Arena REIT (ASX code: ARF)

Internalisation Proposal

Creating enhanced alignment and competitive advantages

4 November 2014

Arena

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1 Executive summary

Internalisation Proposal to be presented to ARF Investors

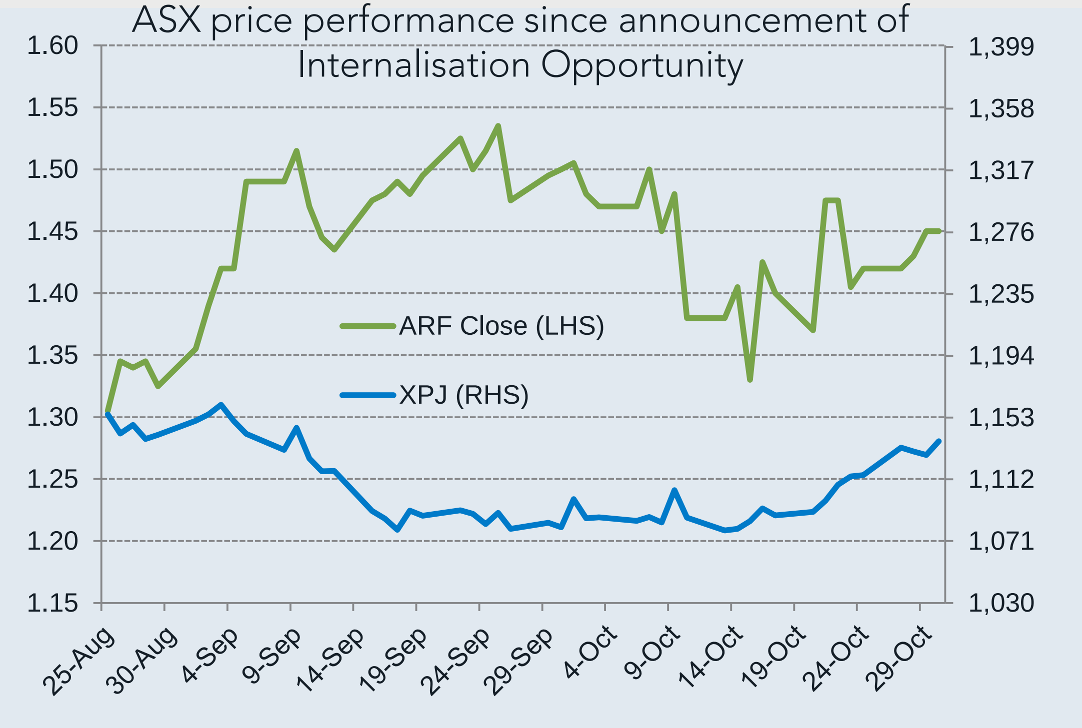
- Arena REIT to internalise its management structure subject to conditions precedent including ARF Investor approval and no superior proposal (**Internalisation Proposal**).
- If the Proposal is approved and implemented, Investors expected to benefit from:
  - expected ongoing net management cost savings contributing to ARF distribution guidance for FY15 being upgraded to 10.0 cents per security[1] (up from 9.75 cents);
  - greater alignment of interests through the new Board and management being accountable only to Investors; and
  - a superior outlook for ARF earnings growth per security with the elimination of external funds management fees.
- KPMG Corporate Finance acting as Independent Expert has reviewed the Proposal and concluded that the Proposal is "fair and reasonable and in the best interests" of Investors.
- Arena's Independent Directors have also concluded that the Proposal (as compared to other alternatives) is in the best interests of Investors, and unanimously recommend that Investors "vote in favour of the Internalisation Proposal" in the absence of a superior proposal.
- An Investor meeting is scheduled to be held at 11 am (AEDT) 5 December 2014. Refer to Meeting Booklet comprising Notice of Meeting, Explanatory Memorandum and Prospectus (lodged with ASX) expected to be dispatched to Investors by 13 November 2014.

[1] On a status quo basis assuming no new acquisitions, developments in progress are completed in line with budget assumptions and tenants comply with all their lease obligations.

2 Background

Internalisation opportunity flagged to market on 25 August 2014

- On 25 August 2014, Arena announced that it had entered into an exclusivity agreement for a period of six months with Citrus II Investments Pty Ltd (the ultimate owner of Arena Investment Management Limited) for Arena REIT (ARF) to consider an internalisation of its corporate governance and management function and to assume the managements rights over two wholesale funds, being PHC Darlinghurst Syndicate and Trust and BSH Joint Venture (which both own healthcare properties).



