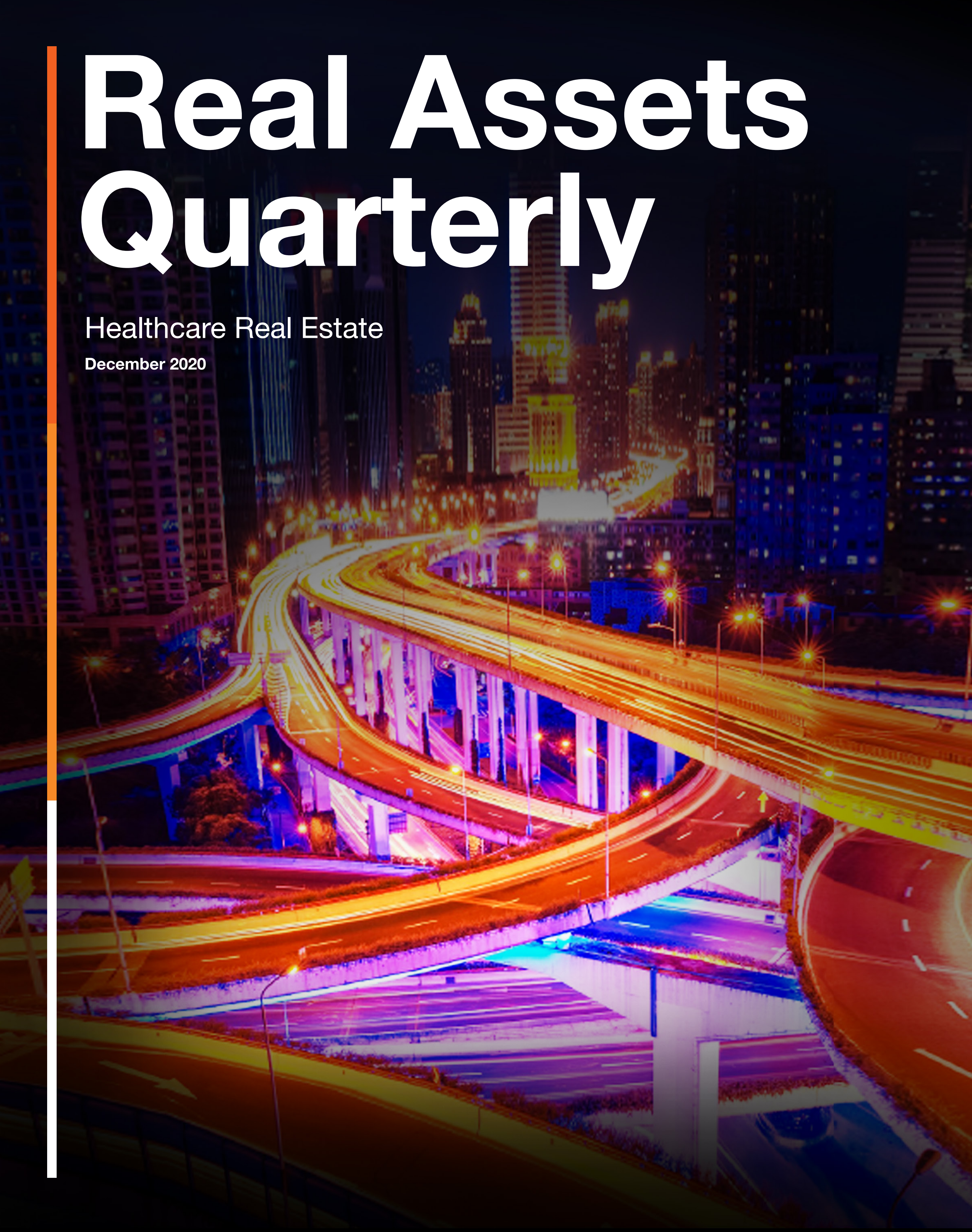
Real Assets Quarterly



Healthcare Real Estate

December 2020

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Frontier's real assets team

We constantly monitor events in real assets markets around the globe and apply our insights to advise clients on opportunities and risks facing their investment portfolios. International trends and developments, as well as those here in our own market, continually shape our opinions around portfolio management and opportunities. This quarterly review provides our summary of recent developments concerning real assets markets globally, our current investment outlook and a round-up of transactions.

