

# UNITHOLDER UPDATE

## ING Real Estate Community Living Group

27 FEBRUARY 2009

Dear Unitholder,

I am writing to you to provide an update on ING Real Estate Community Living Group (ILF) for the six month period ended 31 December 2008. Further information is included in the Fund's half year announcement and presentation, available on the ING Real Estate website: [www.ingrealestate.com.au](http://www.ingrealestate.com.au)

### THE ECONOMIC ENVIRONMENT AND THE MARKETS

During the six months to December 2008, global economies were in turmoil as financial markets fragmented. A record slump in business confidence has put many economies in recession. This has prompted Governments to act swiftly with unprecedented stimulus packages to rescue their economies. Despite this, no one can predict if the eventual recovery will be felt in months or possibly years to come.

Locally, we have seen a rapid deterioration of the value of Australian REITs (A-REITs). The key issue is the exposure of many listed entities to maturing debt in an environment where refinancing is very difficult and costly. Similar to the other A-REITs, ILF has also borne the full impact of the current economic conditions. For ILF, this is reflected in considerably slower demand and hindered short term growth in the independent living retirement sector. We have seen many potential residents prolong their move-in decisions as they assess the effects of the residential housing downturn and the diminished superannuation that suffered as a result of the battered share markets. In spite of this, the long term outlook for this largely needs driven sector, remains positive as the ageing population will continue to drive demand for years ahead.

While we are not pessimistic about the future, we are pragmatic about how this outlook could impact ILF. Therefore Management has undertaken a strategic review of the business to better navigate the Fund through 2009 and beyond. This process is not yet complete although positive changes are occurring.

The Fund's unit price performance for the six months to December 2008 was very disappointing. The Fund's debts, its exposure to the US economy and to Australian retirement developments were the main contributors to the significant decline in unit price. We have already begun to address some of these issues.

Many of our fellow A-REITs have benefited from raising monies to address their gearing issues. Due to ILF's price fall in the last six months, this option has not been available to the Fund. Therefore for some time, the Fund's debt may remain at a level higher than considered acceptable by Management and the market. Without a capital raising, maintaining a positive cashflow is the number one focus for the Fund in the next 12-24 months. We have been actively pursuing asset sales and while we have had some success, conditions remain challenging.

# UNITHOLDER UPDATE

## FINANCIAL PERFORMANCE FOR THE HALF YEAR

For the six month period ended 31 December 2008, the Fund recorded a net operating income of \$15m (down by \$8.9m from \$23.9m in December 2007). This decline is largely attributed to the Australian Garden Villages portfolio. Its results in December 2007 were cushioned by the ILF income guarantee that expired in June 2008 and the SCV master lease that terminated in September 2008. Since our management takeover in September 2008, we are working to restabilise the occupancy of Garden Villages and we are already seeing positive signs.

A summary of the Fund's results for the December 2008 half year is summarised below:

	HALF YEAR 2008	HALF YEAR 2007
Net loss <sup>1</sup> (\$m)	(242.4)	(5.4)
Net operating income <sup>1</sup> (\$m)	15.0	23.9
Net operating income per unit (cpu)	3.4	5.5
Property revaluations (\$m)	(144.1)	(16.8)
	Dec 08	June 08
Total assets (look through) <sup>2</sup> \$bn	1.3	1.2
Gearing (look through) <sup>2</sup> %	69	57
Net asset value per unit (\$)	0.55	0.94

## NET OPERATING INCOME \$M – BY SEGMENT

	HALF YEAR 2008	HALF YEAR 2007
AUS Seniors	7.5	12.5
US Seniors	12.0	11.5
CDN Seniors	2.6	2.7
Students	4.1	6.0
Net finance costs	(8.7)	(6.7)
Management fee	(1.7)	(1.5)
Fund admin	(0.8)	(0.6)
Net operating income	15.0	23.9

## OPERATIONAL RESULTS

The results by portfolio have varied in the first six months.

### Australian Seniors – Settlers Lifestyle

Despite the decline of the Australian economy which affected residential markets, sales at Settlers held up relatively well for this first half of the 2009 financial year. The overall sales for the portfolio were slightly lower than target, however it was still a pleasing result nonetheless. Ridgewood Rise was a standout as it outperformed the industry average with 15 new sales (grossing \$6.1m in revenue) in this tough market.

