February 2017

Australian Healthcare Real Estate Investment Review

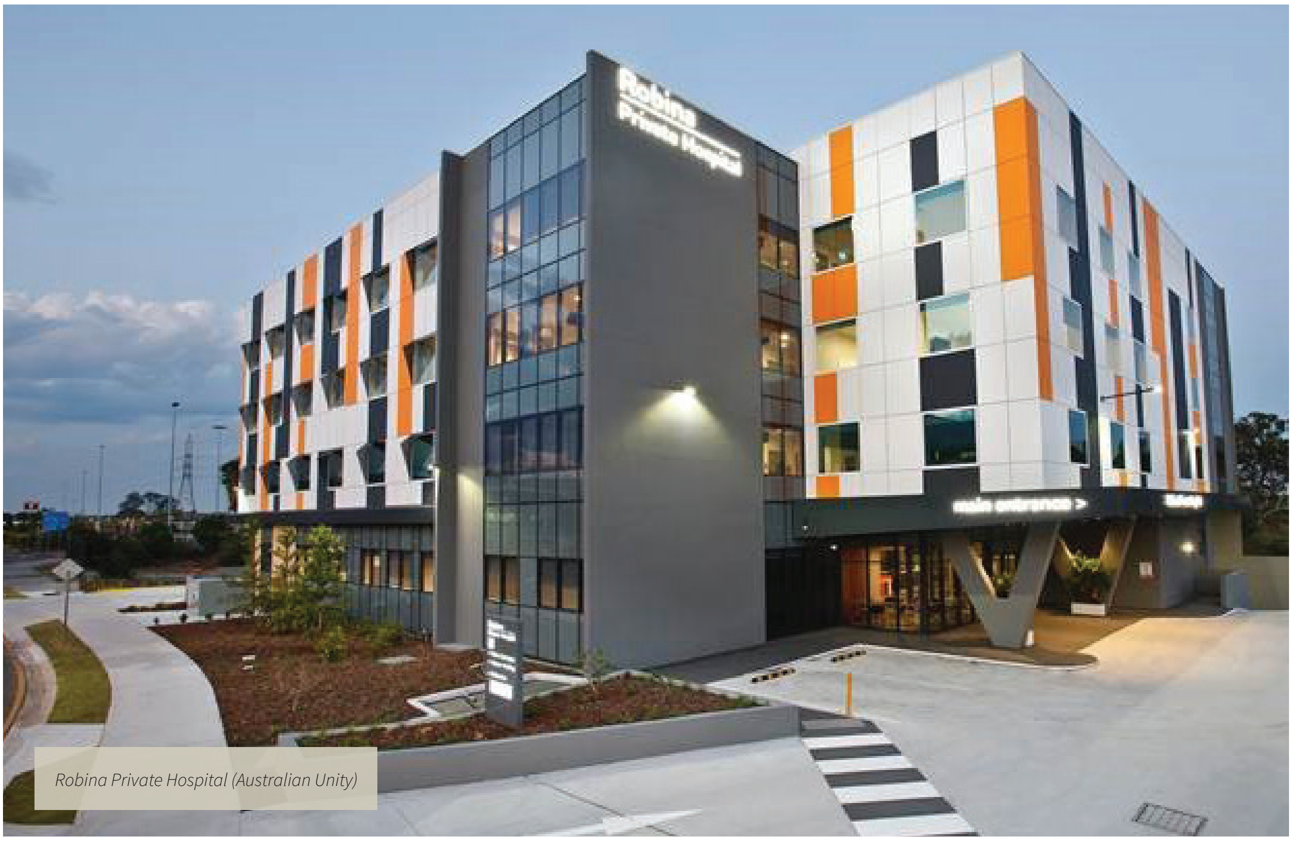
Market Review

The ageing of the Australian population and increased use of medical services by the general population are regarded as the main drivers of healthcare (both public and private) accounting for a progressively larger proportion of Australia's GDP.

However, the increase in expenditure has not been uniform across sectors, with expenditure on hospitals increasing at a faster rate than other areas of the healthcare sector (e.g. pharmaceuticals or primary care and medical services).

In response to this trend, the Federal Government has been attempting for some time to reduce the burden on the public sector by increasing the opportunities that exist for the public sector such as PPPs, operator agreements and the continued encouragement of private health insurance amongst others.

One of the key features of the private healthcare sector has been its low volatility relative to other sectors such as office, industrial and retail over the past decade. Each of these sectors were impacted strongly by the global financial crisis in 2008-09 however the healthcare sector continued to provide positive annual returns throughout this period. Annualised returns for the healthcare industry have consistently been above 10% since 2010. These strong returns combined with Australia's perception internationally as a safe haven, both politically and financially, has resulted in increasing interest from overseas investors. Given the heightened interest from offshore investors, competition for stock with local entities is high. However with limited opportunities for investment in the private hospital segment available, there has been greater attention on medical centres, particularly from specialist funds created to target this investment class.

