



**Stockland**

# Retirement Living Accounting Workshop

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# Agenda

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- 1. Scope of the workshop**
- 2. Recap of Retirement Living business model**
- 3. Accounting lifecycle of Retirement Living assets**
- 4. Step through the accounting for each lifecycle phase using an illustrative example**
- 5. Summary of profit and balance sheet positions across the full lifecycle**
- 6. Wrap up of key messages**

# Scope of the workshop

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- ▶ **Overview of the accounting entries throughout the four phases of a unit's development and occupation**
  
- ▶ **Summarise the profit and loss, balance sheet and cashflow positions during each phase, including a reconciliation back to the disclosure in the Stockland Financial Report**

# Recap - Retirement Living combines two basic property businesses

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## Residential development

- Acquire land, re-zone, masterplan a community, build a village
- Development profit
  - Sales revenue less costs of land, development and construction
  - Lower percentage margin than pure residential due to community facilities

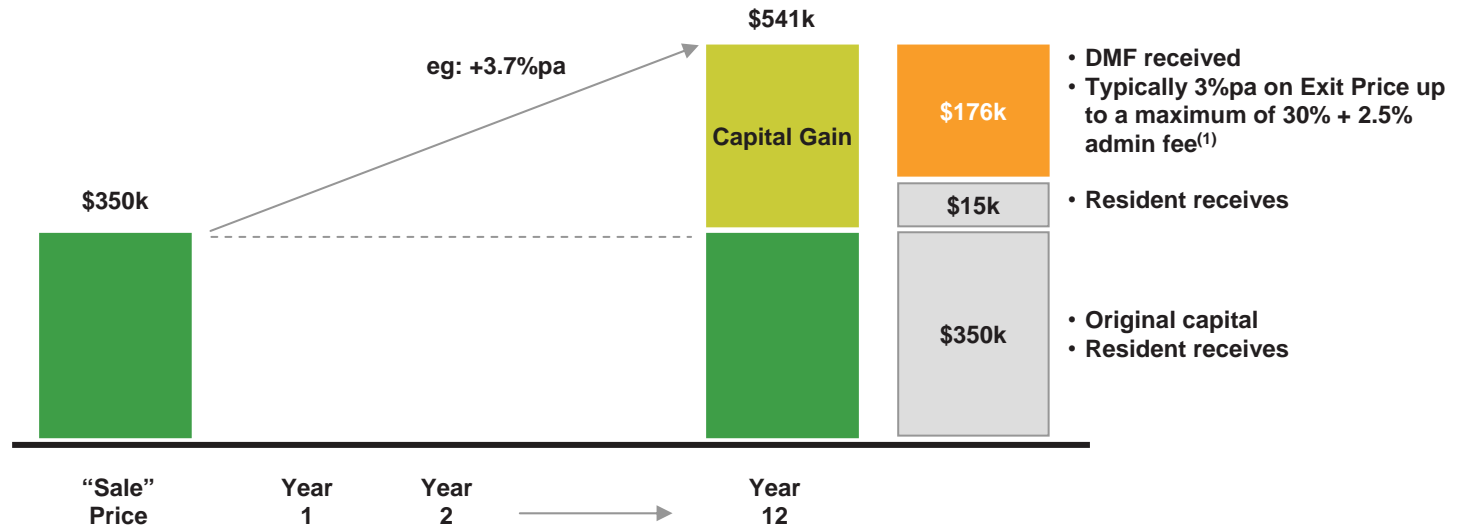


## Asset management

- Manage a portfolio of tenanted assets; keep residents satisfied
- Replace outgoing residents efficiently
- Refurbish periodically to maintain economic value
- Deferred Management Fees (DMFs)
  - A fee on exit linked to the duration of stay
  - Effectively pays for the upfront community facilities

