

13 December 2018

Vital Healthcare Property Trust (VHP)

The trust will hold its Annual General Meeting **2.00pm 20 December 2018**

The location is **Ellerslie Event Centre, 80 Ascot Ave, Auckland.**

Vital Healthcare Property Trust (VHP) is externally managed by Vital Healthcare Management Ltd (VHM). The 100% shareholder of VHM is NorthWest Healthcare Property Management Ltd (NWM). VHP is one of the few remaining externally managed listed property trusts on the NZX. The Association has never favoured externally managed vehicles due to the potential for misalignment between the Manager and the Unitholders.

Since NWM acquired the management contract in January 2012 the property portfolio has increased from \$567 million to \$1.73 billion a 205% increase. The Rental Income has increased from \$48 million to \$90.7 million, an 88% increase and Distributable Income has increased from \$23.3 million to \$46.1 million, 97% increase. The Unit Price has increased from \$1.21 to \$2.01, an 80% increase.

However, management fees have increased by a staggering 553% from \$4.3 million in FY12 to \$28.1 million in FY18. There is clearly a serious misalignment between the Management fees and the other metrics.

The Manager is paid an annual fee of 0.75% of the gross value of the Trust, plus an incentive fee equal to 10% of the average annual increase in the gross value of the Trust up to but not exceeding 1.75% of the Trust's total assets.

NWM, through Baincor Nominees Pty Ltd holds 24% of the units but because of the governance arrangements, NWM has more effective control over the Board and the Trust than its holding would indicate.

Concerns have been expressed around the recent merger of the management activities of VHP and NWM's wholly owned NorthWest Healthcare Properties Australia and whether this will lead to conflicts of interest.

In May the former Independent Chairman Graham Horsley, who was appointed to the Board in 2007, unexpectedly resigned, having been re-elected at the October 2017 meeting. He was replaced by Claire Higgins, an Australia-based Director who was appointed to the Board in January 2012, the same time as Non-Executive Directors Paul Dalla Lana, the founder of NMW, and Bernard Crotty the President of NWM. Seven days later NWM announced it had acquired a 10% interest in Healthscope Ltd an Australian private hospital operator via complex derivatives contracts. The announcement stated that opportunities to purchase Healthscope's underlying real estate assets were of interest to NWM and VHP jointly. Acquiring an indirect 10% stake in a listed company whose assets include operating businesses as well as real estate assets is a most unusual transaction for an NZX listed property trust.

In November NWM announced it had bought 1% of shares in Healthscope on market and then amended the forward derivative contracts to increase its holding in Healthscope to total 13.41%. It also announced it had increased its borrowing from VHP by A\$40 million to a total of A\$81 million repayable no later than 12 months. No interest rate for the loan was disclosed. We would hope the terms and conditions around the derivative contracts will not result in an unfortunate outcome for Unitholders. Significant risk is attached to such arrangements.

Also in November, NWM announced it would review its Management fees in the first quarter of 2019 and not exercise its rights to unilaterally increase fees above current rates in the meantime and not exercise its rights to remove Independent Directors at will. Whilst some might see this announcement as positive it illustrates the governance gap between an externally managed trust and a traditional internally managed company structure.

Board Composition

The Board comprises an Independent Chair, 2 Independent Directors, 2 Non-Executive Directors and the CEO.

We note one of the Independent Directors, Andrew Evans was appointed in 2007. Internationally recognised governance principles state that a Director ceases to be considered Independent after they have served for 12 years, in Mr Evans case in 2019.

The executive backgrounds of the Board are in the property industry, accounting and finance and law. We consider the Board skill sets to be appropriate.

A major concern around this entity and the conduct of the meeting is that the manager determines whether resolutions may be put before the meeting.

NZSA has engaged with the all the parties over a long period. After carefully considering the unsatisfactory governance processes and the poorly disclosed actions taken by the manager, NZSA has concluded that it must support the resolutions put forward by institutional investors to convey the strongest message to the manager that reform is essential and urgent. In the absence of reform, we believe the Trustees will have to review the situation and take whatever action is possible to address the situation.

We are very concerned at the timing of the meeting and that the option of online voting is not being offered to unit holders. This procedure is now routine, and no explanation has been given for it not being offered, which leads to the inevitable conclusion that the manager has no respect for the unit holders.

In light of all the above and the further details that follow NZSA concludes that the approach being taken by the manager NWM shows only contempt for the significant majority of unitholders.