- Since the announcement, Arena has received positive feedback from ARF's larger institutional investors and ARF's share price has moved favourably.
- The Arena Board established an Independent Board Committee comprising solely the independent directors to review the internalisation opportunity and consider possible alternatives.

3 Proposal overview

Key elements of the Proposal are …..

- **Consideration** - ARF is to pay consideration to Citrus II which implies a purchase price of approximately $10.7 million for the ARF and wholesale funds management (intangible) rights plus net asset adjustments of approximately $0.8 million in relation to all other operating assets and liabilities of the management business such as intellectual property, IT systems, office equipment, syndicate receivables and other working capital balances. As a consequence, ARF will no longer pay ongoing management and transaction fees to an external manager. The consideration will be funded utilising ARF's existing debt facility.

Basis	Consideration $ million	Consideration AUM (%)	Multiple of Base Fees (times)	Multiple of Net Savings (times)
$ paid to Citrus II	11.5	2.8%	3.4	10.7
$ net of Unlisted fund rights	9.5	2.5%	3.1	12.5

Source: KPMG Corporate Finance Report, page 45

- **Quality Management Team** – Post internalisation, the new ARF Board will comprise the current independent directors and Bryce Mitchelson as Managing Director (current Joint Managing Director of Arena). In addition, other senior staff including Gareth Winter (CFO) and Rob de Vos (Head of Property) have accepted employment with ARF, subject to the Internalisation Proposal proceeding.
- **No Change in "Social Infrastructure" Strategy** – ARF's existing investment strategy will essentially not change and will remain focussed in investing in social infrastructure style property including Childcare and Healthcare leased assets. ARF will also assume the management rights to two well performing unlisted wholesales funds (also invested in Healthcare assets) and may seek to grow earnings further by leveraging its existing capabilities by providing funds management and property services to other unlisted managed funds.

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3 Proposal overview (cont)

Key elements of the Proposal are …..

- **Retain Existing Name & Branding –** ARF will retain the existing Arena brand, investor goodwill and intellectual property built up over the past few years.
- **Other Management Services –** CISL (which post implementation will be part of the new ARF group) will provide management services to Arena for its remaining managed funds for a period to no later than 31 December 2016. Certain CISL employees will be retained to provide these services and all costs associated with these management services will be reimbursed to ARF.

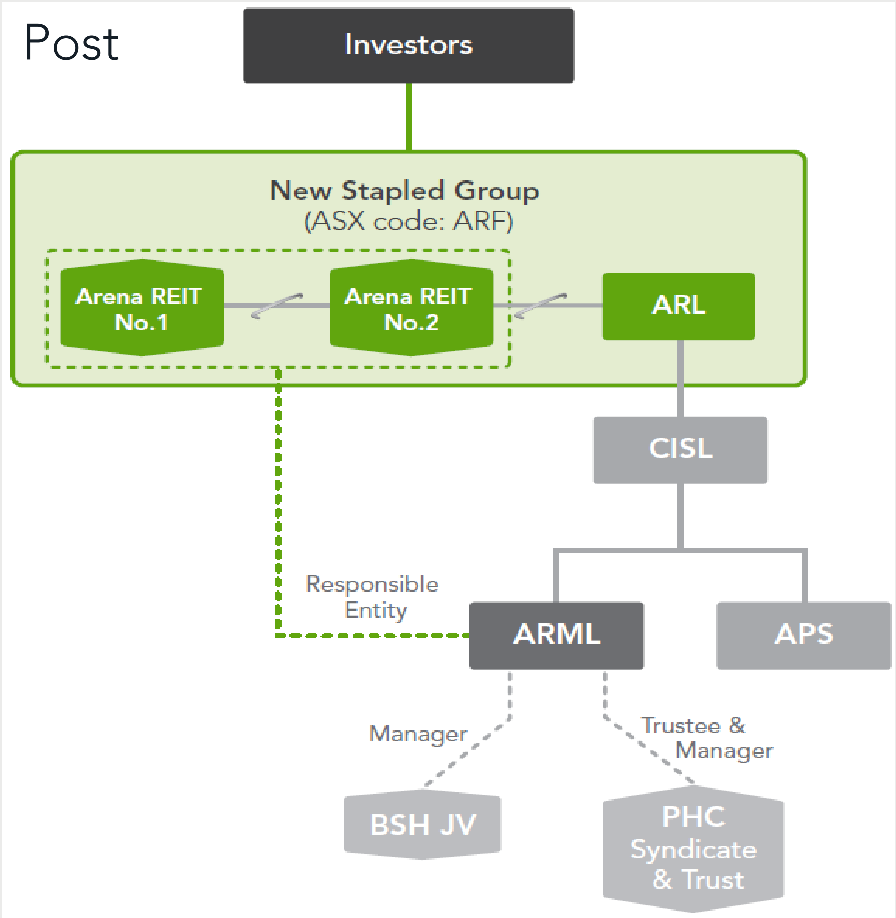
Conditions precedent to be satisfied:

- ARF investor approval of the Internalisation Proposal;
- The Independent Expert does not change their opinion that the Internalisation Proposal is "fair and reasonable and in the best interests of" ARF investors;
- No superior proposal;
- ASIC issuing a new Australian Financial Services Licence to ARML in an appropriate form; and
- All required consents of financiers being obtained.

Proposal overview (cont)

No changes required to constitutions

- The Proposal will enhance alignment of the Board and management with Investors' interests and will be implemented via:
  - the distribution to Investors of one fully paid ordinary share in Arena REIT Limited (**ARL**) for each existing stapled security in Arena REIT (**Existing Stapled Security**). ARF is a newly formed company that post internalisation will undertake the business and management activities of the new ARF group;
  - the stapling of each share in ARL to each Existing Stapled Security to form a new stapled security;
  - the acquisition by ARL of Citrus Investment Services Pty Ltd (**CISL**) (and its wholly owned subsidiaries Arena REIT Management Limited (**ARML**) and Arena Property Services Pty Ltd) from Citrus II; and
  - the change of the responsible entity of Arena REIT (and manager of PHC and BSH) from Arena to ARML (newly established).



4 Investor meeting

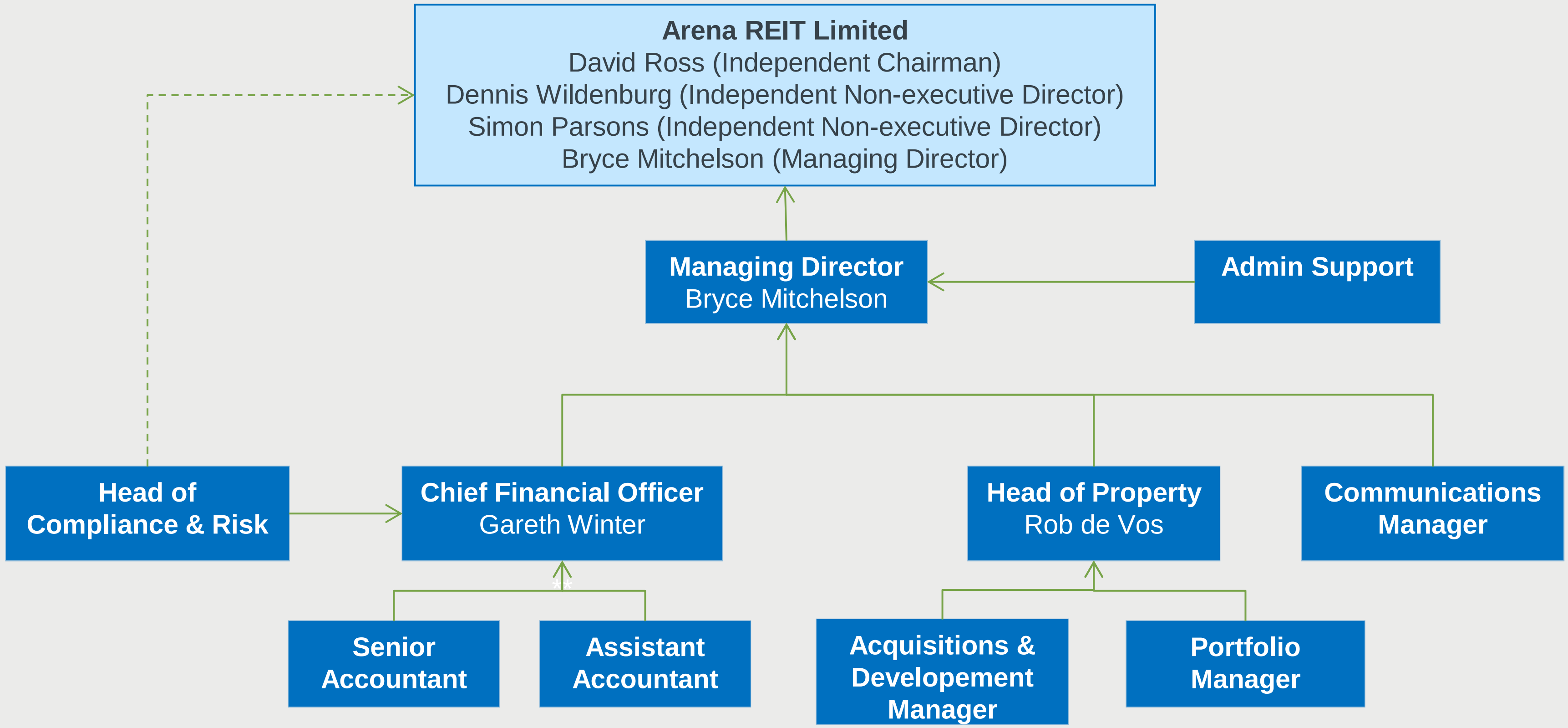
Scheduled for 5 December 2014

- An Investor Meeting is scheduled to be held at 11.00am Friday 5 December 2014 at West Tower Suite, Level 35, Sofitel Hotel, 25 Collins Street, Melbourne.
- Investors will be requested to consider, and if thought fit, pass the following three resolutions:
  1. "That ... the Internalisation Proposal ... be approved";
  2. That … upon the retirement of Arena Investment Management Limited …, Arena REIT Management Limited be appointed as the new responsible entity of Arena REIT …";
  3. That …approval is given … to the acquisition by the Managing Director … under the New ARF Long Term Incentive Plan of each of the rights …."
- Resolutions 1 and 2 are inter-conditional i.e. both must be passed for the Internalisation Proposal to proceed. Resolution 3 is conditional on the passing of both Resolutions 1 and 2.
- All these three resolutions are Ordinary Resolutions and therefore to pass, will require a minimum 50% majority vote of those securities voted on day.
- Arena intends to appoint David Ross, Arena Independent Chairman, as Chair of the meeting.
- Meetings for ARF 1 & ARF 2 will be held concurrently.

Investors are encouraged to vote and attend the meeting

5 Board & management team

Experienced and resourced



5 Remuneration Structure

