



INDICATIVE NON-BINDING PROPOSAL FOR THE MERGER OF ARENA REIT AND FOLKESTONE EDUCATION TRUST

On 29 September 2014 Folkestone Education Trust ("FET") submitted an Indicative Non-Binding Proposal (the "Proposal") to the Chairman of Arena REIT ("ARF") outlining the proposed merger of FET and ARF.

On 4 November 2014, the Responsible Entity of ARF announced that it had entered into the Implementation Agreement with Citrus II pursuant to which ARF will internalise its corporate governance and management function.

In conjunction with the release of ARF's Internalisation Proposal materials, the Independent Board Committee of ARF rejected the FET Proposal on the basis that it did not provide ARF unitholders with a compelling value proposition compared to the Internalisation Proposal. Full details supporting this position were not released.

In the interests of full disclosure we attach the proposal as sent to ARF on 29 September 2014.

FET believes the Proposal represents a compelling proposition for both ARF and FET, and their respective unitholders, including:

- **Attractive accretion metrics:** The Proposal is expected to be 4.6% accretive to ARF's FY15 distribution guidance of 9.75cps (pre-internalisation) and 1.0% accretive to FET's distribution guidance of 12.70cps;
- **ARF NTA uplift:** ARF unitholder NTA of at least \$1.13 per ARF stapled security, compared to \$1.071 under the Internalisation Proposal;
- **Lower gearing:** Post-transaction gearing is expected to be 34.0% compared to 36.7% under the Internalisation Proposal;
- **Material reduction in base fees:** By virtue of benefit of scale, FET will reduce base management fees from 80bps to 45bps up to \$900m. FET offered to reduce base fees to 40bps above this threshold providing for an enduring benefit to all unitholders;
- **Enhanced earnings quality and growth opportunities:** Improved portfolio scale and geographic diversification will contribute to lower earnings volatility, improved growth prospects and an enlarged portfolio that can sustain a larger development pipeline; and
- **Manager with childcare expertise:** FET is externally managed by Folkestone Investment Management Limited, a subsidiary of Folkestone Limited an ASX listed real estate fund manager (ASX:FLK). As a well-regarded and experienced early learning property manager, a merger with FET mitigates any potential concerns associated with the transfer of management.

As noted, FET believes its Proposal represents a compelling proposition for both ARF and FET and their respective unitholders.



For further information contact:

Unitholder Enquiries

NICK ANAGNOSTOU

CEO – Social Infrastructure Funds
T: +61 3 8601 2092

LULA LIOSSI

Investor Relations Manager
T: +61 3 8601 2668

Media Enquiries

JOHN HURST

Cannings Corporate Communications
T: +61 2 8284 9901

About Folkestone Education Trust

The Folkestone Education Trust (FET) is a listed real estate investment trust (A-REIT) that invests in early learning properties. FET's website, www.educationtrust.folkestone.com.au provides information on FET, its Manager, announcements, current activities and historical information.

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 \$813 million under management, offers listed and unlisted real estate funds to private clients and select institutional investors, while its on balance sheet activities focus on value-add and opportunistic (development) real estate investments. www.folkestone.com.au

Folkestone Investment Management Limited
ABN 46 111 338 937 AFSL 281544

e: fet@folkestone.com.au
www. educationtrust.folkestone.com.au

Sydney Office
Level 10, 60 Carrington Street
Sydney NSW 2000
t: +61 2 8667 2800
f: +61 2 8667 2880

Melbourne Office
Level 12, 15 William Street
Melbourne Vic 3000
t: +61 3 8601 2092
f: +61 3 9200 2282

29 September 2014

STRICTLY PRIVATE AND CONFIDENTIAL

Mr. David Ross
Chairman
Arena REIT
71 Flinders Lane
Melbourne VIC 3000 Australia

INDICATIVE NON-BINDING PROPOSAL FOR THE MERGER OF ARENA REIT AND FOLKESTONE EDUCATION TRUST

Dear David,

We are writing you to put forward an indicative non-binding proposal for the potential merger of Arena REIT (“ARF”) and Folkestone Education Trust (“FET”) towards creating the leading ASX listed REIT specialising in early learning childcare centres (the “Proposed Transaction”).

