ASX announcement

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Investa Office Fund (ASX:IOF)

Guidance upgraded on the back of strong HY17 performance

Investa Listed Funds Management Limited (ILFML) as Responsible Entity for Investa Office Fund (IOF or the Fund) today reported strong results for the six months to 31 December 2016, underpinned by active asset management, major re-leasing and favourable office market fundamentals. Consequently, IOF has upgraded market guidance for the financial year 2017.

The Fund has delivered a Return on Equity[1] of 8.5% over the past six months and 17.8% over the past 12 months. This resulted from a strong unlevered portfolio total return of 14.0% for the 12 months to 31 December 2016.

Funds From Operations (FFO)[2] per unit grew by 1.4% compared to the six months to 31 December 2015, on the back of strong like-for-like Net Property Income (NPI) growth of 4.5% offset by the loss of rental income resulting from the development of 151 Clarence Street in Sydney. Growth was delivered through improved occupancies in the Brisbane and Perth portfolios and strong growth in face rents within the Sydney market. Distributions per unit subsequently increased by 2.0%.

Statutory net profit was $224.0 million, 20.2% lower than the previous corresponding period (pcp). The decrease was primarily due to valuation increases of $176.0 million being $20.8 million lower than the pcp and the combined fair value change of derivatives and foreign exchange movements being $37.9 million lower than the pcp.

Key financial result highlights include:

- FFO of 14.9 cents per unit, up 1.4% on pcp post the impact of the 151 Clarence Street development;
- Distributions of 10.0 cents per unit, up 2.0% on pcp;
- Net Tangible Assets (NTA) increased 6.1% over the half year period to $4.49 per unit primarily resulting from positive property valuations;
- Return on Equity of 8.5% for the half year and 17.8% for the full year to 31 December 2016; and
- Low Management Expense Ratio over calendar year 2016 of 0.40% of total assets.

Penny Ransom, IOF Fund Manager, said “Our strong first half results highlight the quality of the property portfolio and the specialist skills of the Investa Office Platform. This has driven attractive returns for Unitholders and we look forward to continuing to optimise returns. The Fund’s 61%[3] weighting to Sydney and North Sydney comprises a portfolio valued at $2.3 billion, which is expected to benefit from the continued strengthening in office market fundamentals and a number of attractive value add opportunities which will improve the quality of the portfolio for Unitholders.”

Portfolio performance driven by leasing outcomes and favourable capital markets:

- Like-for-like NPI increased 4.5% compared to 1.9% (pcp);
- 95,092sqm leased compared to 16,177sqm (pcp);
- Average incentives over the half year of 16%, reduced from 29% (pcp);
- Portfolio occupancy of 97% (96% 30 June 2016) with high tenant retention of 89%;
- Weighted average lease expiry (WALE) of 5.6 years, up from 4.8 years as at 30 June 2016; and
- External valuation uplift of $160.9 million (11 of 22 properties were externally valued), resulting in an overall portfolio value increase of 4.4% and the average capitalisation rate reducing from 6.20% as at

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1. Return on Equity calculated as the growth in Net Tangible Assets plus distributions.
2. 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. Refer to the June 2016 Financial Report for the complete definition.
3. As at 31 December 2016 and excludes 383 La Trobe Street, Melbourne which settled 17 January 2017.

30 June 2016 to 6.01% as at 31 December 2016. A $13.1 million uplift was also recorded for the sale of 800 Toorak Road, Melbourne.

In Sydney, strong market conditions resulted in face rental increases on new leases signed during the period of 13.2%. In the Brisbane portfolio, substantial leasing achieved over the last 12 months saw occupancy rise from 82% to 92%.

