Folkestone
EDUCATION TRUST

ASX ANNOUNCEMENT
14 FEBRUARY 2018

# FOLKESTONE EDUCATION TRUST
# RESULTS FOR THE HALF YEAR ENDED 31 DECEMBER 2017

Folkestone Investment Management Limited as Responsible Entity of the Folkestone Education Trust ("FET") provides the results of FET for the half year ended 31 December 2017.

## KEY HIGHLIGHTS FOR THE HALF YEAR

- Distributable income of $21.0 million, an increase of 12.3% on pcp;
- Distribution of 7.55 cents per Unit ("cpu"), an increase of 6.3% on pcp;
- NTA per Unit of $2.67, an increase of 6.4% from 30 June 2017;
- FET's development pipeline, post completions, is now 26 sites (+7) with a total value of $156.3 million;
- 3 developments were completed, with a completion value of $16.5 million;
- 14 five year options were exercised and 10 new leasing transactions were completed;
- 21 market rent reviews were completed, achieving an average rent increase of 4.8%; and
- 7 properties were sold for a total of $10.9 million, at an 11.2% premium to carrying values[1].

## FINANCIAL SUMMARY

The tables below summarises FET's results for the six month period in comparison to the pcp:

| INCOME STATEMENT SUMMARY | DEC 17 | DEC 16 | VAR % |
|---|---|---|---|
| Total Operating Revenue ($m) | 35.7 | 32.6 | 9.5 |
| Total Operating Expenses ($m) | 14.7 | 13.9 | 5.8 |
| Distributable Income ($m) | 21.0 | 18.7 | 12.3 |
| EPU[2] (cpu) | 8.3 | 7.5 | 10.7 |
| Distribution (cpu) | 7.55 | 7.1 | 6.3 |
| Statutory Profit ($m) | 55.4 | 69.1 | (19.9) |

| BALANCE SHEET SUMMARY AS AT | DEC 17 | JUNE 17 | VAR % |
|---|---|---|---|
| Total Assets ($m) | 954.1 | 903.3 | 5.6 |
| Investment Properties[3] ($m) | 908.3 | 861.2 | 5.5 |
| Borrowings[4] ($m) | 255.8 | 249.9 | 2.4 |
| Net Assets ($m) | 680.2 | 629.7 | 8.0 |
| Gearing[5] (%) | 26.8 | 27.7 | (0.9) |
| Units on Issue (m) | 254.6 | 250.6 | 1.6 |
| NTA per Unit ($) | 2.67 | 2.51 | 6.4 |

[1] *Carrying value at contract date.*
[2] *Distributable income divided by weighted average number of Units.*
[3] *Includes $1.5 million of transaction costs in relation to properties contracted and not settled.*
[4] *Borrowings as at 31 December 2017 include loans of $255.0 million and bank overdraft of $0.8 million.*
[5] *Gearing is calculated by borrowings / total assets.*

## PROPERTY PORTFOLIO PERFORMANCE

Key property portfolio performance as at 31 December 2017:

| AS AT | DEC 17 | JUNE 17 | VAR % |
|---|---|---|---|
| Value of Investment Properties ($m) | 906.8 | 858.8 | 5.6 |
| Current Annual Income ($m) | 59.2 | 58.3 | 1.5 |
| Average Annual Lease Income Increase (y-o-y) (%) | 3.0 | 3.1 | (0.1) |
| Property Yield – Freehold Properties (%) | 6.3 | 6.5 | (0.2) |
| Property Yield – Leasehold Properties (%) | 13.0 | 13.8 | (0.8) |
| Overall Portfolio Yield (%) | 6.5 | 6.7 | (0.2) |
| Occupancy Rate (%) | 100.0 | 99.5 | 0.5 |
| Weighted Average Lease Expiry (yrs) (by income) | 9.2 | 9.1 | 1.1 |

## PROPERTY SUMMARY

FET's property portfolio as at 31 December 2017:

| PROPERTY PORTFOLIO | NO OF PROPERTIES | CARRYING VALUE ($m) | CURRENT ANNUAL INCOME ($m) |
|---|---|---|---|
| Australia – Early Learning | 334 | 756.4 | 51.0[6] |
| New Zealand – Early Learning | 51 | 68.3 | 4.4[7] |
| **Total Early Learning** | **385** | **824.7** | **55.4** |
| Medical Centre | 1 | 14.0 | 0.8 |
| **Total Improved Properties** | **386** | **838.7** | **56.2** |
| Development Sites (Settled) | 21 | 68.1 | 3.0[8] |
| **Total Properties** | **407** | **906.8** | **59.2** |

## FET'S PERFORMANCE

FET paid distributions to investors of 7.55 cpu for the half year, in accordance with the annual FY18 forecast of 15.1 cpu.