Aligning performance with investor returns

- The Board has adopted a remuneration policy that recognises the need to motivate, attract, and retain employees to deliver sustainable and superior business performance.
- The Independent Board Committee consulted with Ernst & Young to ensure that the remuneration structure and terms of the Short Term Incentive (STI) and Long Term Incentive (LTI) plans offered to selected staff are appropriate and in line with market practice.
- The STI will be assessed against specific KPI's for each individual and apply for FY15 on a pro-rata basis.
- The LTI is equity based, which for FY15 is split into Performance Rights (60%) and Recognition Rights (40%) which vest as at 30 June 2017 subject to certain hurdles being achieved.
- The number of rights issued is equal to the employees Maximum LTI value divided by the value of the respective rights.

  - LTI Performance rights Hurdle 1 – Relative TSR ranking (ASX 300)

New ARF's percentile ranking	Proportion of TSR-hurdled Performance Rights that vest
Below 50th percentile	0%
50th to 75th percentile	Progressive pro-rata vesting between 50% and 100% (ie. on a straight-line basis)
At or above the 75th percentile	100%

  - LTI Performance rights Hurdle 2 – Distributable income per security

FY17 distributable income per security	Proportion of distributable income per security-hurdled Performance Rights that vest
Below 11.0 cps	0%
Between 11.0 and 12.0 cps	Progressive pro-rata vesting between 50% and 100% (ie. on a straight-line basis)
≥ 12.0 cps	100%

5 Managing Director's REM for FY15

Designed in line with market practice

- The annualised remuneration for the Managing Director, Bryce Mitchelson, for FY15 has been set at:

Employee	Total Fixed REM (TFR)	Max FY15 STI % of TFR	Max FY15 LTI % of TFR
Bryce Mitchelson	$475k	$237.5k (50%)	$237.5k 50%

- The actual FY15 STI paid will be pro-rata adjusted for the year and the amount paid in cash will depend on the performance of the Managing Director relative to the KPI's set by the Board.
- The issue of the FY15 LTI grant to Bryce Mitchelson requires Investor approval at the meeting.
- The FY15 LTI Plan rights have been independently valued by Ernst & Young ABC Pty Ltd as follows:

Rights	%	Value/Right
Recognition*	40%	$1.22
Performance	60%	$0.94

- Accordingly, the maximum number of rights to be issued to the Managing Director are noted below:

Employee	Performance Rights	Recognition Rights*	Total Rights
Bryce Mitchelson	151,596	77,869	229,465

- The number of actual ARF securities issued post 30 June 2017 will depend on the extent to which performance hurdles are satisfied over that period.

