

# Vital

Healthcare  
Property Trust

## NOTICE OF ANNUAL MEETING 2018

**The 2018 Annual Meeting of unitholders of Vital Healthcare Property Trust will be held at Ellerslie Event Centre, 80 Ascot Ave, Auckland on Thursday 20 December 2018 commencing at 2.00pm**

**30 November 2018**

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This is an important document and requires your immediate attention. Please read it carefully.

If you are in doubt as to anything contained in this document, you should consult a person authorised to undertake trading activities by NZX or a financial or legal adviser.

This notice of meeting is dated 30 November 2018 and has been prepared by NorthWest Healthcare Properties Management Limited (the **Manager**) as manager of Vital Healthcare Property Trust.

The information in this Notice of Meeting and any discussion at the meeting are general information only and are not intended as investment or financial advice and must not be relied upon as such. You should obtain independent professional advice prior to making any decision relating to your investment or financial needs.

[www.vhpt.co.nz](http://www.vhpt.co.nz)

# Letter from the Chair of the Manager

Dear unitholders,

This notice of meeting convenes the 2018 annual meeting of unitholders of the Vital Healthcare Property Trust (**Vital**). We look forward to seeing you at 2.00pm on 20 December 2018 at the Ellerslie Event Centre.

## Graham Stuart's appointment

It will be the first annual meeting for Graham Stuart, who joined the board of the Manager earlier this month as an Independent Director, following an extensive and thorough recruitment process from which he emerged as the outstanding candidate. Graham is an experienced corporate director with an established track record of performance in governance and in prior executive roles and is standing for re-election at the annual meeting. Importantly, he has public markets experience and the requisite skills to assume the important role of acting as chair of our audit committee. We are very pleased to welcome Graham to the board and are confident that he will play an important role in our drive to maintain a high level of performance in the future.

In addition, Paul Mead has been nominated by three unitholders and is standing for election as an independent director. Biographical details for Mr Stuart and Mr Mead are set out below. As there is only one vacant seat, the candidate with the most votes will be appointed.

<b>The Board unanimously recommends that unitholders vote in favour of Graham Stuart.</b>
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## Matters raised by unitholders for non-binding resolution

In addition to the business usually conducted at an annual meeting, the annual meeting will consider five separate matters which have been jointly raised for resolution by three unitholders (the **Proposals**). Our Trust Deed makes it clear<sup>1</sup> that these Proposals would not be binding on any of the parties directly involved in the governance of Vital (including the Manager, the Board or the Supervisor), even if approved at the annual meeting. The nature of the matters raised in the Proposals cannot be determined by a unitholder vote, they require the agreement of others, and this can only be achieved through reasoned commercial dialogue.

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<sup>1</sup> Clause 16 of Schedule 1 of the Trust Deed allows unitholders to provide notice of matters that they want to raise for resolution at an upcoming unitholder meeting, but states that they will be non-binding.

<b>THE BOARD UNANIMOUSLY RECOMMENDS THAT UNITHOLDERS VOTE <u>AGAINST</u> THE NON-BINDING PROPOSALS</b>
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## **We have substantively addressed the matters raised in the Proposals**

During the course of 2018, we have engaged in good faith on multiple occasions to address the concerns raised by the Proposing Unitholders. We have made a number of amendments to our core governance documents as a result of those discussions, as announced as part of Vital's August 2018 results.

Further, on 23 November 2018, we announced that we will:

- undertake a board-led review of management fees in the first quarter of calendar 2019; and
- suspend the ability to exercise certain rights for the duration of the fee review, including rights relating to the removal of independent directors and rights to increase the management fee<sup>2</sup>.

The fee review will take account of all relevant context, including the broader governance, management, strategic and operational requirements of Vital going forward. The fee review will be led by the full board, with input to be sought from a range of unitholders. The Proposing Unitholders have sought to dictate the terms of our fee review, including proposing terms that go well beyond what a reasonable board would accept. Substantively, we are going to review our fees and my fellow independent directors and I will have a significant role in that review, including obtaining input from unitholders.

The Board believes that it has responded to the issues arising from our engagement with the Proposing Unitholders throughout the year. We are disappointed that the Proposing Unitholders, who collectively hold less than 10% of the units in Vital<sup>3</sup> and have given no indication of support from other unitholders, have chosen to proceed with the Proposals in light of these responses.

In our view, the Proposals:

- fail to understand our governance structure; and
- are misleading by suggesting that they will result in change.

Further, our engagement with these Proposing Unitholders throughout the year, now coupled with these Proposals, have significantly diverted the time and

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<sup>2</sup> This assurance has been provided until 31 March 2019, assuming no material change in circumstances.

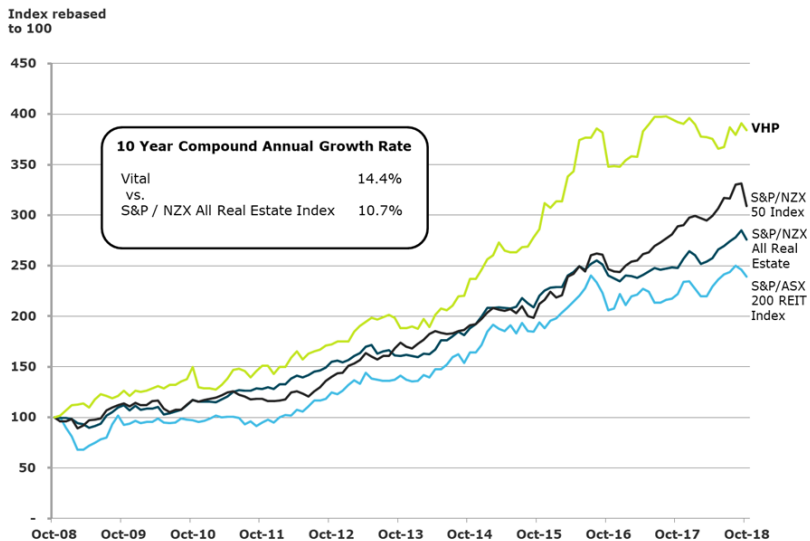
<sup>3</sup> Based on information available as at the date of this Notice of Meeting.

resources of the Board and senior management team away from running the core activities of managing the Vital Healthcare Property Trust on behalf of all unitholders.

