Recommended

Direct Assets Review
Centuria Healthcare Property Fund

ISSUE DATE: 10-05-2024

Fund financial position	December 2023*
TOTAL ASSETS	$602M
PORTFOLIO	HOSPITALS 52%, MEDICAL CENTRES 25%, SPECIALISED CENTRES 16%, LIFE SCIENCE 7%
DEBT	$275.7M
GEARING (LVR)	46.4%
GEARING TARGET	35-49%

Portfolio summary	
No. of PROPERTIES	20
PROPERTY LOCATION	QLD 37%; VIC 24%; NSW 23%; WA 14%; SA 2%; TAS 1%;
WTD AVG LEASE EXPIRY (WALE)	10.1 YRS
OCCUPANCY	94.4%

Other Fund details	
RESPONSIBLE ENTITY/ MANAGER	CENTURIA PROPERTY FUNDS NO.2 LIMITED
APIR CODE	CTR0438AU
MINIMUM INVESTMENT	$10,000
DISTRBUTION PAID	MONTHLY
REDEMPTIONS	QUARTERLY (MIN 0.5% OF NET ASSETS $10M CAP); FULL LIQUIDITY EVENT 5 YRLY, NEXT AUGUST 2025
% OF FUND HELD BY MANAGER	14%

Manager fees and expenses	
MANAGEMENT FEES AND COSTS	MANAGEMENT FEE 0.8% P.A. OF GROSS ASSET VALUE. EXPENSES CAPPED AT 0.35% P.A. ABNORMAL EXPENSES 0.06% P.A., INDIRECT COSTS 0.03% P.A.
PERFORMANCE FEE	20% OF EXCESS ABOVE 8% P.A. OF GAV. AVERAGE SINCE INCEPTION TO 30 JUNE 2023 WAS 0.20% P.A.
TRANSACTION COSTS	0.54% P.A. OF GROSS ASSET VALUE FOR THE YEAR TO 30 JUNE 2023 (INC STAMP DUTY)
BUY / SELL SPREAD	NOT APPLICABLE

*Data as at, unless otherwise stated.

What this Rating means

The **'Recommended'** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy

Strengths

- Good quality management team with significant experience in healthcare properties in excess of 10 years.
- Co-investment in the Fund of 14% from the Manager provides strong alignment with investors.
- Well diversified portfolio within the healthcare property sector.

Weaknesses

- The Fund is reasonably well diversified, though lacks the scale and flexibility of some peers.
- Some metrics including occupancy, gearing and valuations have reduced since Lonsec's last review of the Fund.
- Recent high levels of redemption requests have been scaled back, in line with some peers.

Lonsec Opinion of this Fund

- Lonsec has assigned a 'Recommended' rating to the Centuria Healthcare Property Fund ('CHPF' or 'the Fund') following the latest review. Since the Fund's inception in September 2020, the Manager has acquired interests in 23 properties across Australia (currently hold 20), with a diverse portfolio including short stay/day hospitals; medical/specialist centres; mental health and specialist health facilities.
- Centuria has demonstrated an ability to form relationships with healthcare operators, including partnering with lead tenant Nexus on four hospitals and acting as a capital partner for Weststate Private Hospital in Townsville. These relationships provide opportunities to acquire quality assets in what is a tightly held market. The Manager has also entered acquisition/expansion opportunities, where the Fund is not taking development risk.
- The portfolio is currently at 94.4% occupancy with a range of quality tenants. Healthcare portfolios often have long leases and the WALE for the Fund of 10.1 years is reflective of this.
- The Centuria Healthcare team are experienced property managers in the healthcare sector. Centuria Healthcare are now part of the wider Centuria Capital property funds management team, both of which have a good record of performance over a long period.

Centuria Healthcare Property Fund

- There is strong demand for healthcare services in Australia due to structural factors like an ageing population, greater life expectancy and an increase in the prevalence of chronic conditions. However, given cost pressures between private health funds and long-stay private hospitals, CHPF has a focus on shorter-stay hospitals with less out-of-pocket expenses for patients.
- The Fund's PDS dated 22 January 2024 disclosed Annual Fees and Costs ('AFC') totaling 1.79% p.a. This value comprises (1) management fees and costs of 1.05% p.a. (2) performance fee estimate of 0.20% p.a. and; (3) transaction costs of 0.54% p.a. In line with RG97, some fees and costs have been estimated by the issuer on a reasonable basis. Actual fees and costs may vary to these estimates, with performance fees having the potential to vary significantly based on the Fund's realised performance and the fee's calculation requirements. Management fees and costs are at the high end the peer group, while the performance fee of 20% above a hurdle of 8% p.a. (net of tax and fees) is reasonably in-line with other property funds that have a performance fee.
- The Fund has a limited quarterly liquidity facility (capped at $2.5m), which has scaled back redemption requests since March 2023. The Manager divested five properties during 2023 to facilitate liquidity. The Fund has a five yearly full Liquidity Event, with the next being August 2025. However, investors are reminded that liquidity of direct and unlisted property may be restricted due to market conditions and redemptions are at the discretion of the RE.