During the six month period, a total of 95,092sqm of leasing was achieved with the highlights being:

- A lease extension to Telstra at 242 Exhibition Street, Melbourne across 63,372sqm until 2031. This de-risked the Fund's second largest lease expiry and was reflected in the asset's most recent external valuation which recognised a 3% uplift during the period;
- A 10 year lease extension with the Commonwealth of Australia over the entire building (11,973sqm) at 836 Wellington Street, Perth. This lease was on more favourable terms compared to current market conditions and was reflected in the asset's most recent external valuation which experienced a 3% uplift during the period;
- Agreement to extend Allens Linklaters' occupation of 126 Phillip Street, Sydney (8,424sqm) for 7.5 years from their current expiry in June 2019. This addresses the Fund's fourth largest lease expiry in FY19. The extension was agreed on terms that reflect current market conditions for a Premium Sydney CBD grade property and provided a financial outcome in line with the asset's most recent external valuation; and
- Multiple smaller leasing transactions in Sydney and Melbourne including 10-20 Bond Street, Sydney (3,978sqm), 6 O'Connell Street, Sydney (2,269sqm), and 567 Collins Street, Melbourne (2,059sqm).

The successful leasing resulted in an increased WALE to 5.6 years[4] as at 31 December 2016 and reduced the Fund's FY19 lease expiry from 29.0% to 24.4%.

Nicole Quagliata, IOF Assistant Fund Manager, said "Active asset management and our close relationships with our tenants have again resulted in significant leasing success. Tenant retention has been outstanding at 89% and the average incentive for the period has declined significantly from 29% for the previous corresponding period to 16%. Leasing activity is set to continue with a further 3,000sqm of leasing completed post 31 December 2016 and 15,600sqm in heads of agreement, including the lease renewal to Allens Linklaters at 126 Phillip Street."

Looking forward, the Fund remains well positioned with over 85% of lease expiries over the coming three years weighted to the high performing Sydney market, which is experiencing limited supply and strong tenant demand. Key FY19 lease expiries at 347 Kent Street, Sydney and 388 George Street, Sydney will provide the Fund with the opportunity to upgrade the assets and drive returns for Unitholders, whilst enhancing the overall quality of the Fund.

The redevelopment of Barrack Place at 151 Clarence Street, Sydney is well underway, with demolition nearing completion and construction due to commence shortly. There has been strong leasing interest in the property which is due to be completed at an opportune time in the cycle, with vacancy forecast to be under 4%. The property will provide a key exposure to the Sydney market at an attractive yield on cost in excess of 7.5%.

Valuations and asset disposals

In line with the Fund's Valuation Policy, external valuations were undertaken on 11 of the 22 properties as at 31 December 2016, resulting in an uplift of $160.9 million or 8.7% over book value and a 4.4% increase for the overall portfolio. Importantly, circa 56% of the upside was a result of improved asset fundamentals and new leases signed, independent of capitalisation rate movement.

The Sydney portfolio provided a major contribution to the overall valuation uplift, with properties such as 151 Clarence Street, Sydney ($36.1 million), 6 O'Connell Street, Sydney ($23.6 million), 111 Pacific Highway, North Sydney ($21.0 million) and the Piccadilly Complex ($19.5 million) benefiting from active leasing, increased market rents and strong investor demand.

The average capitalisation rate for the externally valued assets tightened by 39 basis points, or by 21 basis points excluding 242 Exhibition Street, Melbourne and 836 Wellington Street, Perth, where major upgrades

4. If the HoA with Allens at 126 Phillip Street, Sydney is included and 383 La Trobe Street, Melbourne is excluded the WALE is 5.7 years.

to the assets were reflected in the capitalisation rate movement. The weighted average capitalisation rate for the total portfolio decreased by 19 basis points from 6.20% to 6.01%.

The Fund has taken advantage of the attractive property market cycle to strategically divest two properties. In September 2016, post extending the lease to Coles for the entire building at 800 Toorak Road, Melbourne to 2030, IOF announced the sale of the property at a 10.5% premium to book value. The sale is expected to settle on 23 February 2017. In January 2017, IOF settled the sale of 383 La Trobe Street, Melbourne for $70.7 million, at a 31% premium to book value.

The remaining IOF portfolio of 20 assets is high quality, well diversified and focused on the CBD markets of Sydney, North Sydney, Melbourne, Brisbane, Perth and Canberra.

Long debt maturity, low debt costs and increased hedging

IOF's debt capital structure continues to be stable and well balanced. The Fund's look-through gearing reduced to 26.5% over the half and is anticipated to fall further post the two asset disposals which will reduce gearing by approximately 4%. The capital will be recycled into funding the 151 Clarence Street development and the value add opportunities within the existing portfolio.