## Changes can only be achieved through commercial dialogue

The commercial and contractual relationship between the Manager, Supervisor and unitholders is set out in our Trust Deed<sup>4</sup>. That document has evolved over 20 years as a result of balanced commercial discussions, acknowledging that any changes need to be agreeable to the different parties, acting reasonably. The matters raised cannot be addressed through unilateral action by the Proposing Unitholders (or unitholders generally), and can only be addressed through balanced commercial discussions where the parties' existing rights are respected.

Our existing structure has delivered strong long term total returns, which have benefited all unitholders, as shown in the chart below.



<sup>4</sup> In particular, see clauses 3.3 (Appointment of manager); 12.1 (Manager's power to invest); 22 (Remuneration of Manager); 23 (Removal and Retirement of Manager) and 27 (Manager's Powers, Duties and Covenants).

The table below tracks our 5 and 10 year total returns against other New Zealand listed property entities – showing that our structure, governance and fees have in no way impeded total returns to investors.

#### **NZ Listed Property Stocks - Total Shareholder Return**

	<b>5Yr</b>	<b>10Yr</b>
<b>Vital Healthcare</b>	<b>104.1%</b>	<b>284.3%</b>
Argosy Property	54.9%	262.3%
Goodman Property	90.3%	177.2%
Kiwi Property	55.6%	130.6%
Precinct Properties	80.0%	156.3%
Property For Industry	68.4%	181.6%
<hr/>		
<i>S&amp;P/NZX All Real Estate Index</i>	<i>71.8%</i>	<i>175.9%</i>
<i>S&amp;P/NZX 50 Index</i>	<i>77.7%</i>	<i>209.2%</i>

Source: Bloomberg, Craigs Investment Partners

## **Externally managed trust fund structures are common**

The Proposals largely focus on Vital's structure as an externally managed trust fund, which has not changed since it was established.

Vital is an investment entity. It provides investors with exposure to a portfolio of assets within the healthcare real estate sector. Those assets are managed by an external management company that is paid a fee. An externally managed trust fund is an appropriate, valid and common business structure for a business like ours. Indeed, two of the Proposing Unitholders themselves operate externally managed funds. Vital being NZX listed provides our unitholders with liquidity to buy and sell units, and imposes a level of regulation and oversight that other externally managed funds are not subject to. An NZX listing is not inconsistent with an externally managed trust fund structure in the way implied by these Proposals.

This is not the first time that our structure has been discussed at an annual meeting. One of the Proposing Unitholders proposed a resolution objecting to our structure in 2011. That resolution was voted down by a significant majority, although by that time that unitholder had largely sold out of its Vital stake. In the meantime, it has rebuilt its investment in Vital, although at no point has our structure changed.

## **Fees under review. Analogous to Proposing Unitholder fees.**

The non-binding Proposals imply that Vital's fees are not in-line with market practice. Our fee level and structure will be considered as part of the fee review.

We note that a number of the externally managed trust funds operated by the Proposing Unitholders pay fees that are broadly analogous to Vital's fees.

## **Conclusion**

The details of the non-binding Proposals are set out in the balance of this Notice of Meeting, including a response from the Board in respect of each Proposal. A statement prepared by the Proposing Unitholders is set out in the Schedule.

For all of the reasons set out above, the Board recommends that unitholders vote AGAINST each of the non-binding Proposals. The Board members intend to vote any units they hold or control, including any undirected proxies, against each of the Proposals.

We look forward to discussing these matters with you at our upcoming annual meeting.

Kind regards,

A handwritten signature in black ink, appearing to read 'C. Higgins', with a stylized flourish at the end.

**Claire Higgins**  
**Independent Chair**  
**NorthWest Healthcare Properties Management Limited**

# NOTICE OF MEETING

Notice is hereby given that the 2018 annual meeting of Vital Healthcare Property Trust unitholders will be held at Ellerslie Event Centre, 80 Ascot Ave, Auckland on Thursday, 20 December 2018 commencing at 2.00pm.

## Agenda

Chair of the Manager and Chief Executive Officer presentations.

### Annual Financial Statements

The annual financial statements of Vital for the year ended 30 June 2018 will be tabled at the meeting.

### Resolution – Election of independent director (one of two candidates)

To consider and vote to approve:

Either: *That Graham Stuart, who was appointed by the Board and stands for re-election, be re-elected as an Independent Director of the Manager*

Or: *That Paul Mead, who has been nominated by three unitholders, be elected as an Independent Director of the Manager.*

The biographical details of Graham Stuart and Paul Mead are set out in the Explanatory Notes.

### Non-binding Proposals

To consider the following non-binding resolutions which have been raised by certain unitholders:

1. *For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 30.11 of the Trust Deed which provides that the Shareholder of the Manager can unilaterally remove Independent Directors and can unilaterally remove the right for Unitholders to nominate and vote on Independent Directors.*
2. *For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 22.5 of the Trust Deed which provides that the Manager can unilaterally alter*



*the amount of the Manager's fee.*

3. *That Unitholders request that [the] Manager negotiate in good faith with Unitholders to bring fees currently charged by the Manager in line with current market levels and improve the alignment of interests between the Manager and Unitholders.*
4. *That Unitholders request that Manager increase the size of the Board to 6, with a minimum of 4 Independent Directors and a minimum of 2 Independent Directors being elected by Unitholders.*
5. *The Unitholders request that the Manager amend all policies and procedures, including the Conflicts of Interest Policy and the Board Charter, to reflect resolutions 1, 2 and 4, and to ensure that the primary duty of the Board of the Manager is to Unitholders.*

By Order of the Manager

A handwritten signature in black ink, appearing to read 'C Higgins', written over a circular stamp or seal.

**Claire Higgins**  
**Independent Chair**  
**NorthWest Healthcare Properties Management Limited**

Dated 30 November 2018

**VITAL HEALTHCARE PROPERTY TRUST**  
**NOTICE OF ANNUAL MEETING 2018**

# EXPLANATORY NOTES

## Election of Independent Director

The Trust Deed provides that, so long as the shareholder of the Manager agrees, unitholders are entitled to vote on the appointment of an independent director of the Manager.

This year there are two candidates standing to be appointed as an independent director of the Manager. Brief details of the candidates, Graham Stuart and Paul Mead, appear below.