# Recap - Established villages deliver an attractive yield through the DMF

## How The DMF Works: Example of a Single Unit Over One Ownership Cycle<sup>(1)</sup>

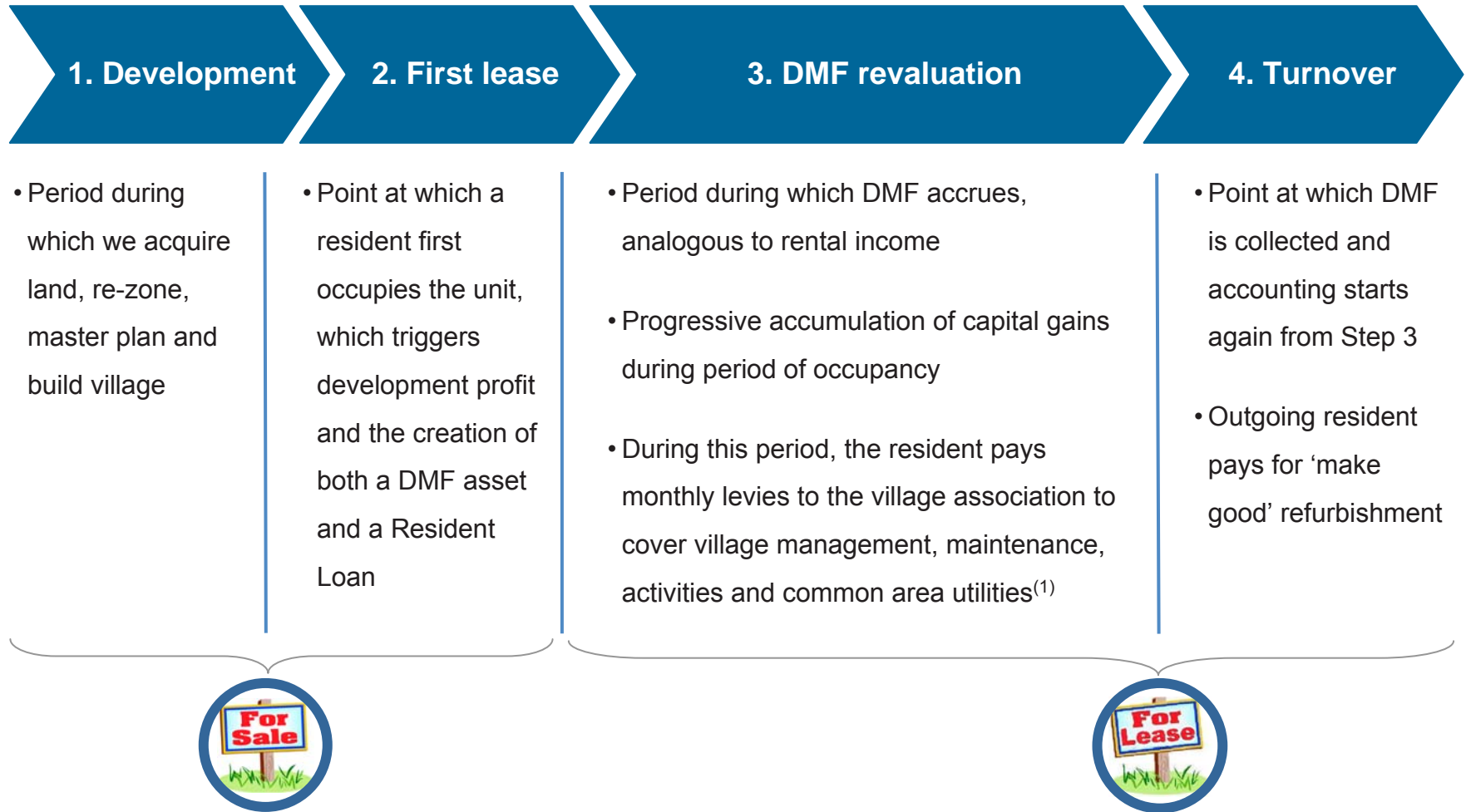


- DMFs are the primary income source for established villages
- At critical mass, the stream of DMFs is analogous to rent
- Can therefore express this income in terms of yield<sup>(2)</sup>
- Low risk of no collection: DMF cash is deducted from the upfront payment made by the incoming resident
- Stockland is also entitled to 2.5% of the exit price as a cost-recovery administration fee, in addition to the DMF

(1) Illustrative example using a typical contract; Capital appreciation and contract terms shown are for illustrative purposes