* To remain employed by ARF as at 30 June 2017

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Financial impact

Annualised pro-forma management costs

$ million	Pre Internalisation [1]	Adjustments	Pro forma Post internalisation
Base management fee	3.1	(3.1) [2]	-
Other management operating costs	0.3	2.3 [3]	2.6
Management fee income	-	(0.3) [4]	(0.3)
Net Management Costs	**3.4**	**(1.1)**	**2.3**
Interest expense on funding the consideration	-	0.4	0.4
Net Operating Cost	**3.4**	**(0.7)**	**2.6***

* Due to rounding

Net saving in pro forma annual operating costs of $1.1 million represented by:

1 Arena REIT's FY15 pre internalisation annual operating expense budget for base management fees and other management cost recoveries, including property services.

2 Represents the elimination of the base management fee payable to AIML (based on Arena REIT's gross asset value) no longer payable post internalisation.

3 Represents the incremental pro forma annualised expenses in respect of staff remuneration and other operating costs such as IT systems and office accommodation post internalisation.

4 Represents the pro forma annual management fees receivable from the Syndicates.

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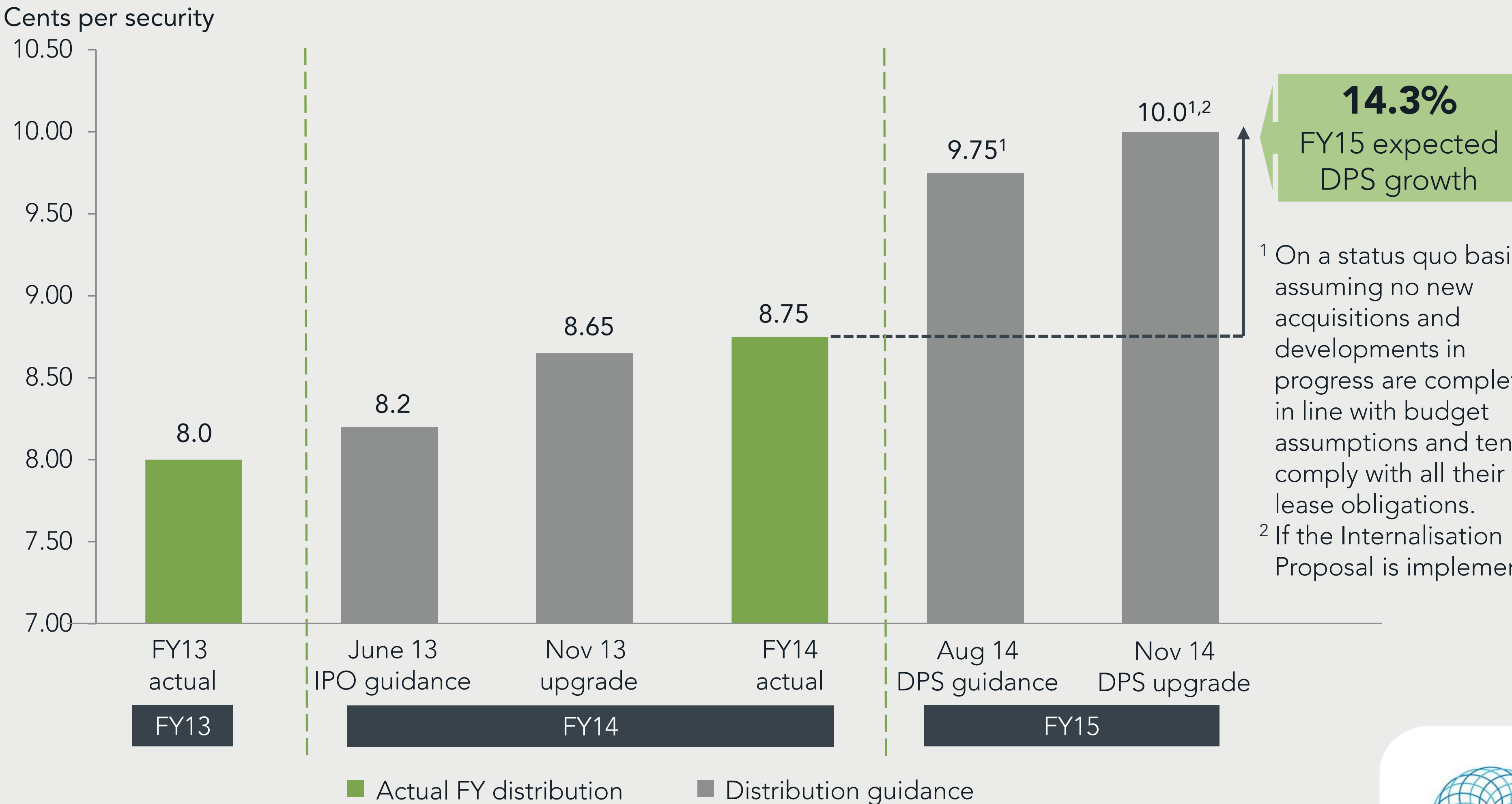
Financial impact (cont)

