Social infrastructure sector yields results

Investors are turning to this area as it grows and matures

ADRIAN HARRINGTON

Investors are increasingly turning their attention to the real estate social infrastructure sector — that is, investments reflecting broader trends in society that, in turn, influence the types of buildings and infrastructure we need as a nation.

Real estate social infrastructure includes investments in the infrastructure behind childcare, seniors housing (manufactured housing, retirement villages and aged care), student accommodation, government premises (police stations, courthouses), and medical and health facilities.

Growth in real estate social infrastructure opportunities is primarily being driven by five factors.

• **Demographic and social changes**. Our ageing population is increasing demand for seniors housing and health services, while higher participation of females in the workforce and the growing number of 0- to five-year-olds is increasing demand for childcare. The rise of international students is also one reason the student accommodation market is booming.

• **Demand for better quality facilities.** Operators (tenants) and their customers require higher quality facilities. For example, the childcare sector is moving from "child minding" to early learning, which is changing the design and layout of centres, as they move away from being what were often just converted houses. The healthcare sector is being driven by advances in medical technology and procedures while the aged care sector — supported by government regulation on quality standards — is increasing demand for higher-quality aged care facilities.

• **Government financing and budget constraints**. The public sector's ability to fund the level of infrastructure required to meet the needs of the community is under pressure and governments are increasingly seeking private sector participation.

• **Relatively high population growth rates and greater density and urbanisation of cities.** These factors are increasing the need for investment in social infrastructure assets that support communities both in the inner city and on the urban fringes.

• **Growing realisation operators should focus on their core business.** This means managing and delivering services to the community rather than the provision, ownership and management of the underlying real estate assets.

Of course the benefits of social infrastructure assets need to be considered in light of the risks.

The key risk to investors is the specialised nature — and often the critical importance — of the operator leasing the asset.

A private hospital is a highly specialised asset and having a well capitalised and competent hospital operator such as Ramsay Health Care is critical.

Successful investing in this sector requires a sound relationship between the operator (sometimes a government agency) and the real estate owner, and an understanding of the underlying businesses operating within the facility. Also, social infrastructure assets to varying degrees have high levels of government regulation and intervention that are susceptible to change.

But this can also be a positive, especially if the government is partially or fully underwriting the cashflows of the sector.

While the increased operating leverage and other industry risks clearly warrant a risk premium, the sector's risk-reward profile has improved greatly as many areas of the social infrastructure sector have grown and matured.

> Perhaps the outstanding attraction of the sector to investors is the relatively high yields

Consolidation of operators in the early learning, health and aged care sectors is well under way. Many operators are publicly listed companies. For example, G8 in the early learning sector, Ramsay Health Care and Primary Health Care in the healthcare sector and Japarra, Regis and Estia in the aged care space.

Allowing for these risk factors, investors are increasingly examining real estate social infrastructure as it offers some of the most sought after factors in the present low growth and low interest rate environment.

Perhaps the outstanding attraction is relatively high yields. Social infrastructure asset yields are typically between 100 and 150 basis points higher than major office, retail and industrial assets.

There are also strong real estate factors such as attractive lease structures, "stickiness" of tenants — tenants are inherently linked to their premises due, in many cases, to the specialised nature of the assets — strong demand and government support.

At present, there are five sector specialist A-REITs and four sector specialist real estate developers and managers listed on the ASX, providing exposure to early learning, manufactured housing, retirement, aged care and health/medical.

It is early days, as these entities represent less than 0.5 per cent of the entire listed A-REIT and real estate manager/developer sectors. By comparison, social infrastructure real estate represents more than 20 per cent of the market capitalisation of the US REIT index. The performance of the social real estate focused A-REITs has generally been positive. The two best-performing A-REITs in the S&P/ASX 300 Index over the three years to October 31 were both real estate-related social infrastructure A-REITs: Folkestone Education Trust (early learning) and Ingenia (seniors living), with annual total returns of 30.8 per cent and 24.7 per cent respectively, outperforming the S & P/ASX 300 A-REIT Index's 16 per cent.

The unlisted market is also embracing the real estate social infrastructure sector.

Three notable unlisted social infrastructure funds are: the Australian Unity Healthcare Fund, which owns more than $760m of hospitals, medical clinics, nursing homes, day surgeries, consulting rooms, rehabilitation units, radiology and pathology centres; the Folkestone-managed CIB Fund, which owns a portfolio of police stations and courthouses leased back to the Victorian government; and the Transfield-managed Campus Living Villages Fund, which owns a portfolio of student accommodation facilities in Australia, New Zealand, the US and Britain.