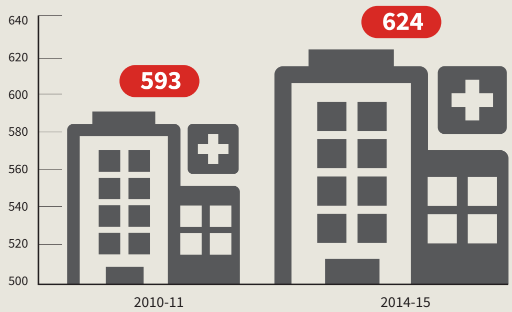


Robina Private Hospital (Australian Unity)

Market Drivers

Growth in Private Hospital demand has continued to outpace population growth, driven primarily by historical highs in private health insurance coverage and an ageing population.

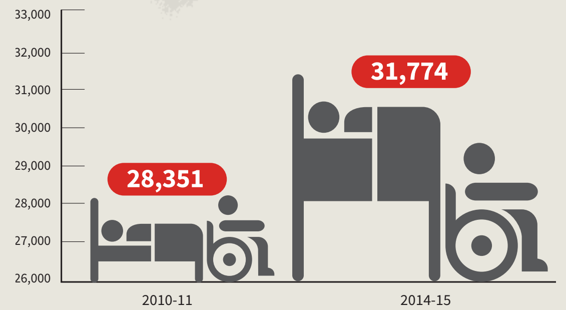
Number of Private Hospitals



Source: ABS (Cat. 4390.0)

Private Hospitals now account for 47% of all hospitals, up from 44% in 2011.

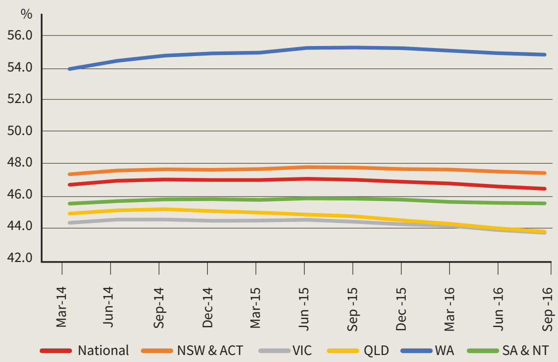
Number of Private Hospital Beds / Chairs



Source: ABS (Cat. 4390.0)

Private Hospitals provide 35% of all beds, an increase from 33% in 2011. The number of private hospital beds per 1,000 people has increased from 1.26 in 2011 to around 1.35 in 2015.

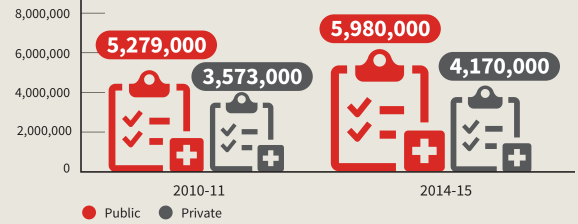
Australian Population Hospital Treatment Coverage (Private Health Insurance)



Source: APRA

The proportion of the population with Basic Hospital Treatment Coverage has edged down recently after reaching its highest point since 1988 in 2015. Western Australia continues to lead the nation in the proportion of the population covered.

Total Number of Separations, 2010-11 to 2014-15



Source: AIHW

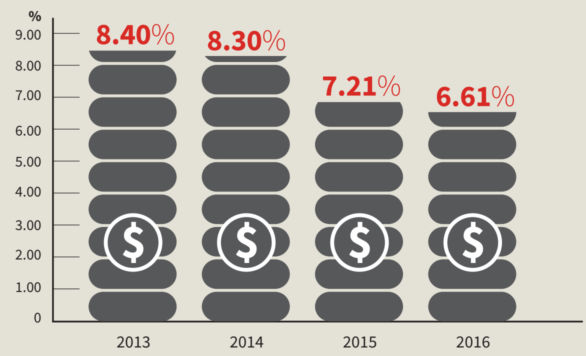
The total number of separations (i.e. number of completed treatments) has averaged growth of 3.5% per annum since 2011. The proportion of separations between public and private hospitals has remained relatively consistent at around 41%.

Market Performance

The year 2016 represented another strong year for healthcare related assets, represented by ongoing capital growth and tightening yields.