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Healthcare real estate

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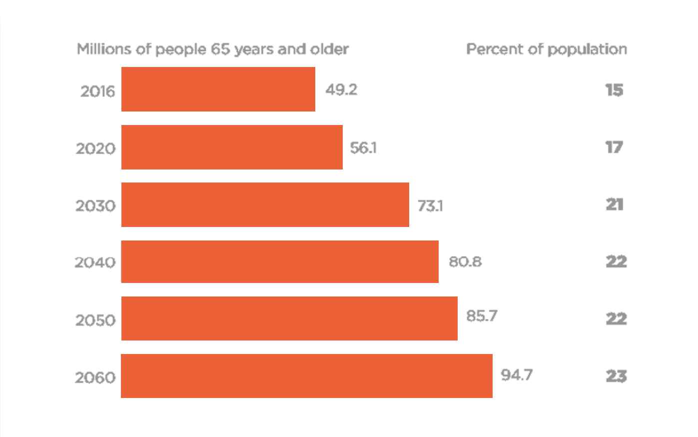
Background

Globally, people are living longer and the elderly are accounting for a larger portion of the population. A consequence of this is the increasing demand for healthcare services. For real estate investors, this provides an opportunity to access an enduring thematic with a strong demographic tailwind.

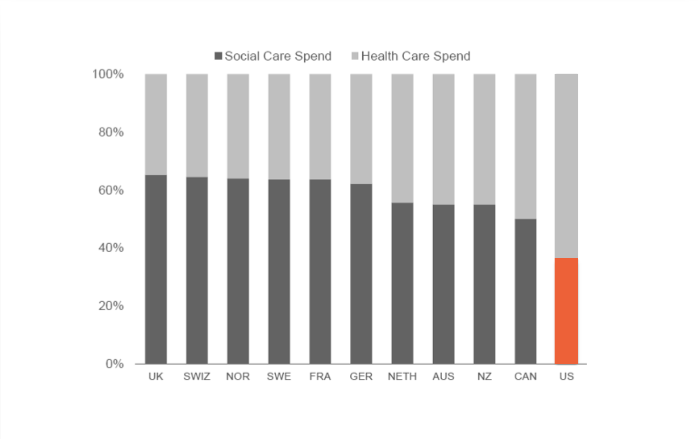
Healthcare real estate comprises several different sub-categories including medical office, life sciences, hospitals and aged care, each with varying characteristics and appeal for institutional investors. Healthcare property diversifies traditional real estate portfolios which are typically more closely tied to the economic cycle and can share infrastructure-like characteristics like providing essential services and exhibiting long and resilient cashflows. In this RAT Quarterly, we look at the key demand drivers and the healthcare opportunity set in the United States and Australia. The US has a long institutional history of investing in healthcare and offers a deep, liquid and diverse opportunity set. While the current investible market in Australia is relatively limited, we expect institutional real estate investors will increasingly seek exposure as the sector matures.

Chart 1:
US ageing population and healthcare expenditure (2019)



Source: US Census Bureau

Chart 2: Healthcare expenditure (2019)



