Market Release

1 March 2019

Vital announces interim results & update on strategic initiatives

Vital Healthcare Property Trust (Vital) today released its interim results for the six months ended 31 December 2018. It also confirmed a second quarter cash distribution of 2.1875 cents per unit will be paid to unitholders on 29 March 2019, an increase of 2.9% over the prior period.

Half year result highlights

- Gross rental income of $50.5m, up 12.9%, driven by investment activity and organic growth;
- Net distributable income of 4.19 cpu;
- Cash earnings (or AFFO[1]) of $19.7m, representing a 98% payout ratio;
- LVR at 39.5%[2], post balance date completed bank facility expansion of A$150m;
- Portfolio independently assessed at $1.77bn, WACR[3] firmed 3bps to 5.73%;
- NTA of $2.24, down $0.02/unit from 30 June 2018 due to the impact of foreign exchange;
- 99.4% occupancy, now maintained at over 99% for 9 years;
- Market leading WALE of 18.0 years;
- Invested $17.8m in brownfield projects, $223m to be completed over next 3 years;
- Agreement for A$126.2m brownfield development at Epworth Eastern Hospital, completion late-2021;
- Forecast weighted average brownfield development yields of ~6.70%, a spread of approximately 100bps to Vital's WACR[3];
- Board reconfirmed FY19 cash distribution guidance of 8.75 cpu, up 2.2% from FY18.

Strategic update

On 1 February 2019, NorthWest Healthcare Properties Management Limited, as manager of Vital Healthcare Property Trust (Vital), announced that its related company, NorthWest Healthcare Properties Real Estate Investment Trust (NorthWest) had entered into a conditional contract to acquire 11 freehold hospital property assets for A$1,258 million from ASX listed Healthscope Limited (Healthscope) (the Portfolio) as part of a sale and lease back transaction. This transaction is conditional on Brookfield's acquisition of Healthscope.

Claire Higgins, Independent Chair of Vital's Manager said "Vital is not currently a party to the potential transaction, however views it as potentially an attractive opportunity and the Independent Directors are optimistic they will be able to agree terms with NorthWest that sees Vital participate in the Healthscope transaction to the benefit of unitholders. Discussions with NorthWest remain ongoing and a non-binding term sheet is well advanced. However, there can be no guarantee that an agreement will be able to be reached".

Mrs Higgins also said "We have made good progress on the previously announced fee review, and have engaged EY to prepare an independent research report and conduct direct unitholder engagement on our behalf. At this stage the Board expects to be in a position to provide an update on both Healthscope and the fee and governance review by 31 March 2019."

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[1] Adjusted Funds from Operations
[2] Trust deed LVR is based on total borrowings as a percentage of the gross asset value of the Trust
[3] Weighted average capitalisation rate

David Carr, Chief Executive of the Manager said, “In addition to focussing on near term strategic initiatives the team continues to proactively deal with all aspects of the business. Core occupancy remains at 99.4% and our portfolio WALE at an industry leading 18 years. We continue with the brownfield development program, adding capacity and improving asset quality, ultimately driving value and earnings accretion.

Despite some short term private healthcare sector headwinds, our investment and development activities continue to be supported by positive long term trends including a growing and ageing population and increasing demand for healthcare services.”

Interim valuations and portfolio activity

At the half year to 31 December 2018, the incumbent independent valuers from 30 June 2018 were commissioned to provide external desktop property asset reviews. As a result, Vital recorded an increase of $43.5m in the fair value of its portfolio to $1.77bn, or 2.4% over carrying book value. The increase is over and above acquisitions and development expenditure incurred in the period. The valuation uplift was driven by post development revaluation gains on the spread between rentalisation and market yields at Lingard Private and Toronto Private and supported by rent reviews over the period.

Vital’s WACR for the six months to 31 December 2018 firmed approximately 3 bps to 5.73%. The Australian portfolio reported a 3bps firming to 5.70% and the New Zealand portfolio firmed 1 bps to 5.82%.

A total of 47 rent reviews (approximately 25% of total income) were completed to 31 December 2018, resulting in annualised rent growth of 3.0%. With around 53% of Vital’s total income remaining subject to review to 30 June 2019, we expect these reviews will contribute to forecast income growth approximately in line with inflation.

Vital’s WALE was 18.0 years, supported by favourable lease renewals at Ascot Central and Epworth Eastern Medical Centre. With a very low lease expiry profile at the start of FY19 representing 3.9% of total income, approximately 50% of these renewals or expiries are now completed, with an 84% retention rate.

We look to resolve the remaining expiries over the next six months with a high expectation of renewal and we continue to proactively seek to secure future renewals well ahead of actual lease expiry dates.

Financial performance

Gross rental income grew 12.9% during the period. After property expenses, net income grew at 13.2%.

This operating result was driven by same-property income growth of 1.4% (or 2.2% on a same currency basis) and over NZ$210m of property acquisitions and approximately NZ$50m of developments over the last 18 months.

Finance expense of $16.0m was up 52% from the prior year resulting from higher overall average debt levels within the respective half year periods. This reflects the timing of acquisitions (eg. Acurity properties $147m in Dec 2017) and development activity and the related party loan. Contributing to the increased finance expense was an increase in Vital’s weighted average cost of debt to 4.50% (including bank line and margin fees) compared to the prior year of 4.09%.

Net distributable income for the period was $18.5m (or 4.19 cents per unit). AFFO, which adjusts for maintenance capex, lease incentives and non-recurring items, was $19.7m (or 4.46 cents per unit) down 17.4% versus the prior year period. This was primarily due to $1.8m (0.41 cents per unit) of higher income tax expense, reflecting tax on unrealised foreign exchange gains, and $1.4m (or 0.33 cents per unit) of higher maintenance capex and lease incentives versus the prior year period.