Pursuant to the Trust Deed, the nominee who receives the most votes from unitholders will be appointed by the shareholder of the Manager.

Graham Stuart was appointed as an Independent Director by the Board and stands for re-election by unitholders. Mr Stuart's appointment follows a comprehensive search process led by the Independent Chair, Claire Higgins, and with advice and assistance from international search and recruitment firm Heidrick & Struggles.

**The Board unanimously recommends the re-appointment of Graham Stuart as an independent director.**

Accordingly, if the Chair of the meeting, or any other Director, is appointed to act as proxy and is not directed on how to vote, they will cast the proxy votes in favour of the appointment of Mr Stuart.

Voting will be conducted by way of a poll. A unitholder may only vote for one of the nominees.

If you are attending the meeting and voting in more than one capacity (e.g. also as proxy, attorney or representative for one or more other unitholders) you must fill out separate voting papers in respect of each capacity in which you vote.

The following profiles have been provided by each nominee:

### Biographical notes – Graham Stuart

Graham is an experienced director, based in Auckland. His current

directorships include Independent Chair of NZX listed technology company EROAD Limited and Independent Director of Tower Limited.

Graham has over 30 years' experience in senior executive and governance roles in New Zealand and internationally. These include the Sealord Group of which he was Chief Executive Officer for seven years. Prior to that, he was Chief Financial Officer and Director of Strategy for the Fonterra Co-operative Group, Managing Director of Lion Nathan International and CEO of Mainland Products.

Graham holds a Bachelor of Commerce (First Class Hons) from the University of Otago and a Master of Science from Massachusetts Institute of Technology, and is a Fellow of the Chartered Accountants Australia and New Zealand.

The Board has determined that Graham Stuart is an independent director for the purposes of the NZX Listing Rules.

## Biographical notes – in respect of Paul Mead

The following has been supplied by the Proposing Unitholders as the biographical notes for Mr Mead, which have not been verified by the Manager.

*Paul Mead is an experienced and well regarded Director and businessman. He has both senior corporate and Board level experience from a career both abroad and in New Zealand. He is experienced in property, banking and finance and holds an undergraduate degree in Property from the University of Auckland and an MSc in Investment Management from Cass Business School in London.*

*Paul currently holds a number of positions. He is a shareholder and Director of Tangible Ltd – a bespoke investment business that arranges and manages the syndicated ownership of commercial vineyards in NZ. He is an independent director of Simply Group Ltd – an NZ energy solutions business handling embedded networks, utility billing, and wholesale electricity market operations for a range of NZ businesses. He is also a Director and minority shareholder in Nextminute Ltd – a NZ software company offering job management software to NZ trade businesses such as Placemakers. He has also been an investor in NZ-based private equity transactions.*

*Paul has experience in the NZ property sector from early in*

*his career when he held positions with both Jones Lang LaSalle and Bayleys, and more recently in an advisory capacity for a NZ commercial wine company. His banking, finance and transaction experience comes from 17 years working abroad, primarily in London where he held executive positions for Citibank and Barclays Capital, where he specialised in Trading and Risk Management in Commodity markets.*

*Paul's track record offers experience in derivatives, insolvency workouts, capital raising, risk management, credit management, transactional operations and business development.*

*Paul is a NZ citizen, is married with three children and is currently Auckland based.*

# EXPLANATORY NOTES

## Board's view on Proposals

The Board's detailed response to each of the Proposals raised by the Proposing Unitholders<sup>5</sup> is set out below.

### Proposal 1

*For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 30.11 of the Trust Deed which provides that the Shareholder of the Manager can unilaterally remove Independent Directors and can unilaterally remove the right for Unitholders to nominate and vote on Independent Directors.*

#### Board response:

**The Board unanimously recommends that unitholders vote AGAINST Proposal 1.**

This non-binding Proposal inaccurately suggests that, if it is approved, it will result in Vital's Trust Deed being amended. This is not legally correct. The Trust Deed can only be amended by agreement between the Supervisor and the Manager. The FMCA provision referred to above permits the Supervisor to agree to amendments to the Trust Deed if approved by unitholders, but this Proposal ignores the fact that the Manager's agreement is also required.

The Manager is a wholly-owned subsidiary of the NorthWest group and, as a result, the right to appoint and remove directors to the Manager's board would normally vest solely with NorthWest. However, acknowledging the important role that Independent Directors play, the Vital Trust Deed allows unitholders to appoint and

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<sup>5</sup> The three Proposing Unitholders are Accident Compensation Corporation, ANZ New Zealand Investments Limited and Mint Asset Management Limited.

remove two Independent Directors to the Manager's board.

However, it has always been the case since this right was added in 2007, that the shareholder of the Manager retains the ability to take back its right to appoint and remove Independent Directors, meaning that clause 30 would cease to have any effect. NorthWest has not exercised this right. We consider that this represents a practical and fair balance between the respective interests of NorthWest and the other unitholders.

On 23 November 2018, NorthWest announced it would not exercise its rights under clause 30.11 regarding the appointment of independent directors so as to preserve the status quo and allow a board-led fee review to take place. The assurances in that announcement were provided until 31 March 2019, assuming no material change in circumstances.

## Proposal 2

*For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 22.5 of the Trust Deed which provides that the Manager can unilaterally alter the amount of the Manager's fee.*

### Board response:

<b>The Board unanimously recommends that unitholders vote AGAINST Proposal 2.</b>
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Like Unitholder Proposal 1, this non-binding Unitholder Proposal inaccurately suggests that, if it is approved, it will result in Vital's Trust Deed being amended. This is not legally correct.

The Board is focused on completing the review of the management fee in the first quarter of calendar 2019, as announced on 23 November 2018. The Manager announced it would not exercise its rights under clause 22.5 of the Trust Deed to proportionately increase its fees to allow the fee review to take place.

The fee structure in the Trust Deed has not changed since it was established in 1994. This structure has been fully disclosed and investors have had the opportunity to understand Vital's fee structure before choosing to invest.

The Manager's right to alter its fee under clause 22.5 of the Trust Deed is always subject to the overall cap of 1.75% per annum of the

gross value of the Vital trust fund. The Manager has never exercised this right.

