UK healthcare has established itself as a mainstream asset class as the market continues to mature and attract a broad variety of investors, both domestic and overseas. UK institutions have dominated recent activity, closely followed by US REITs which have been active in the private pay care market for a number of years. Improved availability of funding has helped UK pension funds and institutions increase their exposure to the healthcare sector.
The structural rise in user demand for elderly care is a key driver for investment into the sector. Key trends which will impact the sector in the future include not only the expansion of the elderly population but also changes in health and dependency levels of the very elderly.

There has been a resurgence of demand for specialist care homes and independent hospitals. Specialist sectors such as mental health establishments and specialist schools are now also attracting interest from both domestic and overseas capital, partly driven by the lack of available elderly care platforms.

Further yield compression is expected on the back of strong demand for modern, purpose-built healthcare properties from both UK institutions and international investors as debt financing is readily available.

A growing number of investors, notably UK institutions and US REITs, are including healthcare assets in their portfolios. Low inflation and low interest rates are making investors seek opportunities with good rental prospects and the healthcare sector is particularly benefitting from favourable demographics and stable and very long term index-linked income.

**Key drivers**

The first quarter of 2015 has seen a flurry of major transactions and more than £1.5 billion worth of healthcare facilities have changed hands in the past 12 months. Investment yields moved in further over the past year with care homes selling for yields of 5.0% and below, predominantly to UK institutional buyers. The prime covenant market has compressed and is being hotly pursued by mid-cap group operators and charitable covenants at 5.5%.

In contrast to previous years when overseas investors, and in particular US REITs, have been the most active buyers, investment in healthcare properties is now dominated by UK Institutions such as pension funds and insurance companies which have accounted for circa 40% of the market in the past year; overseas investors made up around a third of all transactions. However, there has also been increased activity from public property companies while private property companies along with occupiers have been the main sellers of healthcare assets (Figures 1 and 2).

Key transactions include the acquisition of Meridian Healthcare by HC-One for more than £100 million, US REIT Ventas’s purchase (sale & leaseback) of five care homes from Canford Healthcare, the sale of Care UK’s Manor Lodge in Chelmsford to AXA REIM at an initial yield of 4.75% and TH Real Estate’s purchase of 3 Care UK care homes for just under £50 million. Around £2 billion of private equity is being earmarked for healthcare assets in 2015 and UK pension funds and institutions are both actively buying and lending in the sector, with a plethora of funding opportunities available for best in class operators with sizeable platforms.

UK healthcare property continues to attract investors because of the sector’s characteristically long 25-35 year leases with RPI-linked annual rental uplifts. Contrastingly, average lease lengths in the core commercial property sectors in 2014 stood at just 6.8 years for UK All Property, according to IPD’s Lease Events Review. Additional benefits can be gained from increased diversification which has led investors to raise their allocations to the sector, evidenced by the number and value of healthcare properties in the IPD sample which has doubled over the past 8 years. The implementation of the Care Act which in part came into effect in

---

**KEY FINDINGS**

- The structural rise in user demand for elderly care is a key driver for investment into the sector.
- Key trends include the expansion of the elderly population and changes in health and dependency levels.
- There has been a resurgence of demand for specialist care homes and independent hospitals.
- Specialist sectors such as mental health and specialist schools are attracting interest.
- Around £2 billion of private equity is being earmarked for healthcare assets in 2015.
- UK institutions and US REITs are the most active buyers, with overseas investors making up around a third of all transactions.
- Key transactions include acquisitions by HC-One, Ventas, AXA REIM, and TH Real Estate.