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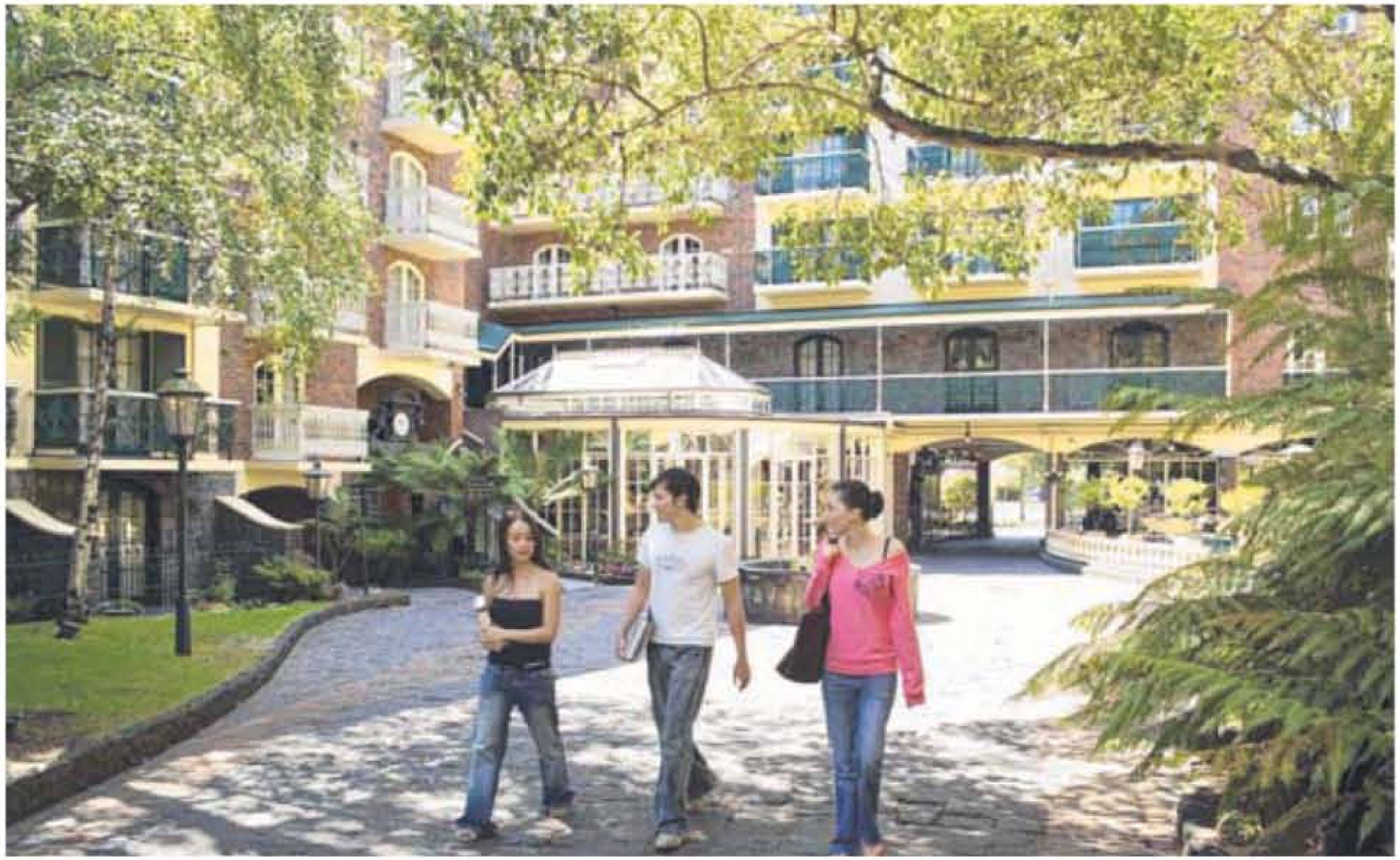

JOHN GOLLINGS

An increase in international students is one of the demographic changes driving the boom in student accommodation

ASX listed real estate social infrastructure – Nov 2015

A-REIT	Sub-sector	S&P sub-sector classification
Folkestone Education Trust	Early learning	A-REIT
Ingenia Group	Manufactured housing/retirement villages	A-REIT
Arena REIT	Early learning and medical/healthcare	A-REIT
Generation Healthcare REIT	Medical/healthcare and aged care	A-REIT
Aspen Group	Manufacturing housing/caravan parks	A-REIT
Aveo	Retirement villages	Real estate manager/developer
Gateway Lifestyle	Manufactured housing	Real estate manager/developer
Lifestyle Communities	Manufactured housing	Real estate manager/developer
Eureka Group	Manufactured housing	Real estate manager/developer

Source: IRESS