value change in derivatives and foreign exchange being $74.8 million lower than the pcp. Property valuation increases of $360.4 million were $44.2 million higher than the pcp, reflecting the continued strength of investment demand for high quality office assets.

Key financial result highlights include:

- FFO of 29.7 cpu, up 4.0% on the pcp which included the impact of the withdrawal of 151 Clarence Street for redevelopment and the divestment of two assets during the period;
- Distributions of 20.2 cpu, up 3.1% on the pcp;
- NTA increased 13.2% to $4.79 per unit primarily due to positive property valuation uplifts;
- Return on Equity of 18.0% for the year; and
- Management Expense Ratio of 0.43% of total assets.

Penny Ransom, IOF Fund Manager, said “We are very pleased to provide IOF Unitholders with continued strong performance. The Fund’s high exposure to the favourable Sydney and North Sydney CBD markets, together with significant leasing activity across the portfolio, has delivered strong results. Moving forward the Fund has a number of value add opportunities based in the Sydney CBD which have the potential to provide enhanced returns for Unitholders whilst further elevating the overall quality of the portfolio.”

Active asset management driving portfolio performance:

- 15.7% unlevered portfolio total return;
- Net Property Income (NPI) increased by 0.5% to $201.2m, impacted by divestments during the period;
- Like-for-like NPI increased 4.7% compared to 3.1% in the pcp;
- 116,805 sqm leased compared to 52,004 sqm in the pcp;
- Average incentives over the year of 18%, down from 30% in the pcp;
- Portfolio occupancy of 97% (96% at 30 June 2016), with high tenant retention of 85%; and
- Weighted average lease expiry (WALE) of 5.1 years, up from 4.8 years at 30 June 2016.

The portfolio generated like-for-like NPI growth of 4.7% benefiting from favourable leasing conditions in the Sydney market driving effective market rental growth and additional income generated from the Brisbane portfolio following significant leasing undertaken during the last 18 months. Total NPI growth was tempered by the divestment of two assets and the withdrawal of 151 Clarence Street, Sydney for redevelopment during the period.

[1] The Responsible Entity considers the non-AAS measure, Funds From Operations (FFO), an important indicator of the underlying performance of IOF. To calculate FFO, net profit attributable to unitholders is adjusted to exclude unrealised gains or losses, certain non-cash items such as the amortisation of tenant incentives, fair value gains or losses on investments and other unrealised or one-off items. IOF’s FFO calculation is in line with the Property Council of Australia definition of FFO.

The Investa Office Management platform again demonstrated its ability to proactively add value to the portfolio, completing a number of transformational leasing deals to improve overall portfolio quality and drive returns for Unitholders. During the period 96 leases over 116,805 sqm (excluding Heads of Agreement) were completed representing over 22% of the portfolio by area. Material lease transactions included:

- An 11.5 year lease extension with Telstra for 63,372 sqm at 242 Exhibition Street, Melbourne. This lease provides a long term income stream and de-risks the Melbourne portfolio;
- A 10 year lease extension of 11,973 sqm to the Commonwealth of Australia at 836 Wellington Street, Perth on terms favourable to current market conditions;
- An agreement to extend Allens lease over 8,424 sqm for 7.5 years and a new 7 year lease to Property NSW over 2,888 sqm at 126 Phillip Street, Sydney. These deals have extended the WALE of the property by 1.3 years to 5.7 years;
- 5,063 sqm of leasing at 567 Collins Street, Melbourne increasing occupancy to 91%. There are two years remaining on the income agreement with Leightons over the remaining vacant space; and
- 17 leases signed over 4,647 sqm at 6 O'Connell Street, Sydney with average face rental increases of 26% on prior passing rent.

The successful leasing over the year resulted in the portfolio's WALE increasing from 4.8 to 5.1 years and increased portfolio occupancy to 97%.

Nicole Quagliata, IOF Assistant Fund Manager, said "Investa's pro-active asset management and strong tenant relationships have resulted in an extraordinary year of leasing success. The total area leased of 116,805 sqm was a near record year, and tenant retention was high at 85%. Tenant demand from occupiers under 1,000 sqm was particularly strong, accounting for over 90% of all leases signed. Consistent with the favourable market conditions, the average incentive granted on new deals was down from 30% to 18%, which is a marked improvement in just 12 months. With vacancy expected to decrease over the next two years in all of IOF's markets, and particularly in the Sydney CBD, we are optimistic regarding the outlook for the portfolio."

IOF's Sydney portfolio has a number of opportunities to drive returns for Unitholders in a market that is expected to experience continued demand and near term supply constraints, fuelling further effective rental growth:

- The Barrack Place development at 151 Clarence Street, Sydney is progressing well with demolition complete, construction well underway and practical completion on target for third quarter 2018. The development became the first building in Australia to be awarded a WELL Core and Shell Gold Precertification and ARUP extended its pre-commitment by 1,591 sqm during the year resulting in 35% of the total floor area now leased;
- 388 George Street, Sydney provides an attractive opportunity to drive long term returns for Unitholders when IAG departs post its lease expiry in October 2018. The asset maintains a prime position in the heart of Sydney's CBD and has the potential to be fully refurbished including the activation of five office atriums, the plans for which received development approval in July this year. New end of trip facilities and enhanced tenant and retail amenity will further transform the asset and the marketing campaign is well underway; and
- 347 Kent Street, Sydney where ANZ currently reside until January 2019, also presents an attractive opportunity to be refurbished to drive future performance. The Fund is on track to reposition the building over the next three years with a relocated and significantly enhanced entrance foyer, newly activated leasable areas, new mechanical services, improved amenity and refurbished office floors. The Development Application for the major works has been approved and the marketing campaign has commenced. Discussions continue with ANZ regarding its tenancy.