Changes since Lonsec's previous review

The table below summarises the major changes to the portfolio and Fund since Lonsec's last review.

	PREVOUS REVIEW	THIS REVIEW
TOTAL ASSETS	$557M	$602M (▼)
NO. OF PROPERTIES	23	20 (▼)
WALE DIRECT (by inc)	10.2 YRS	10.1 YRS (▼)
OCCUPANCY	96.2%	94.4% (▼)
NO. OF DIRECT TENANTS	86	84 (▼)
INCOME YIELD PORTFOLIO	5.08%	5.92%
CAP'N RATE	5.14%	5.25% (▲)
DEBT	$236M	$275.7M (▼)
GEARING LVR	45.5%	46.4% (▲)
INTEREST COVER	3.1x	2.3x (▼)
UNIT PRICE	$1.0077	$0.84 (▼)

What is this Fund?

- Centuria Healthcare Property Fund ('CHPF' or 'the Fund') invests in healthcare properties, including hospitals, medical centres and aged care facilities. The Fund can also invest up to 10% in liquid assets, namely A-REITs and cash.
- CHPF is an open-end fund with rolling five year investment terms (next August 2025). The Fund offers limited liquidity outside of this investment term at the RE's discretion and the Fund's assets should be considered illiquid.
- The Fund's objective is to provide investors with stable income returns and the potential for capital growth by investing in properties in the healthcare sector underpinned by leases to a range of reputable healthcare operators.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure, and Warning on the final page.

- While the returns of the Fund are expected to be less volatile than equities and listed property securities investments, investors should be aware that the Fund may experience periods of negative returns and that there is a risk of incurring capital loss on the Fund.
- The limited liquidity offered by the regular withdrawal offer, which is at the discretion of the RE, means potential investors should take a long-term view of their investment.
- As such, Lonsec considers the Fund suitable for medium to high-risk profile investors with a 5+ year investment time horizon. The Fund will generally sit within the growth component of a balanced portfolio.

Risk Assessment

Lonsec assesses the Fund's **key risk factors** in the overall context of both competing unlisted property funds and relative to other asset classes.

Level of assessed risk	Low	Med	High
OPERATIONAL EARNINGS			
BUSINESS	●		
LEASING	●		
CAPITAL GAIN VS. INCOME		●	
DIVERSIFICATION			●
MARKET VOLATILITY		●	
FINANCIAL			
LEVERAGE (GEARING)		●	
REFINANCING	●		
INTEREST COST / HEDGING	●		
CURRENCY	●		
COUNTERPARTY	●		
SUPPORT TO DISTRIBUTIONS		●	
MANAGEMENT & OTHERS			
EXPERIENCE	●		
INDEPENDENCE	●		
RELATED PARTY TRANSACTIONS		●	
LIQUIDITY			●

- **Capital gain vs income risk** is deemed medium given that property funds have a higher element of capital risk than some other asset classes (e.g. cash or bonds).

Centuria Healthcare Property Fund

- **Gearing (Leverage)** risk is judged medium relative to other investment classes (including 100%-listed property trusts), where there is lower or no gearing involved (including some wholesale property funds).
- **Diversification risk** is deemed high on the basis that the Fund will hold investments concentrated in a single property subsector, however, the different property types such as short-stay hospitals, specialist clinics and GP practices are underpinned by different funding models.
- **Leasing Risk** is considered low.
- **Interest Costs / Hedging risk** is low with a high percentage of debt hedged.
- **Management experience** is assessed to be low risk due to the relatively large team and their experience in establishing and managing healthcare property syndicates.
- **Related Party Transactions** risk is deemed medium as some of the Fund's investments were purchased from related parties. The RE will also utilize Centuria's internal resources. That said, the Manager has clearly defined protocols for managing conflicts of interest, and any such transactions must be approved by the independent Compliance Committee and the Compliance Officer.
- **Liquidity risk** is deemed high due to the possibility that the majority of unlisted assets may not be able to be sold and that other liquidity options (cash, property securities, debt or equity inflows) may be limited. The provision of a full liquidity event every five years may still be subject to the same potential restricted liquidity of the unlisted assets at this time.