## Proposal 3

*That Unitholders request that [the] Manager negotiate in good faith with Unitholders to bring fees currently charged by the Manager in line with current market levels and improve the alignment of interests between the Manager and Unitholders.*

### Board response:

<b>The Board unanimously recommends that unitholders vote AGAINST Proposal 3.</b>
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The Board is focused on completing the review of the management fee in the first quarter of calendar 2019, as announced on 23 November 2018.

The Proposing Unitholders have sought to dictate the terms of the Board's fee review, including proposing terms that go well beyond what a reasonable board would accept. Substantively, as announced, the Board will review the Manager's fees and the independent directors will have a significant role in that review, including obtaining input from unitholders.

As noted above in respect of Proposal 2, Vital's fee structure has not changed for more than 20 years. The fee structure has always been publicly available and is regularly disclosed to the market. Investors (including the Proposing Unitholders) have had the opportunity to understand Vital's fee structure in making their decision to invest in Vital units.

Actively managing a fund comprising Vital's portfolio of high quality healthcare real estate assets across New Zealand and Australia is complex and requires significant specialised management skills and experience, which have over the long term delivered exceptional returns to unitholders. Vital does not have a comparable NZX listed, externally managed Real Estate Investment peer managing such a geographically diverse range of highly specialised acute healthcare assets. As a result, it is misleading to refer to "current market levels" by applying a simple comparison of fee levels across externally managed funds.

Having said that, the Board notes that its fees are at a broadly

analogous level to other actively managed funds in the New Zealand market, including some operated by two of the Proposing Unitholders.

The shareholder of the Manager, NorthWest, is Vital's single largest unitholder. NorthWest holds just under 25% of the total units on issue. This creates a significant alignment of interests between the Manager and unitholders.

## Proposal 4

*That Unitholders request that Manager increase the size of the Board to 6, with a minimum of 4 Independent Directors and a minimum of 2 Independent Directors being elected by Unitholders.*

### Board response:

<b>The Board unanimously recommends that unitholders vote AGAINST Proposal 4.</b>
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Vital's board composition fully complies with all applicable regulatory requirements and guidance.

The board composition anticipated by this non-binding Proposal goes beyond anything required by corporate governance recommendations or requirements, whether in the NZX Listing Rules, the FMCA or Vital's Trust Deed.

Vital's long term model is to have a board of five directors, of whom three are Independent Directors, with two of those being elected by Unitholders. We will return to that composition given the appointment of Graham Stuart on 12 November 2018 and the departure of David Carr, who will step down from his interim role as Executive Director.

This long term model has a majority (by one) of independent directors, which is consistent with the practice of a number of other NZX listed externally managed entities.

In many cases, boards of the managers of externally managed funds in New Zealand are entirely appointed by the shareholder of the manager. It is relatively unusual for investors to have any input into board composition in the way Vital unitholders do, and there are often no independent directors.

For example, two of the Proposing Unitholders themselves operate externally managed funds, neither of which allow investors any say in who sits on the board of the manager and in neither case is there a



majority of independent directors (in one case there are no independent directors).

## Proposal 5

*The Unitholders request that the Manager amend all policies and procedures, including the Conflicts of Interest Policy and the Board Charter, to reflect resolutions 1, 2 and 4, and to ensure that the primary duty of the Board of the Manager is to Unitholders.*

### Board response:

<b>The Board unanimously recommends that unitholders vote AGAINST Proposal 5.</b>
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This non-binding Proposal inaccurately suggests that there is an ability, through the Vital Trust Deed, to change fiduciary duties that the directors owe to the Manager under the Companies Act 1993. The provisions of the Companies Act 1993 and the FMCA are quite clear, and are unable to be changed through action by any party in Vital's governance. They provide that:

- the directors of the Manager owe duties to the Manager (under the Companies Act); and
- in turn, the Manager owes duties to unitholders (under the FMCA).

No change can be made to the corporate documents referred to in this Unitholder Proposal that will alter this position.

Implementing this Proposal would be inconsistent with New Zealand law. The FMCA includes a comprehensive and robust regulatory regime relating to the governance of externally managed trust funds like Vital. That regime does not require the directors of the Manager to attempt to absolve themselves from the duties that they owe the Manager under the Companies Act, which they clearly cannot do.

For the Proposing Unitholders to raise this Proposal reinforces their apparent lack of understanding of the New Zealand regulatory framework that applies to entities like Vital.

# PROCEDURAL NOTES

## Attendance and voting rights

1. Every unitholder, or that unitholder's proxy or representative, is entitled to attend the meeting and vote. On a poll, each unitholder has one vote for each unit.
2. If you are attending the meeting and voting in more than one capacity (e.g. also as proxy, attorney or representative for one or more other unitholders), you must fill out separate voting papers in respect of each capacity in which you vote.

## Approval required – Director appointment

3. The Resolution relating to the appointment of an Independent Director is proposed under clause 30 of the Trust Deed. Because both Graham Stuart and Paul Mead are eligible and seeking election as an Independent Director, but only one may be elected, the candidate who receives the greatest number of votes in favour at the meeting will be elected.

## Proxies and board recommendation

4. A unitholder entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote instead of that unitholder. A proxy need not be a unitholder. A unitholder may appoint the Chair of the meeting, or another person, to act as proxy. A proxy form is enclosed.
5. **The Board supports the re-appointment of Graham Stuart as independent director.** Accordingly, if the Chair of the meeting, or any other Director, is appointed to act as proxy and is not directed on how to vote, they will cast the proxy votes in favour of the appointment of Graham Stuart.

6. **The Board does not support the Proposals raised by the Proposing Unitholders.** Accordingly, if the Chair of the meeting, or any other Director, is appointed to act as proxy and is not directed on how to vote, they will cast the proxy votes against each of the Proposals.
7. **The Proposals are non-binding.** They will have no legal effect, even if passed by unitholders.
8. A unitholder wishing to appoint a proxy should complete the enclosed proxy form. All joint holders must sign the proxy form.
9. A proxy granted by a company must be signed by a duly authorised officer or attorney who is acting under the company's express or implied authority.
10. If the proxy is signed under a power of attorney or other authority, that power of attorney or other authority or a copy of such power of attorney or authority certified by a Notary Public or in such manner as the Manager shall approve (unless previously provided to the Trust) and a completed certificate of non-revocation, must accompany the proxy form.
11. Completed proxy forms must be received by the Registrar, Computershare Investor Services Limited at either Level 2, 159 Hurstmere Road, Takapuna, Auckland or Private Bag 92119, Auckland 1142 or via email at [corporateactions@computershare.co.nz](mailto:corporateactions@computershare.co.nz) or via facsimile +64 9 488 8787, by no later than 2.00pm on Tuesday, 18 December 2018 (being 48 hours before the meeting).

