

SENIORS LIVING - BECOMING A MAINSTREAM INVESTMENT SECTOR - MARCH 2017 -

Australia's population is ageing and the accommodation requirements are evolving.

The seniors living industry has three key accommodation components:

- manufactured housing estates (MHE) - operate under a ground lease agreement in which the resident owns the re-locatable home and leases the right to occupy the site from the village owner/operator;
- retirement living communities/villages – a facility comprising units/apartments or villas in which the residents does not own the unit but will live in it subject to a lease or licence to occupy. Retirement villages typically operate under a deferred management fee (DMF) structure; and
- aged care - a special-purpose facility which provides accommodation and other types of support from assistance with day-to-day living through to intensive forms of nursing care to frail and aged residents.

Older Australians are increasingly moving along the spectrum of seniors housing, from independent living at home, to accessing low level support services in a retirement living community or MHE, to ongoing nursing care in a residential aged care facility (Figure 1).

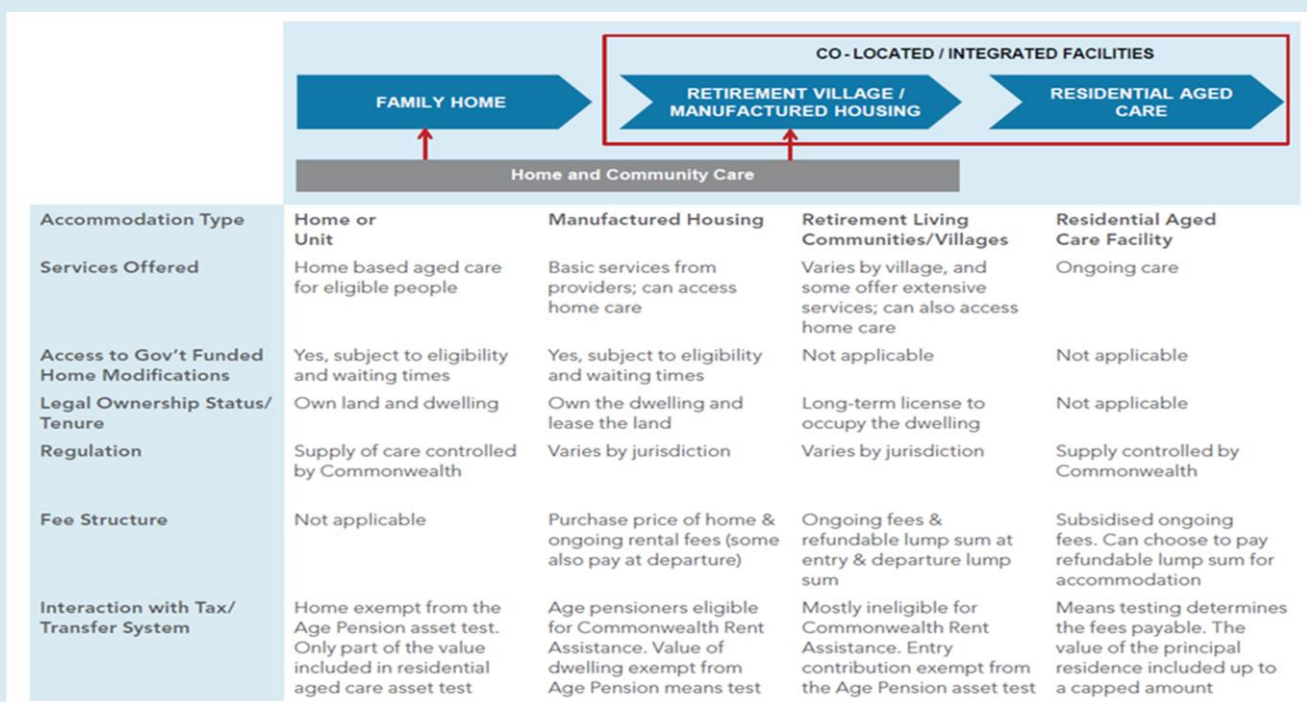
As part of the evolution of the industry, there is also a growing move toward integrated facilities – offering a 'continuum of care', through the integration of an aged care facility and/or provision of home care services within, or adjacent to, an MHE or retirement living community (Figure 2).

