Australian Shareholders' Association

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Solid Result in Year of Uncertainty

Company/ASX Code	Arena REIT (ARF)
AGM date	Thursday 19 November 2020
Time and location	10am AEDT – Online via lumi
Registry	Boardroom
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Jason Cole assisted by Steve van Emmerik
Pre AGM Meeting?	Yes with David Ross (Chair) and Samantha Rist (Investor Relations)

Please note any potential conflict as follows: The individual(s) (or their associates) involved in the preparation of this voting intention have no shareholding in this company.

	Consideration of accounts and reports
ASA Vote	No vote required

Summary of ASA Position

Arena REIT (ARF) is an ASX300 listed group that owns, manages and develops social infrastructure property across Australia. Its objective is to deliver an attractive and predictable distribution to investors with earnings growth prospects over the medium to long term. This is the first year that it has been monitored by the ASA.

ARF consists of three separate entities Arena REIT No.1 (ARF1), Arena REIT No.2 (ARF2) and Arena REIT Ltd (ARL) for which the shares have been stapled together to enable trading as one security. Arena REIT Management Limited (ARML) is the responsible entity for ARF1 and ARF2.

As of 30 June 2020, the ARF portfolio consisted of 239 properties, 85% of which are early learning centres (ELC) with the balance in healthcare. Properties are located in all states, but concentrated in the eastern states with 82% located in Queensland, Victoria or New South Wales.

<u>Governance and culture</u>

A comprehensive corporate governance statement is available on the ASX announcement platform via ASX website. It contains information pertaining to board appointments, diversity objectives, a board skills matrix, disclosure obligations, commitment to security holders and risk framework.

<u>Financial performance</u>

The ARF portfolio is heavily concentrated in the childcare sector and the onset of Covid-19 provided much uncertainty with lockdown restrictions impacting the group's tenant partners. ARF provided rent relief to tenant partners which amounted to 4% of contracted rent, 3.5% of which has been deferred and will be collected in future periods (mostly FY21). Government support to tenant partners, both broadly and to the childcare sector specifically, assisted the group in posting a statutory net profit of $76.6m, an increase of 29% on FY19.

The distribution per security (dividend) increased to 14 cents from the previous year's 13.5 cents and was funded from net operating cash flow. The Weighted Average Lease to Expiry (WALE) remained steady at 14 years compared to the 14.1 years for FY2019.

Key events

Four operating ELCs where acquired with a net initial yield on total cost of 6.5% and weighted average lease term of 18 years. Five ELC's were divested.

Three ELC development projects were completed and the development pipeline contains 20 ELCs with a forecast cost of $112 million.

ARF acquired a multi-disciplinary health care centre co-located at the Kalamunda Hospital in Perth for $11m, in line with its strategy to diversify the portfolio.

A fully underwritten institutional placement which raised $60m was undertaken in June 2020 and a further $24.9m was raised via a security purchase plan in July. See item 3 for more detail

ASA focus issues

Directors and Boards

The ARL board comprises four non-executive directors (NEDs) and the Managing Director (MD). This group employees the company's ten employees. The board of ARML contains an additional executive, director being the Chief Financial Officer (CFO). The board has only one female director, so at 20% is below the gender diversity objective of at least 30% representation. The ARF corporate governance statement contains comprehensive diversity objectives across all levels of the company, including 30% female representation at board level by the end of FY24. Having listed in 2014, the company and board is evolving. It is not considered that the company size warrants additional directors at this time, but with Rosemary Hartnett being the most recent director appointed in August 2019 it is working towards this objective.

The performance of the board, committees and individual directors is reviewed annually with details provided in the corporate governance statement and there are no identified issues with director workload. All NEDs have a meaningful equity holding, with the exception of Rosemary Hartnett, who has not yet served a full term.

Risk Management

The Annual report outlines several material business risks to the group. These include

Covid-19 – relates to the extent to which the company's tenants, and their ability to pay rent, is impacted by Covid-19

Concentration Risk **–** the property portfolio is 85% invested in ELCs and ELC development sites and 15% in healthcare assets.

Tenant Risk **–** Loss of rental income caused by tenants experiencing financial difficulty

Macroeconimic Risk **–** Operations can be influenced by the Australian and global economies

Government Policy Risk – The modification to government childcare and healthcare funding may impact the demand for these services.

Property Valuations - Changes in the property market (valuation and rents) can impact financial performance.

The ASA had discussions with company representatives as to the success of the existing risk management framework at the onset of covid-19. Overall, the company has been satisfied with its agility and ability to function with employees working from home.

Steps taken during the crisis included daily tenant engagement, formation of a rent relief committee, engagement with banking partners and developers, an additional eleven board meetings and deferral of the March distribution.

Summary

(As at FYE)	**2020**	**2019**	**2018**	**2017**	**2016**
NPAT ($m)	76.6	59.3	64.4	96.8	72.6
UPAT ($m)*	43.8	37.7	34.7	28.7	25.6
Share price ($)	2.19	2.74	2.15	2.25	1.99
Dividend (cents)	14	13.5	12.8	12	10.9
TSR (%)	-15.6	34.3	1.2	19.8	37.6
EPS (cents)	14.55	13.8	13.1	12.3	11.1
MD total remuneration, actual ($m)	1.1	.74**			

For 2020, the CEO's total actual remuneration was **12 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2020 data from the Australian Bureau of Statistics).