The Fund's weighted average debt term is 4.5 years and the Fund's weighted average cost of debt reduced to 3.9% from 4.2% as at 30 June 2016, benefiting from reduced debt costs on our floating debt facilities. The higher result in the prior period also reflected the impact of one-off refinancing costs.

The Fund's hedging at 31 December was 44%. The Fund's hedging policy was reviewed by the IOF Board during the half year. This resulted in an increase in the annual hedge ratio limits, reflecting the Board's preference towards a lower exposure to an increase in interest rates. In particular, the revised hedge ratio for years one to three has been amended to 50%-80%, and we anticipate operating towards the mid to upper end of this range.

Reflecting this approach, management has increased IOF's forward hedging profile with $750 million of new forward start hedges at various intervals through until 2022.

The focus is now on refinancing the $125 million of Medium Term Notes (MTN) which expire in November 2017. The Fund's strategy is to refinance the MTN with either bank debt or new debt capital market issuance. Following the MTN expiry, the next debt expiry is a $50 million bank facility in June 2018.

Investa Office Management platform joint ownership option

IOF has a 12 month period (that commenced on 12 August 2016) in which it may choose to exercise its right to commence the process to negotiate the purchase of a 50% interest in the Management Platform.

In December 2016, the Independent Directors successfully negotiated with Investa to extend the date for which the acquisition price is $45.0 million plus agreed working capital and other agreed reimbursement adjustments, if completion of the sale takes place from before 28 February 2017 to 31 May 2017.

Any decision on the potential acquisition of 50% of the Management Platform will be taken as part of an operational and governance review of how IOF works with the Management Platform. The aim of the review is to maximise the benefits for IOF unitholders.

The IOF Board will keep unitholders informed of any material developments with regard to the operational and governance review and the joint venture option.

Cromwell Property Group (CPG)

During the period, ILFML received a highly conditional, non-binding and indicative letter from CPG referring to the conditional possibility of an all cash arrangement to acquire all of IOF's outstanding issued capital for $4.45 per unit. CPG's request to carry out a comprehensive due diligence on IOF was not granted, as the Independent Directors considered that CPG's highly conditional approach undervalued IOF and was not compelling or attractive.

Following the determination not to grant CPG comprehensive due diligence, the Independent Directors have been in regular discussions with CPG and are willing to provide CPG with limited confidential information in order to facilitate CPG being in a position to provide IOF unitholders with an all cash proposal which is compelling and attractive.

IOF has prepared a Confidentiality Agreement to ensure IOF's confidential information is protected. CPG has insisted on additional exceptions to certain provisions of the Confidentiality Agreement which the Independent Directors do not believe, with the benefit of independent external legal and financial advice, are market standard nor in the best interests of all IOF unitholders. As such the Independent Directors have been unable to agree with CPG the form and content of the Confidentiality Agreement which adequately protects IOF unitholders and its information.

The Independent Directors remain open to continuing discussions with CPG and should a Confidentiality Agreement be agreed in a form that protects and is in the best interests of all IOF unitholders, the Independent Directors will be able to provide the limited confidential information.

The IOF Board will keep Unitholders informed of any material developments with regard to CPG.

Financial Year 2017 Outlook

IOF is well positioned to perform going forward given its high quality portfolio, primary exposure to the attractive Sydney and North Sydney markets, and strong balance sheet. Portfolio occupancy is high at 97% and lease expiries are relatively low over the next 18 months.

Given the strong leasing outcomes, FY17 like-for-like NPI growth is anticipated to exceed 5%. Combined with a lower debt balance, FY17 FFO guidance has been upgraded from 29.0 to 29.5 cents per unit, a 3.1% increase on FY16. Distribution guidance has been increased from 20.0 to 20.2 cents per unit, representing an increase of 3.1% on FY16. This guidance is subject to prevailing market conditions and no new material changes to the portfolio.

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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 31 December 2016, IOF had total assets under management of AU$3.8 billion with 22 investments located in core 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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