

19 December 2011

## Austock Childcare Fund Update

Austock Property Management Limited (APML) the responsible entity of the Austock Childcare Fund (ACF or the Fund) provides the following update on relevant matters to ACF Unitholders:

Key Highlights Include:

- Goodstart Rebranding & Performance
- Cost Saving Initiatives by the Manager
- Upgraded Distribution Forecast

In addition, a market commentary is included to give unitholders a better understanding of the market within which the underlying assets currently operate.

### 1. Goodstart Early Learning

Goodstart's (ACF's major tenant of 11 properties representing 46% of the Fund's portfolio) Chief Executive Officer Julia Davison and the Minister for Childcare, the Hon Kate Ellis MP, announced on 15 November 2011 that more than 650 ABC Learning centres across Australia will be officially renamed Goodstart Early Learning. Goodstart has owned and operated the former ABC Learning centres – Australia's largest childcare and early learning network – since 2010, with a workforce of more than 15,000 staff caring for and educating more than 72,000 children. All centres across Australia will transition from ABC Learning to Goodstart Early Learning including new signage over the coming months. ACF considers this to be another positive development by Goodstart in further improving the early learning landscape for Australia's children.

Goodstart also released their financial information for the year ending 30 June 2011. As previously advised, those results were positive in that Goodstart achieved over \$600 million of revenue and the retirement of almost \$21 million in debt. Goodstart achieved EBIT of \$40.2 million and an overall surplus of \$5 million, which was an extremely positive outcome in their first full year of operation. Goodstart also noted increasing occupancy levels within their overall business which is encouraging as the industry regains the significant ground lost in 2008-2010 due to ABC Learning Centre's demise.

### 2. ACF Debt Facility

The Fund has a 3 year \$10.7 million debt facility (drawn to \$10.0 million) with the Commonwealth Bank of Australia (CBA) expiring on 31 July 2013. ACF has entered into an interest rate swap for \$5.5 million at a rate of 5.49%. Based on the current drawn debt of \$10.0 million, ACF has hedged 55% of its interest rate exposure against interest rate movements.

As a result, 45% of the Fund's debt is subject to fluctuations in interest rates, through the Bank Bill Swap Rate (BBSW). Although not directly linked to the Reserve Bank's cash rate, the BBSW rate (90 day rate) has declined since mid 2011 from a high of 5.1% to a present BBSW rate of 4.5%. The Fund has been able to benefit from this decline in BBSW on its unhedged component and also benefit from any further declines in the BBSW. Any savings in interest rates, assuming fund costs do not increase and revenue remains stable; will directly flow through to increases in distribution levels.

Whilst the facility does not expire until 2013, Management is exploring options for achieving a lower cost of debt on a regular basis.

### 3. Fund Costs

Management is focused on reducing the Fund's non-recoverable expenses as a means of increasing distributions to Unitholders. To date, we have focussed on reducing non-recoverable rates and taxes, particularly land tax that is paid by the Fund, legal expenses and valuation expenses.

Objections to council valuations have been underway over the last two years that have seen rateable values decrease in many instances. This will provide ongoing benefits to unitholders until the next rating valuation cycle commences.

In order to reduce the potential significant cost to the Fund of external legal advisors together with increasing the quality of outcomes of ACF's legal activities, APML has maintained an in house legal resource to meet these objectives. This has been achieved and Management has been able to significantly reduce the legal costs over the prior year, in line with our forecast for ACF.

Management has decided not to undertake formal independent valuations of the Fund's assets in FY12 on the basis that any movement in value, although expected to be positive, would not provide any benefit to unitholders in terms of the cost of financing and would reduce distributions significantly. This policy recognises the need to balance prudent practice from a reporting aspect with maximising distributions to unitholders. It is our expectation that had we undertaken valuations of the assets, a small increase in overall value would have been experienced, but not one that would justify the cost and resultant fall in distributable income. With refinancing due in 2013, we expect to undertake valuations in late 2012 or early 2013 to better match the re-financing cycle and avoid a doubling on cost of valuations.