The industry is undergoing significant change and growth largely driven by an ageing population, industry consolidation, changing consumer expectations and a shortage of quality accommodation.

AGEING POPULATION

Australia's population is ageing. The number of Australians aged over 65 years has almost doubled in 20 years from 1.62 million in 1995 to 3.6 million in 2015. The over 65s are forecast to increase by 57% to 5.6 million by 2030.

Figure 1: Continuum of Care





INDUSTRY CONSOLIDATION

Ownership across all three components of the seniors living industry is highly fragmented and the quality of facilities varies widely.

In the retirement living sector, the top six operators represent approximately 29% of the operators in the sector¹. Approximately 60% of the facilities are accounted for by the For Profit operators such as Lend Lease, AVEO, Stockland, Retire Australia, Living Choice, and Australian Unity and 40% by the not for profit operators.

The aged care sector is a similar story. As at June 2015, approximately 64% of operators operated a single facility which accounted for 23% of all operational aged care places and 28% operated between two and six facilities². Conversely, providers with more than 20 homes accounted for only 2% of all providers, however they accounted for 26% of operational places.

Increased participation from the private sector and institutional investors is leading to the move from a boutique cottage industry to one of growing sophistication and scale.

A flurry of ASX listings in the recent years by both specialist aged care operators – Japara, Regis and Estia, and listed A-REITs – Gateway Lifestyles, Ingenia, and Lifestyle Communities have shone the spotlight on the sector. AVEO (the former FKP) is transforming itself into a specialist retirement and aged care operator. We also expect to see more opportunities for investors to access the sector through the unlisted space via both private equity and unlisted real estate funds.

CHANGING CONSUMER EXPECTATIONS

The wave of baby boomers coming through over the next 10-20 years will have a higher level of affluence, and greater expectations in the standard, quality and services of seniors living accommodation than the previous generation of seniors.

These customers will pay more for facilities and services but they will also expect higher standards. There will be a greater emphasis on service, brand

quality and the reputation of service providers (Figure 3).

The Federal Government wants more people to age in place, and has committed to increase funding for home care packages; it's more cost effective to provide care in someone's home than have them occupying an aged care bed 24/7. In addition, the Government is moving to a system where consumer choice and control is at the centre of the future aged care system (Consumer Directed Care - CDC). From February 2017, home care packages will no longer be allocated to providers. Instead, eligible older Australians will be assigned a home care package that they will be able to direct to their preferred provider. MHE's and retirement living communities will increasingly look to offer additional services including home care packages within their communities.

There is no hiding from the fact the cost to Government of subsidising aged care is set to blow

Figure 2: Convergence

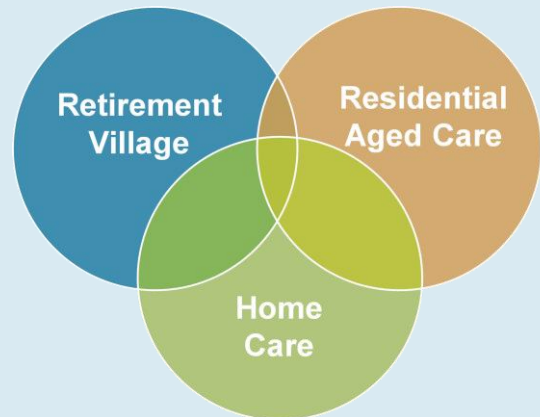


Figure 3: Customers Expectations Will Change as Customers Are Becoming....

- more educated
- more discerning
- more demanding
- have more money
- with more choice



Consumer Directed Care

¹ Healthcare and Retirement Living – Colliers International - 2015.

² Fourth Report on the Funding and Financing of the Aged Care Sector – Aged Care Financing Authority – July 2016

out in next few years. The Federal Government is committed to making the system more transparent and fairer but as the Government tweaks the funding model and rules around how much and how people can pay to access aged care (ie between Refundable Accommodation Deposit (RAD) - a standard bond price set by the respective aged care facility and Daily Accommodation Payment (DAP) - effectively a daily payment to the operator) it is causing some confusion for the people and their families who are considering entering an aged care facility. Seeking professional advice is essential to stepping through the maze of accessing and paying for aged care and home care services.

Those that can provide high quality facilities and these additional services will be well placed to capture a growing share of Australia's seniors, at the same time, as enhancing their overall profitability.