Source: Welltower

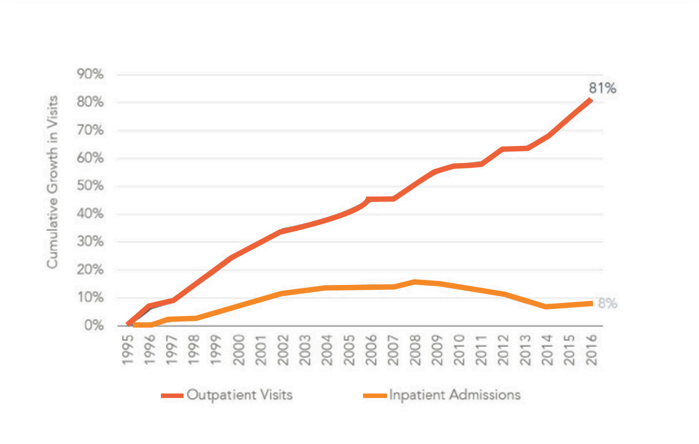
US healthcare demand

The US population is forecast to grow by 74 million people by 2058, reaching 400 million people[1]. The population is also ageing; the over 65 population is expected to increase from 17% to 21% of the total population by 2030[2]. This is important for healthcare demand because seniors visit the doctor much more frequently than younger cohorts; over 65s visit the doctor 89% of the time every 6 months, whereas those in the 18 to 44-year bracket only do so 61% of the time[3].

As shown in Chart 2, relative to other countries, the US allocates a large proportion of the government budget to healthcare. In addition to this, healthcare expenditure is forecast to grow, increasing from US$4.1 trillion in 2020 to $5.7 trillion in 2026[4]. Given this material cost burden, the US continues to search for more effective treatments. One method of improving patient outcomes at reduced cost has been achieved through hospitals shifting “inpatient” services to “outpatient” facilities. This has been a key driver of the demand for medical office (see Chart 3).

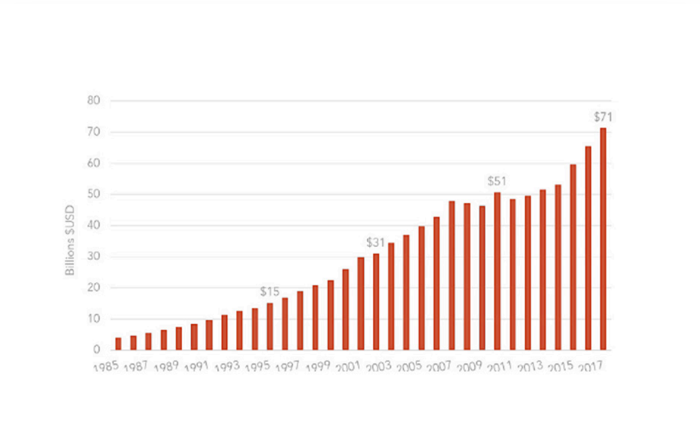
1. US Census Bureau
2. US Census Bureau
3. Harrison Street
4. American Healthcare Association

Chart 3: US inpatient vs outpatient visits



Source: American Hospitals Association

Chart 4: US corporate funding for pharmaceutical research



Source: American Hospitals Association

The pharmaceutical sector has also been a key beneficiary of the desire to find more effective treatments. Both public and corporate funding for pharmaceutical research continues to grow, reaching historic peaks prior to the onset of COVID-19, which saw a further acceleration in funding for the sector. This is fuelling demand for lab space in life science offices.

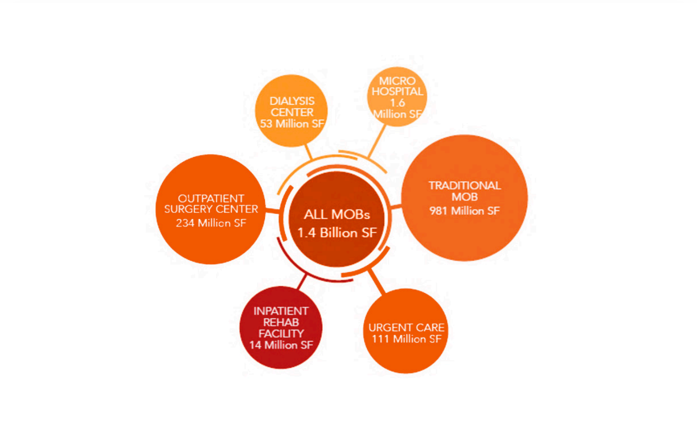
While the healthcare thematic can be accessed through several avenues, our focus in the US has been on the medical office (which encompasses a broad range of service – see Chart 5) and the life sciences sectors. Given our preference for the lower acuity segments of aged care in the US (i.e. senior living), we typically consider this sector under the housing thematic. In Table 1, we highlight some of the key characteristics of the medical office and life sciences sectors.