* Net Operating Profit – Represents the underlying cash-based profit of the Group for the relevant period. Excludes fair value changes from asset and derivative valuations and items of income or expense not representative of the Group's underlying operating earnings or cashflow.

** Managing Director Rob de Vos was promoted to Managing Director in February 2019 and was formerly Head of Property.

Item 1	Non-binding advisory vote on the Remuneration Report
ASA Vote	**Against**

Summary of ASA Position

MD rem. Framework for FY21	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	0.5	62%	0.5	45%
STI - Cash	0.083**	10%	0.167	15%
STI - Equity	0.083**	10%	0.167	15%
LTI	0.139**	17%	0.278	25%
Total	0.805	100.0%	1.11	100%

*The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan. *Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting.*

*** 50% of the STI is measured against financial objectives. Of this component, 50% is payable upon meeting an eligibility gateway (Target) and the remaining 50% on achieving stretch targets (Max Opportunity). For the LTI, 50% vesting occurs at the targets (DIS - 15.9 cents) (rTSR – 50th percentile) with progressive pro-rata vesting to the Max Opportunity as per below.*

The link between appropriately rewarding and incentivising Key management Personal (KMP) and aligning shareholder value with remuneration is outlined in the Annual Report. The Remuneration components consist of Fixed Remuneration (FR), Short-Term Incentive (STI) and Long-Term Incentive (LTI). The remuneration mix for the managing director consists of FR of 45% and 55% at risk (30% STI, 25% LTI) which is reasonably consistent with ASA objectives. No change to the performance framework is proposed in FY21 and an actual remuneration table is included. It is intended that a review of the remuneration framework will be completed in FY21.

STI

The STI is weighted with 50% based on Financial Measures (DPS and EPS growth targets) and 50% on Non-Financial Measures (leadership, strategy development and execution, risk management, liquidity, culture and values). Fifty percent of the STI award is payable in cash, with balance deferred for 1-year and paid in the form of ARF stapled securities.

The ASA prefers that the majority of STIs should be based on quantifiable performance metrics with clear disclosure of performance hurdles. Assessment against the financial objectives is easily identifiable, but this is less so with the non-financial objectives.

For example, the remuneration report states that non-financial KPIs are set across 6 different areas (as listed above) and that based on an assessment of the objectives against individual KPIs, the committee determined to award 88% of the non-financial component. In not declaring quantifiable metrics, the Chair stated the company was considerate of not disclosing competitive information by declaring objectives, but advised from next year that this aspect would be more transparent through the listing of what had been achieved in the previous year.

An eligibility gateway was set for the financial objective, being a minimum FY20 distribution of 14.3 cents per security and this accounts for 50% of the financial objectives. The remaining 50% of financial objectives are stretch targets for Distributable Income per Security (DIS) based on FY20 DIS and FY21 Budget DIS.

The FY20 distribution was reduced to 14 cents per security in response to rent deferred under Covid-19 rent relief arrangements. However, the board exercised its discretion to pay an STI and award 100% of the financial component of the STI as

- The actual distribution was not materially lower than the gateway despite the impact of Covid-19.
- The gateway would have been met in the absence of Covid-19 rent relief.
- Growth in the underlying profit of 14.55 cents per security exceeded the STI gateway and FY20 stretch target.
- FY21 budged DIS target supporting the FY21 distribution was exceeded after adjusting for the $25m capital raised in June 2020.

Executive KMP were awarded 94% of their FY20 STI opportunity and the number of rights granted is based on the volume weighted average price (VWAP) for 15 days prior to 30 June 2020. The FY18 deferred STI fully vested in August 2019 and the FY19 STI will fully vest in August 2020.

LTI

The LTI consists of two hurdles being DIS and relative Total Shareholder Return (rTSR). A 50% weighting is applied to each and there is a 3-year performance period.

The DIS target range for each LTI grant requires compound earnings growth of 3% - 5% over the three-year performance period. The DIS target for FY23 is set to 15.9 cents with zero vesting below this hurdle. Progressive pro-rata vesting will occur from 50% to 100% for achieved performance between 15.9 cents and 16.9 cents.

The comparator group used to test rTSR is the ASX300 A-REIT Index. There is zero vesting below the 50% percentile, with progressive pro-rate vesting from the 50% percentile to 100% vesting at the 75th percentile. LTI performance rights are calculated by dividing the LTI grant value by an independent valuation of an LTI performance right performed by Ernst & Young.

The FY17 LTI grant fully vested in August 2019 as the DIS exceeded the performance hurdle range and Total Shareholder Return of 66% ranked at the 68th percentile of the comparator group. Testing of the FY18 LTI occurred after 30 June 2020, 84% will vest based on ARF's FY20 DIS of 14.55 cents exceeding the performance hurdle range and the TSR of 21% ranked at the 59th percentile of the comparator group.