SHORTAGE OF QUALITY ACCOMMODATION

There are approximately 2,300 retirement living communities/villages in Australia, comprising more than 140,000 dwellings and housing approximately 184,000 older Australians³. The average age of retirement living community/village is 24 years⁴ – with many of the earlier ones are heading towards obsolescence. Folkestone estimates that if the penetration rate of retirement living communities/villages was to increase from just under 6% to 7.5% of the over 65's population, the number of Australians living in retirement living communities/villages would more than double to 419,000 by 2030 (Figure 4). If penetration rates were to increase to 10% (not unachievable, in the US it's currently around 12%), approximately 560,000 people would be living in retirement living communities by 2030.

Despite Federal Government attempts to encourage Australian's to age in place, the Aged Care Financing Authority estimates that the residential aged care sector will need to build approximately 76,000 additional places over the next decade compared with 34,788 new places that came on line over 10 years to 30 June 2015⁵

³ PwC/Property Council Retirement Census – PwC and Property Council - 2015

⁴ PwC/Property Council Retirement Census – PwC and Property Council - 2016

⁵ Fourth Report on Funding and Financing of the Aged Care Sector - Aged Care Financing Authority – July 2016

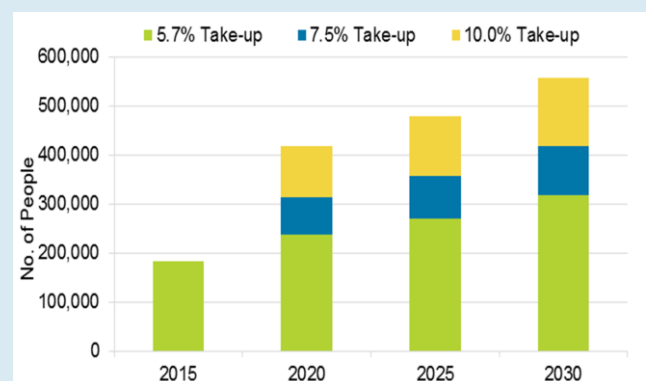
(Figure 5). At the same time, the sector will need to rebuild a substantial proportion of the current facilities which are old, inefficient and don't meet the quality standards of the government and the community.

Assuming that the cost of construction continues to grow at about the current rate, and that a quarter of the current stock of buildings is rebuilt at an even rate over the next decade, the Federal Government estimates that the investment requirement of the sector over the next decade to be in the order of \$33 billion⁵.

AN ATTRACTIVE ASSET CLASS

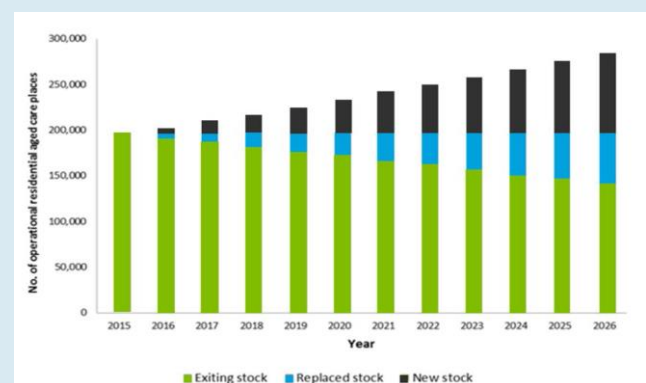
We remain convinced that all three components of the seniors living sector – MHE, retirement villages and aged care will continue to professionalise, consolidate and become more attractive as an investment asset class.

Figure 4: Implied Demand Retirement Living Communities Residents: 2015 – 2030



Source: Folkestone/ABS

Figure 5: Number of Operational Residential Aged Care Places Required: 2015 - 2026



Source: Aged Care Financing Authority

This will require a substantial amount of capital, and we see significant opportunities for investors taking a long term investment view to participate in the evolution and growth of this important sector either through investing in the operations and/or the underlying real estate via both the ASX and unlisted funds.

Folkestone, an ASX listed real estate funds manager and developer, launched its first seniors living fund last year to acquire the Watermark Retirement Living in Castle Cove, Sydney and is set to launch further funds in 2017 to allow investors to participate in the ownership of seniors living communities.

Watermark Castle Cove, an asset of the Folkestone Seniors Living Fund No. 1



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