---

**FIGURE 1**

*Investors 2009-2015*

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Property Companies</th>
<th>Private Property Companies</th>
<th>UK Institutions</th>
<th>Private Investors</th>
<th>Other Overseas</th>
<th>Far East</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-15</td>
<td>20%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>2014/15</td>
<td>25%</td>
<td>30%</td>
<td>25%</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
</tr>
</tbody>
</table>

*Source: PropertyData / Knight Frank Research*

**FIGURE 2**

*Vendors 2009-2015*

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Property Companies</th>
<th>Private Property Companies</th>
<th>UK Institutions</th>
<th>Private Investors</th>
<th>Other Overseas</th>
<th>Occupiers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-15</td>
<td>20%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>2014/15</td>
<td>25%</td>
<td>30%</td>
<td>25%</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
</tr>
</tbody>
</table>

*Source: PropertyData / Knight Frank Research*
April 2015, does not seem to have dented operator and investor sentiment.

Investment performance and yields

The Healthcare sector recorded total returns of 9.0% in 2014 and underperformed All Property (17.8%) in 2014, following buoyant investor interest for the core property sectors, according to IPD’s Healthcare Index (Figure 3). However, Healthcare assets continue to outperform the commercial property market over the longer term, recording average total returns of 5.9% p.a. between 2007 and 2014, compared with only 3.4% p.a. for All UK Property. The only segment achieving higher returns than Healthcare over the period were residential market-lets which recorded returns of 8.6% p.a. on average. Moreover, Healthcare’s robust returns are supported by the lowest level of volatility in comparison with the other property sectors, presenting an outstanding risk-reward profile since the index was launched in 2007.

Performance between the main Healthcare sub-sectors varied slightly in 2014, with primary care (doctors surgeries, dentists etc.) delivering the best returns of 10.2%, compared with 6.3% for secondary care (care homes, hospitals etc.), which was impacted by a 1.4% fall in capital values. Primary care has performed well with average annual total returns of 6.9% since 2007 and continues to outperform secondary care, which has seen average annual returns of 4.3% over the longer term, although the IPD Index currently includes only a small number of modern purpose-built care homes.

In terms of pricing, healthcare assets offer relatively high yields compared with the core commercial property sectors. At around 4.75%, surgeries and clinics command the lowest yields in the healthcare sector, as they are typically backed by robust NHS covenants. Prime care home assets, at 5.50%, command the second lowest yields in the market as demand for high quality purpose-built care homes and new development opportunities continues to outstrip supply. Specialist nursing homes and independent hospitals meanwhile command yields of between 5.50% and 7.00%, a compression of around 100bps since last year, reflecting the more challenging nature of the client base and the danger of reputational damage following reports of mistreatment at a number of care homes in the UK.

FIGURE 3
Total returns 2007 to 2014

FIGURE 4
Maximum deal size in the UK healthcare market

Source: IPD / Knight Frank Research

Source: Knight Frank Research
Sub-sector activity

With UK healthcare becoming an established property asset class, it is important to recognise the different features of its component sub-sectors. Activity in the care homes sector remains buoyant with the sale of NHP, the owner of HC-One, for £477 million late last year and the acquisition of Gracewell Healthcare by US specialist Health Care REIT for £156 million last summer. The most significant movement in the sector, however, has been increased activity by UK institutions which has led to yields moving in significantly, particularly on Care UK and charitable covenants which are now trading between 5.0% and 6.0%.

Specialist sectors such as mental health facilities and specialist schools are attracting interest from both domestic and overseas capital, in part driven by the dearth of available elderly care platforms. REITs are also moving up the acuity curve and are keen to acquire “post-acute care” assets. There has been a resurgence of demand for specialist care homes and independent hospitals and a number of deals have seen increasing multiples including Duke Street Capital’s acquisition of Voyage, Cambian’s purchase of Woodleigh Care and Cygnet’s acquisition of Orchard Portman.

Trading hospitals let to good quality operators are being snapped up due to the shortage of healthcare assets generally, despite the private acute sector being regarded as more risky.

The funded development pipeline in the primary care sector is extremely low and due to increasing demand for services, yields have reached record lows of 4.25%-4.75% for the very best assets. Primary healthcare remains far less volatile than commercial property in terms of rental growth due to the use of index-linked leases, traditionally 15 years, and the fact that covenant strength is supported by government and the NHS.