(2) Refer Retirement Living Investor Briefing - 3 September 2009

# Lifecycle of Retirement Living assets - an accounting perspective

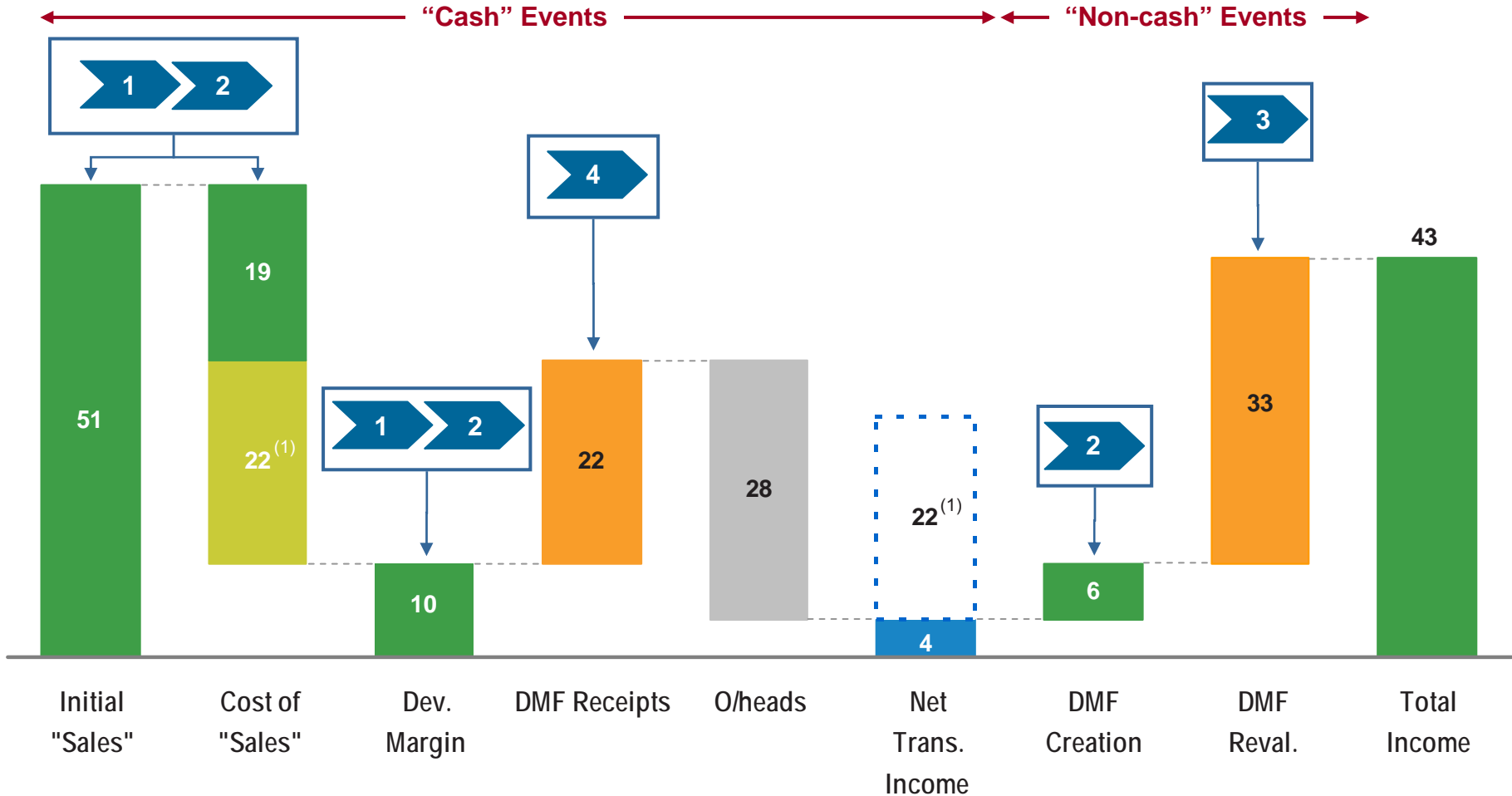


*For the purpose of this presentation, the accounting sign convention has been used whereby credit entries are shown with brackets irrespective of whether it relates to an increase in liabilities or profit*

*Accounting entries are assumed to be in \$'000*

# This Lifecycle maps directly to our financial result disclosure

## Recap: Stockland Retirement Living Financial Results FY09



1) In FY09, land component of cost of sales was \$22m

- Not a cash outflow during FY09
- \$16m impacted by the ARC acquisition (FY07) accounting; pre paid
- Remainder pre paid by drawing from land bank

# Phase 1 - Development period

## 1. Development

- Captures all costs associated with village development
- Equivalent to development of Residential Inventory