FET provided a total return of 19.5 per cent for the year to 31 December 2017, outperforming the S&P/ASX 300 A-REIT Accumulation Index ("Index") return of 6.5 per cent for the same period. FET has also outperformed the Index over three years at 19.6 per cent per annum (v 11.3 per cent per annum), five years at 25.2 per cent per annum (v 13.4 per cent per annum) and ten years at 14.6 per cent per annum (v 1.8 per cent per annum).

[6] *Includes head lease rent on leasehold properties of $1.2 million.*
[7] *Based on NZD rent of $4.9 million at an exchange rate of 1.0993 as at 31 December 2017.*
[8] *Site rent charged on 8 development sites with carrying value of $33.9 million.*

## PROPERTY PORTFOLIO

### *Rent Reviews*

During the half year, FET completed 21 market rent reviews achieving an average increase of 4.8 per cent over the prior year's rent, noting that 95 per cent of these leases have a capped rental increase of 5.0 per cent over the prior year's rent. The cap has restricted potential rental increases with some properties considered to have revised rents, still significantly below their market equivalents.

The like-for-like rental growth across the portfolio for the year was 3.0 per cent taking into account both market, CPI based reviews and new leasing transactions. For the remainder of FY18, there are a further 23 market rent reviews scheduled to be completed.

### *Lease renewals*

During the half year, all 14 option renewals were exercised, increasing the term remaining on these properties from 5 to 10 years. In addition, FET has entered into 10 new 15 year leases for existing FET properties, resulting in a 17.3 per cent increase in rent payable.

These transactions, together with the completion of three new developments has resulted in the weighted average lease expiry for the portfolio increasing from 9.1 years to 9.2 years over the half year. There are a further 18 option renewals remaining for FY18.

### *Property Valuations*

During the half year, a total of 355 properties in the portfolio were revalued. Of these, 62 properties were independently revalued as part of FET's three year independent rolling valuation cycle, with the remainder being Directors' valuations. The Directors' valuations were adopted utilising the parameters drawn from the current independent valuations, to ensure consistency across the portfolio.

The outcome is an overall increase of $33.9 million over the 30 June 2017 carrying values. This has been driven by yield compression, combined with income growth from annual and market rental reviews. Overall, yield compression achieved across the entire portfolio (including leasehold assets) for the half year to 31 December 2017 was 20 basis points, decreasing the overall portfolio yield from 6.7 per cent to 6.5 per cent. The overall passing yield achieved on the freehold independent valuations was 6.3 per cent, a 50 basis point improvement on the passing yield on the same assets from 30 June 2017.

Subsequent to 31 December 2017, a further 13 freehold independent valuations have been completed. These valuations have resulted in a 6.4 per cent ($1 million) increase in value compared with the Directors' valuations adopted at 31 December 2017.

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## DEVELOPMENT PIPELINE

At 30 June 2017, FET owned 17 development sites. During the half year, FET settled 7 more development sites with an aggregate completion value of $43.8 million. Three development sites commenced operations in the half year ending 31 December 2017 with a completion value of $16.5 million. The completed development sites were delivered on time and on budget and provides FET with a yield on cost of 7.5 per cent. FET has contracted a further 7 development sites with a completion value of $42.4 million, with settlement of these sites expected during FY18 and FY19.

| DEVELOPMENT SITES | NO OF PROPERTIES | UPON COMPLETION VALUE ($m) |
|---|---|---|
| Settled as at 30 June 2017 | 17 | 102.1[9] |
| Settled HY18 | 7 | 43.8 |
| *Less* completed developments HY18 | (3) | (16.5) |
| *Less* not likely to proceed | (2) | (15.5) |
| **Settled as at 31 December 2017** | **19** | **113.9** |
| Sites contracted | 7 | 42.4 |
| **Total** | **26** | **156.3** |

The current development pipeline of 26 sites has a forecast upon completion value of $156.3 million and is expected to add approximately $10.0 million per annum of net rental income to FET, an increase of 17.8 per cent on FET's existing lease income.

FET continues to target new opportunities based on our strong understanding of the market, with the key focus on selecting high quality real estate supported by sound early learning demand and supply fundamentals. The acquisitions are consistent with FET's strategy of enhancing the quality of the property portfolio and increasing earnings.

## DISPOSALS

FET's capital and portfolio management strategy includes the sale of selective non-core properties, with proceeds redeployed to new property purchases and/or developments. This provides longer-term benefits to investors in the form of substantially superior real estate where demand, rental and capital growth and underlying land values are expected to be significantly stronger with lower long term risk.

FET settled the sale of 7 properties during the half year, four of which were contracted in the prior financial year. The gross proceeds of the disposals totalled $10.9 million, at an average yield of 7.5 per cent and an 11.2 per cent premium to carrying values as at the date contracted.

