# UNITHOLDER UPDATE

## ING Office Fund

19 FEBRUARY 2009

Dear Unitholder,

I am writing to update you on your investment in ING Office Fund and provide you with an overview of our operational activities for the six months ended 31 December 2008 and an outlook for the remainder of the financial year.

It is now over a year since we first saw the emergence of the US sub-prime housing crisis negatively impact capital markets in Australia and abroad.

The effects of the credit crisis have been far reaching, resulting in an unprecedented period of financial market volatility and negative performance across global equity markets.

Difficult credit market conditions and the impact of falling asset values have heightened concerns about gearing levels in the Australian Real Estate Investment Trust (A-REIT) sector. This has resulted in a significant amount of capital being raised in the sector over the past 6 months to strengthen balance sheets, and, in some instances has resulted in significantly reduced or suspended distributions by some A-REITs to repair stretched balance sheets.

IOF has not been immune from the resulting negative impacts and, along with the entire A-REIT sector, has seen a significant decline in its unit price.

Amidst the turmoil of the global credit crisis, investors continue to support A-REITs with a traditional business model, in which the majority of earnings are derived from property income.

This model, coupled with the quality assets, diverse tenant base and the long lease term of IOF's portfolio remains appealing to investors as evidenced by the success of IOF's recent capital raising.

### CAPITAL RAISING STRENGTHENS BALANCE SHEET

In December 2008 the Fund announced a capital raising to strengthen its balance sheet by reducing gearing and increasing the Fund's undrawn debt capacity.

In total, $414.5 million was successfully raised through the Institutional Placement and both the Institutional and Retail Entitlement Offers.

The proceeds from the capital raising were used to reduce debt and have:

> Strengthened IOF's balance sheet by reducing gearing [1] to 35%
> Increased the Fund's available debt capacity to approximately $580 million at 31 December 2008.

### RESULTS

For the six month period ended 31 December 2008 the Fund's statutory result was a net loss of $445.7 million. This loss was caused by negative fair value movements of investment properties and financial instruments as a result of falling asset values, a depreciating Australian dollar and falling interest rates. Excluding these fair value movements and other non-cash items the Fund's net operating income was $72.2 million compared with $64.7 million for the previous corresponding period, an increase of 11.6%.

1) Total debt including the Fund's share of debt in associates ÷ total assets including the Fund's share of assets in associates.

| KEY FUND DATA | 31 DECEMBER 2008 | 31 DECEMBER 2007 |
|---|---|---|
| Net profit/(loss) | ($445.7m) | $140.4m |
| Net operating income | $72.2m | $64.7m |
| Net operating income (cents per unit) | 5.6 | 5.3 |
| Distributions (cents per unit) | 5.40 | 5.35 |
| Net Asset Value per unit | $1.30 | $1.80 |
| Total assets | $4.0b | $3.9b |
| Gearing | 35.2% | 35.7% |
| Market capitalisation | $1.4b | $2.0b |
| Retained earnings | $19.5m | $12.8m |

## DISTRIBUTIONS

While the capital raising has significantly strengthened the Fund's balance sheet and provided additional debt capacity to navigate the turbulent financial environment, it will impact the distributions unitholders will receive over the remainder of the 2009 financial year.

While the operational earnings of the Fund (net operating income) remains in-line with the guidance provided in August 2008, as a result of the capital raising, the number of units on issue has increased materially from 1.26 billion to 1.78 billion.

An increase in the number of units impacts the payment each unitholder will receive as the funds available for distributions (including the interest expense saving from reduced gearing) is now divided between a larger number of units, resulting in a decrease in the distributions per unit.

Subsequent to the capital raising, distributions for the second half of the financial year to 30 June 2009 are forecast to be 4.25 cents per unit, subject to prevailing market conditions.

## UNITHOLDER MEETING TO REFRESH PLACEMENT CAPACITY

Following the December capital raising, IOF will be holding an extraordinary unitholder meeting to vote on a resolution to refresh the placement capacity of the Fund. This will give the Fund the capacity to undertake more than one unit placement within a 12 month period, of up to 15% of its issued capital.

As the Fund continues to operate in an environment where the availability of credit is limited and expensive the Responsible Entity believes that institutional placements provide the Fund with a quick, cost effective and flexible method of raising equity when and if required to further strengthen the Fund's balance sheet or for any future opportunities.