## **SCHEDULE**

### **FURTHER EXPLANATORY MATERIALS**

The following explanation of reasons for the Proposals has been provided by the Proposing Unitholders. The Manager takes no responsibility for its content.

# Explanatory notes for resolutions

## Context

The proposers of the Resolutions, jointly representing 10.0% of the units on issue, have material concerns about the governance and fee structure of Vital Healthcare Property Trust (VHP). The governance concerns relate both generally to the unit trust structure and, more importantly, to some of the specific governance features of VHP.

We have been in constructive discussions with the Board of VHP's Manager over recent months and, while some improvements have been made, material weaknesses remain.

### VHP's structure inadequately protects Unitholders' interests

VHP is different from almost all other New Zealand listed operating businesses<sup>6</sup>— its legal structure is a unit trust. The key feature of a unit trust is the appointment of a Manager by the Supervisor to effectively run the business (for which the Manager receives a fee), with the powers and functions of the Manager and the Supervisor governed by both the Trust Deed and the Financial Markets Conduct Act 2013 (FMCA).

In its current structure, VHP operates with the board of the Manager as its governing body. The Manager is itself a company and the duty of its directors is to act in the best interests of *that company*. The Manager's duty under the FMCA is to act in the interests of Unitholders in the exercise of its powers and performance of its duties.

The structural weaknesses of unit trusts are evident in recent trends for listed unit trusts to convert to companies (e.g. Kiwi Property Group Ltd and Precinct Properties Ltd) or be subject to material strengthening of the rights of Unitholders (e.g. Goodman Property Trust).

If VHP were instead to operate as a company under the Companies Act 1993, it would have a board of directors with an entrenched statutory obligation to act in good faith and in the best interests of the company.

### VHP's governance needs to recognise the external management of the trust

External manager structures such as VHP's generally result in conflicts of interest between the interests of the Manager and the interests of Unitholders. This conflict exists primarily due to the fees paid to the Manager being defined as a percentage of the assets managed. Consequently, the Manager is incentivised to grow the asset base. In contrast Unitholders are focussed on total unitholder returns (i.e. the sum of dividends paid per unit and the change in the price of those units).

The potential purchase of the Healthscope properties<sup>7</sup> by VHP highlights the need for urgent changes to the governance arrangements to manage this fundamental conflict and ensure a fair outcome for Unitholders.

The governance structure of VHP strongly favours the Manager. We propose the resolutions below to attempt to address what we see as the most critical issues.

## Resolutions

- 1. For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 30.11 of the Trust Deed which provides that the shareholder of the Manager can unilaterally remove Independent Directors and can unilaterally remove the right of Unitholders to nominate and vote for Independent Directors.**

Clause 30.11 demonstrates an unacceptable imbalance of power in the governance of VHP. Unitholders depend on the independent directors to represent Unitholders' interests should they conflict with the interests of the Manager. The right of the

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<sup>6</sup> There are a number of listed *investment* vehicles that are structured as unit trusts.

<sup>7</sup> VHP has indicated that it is interested in acquiring some of the underlying property assets of Healthscope Ltd, a listed Australian healthcare provider. To facilitate this outcome VHP has provided \$41m of funding that was used to prepay a portion of a forward contract to acquire around 10% of Healthscope.

shareholder of the Manager (Northwest Healthcare Properties Management Ltd - NWH) to dismiss independent directors is an unambiguous threat which potentially influences the behaviour of the independent directors, obstructs independent directors in the exercise of this critical role and acts as an impediment to recruit high quality directors.

The removal of this clause will entrench the Unitholders’ rights to appoint and remove the independent directors, and will create a culture of director accountability to Unitholders.

While the Manager has offered to “suspend” this clause through to 31 March 2019 (the period of its fee review), this is not sufficient and this clause needs to be permanently removed.

**2. For the purpose of s 139(2)(a)(i) of the FMCA, the Unitholders approve the Manager and Supervisor removing clause 22.5 of the Trust Deed which provides that the Manager can unilaterally alter the amount of the Manager’s fee.**

The asymmetric/unfair governance structure is further reflected in the existence of the right of the Manager to unilaterally increase the Management fees. As set out in the notes to Resolution 3, the setting of fair fees is perhaps the most direct potential conflict of interest which Unitholders and Managers must manage. The unilateral alteration of fees can perpetuate a lack of alignment between the Manager and Unitholders.

The existence of this clause is unfair to Unitholders and highlights the lack of consideration for Unitholders in the VHP structure. The effect of removing Clause 22.5 would mean that the Manager would not be in a position to unilaterally alter the fees.

The offer to suspend this right through the fee review process acknowledges the conflict that exists but a temporary suspension is not sufficient to resolve the ongoing conflict and this clause needs to be permanently removed.

**3. That Unitholders request that the Manager negotiate in good faith with Unitholders to bring fees currently charged by the Manager into line with current market levels and improve the alignment of interests between the Manager and Unitholders.**

The most direct potential conflict of interest in the VHP structure is the level of fees paid to the Manager by VHP. The revenue earned by the Manager is an expense effectively borne by the Unitholders.

In our view the current level of fees is unfair to Unitholders. There are two main issues:

- 1) VHP’s base fee is materially higher than that charged by other Listed Property Vehicles *and* the lack of a tiered fee structure means that this differential will increase as the asset base grows. A comparison of base fees charged by New Zealand listed vehicles is shown in Figure 1 below.