For the six months to 31 December 2018, Vital’s AFFO pay-out ratio was 98%.

Treasury & capital management

Vital’s loan-to-value ratio (LVR) was 39.5% at 31 December 2018 for Trust Deed purposes, up from 36.4% the same time last year. For the purposes of the bank covenant the LVR was 43.7% as adjustments are made removing the interim desktop revaluations and the related party loan. The LVR remains well below bank and Trust Deed covenants of 50%. At year end Vital had a hedged interest rate position of 68% with a 6.7 year average duration.

Accordingly, the Trust maintains an appropriate level of flexibility to finance announced development commitments over the next three years. We are actively considering portfolio recycling opportunities and recently received multiple qualified offers on a number of properties with an aggregate book value of approximately NZ$100m.

Acquisitions

Vital acquired two significant future development properties and a number of small strategic land holdings in the period for a total cost of NZ$23.6m.

In September 2018, by way of an off-market transaction, Vital acquired an additional ~5,500sqm of vacant land for NZ$9.3m which is located adjacent to Vital’s Ormiston Hospital in Auckland. Existing facilities include a six theatre, 31 bed private hospital in one of Auckland’s strongest population growth corridors. Ormiston is the only private hospital in this area, which has a population estimated at 540,000.

In November 2018, Vital and NorthWest jointly acquired a significant development site for A$13.75m (Vital’s half share ~A$7.0m) which is located adjacent to Lyell McEwin Public Hospital, the third largest public hospital in metropolitan South Australia. The 16,700 sqm site is currently occupied by a retail centre of approximately 2,200 sqm with 100% occupancy on short lease terms with relocation and/or termination rights. The acquisition provides a significant opportunity for development of a private healthcare precinct co-located with a major public hospital.

Epworth Eastern Hospital expansion

Epworth Eastern Hospital, original built in 2005, is a six-level, 227 bed private hospital located in the Box Hill suburb of Melbourne, approximately 14 kilometres east of Melbourne's CBD and operated by Epworth Foundation. The Hospital is adjoined by Vital's Epworth Eastern Medical Centre, which provides 3,000 square metres of consulting suites across two levels to 24 healthcare tenants.

In 2014, Vital purchased an adjacent site as a strategic property held for development to facilitate future expansion of the Epworth campus. Epworth Eastern Hospital is currently near capacity and generating strong operating performance. Epworth Eastern Executive Director, Louise O'Connor commented that Epworth has "a waiting list of doctors who want to operate."

Accordingly, Vital has entered into an agreement to lease with Epworth Eastern to build a new 14 storey tower on the adjacent site. A planning permit has been received, developed design is complete, and a preferred construction contractor is expected to be appointed shortly.

Architect's impression of new 14 level tower development adjacent Epworth Eastern Hospital

Approximately half of the new building is to be utilised by Epworth for clinical services (adding 63 beds and 5 operating theatres) and the remaining area would provide new consulting suites (approximately 4,200 sqm), of which Epworth has agreed to head-lease just under half of the consulting space.

The development is 80% pre-committed, with strong and growing demand from associated healthcare practitioners, many of whom will decant from the adjacent medical centre which will be refurbished to provide theatre recovery space and a new emergency department. At completion the building is forecast to be 100% occupied. Epworth will reset its lease term for the existing hospital and new areas leased to a new 30 year lease term with rental reviews based on the greater of 3% or CPI.

The development is budgeted to cost approximately A$126.2m (including land currently held by Vital for development). On completion, expected in late 2021, this project is forecast to be approximately 1% accretive to AFFO per unit excluding development profit.

David Carr said "the Epworth Eastern development is another example of Vital's strong tenant relationships and our commitment to work with our hospital operating partners. The development will improve the quality and value of the asset and help drive operational benefits and efficiencies for Epworth to meet rising demand for healthcare services in their community. Furthermore, it presents another opportunity for Vital to demonstrate its execution capabilities to enhance portfolio performance and deliver secure and stable returns to unitholders."

Development update

In the first half of the year, Vital completed brownfield developments at NorthWest in Burnie, Tasmania, and a further Stage at Lingard Private Hospital in Newcastle, New South Wales, representing value-add investments of approximately A$21m.

Five further projects, totalling approximately NZ$240.9m remain in various stages of development. These five projects are forecast for completion between early 2019 and 2023, with approximately NZ$223.4m in costs to complete, at a forecast development yield on completion of approximately 6.70%, a spread of approximately 100 bps to Vital's weighted average capitalisation rate.

Longer term, Vital's brownfield development programme remains a core part of Vital's scale and diversification strategy. Brownfield projects not only directly underpin earnings sustainability and long-term value creation but materially improves asset quality, supporting operator performance.

Distribution

The Board confirmed that investors will receive a second quarter distribution of 2.1875 cents per unit with 0.3477 cents per unit of imputation credits attached. The record date is 15 March 2019 and payment will be made on 29 March 2019.

Vital's Distribution Reinvestment Plan remains available to investors for this distribution with a 1.0% discount being applied when determining the strike price.

The Board has also reconfirmed its full year guidance for a cash distribution of 8.75 cents per unit.

Outlook

Mr Carr said "Notwithstanding the last six months being an exceptionally intense period working through a number of important strategic matters, Vital's continued underlying portfolio performance is sound as we continue to deliver on the Board's stated scale and diversification strategy and further enhance Vital's overall position as a market leader focused solely on healthcare real estate".

Vital's management team will present these results via a live webcast from 11:30am NZ time today. Please refer to our market release dated 25 February 2019 for details or click here.

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ENQUIRIES

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