Whilst we expect the economic conditions in Australia to continue to be challenging in the second half of the financial year, we maintain our expectations of good sales as our quality sites, coupled with positive market forces, such as easing interest rates, should see us sustain our performance.

1) Net operating income excludes significant items including negative revaluations of investment properties and derivatives.

2) Excludes Oak Tree and CCV.

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### **Australian Seniors – Garden Villages**

Since ING internalised management of the Garden Villages portfolio in September 2008, we have seen an encouraging lift in occupancy from 65.8% to 67.5% at the end of January 2009. This is a direct result of the more focused marketing initiatives that were implemented by our new team.

For calendar year 2009, we expect to see a steady increase in occupancy as the team continues to work hard to reinvigorate this portfolio, coupled with a forecast increase in demand for rental units as the economic conditions affect the ability of residents to sell their properties.

Management recognises the growth potential of the Garden Villages portfolio in the retirement sector, and will continue to operate and invest adequately to ensure we extract the maximum value out of this core asset going forward.

### **Australian Seniors – Joint Ventures**

The economic environment made it difficult for both our joint ventures to perform. Whilst we were only expecting small gains, the lack of sales and rising cost of debt resulted in a loss in this first half of the 2009 financial year.

With the new strategic direction that ILF has taken, these joint ventures will not form part of our core business. In early 2009, the Fund exited the Oak Tree joint venture.

### **US Seniors**

US Seniors is a quality portfolio that has unfortunately suffered from the deteriorating economic conditions in the US and aggressive price competition especially in the last quarter of 2008. Despite this, the portfolio continues to provide a good income stream for the 2009 financial year.

We are receiving 'bids' for a number of the assets within this portfolio. However at this stage, we view them more as 'opportunistic' bids than fair and reasonable offers for what these assets are worth.

### **Canadian Long Term Care – Regency**

The Regency LTC portfolio has always been a consistent performer for the Fund. In the first half of the 2009 financial year, it provided a steady return.

Despite its dependable performance, the profile of this LTC portfolio is not within the Fund's core strategy going forward. We have commenced very preliminary talks with parties interested in acquiring the assets.

### **US Students**

This first six months of the 2009 financial year have been particularly challenging for our US Students portfolio. Factors affecting its performance include the recessionary US economy, overall increase in operating expenses (with prominent spikes in energy cost and local taxes), and a transitional interruption due to a change in operators.

As previously announced to the market, and in addition to the completed sales of the Virginia student assets, we will continue to divest the Fund's underperforming non-core assets which include part or whole of the US Students portfolio.

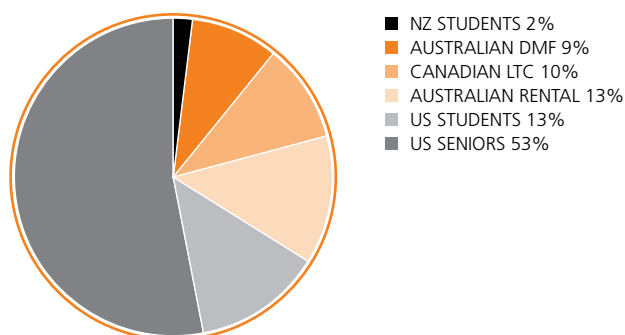
### **NZ Students**

In the six months to December 2008, the NZ Students portfolio saw capital expenditure relating to structural works on one of the properties. Occupancy and revenue were affected whilst these works were undertaken.

Capital was also applied to the upgrade of three floors in one of the properties making them suitable for summer hotel accommodation. With the launch of the 'Ustay' brand in December 2008, trading commenced with 48 refurbished rooms and a further 16 rooms in February 2009. In the first week, 50% occupancy was achieved. This was a pleasing result as we aim to position 'Ustay' as a leading competitor in the Wellington budget stays sector.

With its good reputation within the Wellington students accommodation sector and its continued relationship with the university, we have achieved yet another year of strong lease-up this academic year.