We believe the Proposed Transaction represents a compelling proposition to both Trusts and their respective unitholders. There is strong strategic rationale that is well supported by quantitative and qualitative benefits, involving a scrip based proposal enabling existing ARF unitholders to participate in the future growth and benefits derived from the enlarged entity. Importantly, we believe that the Proposed Transaction is superior, both quantitatively and qualitatively, to the internalisation proposal under consideration from Citrus II Investments (the “Internalisation Proposal”).

Situation Overview

FET has for some time been evaluating the strategic merit of merging with ARF, and the timing of this Indicative Proposal was motivated by ARF’s 25 August 2014 internalisation announcement. Under the disclosed terms, we understand that ARF has entered into a six month exclusivity agreement with Citrus II Investments to consider an internalisation of its corporate governance and management function in addition to assuming the management rights of two of its wholesale healthcare funds (PHC Darlinghurst Syndicate and Trust and BSH Joint Venture). With an implied purchase price of \$10.7m, the debt-funded transaction was indicated as “slightly accretive” to pro-forma EPS and approximately 5 cents dilutive to NTA (-4.4%) post transaction costs.

FET believes that the Proposed Transaction is superior to the Internalisation Proposal on both quantitative and qualitative metrics, providing ARF unitholders with a compelling alternative to an internalisation, and as such, would satisfy the superior proposal condition to which the Internalisation Proposal is subject.

We look forward to engaging with you in constructive, co-operative discussions to finalise a proposal that delivers superior benefits to both our Trusts and respective unitholders.

Indicative proposal

FET has undertaken analysis based on publicly available information and believes that the combination of the respective childcare entities would generate substantial operating benefits.

Subject to due diligence and the other limited conditions set out in this letter, FET proposes a unit-based merger via a Trust Scheme or Stapling.

ARF unitholders would be offered an exchange ratio of 0.795 FET units for each ARF unit. This implies a unit price of \$1.527. This represents a:

- 35.1% premium to Net Tangible Assets (“NTA”) as at 30 June 2014
- 16.5% premium to the undisturbed last closing price of \$1.310 prior to the Internalisation Proposal;
- 9.3% premium to 3-month VWAP of \$1.397; and
- 3.5% premium to last close of \$1.475

The Proposed Transaction is expected to be 4.6% accretive to ARF’s FY15 distribution guidance of 9.75cpu and 0.9% accretive to NTA post transaction costs. The Proposed Transaction is expected to be 1.0% accretive to FET FY15 distribution guidance of 12.70cpu.

Material assumptions

We have based our Indicative Proposal on a review of publicly available information and FET’s knowledge of the markets in which ARF operates. Specifically, we have assumed the following:

- ARF’s internal financial forecasts are consistent with its announcement on 25 August 2014;
- net tangible assets of at least \$1.13 per ARF stapled security;
- fully diluted securities outstanding of 211,495,653;
- net debt consistent with the last reported figure; and
- no management fees from PHC Darlinghurst Syndicate and Trust and BSH Joint Venture.

If ARF declares any distribution after the date of this letter that are either a) not in the ordinary course of business b) in excess of the FY15 guidance, the Indicative Proposal will be reduced by an amount equal to the distribution per security.