The structural rise in user demand for elderly care is a key driver for investment into the sector. The main trends to impact the sector in the future include not only the expansion of the elderly population (the OECD has forecast that the proportion of over-65s globally will almost double from 15% in 2010 to 27% in 2050, while the over-80s in the UK will rise from currently 5% to 10%), but also changes in health and dependency levels of the very elderly. This, and the fact that up to 80% of the UK’s care home stock is arguably below “institutional” quality, provides a clear case for investment in future-proof care facilities.

Rent cover (EBITDARM profit over rent) is perhaps the most important consideration for prospective investors in care home facilities, as it needs to realistically reflect an operator’s ability to pay the rent, given prevailing occupancy rates and fee pressures. Recent evidence

Key healthcare transactions in the last 12 months

<table>
<thead>
<tr>
<th>Address</th>
<th>Purchaser</th>
<th>Covenant</th>
<th>Price</th>
<th>NIY</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 hospitals</td>
<td>M&amp;G Real Estate</td>
<td>The Priory Group Ltd</td>
<td>£223.0m</td>
<td>5.50%</td>
<td>Oct-14</td>
</tr>
<tr>
<td>11 senior housing communities (767 units)</td>
<td>Health Care REIT Inc</td>
<td>Patron Capital Partners</td>
<td>£153.0m</td>
<td>8.00%</td>
<td>Sep-14</td>
</tr>
<tr>
<td>28 medical centres</td>
<td>Assura Group Ltd</td>
<td>MP Realty Holdings Group</td>
<td>£107.0m</td>
<td>5.80%</td>
<td>Jun-14</td>
</tr>
<tr>
<td>New Hall Hospital in Salisbury</td>
<td>LaSalle Investment Management</td>
<td>Ramsay Health Care</td>
<td>£49.8m</td>
<td>5.30%</td>
<td>Apr-15</td>
</tr>
<tr>
<td>3 care homes (264 beds) in Edinburgh, Orpington and Hailsham</td>
<td>Henderson</td>
<td>Care UK</td>
<td>£48.9m</td>
<td>NA</td>
<td>Feb-15</td>
</tr>
<tr>
<td>3 care homes (187 beds)</td>
<td>Legal &amp; General</td>
<td>Care UK</td>
<td>£25.2m</td>
<td>5.50%</td>
<td>Nov-14</td>
</tr>
</tbody>
</table>
Investor demand for UK healthcare property is expected to remain strong, particularly from UK institutions and overseas investors for larger lot-sizes and portfolios. However, further government cuts and funding pressures will mean that investors will focus on the best quality assets and prime covenants.

Care homes continue to provide the bulk of investment opportunities for investors, although hospitals attract the majority share of investment into UK healthcare in terms of value due to their large lot-sizes. New healthcare housing models in urban settings which bridge the gap between care villages and new operators are likely to emerge, increasing brand awareness and supporting new entrants to the sector.

The care homes segment is expected to outperform the wider healthcare market due to a structural undersupply of future-proof assets and annuity grade covenants coupled with increasing demand for such assets. Sub-sectors such as facilities specialising in mental health and learning disabilities are still undervalued and offer potential gains through yield compression. Furthermore we anticipate increased appetite for ground rents on healthcare assets.

The weight of money from both UK institutions and overseas investors drives demand for modern, purpose-built healthcare property and is likely to contribute to further yield compression as debt financing is readily available.
RECENT MARKET-LEADING RESEARCH PUBLICATIONS

- **Prime Global Cities: The 2015 Report**
- **Central London: Quarterly Q1 2015**
- **Global Cities: Skyscrapers 2015**
- **Shopping Centre: Investment Q1 2015**

Knight Frank Research Reports are available at KnightFrank.com/Research

© Knight Frank LLP 2015

This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank LLP for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank LLP to the form and content within which it appears. Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members’ names.