Upgraded FY15 distribution guidance



[1] On a status quo basis assuming no new acquisitions and developments in progress are completed in line with budget assumptions and tenants comply with all their lease obligations.
[2] If the Internalisation Proposal is implemented

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Financial impact (cont)

Balance sheet pro-forma (as at 30 June 2014)

$ million	Arena REIT 30 June 14	Pro forma Adjustment A	Arena REIT Pro forma pre internalisation	Pro forma Adjustment B	Pro forma Adjustment C	Pro forma Post Internalisation
Cash	3.9	-	3.9	3.8	(0.8)	6.9
Trade and other receivables	15.6	(14.0)	1.6	2.2	-	3.8
Investment properties	355.8	23.0	378.8	-	-	378.8
Intangibles	-	-	-	10.7	-	10.7
Total assets	**375.3**	**9.0**	**384.3**	**16.7**	**(0.8)**	**400.2**
Trade and other payables	11.0	-	11.0	3.7	-	14.7
Derivative financial instruments	1.3	-	1.3	-	-	1.3
Interest bearing liabilities	125.0	9.0	134.0	13.0	-	147.0
Total liabilities	**137.3**	**9.0**	**146.3**	**16.7**	**-**	**163.0**
Net Assets	**238.0**	**-**	**238.0**	**-**	**(0.8)**	**237.2**
Total equity	**238.0**	**-**	**238.0**	**-**	**(0.8)**	**237.2**
Net Assets per security	**$1.125**		**$1.125**			**$1.122**
NTA per security	**$1.125**		**$1.125**			**$1.071**
Gearing	**33.3%**		**34.9%**			**36.7%**

Notes:
A – Settlement of asset sales and committed development capital expenditure
B – Acquisition of management business on implementation of the Internalisation Proposal
C – Transaction costs

7 Potential disadvantages and risks

Taking a balanced view

Issue	Description	Comment
Change in risk profile • Change in investment characteristics	ARF will be taking on funds and property management business services risk.	These services are ancillary to owning property and allow better control of investment risk.
• Operating cost structure	Future operating costs may be higher than anticipated.	Higher operating costs are not necessarily bad if they enable higher revenues.
• Regulatory risks	ARF will effectively become its own responsible entity and will be required to maintain an AFSL.	ARF is well capitalised and has appropriate resources to comply with the regulatory requirements.
• Transitional risks	Possible risk of distraction in servicing AIML.	ARF will retain additional resources to manage this process.
• Dependency on key staff	ARF is potentially exposed if key staff leave.	Appropriate remuneration systems are in place which should retain and attract talent.
Decrease in NTA	NTA is expected to decline by 4.8% to $1.07	The intangible value of the management rights are valuable but excluded from the NTA calculation.
Increase in Gearing	On a pro-forma basis is expected to increase from 34.9% to 36.7%	ARF's gearing will remain at the low end of its target range of 35% to 45%.