**Figure 1: Base fee comparison for NZ listed property vehicles**

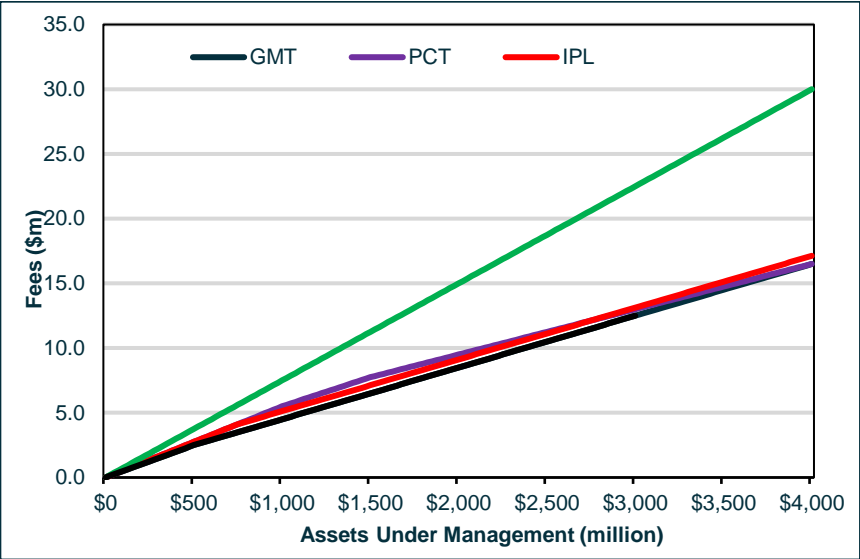
	Asset Plus	Goodman Property Trust	Investore Property	Precinct Properties	Vital Healthcare
Base fee	0.50% up to \$500m, 0.40% thereafter	0.50% up to \$500m, 0.40% thereafter	0.55% up to \$750m, 0.45% thereafter	0.55% up to \$1,000m, 0.45% up to \$1,500m, 0.35% thereafter	Flat 0.75%

Basis for fee	Total assets	Total assets (excl. cash and debtors)	Investment property (excl. development properties)	Investment property (excl. development properties)	Average total assets

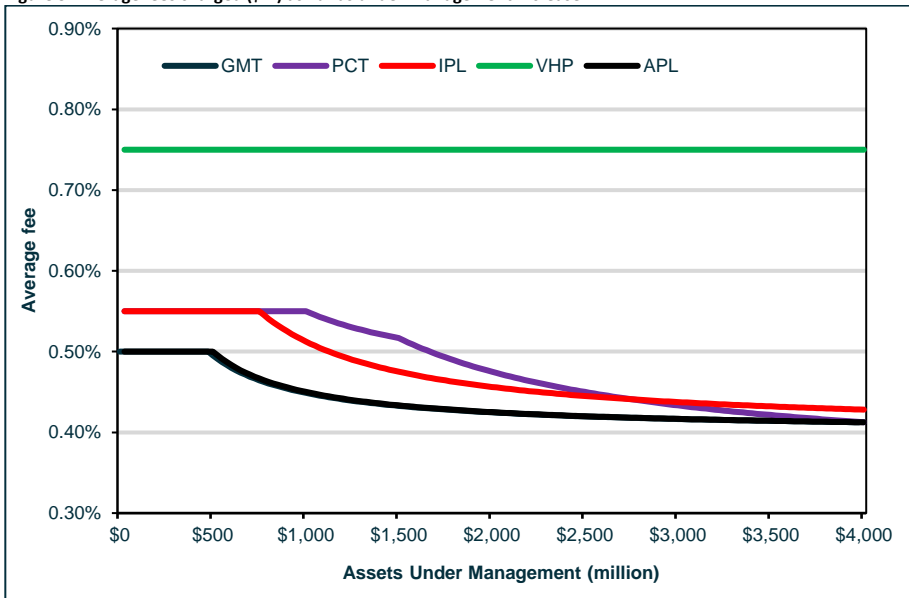
In general this base fee structure incentivises the Manager to continue to grow the portfolio irrespective of whether or not that growth adds value to Unitholders.

Figures 2 and 3 below also highlight the costs to unitholders of VHP’s flat fee structure.

**Figure 2: Average fee charged (%) as Funds under Management increase**



**Figure 3: Average fees charged (\$m) as Funds under Management increase**



For listed property vehicles with a tiered structure, the economies of scale that result from a larger portfolio are effectively shared with investors. In VHP's case, the flat fee structure means all of this benefit accrues to the Manager.

This feature has been recognised by broker research analysts:

*"Given VHP has a flat management fee structure (75bps of AUM), growing AUM does not create operational leverage for VHP unitholders and is very profitable for VHP's manager." Forsyth Barr – 10 August 2018*

- 2) Performance fees are intended to provide alignment between Managers and Unitholders. The concept is that when Unitholders benefit from performance generated by the skill of the Manager then Unitholders share some of the gains with the Manager.

In contrast to the rest of the sector (see Figure 4 below), VHP's performance fee is based on growth in property values. This has resulted in the Manager being extremely well rewarded for a cyclical increase in asset values despite having little influence on the increase. In addition, the lack of a "high water mark"<sup>8</sup> means there are no negative consequences for the performance fee if valuations subsequently fall.

This lack of alignment has also been highlighted by broker research analysts:

*"In our Vital Healthcare note titled 'Paying up for performance', dated 11 Aug 2017, we argued VHP's incentive fee payments need to be better aligned with performance. VHP has outperformed sector peers by 5.2% p.a. over the last 10 years, and has been well remunerated for this outperformance. Looking forward however we see the current incentive structure resulting in a misalignment of interests between unitholders and management. This would be solved by implementing a best practice, total shareholder return-based fee structure." Deutsche Bank - 1 September 2017*

<sup>8</sup> High-water marks ensure that investors do not have to pay performance fees for poor performance but, more importantly, guarantee that investors do not pay performance-based fees twice for the same amount of performance. Source: Investopedia

Figure 4: Performance fee comparison for NZ listed property vehicles

	Asset Plus	Goodman Property Trust	Investore Property	Precinct Properties	Vital Healthcare
<b>Performance fee</b>	10% of out-performance	10% of out-performance	10% of shareholder return over threshold	10% of out-performance	10% of average annual fair value gain over 3 years
<b>Cap</b>	5% of annualised outperformance	5% of annualised outperformance	5% of annualised outperformance	5% of annualised outperformance	1.0% of total asset value
<b>Type</b>	Relative performance to NZ property index	Relative performance to NZ property index (excl. GMT)	Absolute performance >10% shareholder return	Relative performance to NZ property index (excl. PCT)	Increase in value of assets

The impact of the existing fee structure on the revenues of the Manager in contrast to investment returns for Unitholders is demonstrated by results over the last 6 years (Figures 5 and 6 below). While management base fees have grown by 150% over the last 5 years, earnings per unit excluding performance fees<sup>9</sup> have grown by only 13%. If performance fees are included in the analysis the difference is even starker with earnings per unit falling 19%, while the total of base and performance fees paid to the Manager have increased by 481%.