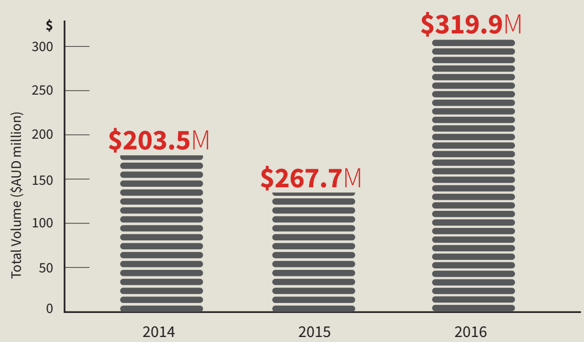
A major trend in healthcare sales has been the significant yield compression in the past four years. The graph below demonstrates the average yield based on sales (over $5 million) that occurred within each given year:

AVERAGE YIELD FOR HEALTHCARE SALES (OVER $5 MILLION)



Source: JLL

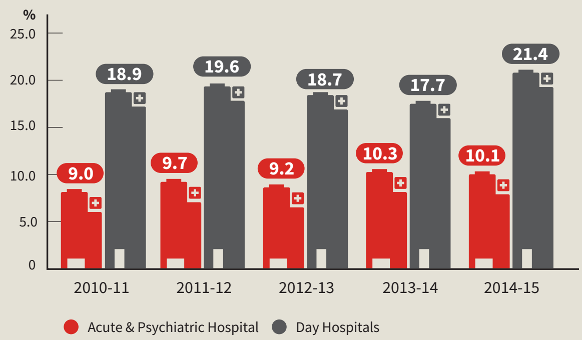
MAJOR AUSTRALIAN HEALTHCARE SALES VOLUME, 2014-2016



Source:JLL Social Infrastructure, 2016

PRIVATE HOSPITAL NET OPERATING MARGINS

The most recent data from the ABS indicates that net operating margins for hospitals were at their most recent highs in 2015, recording 10.1% for acute and psychiatric hospitals and 21.4% for day hospitals.



Source: ABS

Major healthcare real estate Transactions over $5 million (H2 2016)

Centre	Date 2016	Sale Price	Reported Yield %
Sneydes Road, Point Cook, VIC	December	$7.6m	6.57%
Dandenong Road, Clayton VIC	December	$20.5m	5.92%
Hall Street, Spotswood, VIC	December	$9.0m	6.10%
Mollison Street, Bendigo, VIC	November	$12.0m	6.58%
Park Terrace, Salisbury, SA	November	$11.4m	6.23%
GP Plus Health Care Centre, Elizabeth, SA	November	$42.0m	5.78%
Whitehorse Road, Balwyn, VIC	November	$8.0m	5.70%
Mons Road, Westmead, NSW	September	$30.8m	6.37%
Campus Alpha, Robina, QLD	July	$26.2m	7.70%

Source:JLL Social Infrastructure, 2016

Industry News

The second half of 2016 saw plenty of activity from the major players in market.

Ramsay Healthcare continued to grow its Australian portfolio in 2016 primarily through new developments and expansions. The company opened the Wollongong Private Hospital in early 2016 and completed major developments in Perth, southern Sydney, Cairns and Lake Macquarie. The company has also committed to expansions of its Northside Clinic in Sydney and its Albert Road Clinic in Melbourne. Most significantly is that it will open its new Southport Private Hospital on the Gold Coast in early 2017. Ramsay also announced in 2016 that it planned to expand beyond its core business and into pharmacies for the first time.

The major addition to publicly listed Healthscope's portfolio in 2016 was Gold Coast Private, a 284 bed hospital co-located with the Gold Coast University Hospital and Griffith University. Healthscope also completed several expansion projects in Melbourne and Canberra.

Since the acquisition of Healthe Care by Luye Medical Group from China in 2015 the company is pushing ahead with 10 expansion projects across its portfolio at cost of $300 million.

Barwon Investment Partners launched a $500 million healthcare property fund (called the Institutional Healthcare Property Fund) for wholesale investors. The fund will have an initial term of seven years and concentrate on large medical centres, day surgeries, private hospitals, pathology labs and allied health facilities.

Generation Healthcare REIT continued to expand and extend its portfolio in 2016. The two most notable development projects that are progressing are the second stage of the Casey Private Hospital and the Frankston Private Hospital expansion, both located in Melbourne's south-east. Also of particular note was the sale of its management rights to Canada's Northwest Healthcare Properties REIT in a deal worth around $120 million.

Following a $160 million equity raising in July, New Zealand's Vital Healthcare Property Trust has continued its growth in the Australian market with several acquisitions including a medical centre in Westmead for $30.7 million and a majority interest in a medical centre in Box Hill. The Westmead medical centre was purchased off Heathley at an initial yield of 6.7%.