Table 1: Characteristics of US healthcare property types

Characteristic	Medical office	Life sciences
Key tenants	Medical professionals and related industries	Large pharmaceutical companies and biotech firms
Tenant profile	Diversified tenant and sticky base, leading to high retention rates	Asset dependent, although often less diversified than medical office
Lease structure	Longer-term and typically triple-net leases	Asset dependent but longer-term leases are possible, triple net
Asset specialisation	Depends on the acuity of service provision but can be limited specialisation	Specialised fit-out (plumbing, ventilation, floor loading etc.)
Market structure	Fragmented market Preferably close to health hubs or large population centres Relatively liquid market	Market relatively concentrated Typically located in close proximity to universities and research clusters More limited opportunities to invest in core markets
Expected returns (10 year IRR)	6-8%	6-8%

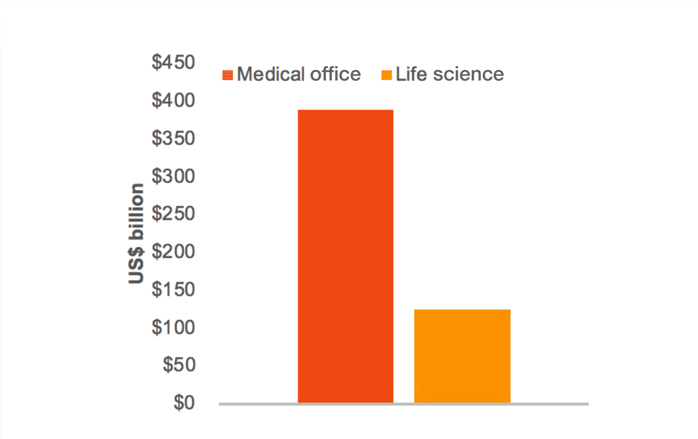
Although not as large as traditional real estate sectors, US healthcare presents a meaningful opportunity set. Within the medical office sector, transaction liquidity continues to grow and market is relatively deep. Life sciences remains a smaller subset of the overall market and assets are typically tightly held within 'clusters' in prime cities within key university precincts (e.g. Boston, San Diego, Bay Area).

Chart 5: US medical office landscape



Source: Revista

Chart 6: US healthcare investment opportunity (2018)



Source: RCA, Revista, JLL

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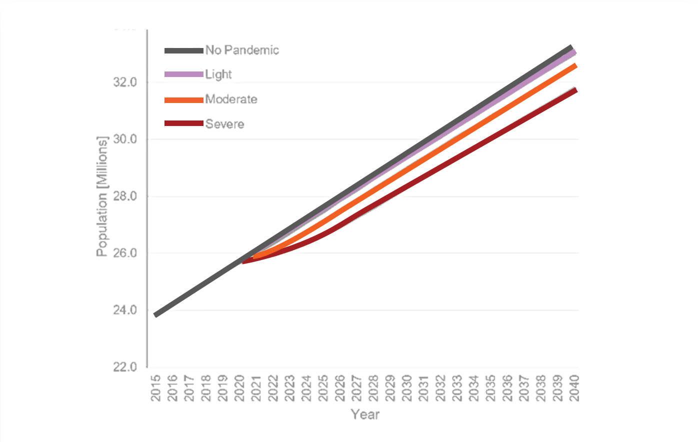
Australian healthcare real estate

A similar demand-led story is playing out in Australia.