This belief is based upon our experience across other similar funds that APML (or its associates) manage that are showing capital value increases of circa 3-5% p.a.

### 4. Upgraded FY12 Distribution Forecast

Management has previously advised of its distribution forecast of **6.4 cents per unit**, subject to continued tenant performance, for the year ending 30 June 2012. This is payable at quarterly intervals, one month in arrears. The last quarter's distribution of 1.6 cents was paid on 20 October 2011.

As a result of cost saving initiatives together with a reduction in the cost of debt, Management has upgraded its forecast for FY12 to **7.0 cents per unit**, inclusive of that already paid. The distribution for the quarter ended 31 December 2011 of 1.8 cents per unit has been declared and will be paid on 20 January 2012.

## 5. Asset Management

The Fund's 24 childcare properties are actively managed on a day-to-day basis to ensure the portfolio performs to its maximum. All of ACF's properties are currently 100% tenanted and there are no rental arrears.

Our Asset Managers have been working hard to ensure that all non-recoverable expenses are minimised and therefore increasing distributions to unitholders.

One tenant has provided notice to vacate a centre on 30 June 2012. We are working hard to find a replacement tenant and ensure continuity of cashflow. Our involvement in the wider childcare market and existing relationships with the major childcare tenants has meant that we are able to target other operators for this site in order to reduce any potential rental downtime that may be experienced.

Unitholders should note that in assigning tenancies to Goodstart in 2010, Goodstart has the ability to terminate two leases from ACF within a two year period with compensation to be received by the Fund up to a maximum of two years' rental income. Management is currently in negotiations with Goodstart regarding the best outcome for the Fund.

One expense that we sought to minimise was a significant local government development charge that had not been paid since 2003. This obligation sat with the previous manager of the Fund and had not been disclosed to APML. It was identified last year and we made a provision for this expense in the Fund's accounts for the year ending 30 June 2011 and therefore it does not impact on the FY12 distribution forecast. Our Asset Managers challenged the validity of the charge, given the time that had passed, but were not successful.

Finally, we have called upon bank guarantees provided by the previous tenant, ABC Learning Centres, to effect capital works required at centres they occupied, reducing any cost to the Fund.

## 6. Childcare Industry Commentary

The Global Financial Crisis ("GFC") and the demise of ABC Learning Centres have been significant events in the Childcare/Early Learning Industry over the last three years. ABC's demise has been a legacy issue that the industry has had to deal with. The magnitude of ABC's failure and the publicity that followed significantly decreased investor confidence in the sector that was otherwise considered to be relatively strong, resulted in a significant reduction in the availability of finance and an increase in the cost of debt funding.

The emergence of Goodstart as the key not-for-profit operative in the industry has been a definite positive aspect in bringing stability back to the industry. Confidence has been slow to emerge, although Goodstart's recent announcement regarding their financial performance (see ACF Announcement dated 30 September 2011) is encouraging.

Increasing occupancy levels across the industry are positive signs of confidence returning to the sector. This is proof of the latent demand for early learning services across Australia. The Commonwealth Government's push for increased productivity from the existing population is reliant upon the provision for early learning services, to allow parents, particularly females, back into the workforce. We expect that demand will continue from family units requiring a second

income to maintain the cost of housing and/or mortgage payments. Accordingly, early learning services are not viewed as a discretionary spending item.

In addition to the \$9.2bn that is expected to be spent on early learning in 2012, the Commonwealth Government recently announced further funding to support early learning services in disadvantages areas worth \$59 million.

### **Market Conditions – Early Learning Centres**

The collapse of ABC Learning and the continuing Global Financial Crisis had a significant effect on value of early learning properties, with further downward pressure created by forced sales of similar assets during 2009 and 2010.

The experience across Australia since that time has been a slow recovery in value as investors monitored the overall health of the industry in the wake of ABC's collapse. Goodstart's positive first year results, is good evidence of the sector's recovery, however the over-riding GFC remains a limiting factor with the availability of finance to fund purchases still at low levels.