Product

Structure

- The Fund is a registered managed investment scheme under the Corporations Act. The Manager employs high quality service providers as Custodian and valuers.
- Lonsec notes the Fund uses a related-party Responsible Entity ('RE') which may lead to potential conflicts of interest. While the use of external REs is Lonsec's preferred operating model, Lonsec notes the RE has built experience in operating and managing a number of registered managed investment schemes over an extended period and is expected to have a structured governance framework in place.

Liquidity

- The Fund has a full Liquidity Event for all unitholders every five years, with the first scheduled in August 2025. Under the Fund's Constitution, Centuria is allowed up to 365 days to accept a withdrawal request.
- The Manager also offers a regular liquidity facility on a quarterly basis. The amount available for redemptions will be at a minimum 2.5% of the Fund's net assets (equivalent to $10m per year). If the amount required to meet withdrawal requests in any one quarter exceeds the amount Centuria determines to be available, then withdrawal requests will carry forward and be met on a pro-rata basis. Lonsec notes this is currently the case.
- Notwithstanding the above, withdrawals may be suspended in certain circumstances. Lonsec stresses to investors that the liquidity facility is limited and the acceptance of redemption requests is ultimately at the discretion of the R.E.

Valuation policy

- All properties are subject to a minimum requirement to complete an independent valuation once every two years.
- Retail schemes: currently in practice valued twice a year, usually one independent valuation.
- Wholesale schemes: annual valuations, or by requirement.
- External Valuers will be rotated so that a property is not externally valued by the same valuation firm for three consecutive years. All properties were independently valued as at 31 December 2022 and 30 June 2023.

Fee Structure

- **Annual management cost** comprises management fee of 0.80% p.a. of the Fund's gross asset value (0.35% on liquid investments). For any investment in another fund managed by an entity within the Centuria Group, the management fee charged at the underlying fund level will be deducted from the management fee payable to this Fund (avoids 'double-charging' of fees by the RE). Expenses (excluding Abnormal Expenses) are capped at 0.35% p.a. of the Fund's gross assets and includes compliance costs, audit, accounting, and legal fees.
- **Transaction Costs -** Acquisition and Disposal fee of 2.0% and 0.5% respectively of the price of any property asset in which the Fund acquires or divests a direct or indirect interest.
- **Performance Fee**: The RE/Manager is entitled to a 20% share of excess total return above 8% p.a. (pre-tax, net of fees). This is at the lower end of the range for the peer group (8%-9% p.a. hurdle). The Performance Fee is charged on a high-watermark basis, with any prior underperformance having to be recovered prior to an amount being paid.

Property Portfolio

The Manager continues to evaluate further potential acquisitions of direct properties, with consideration given to the overall portfolio WALE, gearing, geographic and sector diversification. These will be balanced against the risks and opportunities presented by the proposed acquisitions. Current portfolio characteristics:

Medical Centres

Centres containing a number of medical services including GP, pharmacy, pathology and allied health.

Hospitals

Centuria Healthcare Property Fund

Inpatient and outpatient facilities that provide surgical and other prescribed treatments.

Specialist Centres

Properties dedicated to providing healthcare administration, support or allied health services.

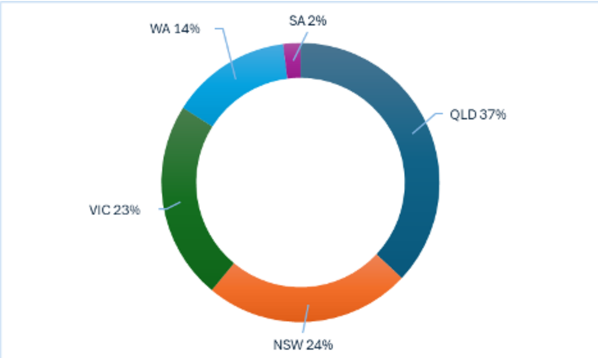
Life Science

Real estate supporting application of biology and technology to the study of health improvement.

Development

- The Fund may consider funding greenfield and brownfield development opportunities that have been substantially 'de-risked'. For example, they have an approved development application or agreements for leasing in place for the majority of the net lettable area. Up to 20% of net asset value can be invested in development projects.
- Lonsec observes that development exposure within the Fund is currently minor, with the Fund preferring to outsource development risk to a developer and receive coupon income over the construction period. Lonsec expects a similar approach to development over time.