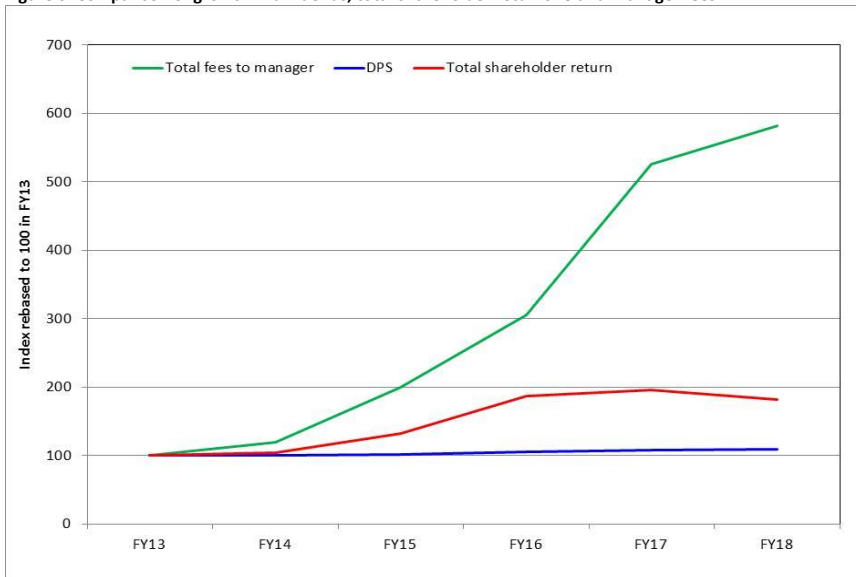
Figure 5: Comparison of unitholder returns vs Manager fees

Comparison of key unitholder return metrics vs manager fees								
	Units	FY13	FY14	FY15	FY16	FY17	FY18	Chg FY12-18
Investment property	\$m	619	613	782	952	1,376	1,731	180%
Net rental revenue	\$m	57.9	58.0	59.4	68.3	89.7	90.7	57%
Distributable earnings	\$m	28.2	34.7	36.3	40.2	48.0	46.1	63%
<b>Key unitholder return metrics</b>								
Distributable earnings per unit	cpu	9.38	10.40	10.60	11.70	11.40	10.62	13%
Dist. EPU incl. performance fee	cpu	9.38	10.23	9.54	9.84	11.76	7.61	-19%
Dividend per unit	cpu	7.90	7.90	8.00	8.30	8.50	8.56	8%
Net tangible assets per unit	\$	1.01	1.04	1.27	1.51	2.05	2.26	124%
Unit price	\$	1.38	1.35	1.64	2.23	2.26	2.01	46%
<b>Manager Fee breakdown</b>								
Base fee	\$m	4.7	4.6	4.9	6.2	8.1	11.9	150%
Performance fee	\$m	0.0	0.5	3.8	6.3	12.3	13.1	
Other fees	\$m	0.1	0.6	1.0	2.3	5.0	3.2	
<b>Total fees</b>	<b>\$m</b>	<b>4.8</b>	<b>5.8</b>	<b>9.7</b>	<b>14.8</b>	<b>25.4</b>	<b>28.1</b>	<b>481%</b>
Fees / rental revenue	%	8%	10%	16%	22%	28%	31%	

<sup>9</sup> And excluding revaluations of property and derivatives



**Figure 6: Comparison of growth in dividends, total shareholder returns<sup>10</sup> and Manager fees**



Following discussions with unitholders NWH has announced plans to undertake a review of its management fees during the first quarter of calendar 2019, with the review to be led by the full board and input to be sought from a range of Unitholders.

Prior to the 23 November release of the fee review announcement we advised NWH that in our view for unitholders to have confidence in the outcome (and noting the direct conflict of interest for NWH) the key requirement of any review would be its independence.

Specifically we requested that:

- the independent directors initiate the report;
- the independent directors seek feedback from Unitholders and the Manager;
- the independent directors utilise appropriate independent advisers;
- a summary of the report be made available to Unitholders.

We also subsequently advised NWH that our expectation was that the independent directors would then enter into a confidential discussion with NWH to represent unitholders interests in the context of the fee review.

NWH has been unwilling to commit that the review would meet these conditions.

In our view the decision by NWH not to commit to the exclusion of the NWH directors from the scope and preparation of the report reflects either a misunderstanding of the conflict of interest which exists or the importance of communicating to unitholders that the conflict is being well- managed.

We believe the Board needs to undertake an *independent* review of the existing fee structure and make changes to ensure that the fees paid are consistent with current market levels. This will result in an alignment of interests between Unitholders and the Manager.

<sup>10</sup> Total shareholder return is calculated as share price change during year plus cash dividend paid

**4. That Unitholders request that the Manager increase the size of the Board to 6, with a minimum of 4 Independent Directors and a minimum of 2 Independent Directors being elected by Unitholders.**

The asymmetry of corporate control is further evident in the current Board structure. The current structure provides NWH with two of five Board seats (i.e. 40%), despite only owning 25% of the units of the trust.

The disproportionate representation on the Board by NWH is strengthened further by NWH's rights to appoint all but two of the total number of Directors and unilaterally remove the two Independent Directors that Unitholders are permitted to appoint.

**5. The Unitholders request that the Board amends all policies and procedures, including the Conflicts of Interest Policy and the Board Charter, to reflect resolutions 1, 2 and 4, and to entrench the statutory duty of the Board of the Manager to act in the best interest of the Unitholders.**

All governance documentation should be reviewed to ensure that they reflect resolutions 1, 2 and 4 (if passed). Specifically, the benefits to the Manager of adding assets to the Trust should be disclosed and be front of mind as the Board assesses acquisitions of assets.

The passing of this resolution is contingent on the passing of either resolution 1, 2 or 4, as applicable.