Assumptions	Accounting Entry	P&L	BS	Cash
		Dr/(Cr)		
Land and development costs total \$285k, including: <ul style="list-style-type: none"> <li>• Land</li> <li>• Development</li> <li>• Construction</li> <li>• Interest</li> <li>• Holding costs</li> </ul>	Property, Plant & Equipment <sup>(1)</sup>  Cash		285	(285)
		-	285	(285)

(1) A recent change to AASB 140 Investment Property will require this item to be classified as Investment Property from 31 Dec 2009 onwards



# Phase 2 - First Leasing – Development Profit Recognised

## 2. First lease

- Point at which development profit is recognised
- Recognised at point resident takes occupation of unit
- A recent change to AASB 140 Investment Property will affect both the timing of development profit recognition and classification of villages under construction from 31 Dec 2009 onwards. The impact of the change is currently being assessed and will be announced at 1H10 results

Assumptions		Accounting Entry	P&L	BS	Cash
			Dr/(Cr)		
Unit leased to first resident		Cash (received from incoming resident)			350
“Sale” price	\$350k	Property, Plant & Equipment <sup>(1)</sup>		(285)	
“Cost of Sale”	\$285k	Revaluation of investment property	(65)		
Development margin	<u>\$65k</u>	(development profit on completion)			
Margin %	18.6%	Investment Property (Capital value)		350	
		Existing resident loan obligation (Incoming)		(350)	
		(Balance sheet “gross up” required under accounting standards and excluded for gearing calculations)			
			<b>(65)</b>	<b>(285)</b>	<b>350</b>

(1) A recent change to AASB 140 Investment Property will require this item to be classified as Investment Property from 31 Dec 2009 onwards

# Phase 2 - First Leasing – DMF First recognised

## 2. First lease

- Point at which PV of DMF into perpetuity is first recognised
- Recognised when resident takes occupation of unit

Assumptions	Accounting Entry	P&L	BS	Cash
		Dr/(Cr)		
DMF into perpetuity recognised on new unit based on following valuation assumptions:	Investment Property (Fair Value of DMF asset)		70	
Growth rate 3.7%pa	Revaluation of investment property (Fair Value movement of DMF contracts) – Profit on creation of DMF	(70)		
Discount rate 12.55%				
Turnover rate 12 yrs				
DMF % 32.5% <sup>(1)</sup>				
NPV of DMF \$70k				
<i>Refer Appendix for calculation</i>				
		<b>(70)</b>	<b>70</b>	<b>-</b>

(1) Represents typical contract structure of 3% DMF for each year of occupancy up to 30% max, plus 2.5% admin fee; simplifying assumption that all residents stay at least ten years

# Phase 3 - DMF Revaluation

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## 3. DMF revaluation

- DMF “earned” by Stockland during resident occupancy period
- DMF valued as a portfolio using discounted cashflows
- DMF value is periodically adjusted for the following events:
  - the passage of time, moving closer to turnover (+ve impact)
  - changes to list prices (+ve or –ve impact)
  - changes to valuation assumptions (+ve or –ve impact)
- Increase in the value of Investment Property (Capital value) and Existing Resident Loan Obligation (balance sheet “gross up”) flow through the P&L but are shown below the line and not in Underlying Profit

The next slide provides example accounting entries during the occupancy period at the individual unit level

- In practice, however, a portfolio valuation approach is applied which takes into account the abovementioned adjustment events

This may result in a net increase or decrease to the overall DMF value, and corresponds to the sum of circa 3500 individual unit level entries

## Phase 3 - DMF Revaluation

Assumptions	Accounting Entry	P&L	BS	Cash
		Dr/(Cr)		
Unit value increases by 3.7% pa for 12 years	Investment Property (Fair Value of DMF asset)		37	
Value after 12 years      \$541k	Revaluation of investment property (Fair Value movement of DMF contracts)	(37)		
Initial Value              \$350k				
Capital gain                \$191k				
DMF progressively revalued over the 12 years using same valuation assumptions to reach the NPV at the end of year 12	The following entries are the adjustment to the balance sheet "gross up":			
	Investment Property (Capital value)		191	
Growth rate                3.7%pa	Revaluation of Investment Property (Capital growth)	(191)		
Discount rate              12.55%				
Turnover rate              12 yrs				
DMF %                      32.5% <sup>(1)</sup>	Fair Value movement of existing resident loan obligation	191		
NPV of DMF Yr12          \$107k				
NPV of DMF Yr0            \$70k	Existing resident loan obligation		(191)	
DMF increase              \$37k				
<i>Refer Appendix for calculation</i>				
		<b>(37)</b>	<b>37</b>	<b>-</b>