Geographic allocation

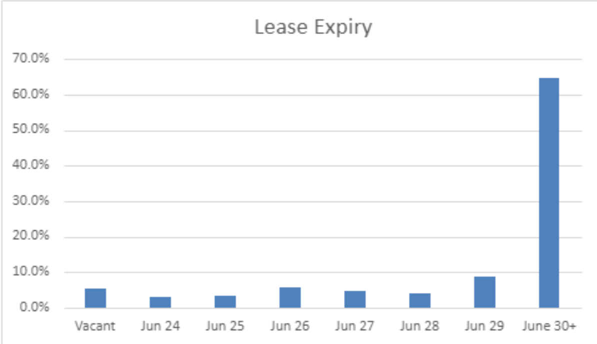


Portfolio by healthcare subsector

SUBSECTOR	% PORTFOLIO
SHORT STAY & DAY HOSPITALS	52%
MEDICAL CENTRES	25%
SPECIALIST CENTRES	16%
LIFE SCIENCE	7%
TOTAL	100%

Lease Expiry Profile

- The Fund has a weighted average lease expiry (WALE) of 10.1 years.
- Leases generally have built-in fixed rental increases (average 3.6% p.a.), with 64% of income CPI linked. Generally, there are provisions for market reviews upon expiry for leases with options to extend.
- Tenant lease expiries are reasonably low over the next five years, with around 65% FY30+.



Tenants

- Occupancy is high at 94.4%, though has fallen from 95.6% at the time of Lonsec's previous review.
- Supporting the major tenants are specialist smaller tenants, the vast majority of whom provide medical services. Examples include pathology, medical imaging, pharmacy, and psychology.

Top Tenants	By Income
STATE GOVERNMENT	13%
WESTSTATE PRIVATE HOSPITAL	10%
PERTH CLINIC	7%
NEXUS HOSPITALS	6%
PARAGON CARE	6%
RAMSAY HEALTHCARE	6%
TOTAL	48%

Debt Position / Interest

Debt Facility	Dec 2023
FACILITY LIMIT	$330M
DRAWN DOWN	$275.7M
HEDGED (AVG)	66%
WTD AVG LOAN EXPIRY	1.7 YRS
LVR	46.4%
LVR COVENANT	55.0%
ICR	3.1X
ICR COVENANT	2.0X

- The Manager has combined debt facilities of $330m with four banks (three Australian and one foreign). As at 30 Dec 2023, $54.3m was undrawn, providing room to fund current development expenditure.
- The Fund has entered into a swap to fix the interest rate of 66% of its debt exposure with a weighted average of 2.0 years.
- The Loan to Value Ratio (LVR) is 46.4%, within the target range and below the 55% covenant, however this has increased since Lonsec's last review. The interest cover ratio of 2.3x is lower than the 3.1x at last review, but above the ICR covenant of 2.0x. As at 31 Dec 2023, the direct property portfolio values would have to fall by over 16% before the bank LVR covenant was breached and the Fund income would have to reduce by 9% before the interest cover covenant was breached.

Centuria Healthcare Property Fund

Management

The Responsible Entity (RE)

- Centuria Property Funds No 2 Ltd (CPF2L) is the Responsible Entity for the Fund and is a wholly-owned subsidiary of Centuria Capital Ltd (Centuria).
- Centuria was established in 1999 and is an ASX listed company (code: CNI) with a current market capitalisation of $1.5b. As at December 2023, the Group manages $21.1b of assets ($20.3b of real estate assets and $0.8b of investment bonds).
- Centuria's property funds under management consists of $14.1b unlisted property funds as well as $6.2b in listed property trusts (ASX: Centuria Office REIT; Centuria Industrial Fund; NZSX: Asset Plus Ltd). The group has expanded its unlisted fund offering into the Healthcare and Agriculture sectors.
- Centuria operates a 'vertically integrated property business', across both property funds management and property services. The group employs 400+ staff and manage asset acquisition/disposal, leasing and tenant relationships in-house.
- CPF2 has appointed Centuria Healthcare P/L (63.06% owned by Centuria Capital with the balance held by Centuria Healthcare management) to provide resources under a services agreement. Centuria Healthcare is an experienced specialist healthcare property funds manager.