Australian Unity was awarded the rights to Brisbane's Herston Quarter, a project valued at up to $1.1 billion. Australian Unity plans to develop and take an ongoing role in the health and aged care components thereafter. The master plan includes a private hospital, a public rehabilitation hospital, health research retirement living, student accommodation and education and training facilities. In July, the Australian Unity Healthcare Property Trust purchased two adjacent medical properties in Robina for $30.0 million which follows its recently completed expansion of the Robina Private Hospital. Other notable acquisitions in 2016 include two Sonic tenanted assets for $81 million and Butterfield Street Herston for $81.4 million.

Dexus Property Group has also entered the healthcare market with the forthcoming development of a 128 bed hospital in Sydney's St Leonards and the acquisition of the GP Plus Healthcare Centre in the Adelaide suburb of Elizabeth for $42 million. Ramsay Health Care will operate the St Leonards hospital on a rental basis.

The NSW government announced that the Maitland, Wyong, Bowral, Goulburn and Shellharbour hospitals would be redeveloped under a public-private deal whereby private companies would be invited to submit tenders to build and run the hospitals whilst patients would continue to receive free care. This follows the planned completion of the new hospital on the Northern Beaches scheduled to open in 2018 and operated by Healthscope.

Stockland will partner with Primary Health Care to build a medical centre in its Highlands master planned community in Craigieburn, Melbourne. The medical centre (proposed to be 1,500 sqm) is the first that Stockland plans to provide amongst its larger master planned communities is response to Australia's ageing population.

In December the Productivity Commission released a discussion paper that identified that the performance of public hospitals could be improved by injecting greater competition possibly in the form of some type of privatisation for particular services. However, the Commission did note the difficulties from past attempts to commission non-government providers as a cautionary. The Commission will work on recommendations for reforms of the public hospital sector which is due for completion in October 2017.

Market Outlook

The hospital and medical market is more resilient to global economic risks than most other asset classes, evidenced by its performance after the global financial crisis whereby it largely continued its long-run growth trend. Nonetheless, there are still a number of concerns going forward in the industry such as possible ongoing changes to the Commonwealth Government's Private Health Insurance Rebate and pressure on operating costs and margins.

The previous 24 months has seen demand for quality assets in the medical and private hospital sector at an all-time high which combined with a lack of supply on the market, has resulted in significant yield compression. JLL's analysis of transactions has excluded the Australian Unity Herston acquisition due to it not being specialised medical. The Epping Specialist Medical Centre has also been excluded due to it not being a direct asset sale.

JLL's view is that we will continue to see some tightening of yields in the healthcare market in 2017 and we classify the sector to be in a peak of its current cycle.

Outlook for 2017:

- Some moderate tightening of yields as the current cycle of monetary easing (i.e. interest rate cuts) appears to be close to its limits. Yields for sub-prime in the 6% to 7.5% range should remain the norm, with prime being in the 5%-6.5% range.
- Ongoing interest from international investors in new assets, particularly in non-traditional markets such as regional locations.
- Offshore interest expected to remain strong based on the attractiveness and affordability of the Australian market whilst the Australian Dollar remains around current levels.
- Smaller medical funds and REITs attracting greater investment levels enabling them to compete for higher valued assets.
- New announcements of partnerships between governments and private hospital operators as government seek to structure alternative healthcare delivery models.
- Current AREITs will continue to search the market to further grow their portfolios to meet retail investor sector appetite.
- Seniors living facilities begin to shoulder more acute levels of medical service which have traditionally been performed in hospitals.

55 Little Edward Street Spring Hill QLD (Generation Healthcare REIT)


Belmont Private Hospital (Vital Healthcare Property Trust)

Social Infrastructure Team

Services Provided

Advisory	Transactions
Valuations Financial reporting, mortgage purposes, acquisition and sale purposes	**Sales and Leasing** Individual sales and asset portfolios to maximise income and asset value, sourcing managers, leasing assets or portfolios
Strategic Consulting Highest and best-use assessments, strategic reviews of portfolios individual assets and exit strategies	**Transaction Support Services** Developing acquisitions and divestment strategies, preparing information memoranda, sales and marketing budgets. Conducting EOI campaigns, aligning vendor's and purchaser's needs
Market Studies Competition, demographic and catchments area analysis and supply and demand analysis	**Transactions Advisory** Our integrated firm-wide service offerings include capital markets, financial structuring, project and development services and asset management
Industry Research Specialist and tailored research across the various social infrastructure markets	**Strategic Partnership** Introduction of operator, equity investor and joint venture partners
Development Feasibilites Ascertain the financial viability of a project or test development scenarios	
Due Diligence Financial and property due diligence for both vendors and purchasers	

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