(1) Represents typical contract structure of 3% DMF for each year of occupancy up to 30% max, plus 2.5% admin fee; simplifying assumption that all residents stay at least ten years

# Phase 4 - First and Subsequent Turnovers

## 4. Turnover

- Point at which DMF is collected from outgoing resident
- Loan arrangement with outgoing resident paid out and new loan arrangement entered into with incoming resident
- Income received by Stockland is secure given Stockland sets pricing, and is the agent for the 're-sale'

Assumptions	Accounting Entry	P&L	BS	Cash
		Dr/(Cr)		
Resident exits unit at end of 12 years and is entitled to original loan plus capital gain, being \$541k (\$350k @ 3.7%pa, 12 yrs)  Stockland collects DMF at 32.5% of exit value, being \$176k (10 yrs @ 3%pa DMF + 2.5% admin fee)  Net payment to outgoing resident therefore comes to \$365k (\$541k - \$176k)  New resident moves in at list price of \$541k	Existing resident loan obligation (outgoing)		541	
	Cash (to outgoing resident)			(541)
	Revaluation of Investment Property (Fair Value movement of DMF contracts)	(176)		
	Cash (DMF deducted from proceeds of 're-sale')			176
	Cash (from incoming resident)			541
Existing resident loan obligation (incoming)			(541)	
		<b>(176)</b>	<b>-</b>	<b>176</b>

# Phase 4 – Make good and refurbishment costs

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## Make Good

- As part of the resident agreement, each resident is required to ‘Make Good’ on their unit upon exit
- Make Good covers items such as carpet, curtains and any other damage
- These costs are deducted from the final payment made to the outgoing resident