Sales evidence in Victoria and New South Wales has shown good growth in values over the last 9 months. This is yet to be experienced in other states to the same level. Various market commentators have attributed the softness in the early learning space in Queensland due to:

- an overall general reduction in values for both residential and non-residential property;
- investor distraction caused by the Queensland floods;
- continuing limited availability of finance on an individual asset level; and
- from an anecdotal perspective, the over-exposure to ABC Learning and its issues in the Queensland market which has been a further dampening factor.

It is possible that material growth in capital value will not become evident until 2013 when we expect to see a return to more typical levels of value in the Queensland market. Our experience in receiving valuations in Queensland on behalf of other funds indicates that values have stabilised and for ACF, most likely remain at a minimum or marginally above those assessed in mid 2010, but by no significant margin. It is reasonable to suggest that the market for ACF's assets is most likely in the lower part of the cycle in terms of asset values at this point in time.

## **7. RG 46 Statement**

APML releases its ASIC RG 46 Statement on a six monthly basis. The RG 46 is aimed at providing unitholders with a clear and accurate picture of the Fund's financial position. ASIC has developed 8 disclosure principles for unlisted property schemes that can help retail investors understand the risks and/or financial position of each fund.

It is APML's policy to provide an RG 46 every six months in order that Unitholders have an up to date, clear and accurate picture of the position of the Fund. This should assist you and your accountants and/or financial planners with quickly identifying the status of the Fund. The last RG 46 Statement was issued on 24 August 2011 and can be found on the Fund's website.

## **8. Financial Metrics**

As outlined in the full year financial accounts, the Fund's financial performance remains strong. The Fund is fully compliant with all of its banking covenants with appropriate headroom and has a



loan to value ratio at a level of 39% and an interest coverage ratio in excess of 2X. There are no debtors within the fund with all tenants meeting their rental and outgoings obligations.

The results for the six months ending 31 December 2011 will be released to investors in February 2012.

## 9. Outlook

The Fund's outlook remains positive with increasing childcare occupancy levels and continued and increased government spending across the early learning sector. The Goodstart rebranding program which removes the last remaining links with the former ABC Learning Centres business should also act to increase and restore confidence in the sector.

Management remains focused on providing reliable quarterly distributions in line with its forecasts. Reducing costs is a key deliverable as well as ensuring that the existing portfolio performs to its maximum and that distributions to unitholders are maximised.

Ongoing rental growth at 3.0% p.a. as achieved under the leases may produce reasonable capital growth across the portfolio over time. Unitholders should note that overall income and distribution levels are subject to continued tenant performance.

Management continually looks for areas of improvement for ACF that will be accretive to value or distributions over time. We are actively involved in the childcare market place and are generally seeing strengthening signs within the early learning sector.

## 10. Investor Relations

Unitholders are invited to call our Investor Relations Manager, Lula Lioffi with any queries regarding the management of the Fund. Boardroom Pty Limited is the Fund's Registry and can be contacted on 1300 737 760 with respect to any queries in relation to your unitholding. All of the Fund's publications are available on its website [www.acfund.com.au](http://www.acfund.com.au), including the Fund Profile that periodically summarises the Fund's overall financial position and asset base, under the website heading of "Reports & Publications/Other Reports". Please contact our Investor Relations Manager if you have any queries.

APML was awarded three property industry awards in 2011 and one in 2010 validating the strategy and focus of management over the last three years to return its childcare funds to traditional and simple property trust models and protect the interest of its Unitholders. This included the 'A-REIT of the year' award for 2011 in relation to the listed Australian Education Trust.

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### Further information

The Austock Childcare Fund internet site, [www.acfund.com.au](http://www.acfund.com.au) is a source of information for Unitholders. It includes details of ACF and its Manager, announcements, current activities and historical information. The site provides access to annual and half-year reports and also ACF updates covering matters of relevance to investors.