Management Team

Board of Directors – Centuria Property Funds Ltd

NAME	POSITION	JOINED CPFL BOARD	EXP.[1] (YRS)
ROGER DOBSON	EXTERNAL NON-EXEC. CHAIRMAN	2017	40+
PETER DONE	EXTERNAL NON-EXEC. DIRECTOR	2007	35+
JENNIFER COOK	EXTERNAL NON-EXEC. DIRECTOR	2001	20+
NATALIE COLLINS	EXTERNAL NON-EXEC. DIRECTOR	2020	20+

1: Experience in property industry

- The RE Board is currently comprised of all external directors. Other Executives closely involved in the management of the Fund include:

NAME	POSITION	JOINED CENTURIA	EXP.[1] (YRS)
JOHN MCBAIN	JOINT GROUP CEO	1999	30+
JASON HULJICH	JOINT GROUP CEO	1999	20+
ANDREW HEMMING	MANAGING DIRECTOR CENTURIA HEALTHCARE	2006	20+
VIJITHA YOGAVARAN	FUND MANAGER CHPF	2014	15+
JESSE CURTIS	HEAD OF FUNDS MANAGEMENT	2019	15+
VICTOR GEOROS	HEAD OF PORTFOLIO & ASSET M'MENT	2013	25+
TOBY KREIS	HEAD OF HEALTHCARE PARTNERSHIPS	2018	25+

1: Experience in property and/or investment industry

- Centuria has recently appointed a GM Sustainability.

CPF2L Audit Risk and Compliance Committee

NAME	POSITION
PETER DONE	CHAIRMAN AND NON-EXEC. DIRECTOR
ROGER DOBSON	NON-EXEC. DIRECTOR

- CPF2L have an established Audit, Risk Management and Compliance Committee consisting of the three non-executive directors from the CPFL board. The role of the committee is to oversee how conflicts of interest /potential conflicts of interest and related party issues are managed.
- The Chief Risk Officer and is responsible for maintaining the compliance policies within Centuria. Any changes made to these policies need to be reviewed and signed off by the CPFL board.
- CPF2L's Fund Managers are assigned responsibilities as 'risk gate-keepers' and are responsible for identifying any actual or potential conflicts of interest that arise from day-to-day operations. This is part of the Fund Manager's key performance indicators.

Investment Style / Process

Investment style/Acquisition criteria

- Centuria has historically focused on 'Core Plus' and 'Value Add' investment opportunities in the office sector. However, in more recent times they have expanded into 'alternative' property sub-sectors like healthcare and agriculture. They view their competitive advantage as being able to add value via their active management approach, including:
  - proactive leasing campaigns.
  - upgrading of building services and reducing occupancy costs.
  - refurbishment and redevelopment projects.
  - re-zoning and development application strategies.
- In the office sector, the major eastern seaboard markets of Sydney, Melbourne and Brisbane are the key areas of focus. Centuria's in-house, end-to-end property capability enables them to take on a wide range of investments and leverage these resources to add value. The team seeks to target mis-priced opportunities or properties that are likely to benefit

from infrastructure investment or urban renewal projects.
- Centuria has a heritage of establishing and managing single asset property funds and has historically acquired assets with either short WALEs, poor lease profiles or properties in need of re-leasing, re-positioning or re-development during the investment term.
- This extends to disposing of properties in the event that an attractive offer is presented before the end of the initially proposed investment term (subject to unitholder approval).

On-going Property Management

- The overall property management will be undertaken by Centuria, including liaising with the major tenants.
- The day-to-day asset management and maintenance tasks are managed by the in-house asset management team. This is a key competency of the company.
- Centuria will also liaise closely with the on-site facility manager to ensure efficiencies are being realised.

Potential Conflict of Interest / Related Party Issues

- The Manager has a 'Conflicts of Interest' and 'Acquisition and Deal Allocation Procedures' policies that are designed to ensure that any interactions and services received between related parties are consistent with 'industry best practice'.

Centuria HPF Performance (to Dec 2023)

Returns % p.a.	1 YR	2 YRS	3 YRS	Since Incep.[1] %p.a.
INCOME	4.22	4.5	4.96	5.02
CAPITAL GROWTH	-17.31	-8.01	-2.85	-2.86
TOTAL RETURN CHPF	**-13.09**	**-3.51**	**2.11**	**2.16**

1: Inception 21 September 2020.

Since inception in September 2020, the CHPF had a modest 2.16% p.a. total return. Income generated was in the 4-5% p.a. range. Post-pandemic cap rates have softened due to higher interest costs, though the healthcare sector has fared relatively well compared to other property sectors, particularly retail and office.

Shorter term performance has been impacted by a reduction in valuations driven by cap rate softening and cost adjustments relating to a tenant dispute at Weststate Private Hospital.

Centuria Healthcare Property Fund

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately-owned entity with a multi-brand strategy of providing leading financial services research and investment execution.
Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.

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Analyst

Michael Elsworth

Approved by

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