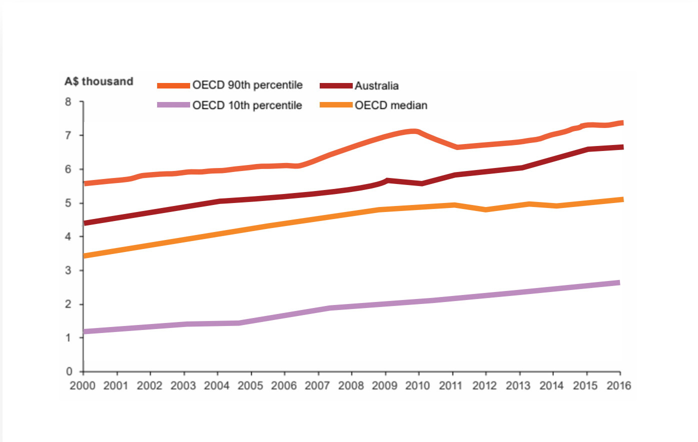
Although COVID-19 is expected to impact the rate of population growth (which grew by 1.4% p.a. for the last 20 years[6]), even under "severe" demographic modelling, Australia is expected to add 6.3 million people by the year 2040[7]. Concurrently, the population is ageing. By 2057, 22% of Australia's total population is expected to be aged 65 or older (up from 15% in 2017[8]). Just as in the US, the elderly population drives demand for healthcare services. For example, of Australia's population over 65, 78% are affected by a chronic disease[9]. While this is only one component of overall healthcare spend, Australia's overall health expenditure has been higher than the OECD median (measured by GDP ratio and per capita) and continues to grow[10].

Chart 7: Australian population growth (post COVID-19)



Source: theconversation.com.au

Chart 8: Annual healthcare expenditure per capita



Source: AIHW

There are a range of different healthcare property types in Australia, each with relatively unique characteristics.

6. ABS
7. TheConversation.com.au
8. ABS
9. AIHW
10. AIHW, OECD

Table 2: Characteristics of Australian healthcare property types

	Hospitals	Medical centres	Tertiary centres*	Aged care
Key tenants	Public (PPP) or corporate operators	Corporate & non-corporate tenants	Corporate & non-corporate tenants	Public or Private operators
Tenant profile	Larger asset values	Smaller asset values, though can be higher for medical office assets	Smaller asset values	Smaller asset values but potential for roll-up opportunities
Lease structure	Very long leases (e.g. 20+ years) Triple net	Mixed lease terms Triple net	Mixed lease terms Triple net	Very long leases Triple net
Location	Long leases Often part of a Healthcare precinct	Often close to other health services	Generally located in areas with high Private Health Insurance take-up	Residential locations
Asset specialisation	Specialised use	Less-specialised use Triple net	Often specialised facilities	Some specialisation
Market structure	Concentration of asset ownership Limited opportunities to acquire/develop	Highly fragmented market Frequent opportunities to acquire	Fragmented market Less frequent opportunities to acquire	Fragmented market, though trend of consolidation
Market structure Expected returns (10 year IRR)	6-8%	7-9%	7-9%	7-9%

*Tertiary centres include pathology, imaging, day procedure, specialists

Australian healthcare opportunity set

Institutional-grade healthcare opportunities of scale are scarce, and yields continue to tighten.

The healthcare real estate market in Australia is estimated to be $124 billion, of which only $5.2 billion was securitised in 2020[11]. Hospitals, aged care and tertiary centres represent the largest opportunity for institutional investors, although each comprises separate risk and return considerations.

Chart 9: Australian health care opportunity set

Source: AIHW, JLL, IBISWorld

Risks

Healthcare investors need to be aware of a number of risk factors when investing in the sector.

While demographics are expected to provide a strong tailwind there are other areas that need a greater level of focus than may be required by other real estate investments, including reputational, operational, regulatory, technology and data availability.

Given the heightened operating and reputational risks associated with healthcare property, we prefer exposure through specialist managers with strong industry relationships built over time.

Conclusion

As the populations of developed countries continue to grow, age, and live longer, demand for healthcare services will continue to expand. The enduring nature of this thematic provides an opportunity for investors to improve portfolio diversification while also supporting critical community services. The sector can also provide several other attractive features, including long-term leases, sticky tenants and resilient cashflows.

The US has a long institutional history of investing in healthcare and offers a deep, liquid and diverse opportunity set. Although the current investible market in Australia is relatively limited, we expect institutional real estate investors will increasingly seek exposure as the sector matures. While the sector has several appealing investment qualities, investors must be mindful of the inherent risks associated with investment in healthcare. These risks can be quite separate from traditional real estate sectors. Specialist advice and management is therefore highly recommended. Provided these are prudently managed, we believe healthcare real estate is an attractive opportunity for investors to access sustained growth, reduce the economic beta of portfolios, and enhance returns.