Benefits of the Proposed Transaction

We believe that the various quantitative and qualitative elements contained within our proposal when evaluated by the ARF Board qualifies it as a superior proposal to the Internalisation Proposal:

- **Creation of the largest childcare REIT:** The combination of two relatively small listed childcare entities will increase market free float and liquidity to position the combined entity as the clear market leading sector specialist with gross assets in excess of \$800m, providing for an increased weighting in the S&P/ASX 300 A-REIT Index;
- **Enhanced earnings quality and growth opportunities:** Improved portfolio scale and geographic diversification will contribute to lower earnings volatility, improved growth prospects and an enlarged portfolio that can sustain a larger development pipeline;

- **Reduction in management expense ratio:** By virtue of the benefits of economies of scale, the enlarged entity also has the capacity to reduce the management fees currently charged to ARF unitholders on an enduring basis;
 - FET will reduce base management fees from 80bps to 45bps;
 - FET also intends to further reduce management fees as the vehicle grows past certain thresholds so as to align the benefits of economies of scale with unitholders; and
 - FET will also remove asset acquisition, disposition and performance fees.
- **Operating synergies:** Whilst various operating synergies have been identified, it is reasonable to anticipate the potential for operating synergies over the medium-term including procurement, administration and overhead;
- **Equity market benefits:** Increased weighting in the S&P/ASX 300 A-REIT index will attract a greater level of investor interest, trading activity and exposure with greater coverage expected by the research community;
- **Manager with childcare expertise:** FET is externally managed by Folkestone Investment Management Limited, subsidiary of Folkestone Limited an ASX listed real estate fund manager (ASX: FLK). As a well-regarded and experienced early learning property manager, a merger with FET mitigates any potential concerns associated with the transfer of management concerns.

About Folkestone Education Trust

FET is the largest ASX listed Real Estate Investment Trust (REIT) that invests in early learning properties with operations throughout Australia and New Zealand (ASX:FET). As at 30 June 2014, FET had total assets under management of \$464.6 million and 357 early learning properties in its portfolio. FET is externally managed by Folkestone Investment Management Limited, a subsidiary of Folkestone Limited an ASX listed real estate fund manager and developer with \$813m in funds under management as at 30 June 2014 (ASX: FLK).

Due Diligence and Process

This Indicative Proposal is subject to a period of due diligence and agreement with FET on the terms and conditions of any formal proposal to be made by FET. Any final, binding offer from FET would be subject to the satisfactory completion of business, legal, tax, accounting and other relevant due diligence. We anticipate that this would include, but not be limited to, customary review of all financial records, valuations, agreements, contracts, material leases, capital expenditure estimates and interviews with management.

We expect to be able to complete due diligence in a very focused and efficient manner over a period of up to 4 weeks once access to requested information is granted. We have outlined in Annexure A the preliminary list of the material information FET would require to conduct its due diligence.

Upon entering into due diligence and with the agreement of the ARFs Independent Directors, FET would seek to engage with ARF's financiers to ascertain the appropriate finance arrangements required within the specified timeframe.

FET expects that the Potential Transaction will be executed via a Trust Scheme or Stapling. FET and its advisers will work with the ARF's Independent Directors and their advisers to complete due

diligence and secure required consents with a view to providing a binding proposal to unitholders by early November 2014.

Approvals

This Indicative Proposal has the support of the FET Independent Directors. Prior to submitting any final, binding offer and executing a definitive agreement, FET will need to obtain final internal approvals, which will be sought within the timeframe referred above.

Regulatory Approvals

It is not anticipated at this stage that any other regulatory approvals (apart from Trust Scheme or Stapling approvals) will be required in order to give effect to the Potential Transaction.

Indicative Proposal

This Indicative Proposal is an incomplete, confidential and non-binding proposal and expresses current intentions only. It is not an offer for ARF units that is capable of acceptance or to otherwise give rise to a binding contract in relation to ARF units. Unless and until definitive agreements are entered into regarding the Potential Transaction, FET will not be under any obligation whatsoever with respect to the Potential Transaction, including, without limitation, to negotiate terms of the Potential Transaction with ARF or any other person.

This Indicative Proposal is strictly confidential and is submitted on the basis that this letter, including its existence, or any of its terms and contents may not be disclosed to anyone (including, without limitation, any other prospective purchaser of units or assets in ARF other than the Independent Directors of ARF and advisers on a need to know and strictly confidential basis), without first obtaining the prior written consent of FET.