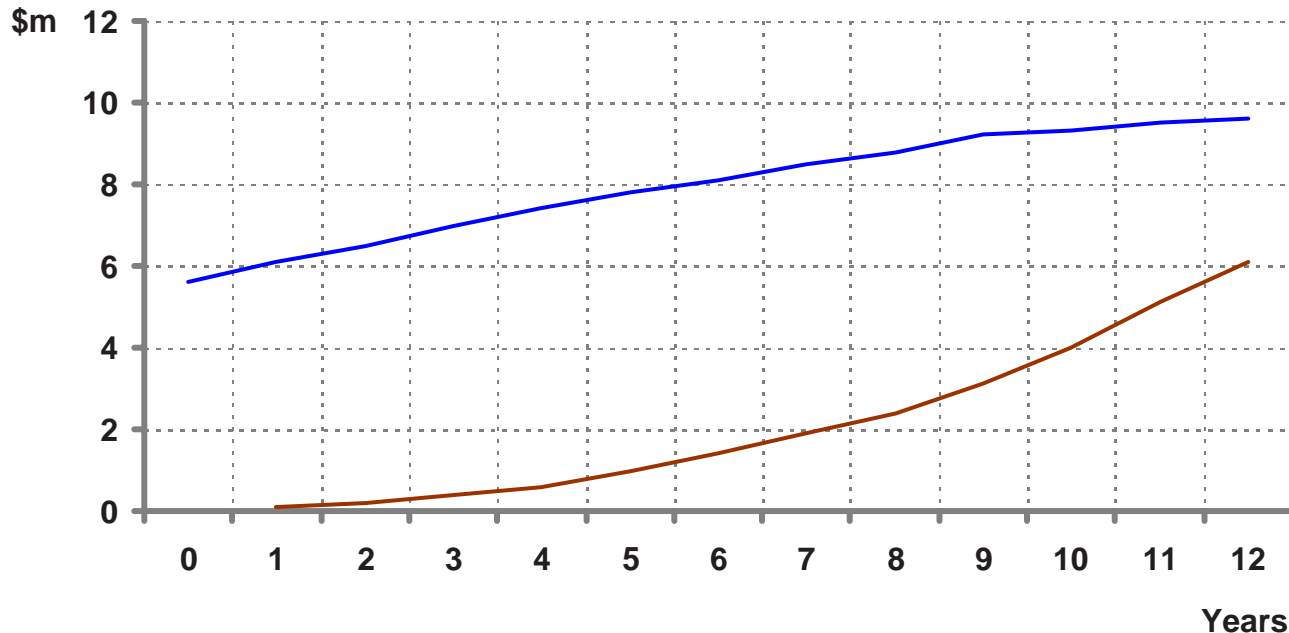
## Refurbishment

- In order to maintain individual unit values and the overall village standard, Stockland performs refurbishment of units as required
- Refurbishment typically includes items such as new kitchen and bathroom
- The refurbishment sustains and/or increases unit values which maintains/increases DMF returns
- Refurbishment costs are factored into the DMF valuation model assumptions and are therefore progressively provided for during the life of a village

# Cash moves closer to accounting profit over time

- As mentioned in Phase 3, the DMF is valued at a portfolio level using discounted cash flows
- Movements in the DMF value are recognised through the profit and loss statement and represent movements in relation to both the existing resident and future resident cashflows
- The cumulative cashflows over time move closer to the cumulative profits recognised as shown in the graph below but does not reach it due to the impact of the present value of future turnovers

**Single Village Example: Projected Cumulative Profit vs. Cash**



**Assumptions:**

- This graph is modeled assuming a new village reaching turnover maturity after twelve years
- 100 unit village with avg initial lease values of \$320k/unit
- DMF accrues at 3%pa up to max of 30% at 10 yrs; 2.5% admin fee
- Valuation assumptions used are assumed growth rate of 3.7% and discount rate of 12.55%
- Realised unit price changes have not been assumed in the valuation model

# Summary Profit Position - Phases 1 to 4

The following table summarises the underlying profit and statutory result during the four phases shown:

Profit & Loss Statement	Phase 1	Phase 2	Phase 3 <sup>(1)</sup>	Phase 4	Total
	Development	First lease	DMF Reval.	Turnover	
Dr/(Cr)					
Revaluation of Investment Property (development profit on completion)	-	(65)	-	-	(65)
Revaluation of Investment Property (FV movement of DMF contracts)	-	(70)	(37)	(176)	(283)
<b>Underlying profit</b>	-	<b>(135)</b>	<b>(37)</b>	<b>(176)</b>	<b>(348)</b>
Revaluation of Investment Property (Capital growth)	-	-	(191)	-	(191)
Fair Value movement of existing resident loan obligation	-	-	191	-	191
<b>Statutory profit</b>	-	<b>(135)</b>	<b>(37)</b>	<b>(176)</b>	<b>(348)</b>

- All profit movements associated with initial development and DMF are recognised as part of Underlying Profit
- Increase in the value of Investment Property (Capital value) and Existing Resident Loan Obligation (balance sheet “gross up”) are shown below the line and not in Underlying Profit



# Summary Balance Sheet Position – Phases 1 to 4

The following table summarises the balance sheet position at the end of each of the four phases shown:

Balance Sheet	Phase 1	Phase 2	Phase 3	Phase 4
	Development	First lease	DMF reval.	Turnover
	Dr/(Cr)			
Cash	(285)	65	65	241
Property, Plant & Equipment <sup>(1)</sup>	285	-	-	-
Investment Property (Fair value of deferred management fee contracts)	-	70	107	107
Investment Property (Capital value of operational retirement living communities)	-	350	541	541
<b>Total Assets</b>	-	<b>485</b>	<b>713</b>	<b>889</b>
Existing resident loan obligation	-	(350)	(541)	(541)
<b>Total Liabilities</b>	-	<b>(350)</b>	<b>(541)</b>	<b>(541)</b>
<b>Net Assets</b>	-	<b>135</b>	<b>172</b>	<b>348</b>
<b>Retained Earnings</b>				
Opening balance	-	-	(135)	(172)
Statutory Profit	-	(135)	(37)	(176)
<b>Closing balance</b>	-	<b>(135)</b>	<b>(172)</b>	<b>(348)</b>

(1) A recent change to AASB 140 Investment Property will require this item to be classified as Investment Property from 31 Dec 2009 onwards

# Recap – Stockland Retirement Living financial position at Jun-09

## Extract from Note 44 Stockland Annual Financial Report 2009

- Net Present Value of the future stream of DMFs (i.e. the value of the financial asset)