Frontier will continue to monitor the healthcare sector for compelling opportunities. Please contact Frontier with any questions you may have on the healthcare property sector to discuss investment opportunities.

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Insights

Notable infrastructure transactions (Q3 2020)

Sector	Transaction	Vendors	Acquirers	Transaction size (m)	Description
Energy	Cheniere Energy Partners (42%)	Blackstone Energy Partners	Brookfield Infrastructure Fund IV	USD 6,961	Sabine Pass LNG export terminal in Louisiana
Energy	ADNOC Gas Pipelines (49%)	Abu Dhabi National Oil Company	Ontario Teachers' Pension Plan, Global Infrastructure Partners IV, Brookfield Infrastructure Fund IV, GIC,NH Investment & Securities, Snam Rete Gas	USD 10,000	Sale of 49% stake in a 600km natural gas liquids pipeline, a 400km natural gas pipeline, and an LNG pipeline
Power	Conrad Energy		ISQ Global Infrastructure Fund II	USD 200	1.8 GW of distributed flexible gas generation, battery storage, and utility-scale renewable energy plants
Power	Orsted Radius	Ørsted	SEAS-NVE	USD 2,900	Danish power distribution business
Power	Cascade Power		Axium Infrastructure, OPSEU Pension Trust, Kineticor Resource Corp, DIF Infrastructure Fund VI	USD 1,000	Development a of 900MW combined-cycle natural gas-fired power project located near Edson in Alberta, Canada
Power	Three Rivers		OSAKA Gas, Harrison Street, GE Energy Financial Services, Axium Infrastructure, Competitive Power Ventures	USD 1,000	Development of the Three Rivers Energy Center project
Power	Meghnaghat Gas-fired Power Plant		Reliance Power (51%), JERA (49%)	USD 856	Development of a 750MW power plant, which is set to be the largest independent power producing plant in Bangladesh
Power	El Paso Electric Co	El Paso Electric Co.	JP Morgan Infrastructure Investments Fund	USD 4,250	Regulated electric utility provider in New Mexico
Power	NSW Transgrid (19.99%)	Kuwait Investment Authority (Wren House Infrastructure)	OMERS Infrastructure	USD 2,340	19.9% stake in Transgrid
Renewables	Huemul Chilean Renewables Portfolio		Mainstream Renewable Power	USD 934	Renewable Power's development portfolio in Chile
Renewables	TerraForm Power	TerraForm Power	Brookfield Infrastructure Fund III	USD 1,413	Acquisition of remaining 38% of renewable power portfolio of solar and wind assets

Notable infrastructure transactions (Q3 2020)

Sector	Transaction	Vendors	Acquirers	Transaction size (m)	Description
Renewables	Fighting Jays Solar	AP Solar Holdings	Copenhagen Infrastructure Partners	N.A.	350MW photovoltaic solar facility
Renewables	Viridor	Pennon Group	Hermes Infrastructure Fund II, KKR Global Infrastructure Investors III, KKR Global Impact Fund SCSp	USD 4,200	Energy from waste company
Renewables	SeaGreen Offshore Wind Farms	Scottish and Southern Energy	Total S.A.	USD 3,350	1.07GW SeaGreen offshore wind park
Telecommunications	Fore Freedom	Ancala Partners	H.R.L Morrison & Co Growth Infrastructure Fund	N.A.	Fibre-to-the-office networks in 80 business parks across the Netherlands
Telecommunications	Telefonica German Towers	Telefonica	Telxius	USD 1,500	German mobile towers acquisition with an agreement to build 2,400 greenfield sites
Telecommunications	Reliance Tower	Reliance Industries	British Columbia Investment Management Corporation, GIC,Brookfield Infrastructure Fund IV	USD 3,400	Sale of Reliance-owned Tower Infrastructure Trust
Telecommunications	Arqiva	CPP Investments, First Sentier Investors, IFM Global Infrastructure Fund, Macquarie European Infrastructure Fund II	Cellnex Telecom	USD 2,000	Telecom towers providing television, radio, satellite and wireless communications in the UK
Transport	A49 Hessen		Strabag SE (50%), Meridiam Infrastructure Europe III (50%)	USD 1,000	Project to extend the existing A49 motorway by the German federal government
Transport	Peel Ports (25%)	Pan-European Infrastructure Fund, Peel Group	AustralianSuper	USD 1,000	Stake of 25% in Peel Ports split equally between them
Transport	GMR Airports Sale (49%)	GMR Infrastructure	Aeroports de Paris Management	USD 1,448	GMR Airport business with operational capacity of 87m passengers