For the avoidance of doubt, this Indicative Proposal is not, and cannot be considered to be, notification or a public announcement of an intention to make a takeover offer pursuant to section 631 of the Corporations Act, and is not intended to give rise to a continuous disclosure obligation for the purposes of the ASX Listing Rules.

This Indicative Proposal should be interpreted under the laws of Victoria, Australia.

Implementation Agreement

We would propose that ARF and FET enter into a Confidentiality Agreement and Standstill Agreement with a view to negotiating and executing an Implementation Agreement which would address the following matters:

- Terms of any proposal, including conditions;
- Requirement for ARF unitholder support;
- Mechanics and timing for implementing the Proposal;
- Customary representations and warranties for a transaction of this nature;
- The requirement for a unanimous recommendation of ARF Directors to support the proposal, in the absence of a superior proposal; and
- Arrangements to facilitate transfer of fund, property and development management activities to Folkestone Investment Management Limited, Responsible Entity of FET.

Next Steps

FET believes that should this Indicative Proposal be embraced by the ARF Independent Directors, and lead to a formal proposal being announced, it would be well received and represents a simple and compelling proposal for ARF unitholders. FET is in a position to move quickly and has retained Goldman Sachs and BG Capital as financial advisor and Clayton Utz as legal advisor in this matter.

FET is seeking to progress a proposal with the support of ARF Independent Directors to be in a position to provide a detailed merger proposal capable of announcement in early November 2014 such that a transaction could be completed prior to year end with your cooperation.

Below we have outlined the key next steps and an indicative timetable.

Event	Date
ARF Independent Directors response to the Indicative Proposal	Late September 2014
Due diligence and negotiations with financiers	4 weeks
Detailed merger proposal and transaction announcement	Early November 2014
Implementation	TBC

We look forward to working with you towards the creation of the leading ASX listed childcare REIT.

Please contact us if you wish to discuss or require clarification of any aspect of this Indicative Proposal.

Yours sincerely,

Folkestone Education Trust



By:
Victor Cottren
Chairman



By:
Greg Paramor
Managing Director – Folkestone Limited

Annexure A Preliminary due diligence request list

The list below outlines some of the items we would expect to review in order to complete our due diligence. We reserve the right to request further items during the due diligence process.

Business

- Corporate structure chart
- Management interviews / presentations

Property level due diligence

- Copies of most recent Independent Valuations or Directors Valuations
- Copies of leases and agreements for lease
- Historical operating statements
- Tenancy schedules
- Leasing update – upcoming rent roll (and replacement prospects), new lease-ups
- Forecast capital expenditure
- Feasibility studies for development sites
- Title particulars
- Current DA's for each development site
- Physical and environmental property reports in the company's possession

Legal

- Trust constitutions
- Property and asset management agreements
- Development management and service agreements
- Joint venture and operating agreements
- Custody agreements
- AFSL
- Leases that contain change of control triggers or other clauses that may have a material impact on value or ownership of the asset due to the proposal
- Compliance plan including breach, conflict/related parties and complaints registers etc.
- Details of material litigation
- Current insurance policies in place
- Other material agreements

Tax

- Australian Tax Returns and supporting work papers for all entities for the previous 5 years
- All correspondence with any revenue authority (eg ATO, state revenue offices) for the past 5 years
- All advice received regarding any taxes including related to material transactions
- Details of all funding and charges with any related entity or entity related to the trustee during the last 5 years
- Details of any positions taken related to taxes that would require disclosure or provision with the accounts of any entity
- Details of the nature and amounts of distributions to unitholders (including distributions from controlled entities)

Accounting / Finance

- Forecast model
- Fund debt documentation
- Fund hedge book and their MTM, including derivative contracts and documentation
- Support for key income statement and balance sheet items
- Details of any off balance sheet items including contingencies and commitments
- Statutory accounts
- Management accounts and budgets

Other

- Unitholder register
- Correspondence with regulators