### ILF'S ASSET ALLOCATION BY VALUE (AT 31 DECEMBER 2008)<sup>3</sup>



### REVALUATIONS AND MOVEMENT IN NAV

Our Net Asset Value per unit (NAV) has fallen from \$0.94 at 30 June 2008 to \$0.55 at 31 December 2008. This decline has predominantly been driven by market revaluations of our portfolios.

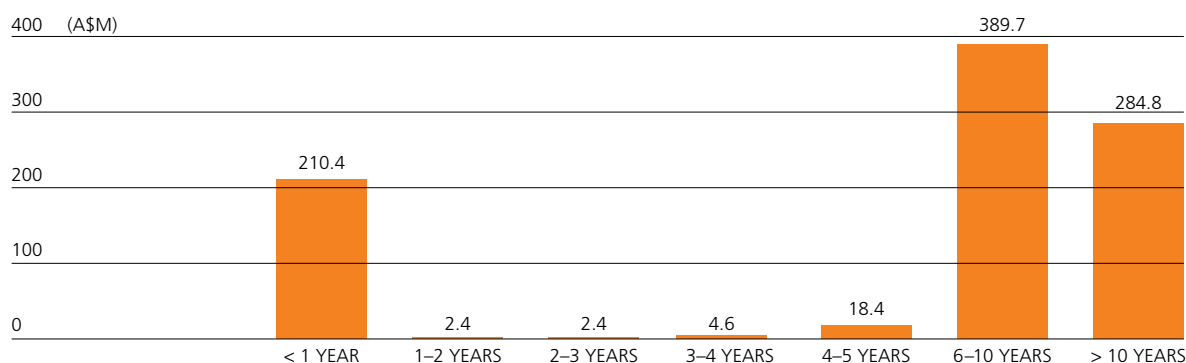
Six of the Fund's portfolios were independently valued down to \$1.2b at 31 December 2008. The combined revaluation loss of \$144.1m has been driven by a softening in capitalisation rates across all the portfolios. The majority of this downward revaluation has arisen in our US portfolios where we have seen the full impact of the US residential decline. In the six months to December 2008, the US residential markets saw the largest recorded falls since the Great Depression of the 1930s.

Late last year, Management reviewed its interest in the two Australian joint venture businesses and wrote down the value of these investments.

### DEBT

As shown in the debt maturity profile chart below, 23% of the Fund's debt will expire before December 2009. This comprises \$136.1m of Head Trust debt, \$24.9m of US Debt, \$15.5m of NZ debt and \$33.7m of Australian joint venture debt (Oak Tree and CCV). The divestment from Oak Tree will materially reduce ILF's exposure to this JV debt. In addition to the Head Trust debt, ILF has hedging liabilities of \$77m (as at 31 December 2008). This will form part of ILF's refinancing negotiations to take place this year.

### DEBT MATURITY PROFILE (AS AT 31 DECEMBER 2008)



3) Includes gross asset values for Oak Tree and CCV.

74% of the Fund's debt has a maturity beyond 5 years. This debt has very few financial covenants that could accelerate repayment.

ILF has capital hedges in place to manage the currency fluctuations against its foreign net asset exposures. As noted above, these hedges represent a liability to the Fund of \$77m (as at 31 December 2008). The extent of this liability or asset will rise and fall in line with movements in the exchange rates. Below is a table showing the potential impact of such movements.

EXCHANGE RATE FLUCTUATION		% MOVEMENT IN EXCHANGE RATE	INDICATIVE HEDGE LIABILITY
AUD/USD	AUD/CAD		
0.77	0.95	+10%	A\$41.6M
0.74	0.90	+5%	A\$58.9M
<b>0.70</b>	<b>0.86</b>	<b>at 31 Dec 08</b>	<b>A\$70.4M</b>
0.67	0.82	-5%	A\$99.0M
0.63	0.77	-10%	A\$122.3M

All figures as at 31/12/2008

While these hedges expire between 2011 to 2012, ILF will pursue foreign asset sales with a view to reducing these liabilities before their maturity.

Throughout 2008, the Fund has remained within all its banking financial covenants across the portfolios. In the six months to December, ILF repaid \$5.5m against its Head Trust facility. This provided head room under the facility's loan-to-value ratio (LVR) covenant in anticipation of a weaker property environment in 2009.