NED fees were increased by 4% from 1 July 2019 in recognition of cost of living and expansion of the role. No increases are proposed for FY21 and the director fee pool is set to a maximum of $650,000, with $543,803 paid in FY2020.

Several aspects of the ARF remuneration structure are at odds with objectives sought by ASA guidelines. These include

- ASA preference for STI metrics and outcomes to be set out individually and clearly disclosed.
- An LTI performance period of 3 years, as opposed to 4 years.
- No clause to prevent LTI if absolute TSR is negative and a vesting schedule more generous than ASA prefers.
- Shares issued rather than purchased on market when incentive schemes vest.
- The use of board discretion to award the STI that would otherwise not have been paid.
- The use of a discounted method to calculate LTI performance rights.

As such it is considered that, on balance, ASA should oppose the remuneration report.

Item 2	**Re-election of Mr David Ross as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Ross is Chair of ARF, was appointed as a director on its incorporation on 16 October 2014 and was re-elected in 2017. He is currently chair of the remuneration and nomination committee and a member of the audit committee.

He has extensive experience property and property funds management both within Australia and Overseas. He is currently a director of property fund Charter Hall Group (CHC) and his current holdings are adequate.

ASA support the re-election of Mr Ross for another term.

Item 3	**Ratification of Placement**
ASA Vote	**For**

Summary of ASA Position

In June ARF announced an equity raising to improve its capacity to take advantage of acquisitions. It initially sought to raise $50m from an institutional placement followed by a non-underwritten Security Purchase Plan (SPP) of up to $10m for eligible security holders. Due to the level of support the institutional placement was increased to $60m, whilst the SPP was oversubscribed and ARF determined to increase this amount to an eventual $24.9m

ARF issued 26,315,790 securities on 5 June 2020 at an issue price of $2.28 per security to existing and new institutional investors. This represented an approximate discount of 5% discount to the previous closing price. Approximately 11.3 million new securities were allotted at the completion of the SPP. These had an issue price of $2.2115 which was equal to the price paid by institutional investors, less the 6.85 cent second half dividend already declared.

The issue of these securities did not exceed the traditional 15% of issued capital that ARF may issue in a 12-month period without securityholder approval. This resolution seeks to ratify this placement and refresh the 15% placement capacity.

ASA guidelines stipulate that ASA will generally oppose refreshment unless the capital raising is conducted in conjunction with a (SPP) on the same or better terms than the institutional offer and with proportionally adequate allocation to the retail shareholders.

ASA sought clarification as to the proportion of retail and institutional investors on the register prior to the capital raising and was advised that retail investors comprised 30% of the register with the balance of 70% institutional. The $85m capital raising reflected the existing ration with $25m representing 30% of the total amount raised.

Given this and the maximum 12-month limit of $30,000 being offered to shareholders, ASA will support this resolution.

Item 4	**Grant of Deferred STI Rights to Managing Director Mr Rob de Vos**
ASA Vote	**For**

Summary of ASA Position

This resolution seeks to grant 68,469 deferred STI rights to the managing director. This amount is calculated by dividing the deferred STI grant value ($156,862) by the VWAP for 15 trading days prior to 1 July 2020 being $2.291. The performance period and hurdles are outlined in Item 1.

The ASA supports this resolution.

Item 5	**Grant of LTI Performance Rights to Managing Director Mr Rob de Vos**
ASA Vote	**Against**

Summary of ASA Position

This resolution is to grant 194,932 LTI performance rights. The amount is calculated by dividing the LTI grant value of $277,778 by an independent valuation of an LTI performance right performed by Ernst & Young.

The ASA is opposed to the use of ‘fair value’ discounting methods in calculating performance rights as it can lead to an inflated number of rights being issued. The preference is for a VWAP to be used as per the STI award. The independent valuation ($1.425) is approximately 55% of the current share price ($2.61).

ASA will oppose this resolution.

Item 6	Grant of Deferred STI Rights to CFO Mr Gareth Winter
ASA Vote	For

Summary of ASA Position

As for item 4, except the number deferred STI rights is 43,649 with a grant value of $100,000.

Item 7	Grant of LTI Performance Rights CFO Mr Gareth Winter
ASA Vote	Against

Summary of ASA Position

As for item 5, except the number of performance rights is 149,123 with a grant value of $212,500

Item 8	Amendment of Constitutions
ASA Vote	For

Summary of ASA Position

ARF are seeking to make amendments to their constitution that relate to the following matters.

- Include provisions that expressly permit meetings of security holders to be held virtually or through hybrid means. This requires a new provision.
- Remove the ability for documents to be provided to the company by fax. This requires the removal of clause 17.6 (c).

When questioned as to the intentions for AGM ongoing, the company felt that it was too early to know. This year's AGM will be held virtually, with company representatives presenting from differing locations throughout Australia. The chair did not feel that this would work particularly well for the company either and that ongoing physical or hybrid meetings were more likely.

The ASA welcomes the addition of additional methods that make the AGM more accessible to shareholders and prefers the hybrid format which allows shareholders to be present either physically or virtually. As such, it will support this resolution.

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