8 Other alternatives considered

- In considering the Internalisation Proposal and in forming the view that the Internalisation Proposal is in the best interests of Investors, the Independent Directors have had regard to possible alternatives, and the potential implications of these alternatives for Investors. In particular, the Independent Directors have considered the merits and risks of:
    - the prospect that Citrus II (as the owner of Arena) may sell the management rights of ARF to another third party external manager; and
    - the potential merger of ARF with another listed A-REIT.
- On 29 September 2014, ARF received an indicative, non-binding, conditional proposal for the potential merger of ARF and the ASX-listed Folkestone Education Trust (**FET**) (**FET Indicative Offer**).
    - Under the FET Indicative Offer, ARF Investors would have received 0.795 FET units for every Existing Stapled Security. Folkestone Investment Management Limited would have externally managed the merged entity with base management fees of 0.45% of gross assets (with the intention of further reductions as the vehicle grows past certain thresholds) and removal of Arena asset acquisition, disposal and performance fees. Implementation of the FET Indicative Offer would have required a trust scheme or stapling of units, requiring the approval of ARF Investors and possibly also FET investor approval.
    - The FET Indicative Offer was subject to several conditions including due diligence, and final approval from FET independent directors.
- The Arena Independent Directors determined that the FET Indicative Offer did <u>not</u> provide ARF Investors with a compelling value proposition compared to the Arena Internalisation Proposal. Moreover, in the event that the Arena Internalisation Proposal is approved by ARF Investors, the ARF Board will retain the ability to pursue strategic initiatives that are in the best interests of Investors.

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9 Independent expert's opinion

Assessed valuation higher than consideration

- The Independent Directors appointed KPMG Corporate Finance to prepare an independent expert's report to opine on the Internalisation Proposal.
- The Independent Expert assessed that the present value of the net financial benefits expected from the Internalisation Proposal is greater than the consideration to be paid and, the consideration is supported by comparable market evidence.
- The table below summaries their valuation of the net financial benefits:

$ million	Status Quo[1]	Growth Scenario[2]
NPV of financial benefit	**12.9**	**16.5**
Consideration paid to Citrus II	(11.5)	(11.5)
Net benefit to existing Stapled Securityholders	**1.4**	**5.0**

Refer KPMG Corporate Finance Report page 45

1. Assumes assets under management growth only based on recurring revaluations and completion of existing projects.
2. Assumes additional AUM growth of $20m p.a. over the forecast period of 3 years.

- Their conclusion is that the Internalisation Proposal is "fair and reasonable and in the best interests" of Investors.
- A full copy of this report is contained in the Meeting Booklet (lodged with ASX) being provided to Investors.

10 Independent directors' recommendation

Unanimously recommend the Internalisation Proposal

- The Arena Board established an Independent Board Committee (comprising only the independent directors) to consider the Internalisation Proposal and the available alternatives to determine what is in the best interests of ARF Investors.
- As noted previously, an indicative, non-binding, conditional offer was received from FET. The details of the FET Indicative Offer were provided to the Independent Expert.
- The Independent Board Committee has concluded that the Internalisation Proposal is the best proposal available at this time.
- The Independent Board Committee has also sought an opinion from an Independent Expert (KPMG Corporate Finance) who has also concluded that the Internalisation Proposal is "fair and reasonable and in the best interests of" ARF investors.

The Independent Directors unanimously recommend that investors vote in favour of all Resolutions, in the absence of a superior alternative.

11 Indicative timetable

If the internalisation is implemented

Last day of ASX trading in Existing Stapled Securities	Monday, 8 December 2014
Admission of New ARF to official list of ASX New Stapled Securities commence trading on ASX on a deferred settlement basis	Tuesday, 9 December 2014
Stapling Record Date Last day for registration of transfers of Existing Stapled Securities Stapling Commencement Date New ARL Shares received by Investors Despatch of holding statements of New Stapled Securities	Thursday, 11 December 2014
Implementation Date (effective date of management internalisation) Change of responsible entity (from AIML to ARML)	Friday, 12 December 2014
Deferred settlement trading ends	Monday, 15 December 2014
New Stapled Securities commence trading on a normal (T+3) settlement basis Sale Nominee to begin selling New Stapled Securities held by Foreign Investors under Sale Facility	Tuesday, 16 December 2014
New Stapled Securities trade ex-distribution	Monday, 22 December 2014
Net proceeds of sale of New Stapled Securities under Sale Facility to be remitted to Registry for payment to Foreign Investors	By Monday, 12 January 2015

Indicative only and subject to change.

12 Summary

Why the Internalisation Proposal is in the investors best interests

The Independent Directors believe that the advantages of the Internalisation Proposal outweigh the potential disadvantages.

The key benefits of the Internalisation Proposal are summarised as follows:

- **FY15 Distribution guidance upgrade** - expected ongoing net management cost savings contributing to ARF distribution guidance for FY15 being upgraded to 10.0 cents per security[1] (up from 9.75 cents);
- **Enhanced alignment** - greater alignment of interests through the new Board and management being accountable only to Investors; and
- **Acquisition growth competitive advantage** - A superior outlook for ARF earnings growth per security with the elimination of external funds management fees which would otherwise be charged on any increases in portfolio valuations, new acquisitions and capital expenditure. An internalised ARF will have operating leverage, meaning that new acquisitions should not require a material increase in internal management cost which should therefore provide greater contributions to earnings growth per security.