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Property performance - to 30 September 2020

	1 year return			Total returns						Index compositions		
	Income	Capital	Total	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	15 yrs % p.a.	20 yrs % p.a.	25 yrs % p.a.	Assets	Value $m	%
All Australian property	**4.7**	**-3.7**	**0.9**	**6.6**	**8.7**	**9.6**	**9.3**	**9.9**	**9.9**	**1,349**	**183,725**	**100**
Retail	3.9	-13.4	-10.0	-0.1	4.0	7.0	7.6	9.2	9.3	366	60,755	33
Office	5.0	1.7	6.8	10.8	11.8	11.0	10.4	10.0	9.9	338	89,744	49
Industrial	5.7	5.2	11.2	11.9	11.7	11.8	10.1	10.8	11.4	424	22,358	12
Others	4.8	2.6	7.5	9.0	12.3	12.8	12.0	-	-	225	11,310	6
Retail - Australia												
Super regional & major regional	3.3	-15.9	-13.1	-1.5	2.8	5.9	7.1	8.8	9.0	64	32,659	18
Regional	4.6	-15.4	-11.5	-1.8	2.6	6.5	7.5	8.8	9.0	26	5,158	3
Sub regional	5.1	-11.1	-6.5	0.5	4.4	7.6	7.5	9.6	9.8	70	8,381	5
Neighbourhood	5.1	-7.2	-2.5	1.8	5.8	8.4	7.8	9.5	10.1	64	2,947	2
Other	3.7	-9.1	-5.7	3.5	6.9	9.1	9.2	-	-	138	11,409	6
Office - Australia												
Premium grade CBD	5.1	1.3	6.5	9.9	10.7	10.8	10.4	10.0	9.9	62	31,433	17
Grade A CBD	4.8	2.1	6.9	11.4	12.3	11.1	10.4	9.9	9.7	123	40,061	22
Grade B CBD	5.0	-1.3	3.6	10.6	13.3	11.3	10.8	10.8	10.3	24	2,285	1
Non CBD	5.4	2.4	7.9	11.4	12.2	11.3	10.2	10.1	10.6	122	15,390	8
Industrial - Australia												
Warehouse	5.6	5.7	11.6	12.1	11.8	12.8	11.0	11.4	11.6	168	6,873	4
Distribution	5.9	6.0	12.2	11.6	11.5	11.5	10.4	11.2	11.2	140	9,111	5
Industrial estate	6.0	3.9	10.1	12.6	12.3	11.3	9.0	10.1	11.3	32	2,254	1
International unlisted												
IPD UK All Property	5.4	-7.6	-2.6	3.3	4.6	7.4	5.1	6.8	5.9	N.A.	N.A.	N.A.
IPD Europe Ex-UK	3.9	5.3	9.3	9.1	8.8	7.1	6.9	6.4	N.A.	N.A.	N.A.	N.A.
NCREIF US Property Index	N.A.	N.A.	2.0	5.1	6.3	9.4	7.4	8.3	9.1	N.A.	N.A.	N.A.
REITs												
S&P/ASX 300 AREIT	N.A.	N.A.	-15.8	4.1	6.0	9.7	3.3	6.3	7.4	N.A.	N.A.	N.A.
FTSE EPRA GREIT $A (H)	N.A.	N.A.	-21.5	-2.0	1.8	6.8	4.6	N.A.	N.A.	N.A.	N.A.	N.A.

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