In these volatile economic conditions, Management cannot provide certainty as to the Fund's covenant position at June 2009.

### CAPITAL MANAGEMENT

In this current economic climate of uncertainty, ILF's priority is to strengthen the Fund's balance sheet. Delivering positive cashflows is Management's main focus. While not without challenges, this will be addressed through asset sales, exiting capital intensive portfolios, and reducing capital expenditure. With the continuing market conditions and uncertainty surrounding the timing of asset sales, the June 2009 quarter distributions will regrettably be suspended.

Collectively, these actions will enable the Fund to reduce its hedged liabilities and debt exposures.

#### Asset sales

The time taken to complete asset sales has increased significantly in this continuing illiquid market. As announced on 16 February 2009 and after a protracted sales process, ILF sold the two Virginia Student assets (Capital Garage and Ramz Hall) for US\$19.3m. The proceeds represented an 8% discount to the 30 June 2008 valuations and have been applied to reduce the Fund's US debt. Management will continue to actively market the sale of the Florida student assets and will provide an update in due course. ILF will continue to balance the difficulty of completing asset sales in a timely matter whilst maximising sale price.

#### Divestment of capital intensive portfolios

With our focus on conservation of cashflow and debt reduction, unearthing development growth has become a lesser priority. A significant proportion of the Fund's cash commitments were attributed to the joint venture vehicles. At December 2008, the Fund held a 50% share in the Oak Tree JV and a 27% share in the CCV JV (both are part of the Australian Seniors portfolio). After considering each portfolio's outstanding financial commitments, current valuations and market demand, Management completed an exit from the Oak Tree joint venture as at 13 February 2009.

#### Reduction in non essential expenditure

Since July 2008, all non-essential capital expenditure and development activities have ceased across all portfolios to conserve the Fund's cashflow.

# UNITHOLDER UPDATE

## STRATEGIC REVIEW

In early December, Management began a strategic review of all ILF's portfolios. This review takes into account the current economic climate and the challenges it brings, the portfolios' operational complexities and performance, and long term objectives needed to steer the Fund into the right direction for the future.

This assessment is guided by a set of criteria that examines whether:

- > the portfolio is cashflow positive;
- > the portfolio has a favourable prospect for long term growth and profitability post the financial crisis; and
- > the investment structure can be simplified.

In the short term, Management hopes to preserve ILF's viability through this financial crisis by ensuring that we focus on building cashflow to strengthen the balance sheet via debt reduction; achieve success in refinancing the Fund's maturing Australian debt in 2009, and implement prudent asset management across all portfolios to ensure they operate at their maximum efficiencies.

In the long term, Management would like to re-define and build on the Fund's core competencies. Key portfolios that have the best prospects for growth and profitability will be retained while the non-core assets will be exited at appropriate times. ILF's operational structure will also be simplified with the reduction of the Fund's joint venture partnerships and the number of geographical markets in which it invests.

To date, the Fund has progressed in this review with news of recent asset sales and an exit from a joint venture. The ultimate objective is for ILF to emerge as a much stronger and more focused owner/operator in the seniors living sector with assets predominately in Australia.

This review is not something Management takes lightly. Therefore this thorough process will be diligently executed and will continue throughout 2009/10.

## FUND OUTLOOK

During my brief time with ILF, the world has continued to change and not for the better. These are trying times for everyone as economic conditions continue to deteriorate. Credit availability has not improved despite numerous measures taken by central banking authorities throughout the world.

The Fund will continue to face many challenges over the coming months with refinancing of some of its debt facility and capital hedging liabilities being the issue at the forefront. As stated at our Annual Unitholders Meeting in December 2008, there is no certainty that our lender will want to refinance and to find new financing in these economic circumstances will be very tough.

On a final note, it is worth remembering that there will be an end to this economic downturn where the economy will stabilise, credit will become more available and volatility will subside. The timing of this is uncertain, therefore I would like to reiterate the need to preserve a positive cashflow as the Fund's highest priority.

On behalf of the Board and Management, I would like to assure you that we are working as hard as we can to steer the Fund out of its very difficult position. We hope to be able to update you with some positive news of our progress soon.

We thank you for your continued and ongoing support.

Yours sincerely,



## VICTOR BREUER

**Chief Executive Officer**

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