The Fund has no current plans nor is it currently contemplating to raise additional capital other than through the operation of the existing Distribution Reinvestment Plan.

Full details of the resolution are provided in the Notice of Meeting and Explanatory Memorandum enclosed with this letter.

***What you need to do:*** *If you are not attending the meeting, you may appoint one or two proxies to attend and vote for you. The Voting and Proxy Form, along with the Notice of Meeting, are enclosed, and provide instructions on how to vote and appoint a proxy. A reply paid envelope for this purpose is also enclosed.*

## CAPITAL MANAGEMENT

The Fund's gearing level[2] at 31 December 2008 is 35%. While the recent capital raising has strengthened the Fund's balance sheet, further active management of the Fund's gearing will continue to be a key focus over 2009.

Given the lower availability and higher cost of credit, in mid-2008 IOF implemented a prudent cash flow management change which saw the Fund's distributions change to be based on effective rents, meaning that tenant incentives (rent free periods, tenant improvements and leasing commissions) will be amortised and funded through operating earnings, rather than drawing down on additional debt.

IOF has no debt facilities maturing until June 2010 and has undrawn debt capacity which is expected to be sufficient to repay the June 2010 debt maturity.

## DISTRIBUTION REINVESTMENT PLAN (DRP) RE-ACTIVATED

IOF reactivated the Distribution Reinvestment Plan (DRP) in October 2008 in response to ongoing investor feedback and as another capital management initiative.

Participation in the DRP allows unitholders to have their distributions automatically reinvested in additional units in IOF at a 2.0% discount to the market price, without incurring brokerage or transaction costs.

If you would like to participate in the DRP for the March 2009, please contact LINK Market Services on 1300 653 497. For callers outside Australia, please call +61 2 8280 7057.

## ASSET MANAGEMENT

IOF has continued to achieve leasing success in difficult office market conditions.

In the six months to 31 December 2008, domestically the Fund leased or renewed over 15,000 square metres of Australian office space, securing $7.9 million of annual rental income to the Fund. Market rent reviews conducted during the period resulted in an additional $1.4 million of annual rental income.

Of the key leasing deals in the six month period, leasing activity totalled 3,515 square metres in Brisbane with face rents of over $600 per square metre continuing to be achieved at both of the Fund's Brisbane properties representing an average increase on previous rents of 84%.

Positive leasing results were also achieved on the US portfolio with over 29,000 square feet of new leasing resulting in an average 45% increase on previous rents.

The portfolio continues to enjoy a strong overall occupancy rate of 96% (Australia – 99%, US – 90%, Europe – 96%) along with a strong average lease term to expiry of 4.9 years.

In a period where office space demand has been subdued, these results show that positive rental growth continues to be achieved across IOF's portfolio.

Although it is anticipated that rents and vacancy rates will continue to come under pressure across all markets in the year ahead, the Fund's lease expiry profile and tenant retention focus should help mitigate the anticipated negative impact of these.

2) Total debt including the Fund's share of debt in associates ÷ total assets including the Fund's share of assets in associates.

## VALUATIONS

Valuations for commercial real estate and all asset classes continued to come under pressure in the six months to 31 December 2008 as valuers made adjustments in response to the impacts of the global credit crisis.

Independent and internal valuations were undertaken for all of the Fund's properties, resulting in a total decrease in values of 6.6%, compared with values at 30 June 2008.

As a result of the valuations, the weighted average capitalisation rate of the property portfolio has increased, from 6.3% at 30 June 2008 to 6.8% at 31 December 2008, and the Fund's Net Asset Value per unit reduced from $1.81 per unit to $1.30 per unit.

As the impact of the global credit crisis spreads through the broader economy resulting in weaker economic growth, a slow down in office space demand, and higher vacancies, it is likely that values will continue to remain under pressure in the year ahead.

## OUTLOOK AND STRATEGY

While the effects of the global credit crisis continue to reverberate domestically and abroad, the core focus of the Fund remains on maintaining a strong balance sheet to navigate the challenges over the year ahead.

Throughout the remainder of 2009, IOF's strategy will focus on:

- reducing capital expenditure, where possible;
- selective assets sales where prudent;
- conserving its debt capacity, and
- tenant retention and leasing.

On behalf of the Board of Director's and the IOF team I would like to thank you for your ongoing support of the Fund in these difficult and volatile times.

TINO TANFARA
**Chief Executive Officer**
ING Office Fund