In the event that the Internalisation Proposal is not approved, Arena would expect Citrus II to pursue alternative transaction structures including sale of the Arena REIT managements rights to a third party.

Both an Independent Expert and the Arena Independent Directors believe that the Internalisation Proposal is in the best interests of ARF investors in the absence of a superior proposal

[1] Assuming the Internalisation Proposal proceeds, no new acquisitions, developments in progress are completed in line with budget assumptions and tenants comply with all their lease obligations.

A Transaction evidence – management internalisations

Announcement date	Entity	Consideration ($ millions)	Consideration as % of AUM	Base mgt fee multiple	Multiple of net savings
Property					
Jul 2014	CFS Retail Property Trust Group	460.0	3.3%	3.4	9.5
Jul 2014	Kiwi Income Property Trust	72.5	3.5%	6.2	6.3
Oct 2013	GDI Property Group	27.3	3.6%	2.8	n/a
Aug 2011	Centro Retail Australia	240.0	3.4%	3.1	n/a
Jun 2009	Macquarie Leisure Trust Group	15.9	2.6%	5.3	15.9
May 2009	Orchard Industrial Property Fund	6.0	0.8%	3.2	5.0
Apr 2009	Babcock & Brown Japan Property Trust	20.0	0.8%	1.7	n/a
Infrastructure					
Oct 2012	DUET Group	95.6	1.5%	4.6	7.1
Apr 2011	Spark Infrastructure	49.0	2.9%	5.6	13.6
Feb 2011	Qube Logistics Holdings	40.0	5.3%	3.8	5.7
Oct 2009	Macquarie Media Group	40.5	n/a	4.1	7.0
Oct 2009	Macquarie Infrastructure Group	50.0	1.3%	2.9	5.4
Jul 2009	Macquarie Airports	345.0	2.7%	8.2	10.7
May 2009	Viridis Clean Energy Group	2.8	n/a	2.8	n/a
Low			**0.8%**	**1.7**	**5.0**
High			**5.3%**	**8.2**	**15.9**
Mean			**2.6%**	**4.1**	**8.8**
Median			**2.8%**	**3.6**	**7.1**

Source: KPMG Corporate Finance Report, page 46

B Current management fee entitlements

Fees to be removed following Internalisation

Type of fee or cost	Entitlements under the Constitution	Fees Paid FY14 $
Ongoing management fees	0.8% of total assets up to $400m 0.7% on total assets between $400m and $950m 0.6% on total assets over $950m In addition, ARF is required to reimburse Arena for certain costs relating to the proper performance of Arena's duties.	2,377k
Acquisition fee	1.0% of the value of any property acquired by ARF	876k
Disposal fee	1.0% of the gross sale price of any property of ARF provided the gross sale price exceeds the purchase price of that property	-
Performance fee	An additional 1.0% of the sale price of any property of ARF provided the gross sale price exceeds the purchase price of that property by more than 20%	-
Total		**$3,253k**

The disposal and performance fees are also payable on the merger or amalgamation of ARF with another managed investment scheme. Based on current valuations, Arena may be entitled to up to 2.0% or approximately $7.5 million on a merger of ARF with another party.

C Unlisted wholesale funds

Single asset vehicles owning well performing healthcare assets to be managed by ARF

PHC Darlinghurst Syndicate & Trust	
No. Investors	40
Asset	Large scale medical clinic leased to Primary Health Care with a current value of $14.75m
Term	The next investor meeting is scheduled to be held in December 2015 at which time investors will vote to either windup or continue the term until Dec 2016.
Management Fee	1% of property value per annum
Disposal fee	At least 1% of the gross sale price
Receivable	$0.8 million representing deferred management fees

BSH Joint Venture	
No. Investors	19
Asset	Pathology laboratory asset leased to Primary Health Care with a current value of $17m
Term	The next investor meeting is scheduled to be held in April 2015 at which time investors will vote to either windup or continue the term until April 2016.
Management Fee	1% of the property value per annum
Disposal fee	1% of the gross sale price

Important Note

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The information in this document should be read together with the Meeting Booklet (containing a Notice of Meeting , Explanatory Memorandum and Prospectus) dated on the date of this document.

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