Although in law the terms of the NWM's management contract permit the conduct, it is grossly unfair and reflects very poorly on the governance standards practised by the manager.

Resolutions.

There is one binding resolution and 5 non-binding resolutions. This illustrates the governance of Vital is markedly different from a listed company in that the Unit Holders can propose and pass resolutions, but these can be rendered nugatory at will by the Manager.

- **To elect either Graham Stuart or Paul Mead as an Independent Director.**

This is yet another illustration of the unusual governance of this entity in that Unit Holders are being asked to choose between 2 candidates rather than being able to vote for each separately. There is no need for this approach. The Trust has capacity for more directors.

Graham Stuart is the Manager's nomination and was appointed to the Board in November 2018. Paul Mead has been nominated by 3 Unit Holders who collectively hold 10% of the units. The candidates' biographies are included in the Notice of Meeting.

Both are excellent candidates with strong track records and NZSA would comfortably support both. However, as unitholders are not being offered that opportunity, we are not able to support the manager's candidate. In any event, Paul Mead has the edge as he has an extensive executive background in the industry and considerable experience dealing with derivatives, an area that requires in depth knowledge.

Accordingly, we will vote undirected proxies in favour of Paul Mead.

The 5 non-binding resolutions have been proposed by the same group of Unit Holders. Some of the resolutions are complex and we suggest members read the Notice of Meeting. We have summarised the resolutions as follows:

- **To remove the Trust Deed clause that allows the Manager to unilaterally remove Independent Directors and unilaterally remove the right of unit holders to nominate and vote on Independent Directors.**

This is a matter of unit holder democracy in that all Unit Holders should have the right of one unit one vote to decide who will represent them to govern the entity.

We will vote undirected proxies **IN FAVOUR** of this resolution.

- **To remove the ability of the Manager to unilaterally alter the Manager's fee.**

Again, this is a matter of unit holder democracy. This situation is the same as if Directors of listed companies could set their fees without any reference to the shareholders or needing to gain approval of the shareholders by a simple majority vote.

We will vote undirected proxies **IN FAVOUR** of this resolution.

- **To request the Manager to negotiate in good faith to bring the current Management fees in line with market levels.**

As noted above the Manager has announced it will review its fees in the near future, however it has not indicated the methodology of the review. We would suggest that in order to show good faith and act in accordance with good governance principles the review should include an appropriate independent assessment of the fees and that the independent reviewer should not be selected or appointed by the Manager but that this process should be conducted by a group of substantial Unit Holders.

We will vote undirected proxies **IN FAVOUR** of this resolution.

- **To increase the size of the management company Board to six Directors (the Trust has no Directors) with a minimum of 4 independent Directors and a minimum of 2 Independent Directors elected by Unitholders.**

We note the Constitution of the Manager (VHM) provides for a maximum of 7 Directors. The shareholder of that Company (NWM) has the ability to change the constitution and the right to appoint and remove members of the Board. This cannot be considered good governance. A 24% Unitholder should not be able to dictate governance to the other 76% of Unitholders.

We will vote undirected proxies **IN FAVOUR** of this resolution.

- To require the Manager to amend its policies to reflect resolutions 1,2 and 4 and ensure the primary duty of the Board is to the Unitholders.

We consider this proposal to be basic good governance.

We will vote undirected proxies **IN FAVOUR** of this resolution.

The Trust's Board is against all the Non-Binding resolutions. If the resolutions were passed and implemented the current power imbalance between the Manager and its shareholder who holds only 24% of the Units and the other 76% Unitholders would be redressed.

Proxies

Please note the Trust does not allow you to vote or appoint a proxy online. You can only vote by completing the Voting/Proxy form and either posting, faxing or emailing to Computershare. **We recommend you either email or fax the form given the time constraints** and uncertainty of the postal service.

We have received information that shareholders are being phoned and asked about their voting intentions. We urge Members who are shareholders to either vote directly or give us their proxy. Although most of the resolutions are non-binding on the Board, a strong vote in favour will place a moral and ethical obligation on Directors to carry out the wishes especially if the vote in favour of these resolutions is greater than 50%.

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **2.00pm 18 December 2018.**

Please note you can appoint the Association as your proxy. We will have a representative at the meeting.

IF YOU FIND NZSA PROXY VOTING INTENTION PAPERS HELPFUL, PLEASE MAKE SURE YOU SPREAD THE WORD AND ENCOURAGE OTHERS TO JOIN NZSA AND SHARE THE BENEFITS.

The Team at NZSA