The disposals consisted of five regional Queensland assets (one with a WALE of less than three years), one ACT asset and one South Australian regional asset (WALE of less than 1.5 years).

[9] *Includes uplift in value of completed centres from $14.1 million to $16.5 million.*

## CAPITAL MANAGEMENT

### *Debt Funding*

As at 31 December 2017, FET's debt facilities totalled $317 million, comprising bilateral facilities with ANZ and HSBC. The facilities are drawn to $255 million as at 31 December 2017. The facilities are split into various tranches ranging from June 2019 to June 2022 with a weighted debt maturity of 3.0 years. FET is exploring options of longer-dated debt maturities and non-bank debt financing which are consistent with FET's predictable income and a weighted average lease expiry of 9.2 years.

FET has significant headroom under its debt covenants with gearing at 31 December 2017 of 26.8 per cent, which is below the targeted long term range 30 – 40 per cent.

As part of FET's interest rate management policy, FET has staggered hedging positions through to June 2022. The average hedged position is 51 per cent based on the existing debt of $255 million at an average rate of 2.97 per cent per annum (30 June 2017: 2.95 per cent per annum).

As at 31 December 2017, FET's cost of debt is 4.2 per cent per annum (30 June 2017: 4.2 per cent per annum) and the all-in-cost of debt is 4.5 per cent per annum (30 June 2017: 4.5 per cent per annum) which includes the amortisation of deferred borrowing costs.

## EARLY LEARNING MARKET

As previously indicated, operators are currently facing tougher trading conditions resulting in marginally softer occupancy levels. The impact varies between locations and operators, with operators prepared to reinvest in their business and improve their service offering having greater success at being able to maintain/increase occupancies. Operator trading conditions have been negatively impacted by a combination of two key factors:

- increased competition through the supply of new centres; and
- increased cost of living increases including childcare combined with the diminished effectiveness of the $7,613 per annum childcare rebate which has had minimal indexation since July 2008.

The passing of the Commonwealth Government's "Jobs for Families" package, supported by all political parties, will assist in alleviating this pressure. This package which includes an additional $3.5 billion of funding to the industry provides a defined funding platform for the future. From 1 July 2018, the rebate will reset and the removal of the existing cap for families earning under $185,000 per annum is expected to provide some positive impetus to the sector.

For calendar year 2017, there was a net increase of 318[10] new centres across Australia (+4.5%). Following the March 2017 quarter when 113[10] new centres were completed, 205 new centres were completed for the remaining 9 months at an average rate of 68 centres per quarter, indicating that the growth in the supply of new childcare centres appears to have slowed as operators have reduced their expansion plans to more specific locations and numbers. Lending criteria for debt funding, for both operators and developers has tightened. As a result, we expect the increase in the number of new centres to moderate and revert back to a similar growth rate in line with demand requirements.

[10] *Canaccord data*

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## OUTLOOK AND DISTRIBUTION FORECAST

Management reconfirms the FY18 forecast distribution guidance of **15.1 cpu.** This is based on continued tenant performance. FET will continue to pay quarterly distributions, one month in arrears.

FET continues to execute its strategy to be recognised as the leading provider of early learning accommodation and together with quality operating partners, focusing on providing a healthy and safe learning environment for future generations. Investors benefit from predictable and secure long term income with the opportunity for capital growth.

FET is committed to active management of its portfolio to capitalise on future growth prospects. Unitholders should note that any investment opportunity is assessed with respect to its consistency with FET's characteristics and overall investment objectives.

## INVESTOR TELECONFERENCE

Management invites investors to participate in the teleconference where FET's HY18 results and presentation will be discussed. To register for the teleconference please follow the registration details below.

| | |
|---|---|
| Date: | Wednesday, 14 February 2018 |
| Start time: | 2:30pm AEDT |
| Register attendance: | To register your attendance please **click here** or on this link https://login.redbackconferencing.com.au/landers/page/fcfc62 |

Once you have registered, you will be provided with dial-in numbers and a passcode. Investors will need to register before **11.30am** today.

For further information contact:


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### FURTHER INFORMATION

**Folkestone Education Trust**
The Folkestone Education Trust is the largest Australian ASX listed (ASX:FET) real estate investment trust (A-REIT) that invests in early learning properties. www.educationtrust.folkestone.com.au

**About Folkestone**
Folkestone (ASX:FLK) is an ASX listed real estate funds manager and developer providing real estate wealth solutions. Folkestone's funds management platform, with more than $1.3 billion under management, offers listed and unlisted real estate funds to private clients and select institutional investors, while it's on balance sheet activities focus on value-add and opportunistic (development) real estate investments. www.folkestone.com.au