	Notes	Consolidated	
		2009 \$M	2008 \$M
Fair value of deferred management fee contracts		<b>282.8</b>	213.9
Capital value of operational retirement living communities		<b>951.5</b>	837.8
Total book value	19	<b>1,234.3</b>	1,051.7
Existing retirement living resident obligations	27	<b>(943.8)</b>	(830.1)
Net investment in operational retirement living communities		<b>290.5</b>	221.6

- Underlying value of the physical property
- Asset side of balance sheet “gross up”
- From 31 Dec 2009 onwards, villages under construction will be included as part of this balance

- Value of resident loans to Stockland
- Liability side of balance sheet “gross up”
- Difference to asset “gross up” relates to value of unoccupied units

***A recent change to AASB 140 Investment Property will result in changes to the above disclosure for 31 Dec 2009 onwards***

# Recap – Stockland Retirement Living financial position at Jun-09

## Extract from Note 44 Stockland Annual Financial Report 2009

• Increase in the value of the Investment Property (Capital value) balance sheet “gross up”

Comprises:  
• DMF creation \$6m  
• DMF revaluation \$33m  
• DMF receipts \$10m<sup>(1)</sup>

Comprises:  
• Development margin \$10m  
• Conversion profit \$12m<sup>(1)</sup>

• Increase in the value of the Existing Resident Loan Obligation balance sheet “gross up”

Notes	Consolidated		Company	
	2009 \$M	2008 \$M	2009 \$M	2008 \$M
The overall contribution of retirement living to the Income Statement comprises the following:				
Net gain from fair value adjustment of retirement living communities				
- Capital growth of operational retirement living communities	52.6	73.1	-	-
- Fair value movement of deferred management fee contracts	49.6	50.0	-	-
- Revaluation upon completion/redevelopment/contract conversion of retirement living communities	21.6	14.9	-	-
	123.8	138.0	-	-
Existing retirement living resident obligations fair value movement	(54.7)	(75.0)	-	-
Net fair value movement from operational retirement living communities	69.1	63.0	-	-

**A recent change to AASB 140 Investment Property will result in changes to the above disclosure for 31 Dec 2009 onwards**

(1) The sum of these amounts equates to DMF receipts of \$22m referred to in page 6

# Wrap up of key messages

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- ▶ Retirement Living is both a recurring and trading style business model producing two sources of income, which fits well with Stockland's overall portfolio strategy
- ▶ The trading element is development profit recognised on first leasing (Phase 2)
  - Profit and cashflow are closely matched at this stage, and could be equal depending on timing of construction
- ▶ The recurring element has two parts: initial DMF creation (Phase 2) and DMF revaluation (Phase 3)
  - The DMF cash collected from outgoing residents in Phase 4 approaches the progressive adjustment to the DMF value over time
- ▶ Cash approaches accounting profit over time
  - They would converge were it not for price increases

# Appendix

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# DMF NPV calculations

*Backup: Detailed NPV Calculation for the DMF*

## Phase 2 – First Leasing – DMF First recognised (NPV calculated at date resident occupies unit)

Year	0	12	24	36	Terminal value
Unit price increased by 3.7% p.a.	350	541	837	1,295	
DMF at 32.5%		176	272	421	396
PV at 12.55%		43	16	6	5
Total DMF NPV	70				

Calculation of Terminal Value:

- Step 1 - Annualise the DMF by taking \$421 DMF in Year 36 and divide by 12 years, given 12 year assumed occupancy period (=\$35)
- Step 2 - Calculate the value of the growing perpetuity based on this annualised figure:  $\$35 / (12.55\% - 3.7\%) = \$396$

## Phase 3 – DMF Revaluation (NPV calculated at date first resident exits unit being 12 years)

Year	0	12	24	36	Terminal Value
Unit price increased by 3.7% p.a.	541	837	1,295	2,002	
DMF at 32.5%		272	421	651	613
PV at 12.55%		66	25	9	7
Total DMF NPV	107				

Calculation of Terminal Value:

- Step 1 - Annualise the DMF by taking \$651 DMF in Year 36 and divide by 12 years, given 12 year assumed occupancy period (=\$54)
- Step 2 - Calculate the value of the growing perpetuity based on this annualised figure:  $\$54 / (12.55\% - 3.7\%) = \$613$

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