IOF's two prime Melbourne assets (16% of the portfolio value), are securely positioned with a WALE of 11.8 years, and the Brisbane portfolio (15% of the portfolio value), continues to benefit from improving office market conditions and strengthening investment demand.

The positioning of IOF's Perth portfolio (4% of the portfolio value) significantly improved during the period with the WALE increasing from 2.9 years to 6.0 years. In addition to the 10 year lease extension at 836 Wellington Street, there were four new leases across 1,984 sqm at 66 St Georges Terrace, which was refurbished in 2016.

Valuations

The portfolio recorded a total external valuation increase for the financial year of $344 million or 10.0% over book value, with the weighted average capitalisation rate decreasing by 46 basis points, from 6.20% to 5.74%. The valuation uplifts were driven by the continued strength of the Sydney office market, value accretive leasing across the entire portfolio, and continued strong investment demand.

Over 75% of the overall valuation increase for the year was from the Sydney and North Sydney portfolios, which increased by 13.0% and 10.1%, respectively. The uplifts were driven by active leasing, increased market rents, reducing incentives and capitalisation rate compression.

The Brisbane portfolio increased by $52.7 million (10.5%), reflecting new leasing and improved investment demand, whilst the Melbourne portfolio increased by $24.9 million (4.4%), with 242 Exhibition Street fully de-risked post the Telstra lease extension.

Asset divestments

The Fund strategically divested two non-core properties during the year comprising 800 Toorak Road, Melbourne for $140.5 million (10.5% premium to book value) and 383 La Trobe Street, Melbourne for $70.7 million (31% premium to book value). The proceeds from these transactions will be recycled into the Fund's value add and development pipeline.

Active capital management

IOF's debt capital structure continues to be prudently managed. Look-through gearing reduced to 21.4%, the Fund's weighted average debt expiry is 4.7 years and the Fund's weighted average cost of debt reduced to 4.1%, benefiting from lower variable rates.

The Fund's hedging policy was revised during the year resulting in an increase to the annual hedge ratio target range from 30%-80% to 50%-80% for years one to three. The Fund's average debt hedged over the year increased as a result from 36% for the pcp to 50%, and the Fund anticipates operating at the upper end of the target range going forward.

The Fund issued inaugural Green Medium Term Notes (Green Bond), in April 2017 to the value of $150 million maturing in April 2024. This was the first Australian dollar green bond issuance by a non-financial corporate and reinforces Investa's corporate sustainability leadership.

The Fund today also announces an on-market buy-back of up to 5% of IOF stapled securities, as part of its active approach to capital management. Penny Ransom, IOF Fund Manager, said "The buy-back is intended to enhance value and returns to IOF unitholders, should market conditions permit." Please refer to the Appendix 3C lodged with the ASX today for further information in respect of the on-market security buy-back.

Platform joint venture proposal

In August 2016 the Fund's opportunity to acquire a 50% interest in the Investa Office Management platform (Platform) was triggered. At an IOF Unitholder meeting held on 31 May 2017 Unitholders voted against the proposal to acquire a 50% interest in the Platform. IOF continues to be externally managed by Investa Listed Funds Management Limited (ILFML).

Cromwell Property Group

During the year, ILFML received highly conditional, non-binding and indicative approaches from Cromwell Property Group (Cromwell) referring to the possibility of an all cash arrangement to acquire all of IOF's issued capital. Following the execution of a confidentiality agreement, Cromwell was granted access to due diligence in relation to IOF and information was made available between 12 April 2017 and 22 May 2017. Since this period the Independent Directors of ILFML have not received any communication from Cromwell.

Corporate governance

ILFML has taken the initiative to appoint global search and leadership advisory firm Russell Reynolds Associates to assist with succession and diversity planning for the ILFML Board by expanding the number of Independent Directors and the Board's diversity. All future appointments of Independent Directors to the ILFML Board will continue to be subject to the approval of IOF Unitholders at the following Annual General Meeting.

Financial year 2018 outlook

IOF is well positioned given its existing strong weighting to the outperforming Sydney and North Sydney markets (63% of portfolio value), the Fund's high quality office portfolio and the potential to drive returns for Unitholders through the active management of its near term value add and development pipeline in Sydney. Portfolio occupancy is high at 97% and the long portfolio WALE of 5.1 years provides security of income.

FFO guidance for financial year 2018 is 30.0 cpu, up 1.0% on financial year 2017, with fixed rental increases and positive East Coast leasing fundamentals offset by the impact of the two divestments during the second half of financial year 2017. The distribution is anticipated to increase by 0.5%, with distribution guidance for financial year 2018 of 20.3 cents per unit. This guidance is subject to prevailing market conditions and assumes no further acquisitions or disposals and no on-market buy-back of IOF units.

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About Investa Office Fund

Investa Office Fund (ASX code: IOF) is an ASX-listed real estate investment trust (A-REIT) and is included in the S&P/ASX100 index. IOF is a leading owner of investment grade office buildings and receives rental income from a tenant register comprised predominately of Government and blue chip tenants. As at 30 June 2017, IOF had total assets under management of AU$3.8 billion with 20 investments located in CBD markets throughout Australia. IOF's focus is on delivering attractive risk-adjusted returns to its unitholders from a portfolio of high quality assets located in the key CBD office markets of Australia.

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