Healthcare  
Property Trust

## Lodge your proxy



### By Mail

Computershare Investor Services Limited  
Private Bag 92119, Auckland 1142, New Zealand



### By Fax

+64 9 488 8787



### By Email

vital@computershare.co.nz

## For all enquiries contact



+64 9 488 8777



vital@computershare.co.nz

**For your vote to be effective it must be received by 2.00pm on Tuesday, 18 December 2018**

## Voting/Proxy Form

### Attending the Meeting

If you plan to attend the meeting please bring this Voting/Proxy Form with you to the meeting as it contains your attendance slip. All unitholders are entitled to attend the meeting.

#### Appointment of Proxy

A unitholder entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote instead of that unitholder. A proxy need not be a unitholder. A unitholder may appoint the chair of the meeting, or another person, to act as proxy. To do this, enter 'The Chair of the Meeting' or the name of your proxy in the space allocated in 'Step 1' of this form.

#### Voting requirements regarding Independent Directors

The Resolution is proposed under clause 30 of the Trust Deed. Because both Graham Stuart and Paul Mead are eligible and seeking election as an Independent Director, but only one may be elected, the candidate who receives the greatest number of votes in favour at the meeting will be elected.

**The Board recommended nominee is Graham Stuart.** As a result, if the Chair of the meeting, or any other director, is appointed to act as proxy and is not directed how to vote, they will vote for Mr Stuart.

#### Non-Binding Proposals

The Proposals have been raised by certain unitholders for resolution at the meeting. They will be put to the meeting and require approval by a bare majority. If passed, they will not be binding on the Manager, Supervisor or Unitholders.

**The Board does not support the Proposals.** As a result, if the Chair of the meeting, or any other director, is appointed to act as proxy and is not directed how to vote, they will vote against each of the Proposals.

#### Voting of your holding

Should you wish to direct the proxy how to vote, please indicate with a tick in the appropriate box overleaf. If you do not provide a voting direction to the proxy, they will vote at their discretion (or may not vote).

### Signing Instructions

#### Individual

A unitholder wishing to appoint a proxy should complete this proxy form.

#### Joint Holding

All joint holders must sign this proxy form.

#### Power of Attorney

If this proxy form is signed under a power of attorney or other authority, that power of attorney or other authority or a copy of such power of attorney or authority certified by a Notary Public or in such manner as the Manager shall approve (unless previously produced to the Trust) and a completed certificate of non-revocation, must accompany this proxy form.

#### Companies

A proxy granted by a company must be signed by a duly authorised officer or attorney who is acting under the company's express or implied authority.

### Comments & Questions

If you have any comments or questions for the Trust, please write them on a separate sheet of paper and return with this form.

### Returning your form

Completed proxy forms must be received by Computershare Investor Services Limited at the mailing address, fax number or e-mail address shown above by **no later than 2.00pm on Tuesday, 18 December 2018** (being 48 hours before the meeting).

**Turn over to complete the form to appoint a proxy and vote**

# Voting/Proxy Form

## STEP 1

### Proxy Form (for use if you are unable to attend the meeting)

being a unitholder/unitholders of Vital Healthcare Property Trust

hereby appoint \_\_\_\_\_ of \_\_\_\_\_

or failing him/her \_\_\_\_\_ of \_\_\_\_\_

as my/our proxy to vote for me/us at the annual meeting of unitholders of Vital Healthcare Property Trust to be held at Ellerslie Event Centre, 80 Ascot Ave, Auckland, on Thursday, 20 December 2018 at 2.00pm and at any adjournment of that meeting.

## STEP 2

### Voting Instructions/Voting Paper

**Please note:** This part of the form can only be used as voting instructions for a proxy vote or as a voting paper at the meeting. Please note that if units are held jointly, the voting instruction is given on behalf of each joint holder. Unless otherwise instructed, the proxy will vote (or choose not to vote) as he or she thinks fit. Should you wish to direct the proxy to vote, please indicate with a tick in the appropriate box below.

If you wish, you may appoint as your proxy "The Chair of the Meeting". If the Chair is not directed, she will vote in favour of Graham Stuart, as the board supported candidate. She will also vote against each of the Proposals.

Capitalised terms used but not defined in this Voting/Proxy Form have the meanings given to them in the Notice of Meeting accompanying this form.

Tick ☒ in box to record your vote

#### Resolution

<b>Either:</b>	That Graham Stuart, who was appointed by the Board and stands for re-election, be re-elected as an Independent Director of NorthWest Healthcare Properties Management Limited, the manager of the Trust.
<b>Or:</b>	That Paul Mead, who has been nominated by three unitholders, be elected as an Independent Director of the Manager.

For	Against	Proxy Discretion	Abstain
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

#### Non-binding unitholder proposals

1.	For the purpose of s 139(2)(a)(i) of the Financial Markets Conduct Act 2013 (FMCA), the Unitholders approve the Manager and Supervisor removing clause 30.11 of the Trust Deed which provides that the shareholder of the Manager can unilaterally remove Independent Directors and can unilaterally remove the right of Unitholders to nominate and vote for Independent Directors.
2.	For the purpose of s 139(2)(a)(i) of the FMCA, the Unitholders approve the Manager and Supervisor removing clause 22.5 of the Trust Deed which provides that the Manager can unilaterally alter the amount of the Manager's fee.
3.	That Unitholders request that the Manager negotiate in good faith with Unitholders to bring fees currently charged by the Manager into line with current market levels and improve the alignment of interests between the Manager and Unitholders.
4.	That Unitholders request that the Manager increase the size of the Board to 6, with a minimum of 4 Independent Directors and a minimum of 2 Independent Directors being elected by Unitholders.
5.	The Unitholders request that the Board amends all policies and procedures, including the Conflicts of Interest Policy and the Board Charter, to reflect resolutions 1, 2 and 4, and to entrench the statutory duty of the Board of the Manager to act in the best interest of the Unitholders.

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## SIGN

### Signature of Unitholder/Unitholders This section must be completed.

Unitholder 1

or Sole Director/Director

Unitholder 2

or Director (if more than one)

Unitholder 3

Contact Name \_\_\_\_\_ Contact Daytime Telephone \_\_\_\_\_ Date \_\_\_\_\_