1

Healthcare property transactions hit a record £2.7 billion

2

Overseas capital targets the private hospital sector

3

Stable returns in healthcare look increasingly attractive

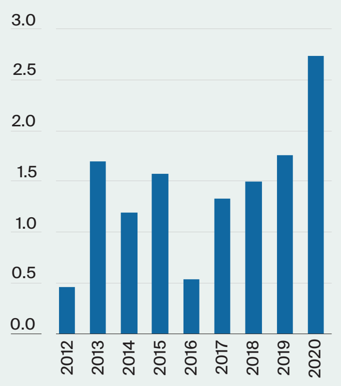
Healthcare Capital Markets

Research 2021

2020: A HISTORIC YEAR FOR THE HEALTHCARE SECTOR

Healthcare real estate investment reaches a record £2.7 billion, despite the pandemic

Fig 1: Recorded healthcare investment volumes, £ billions



Source: Property Data

Even in the midst of a global pandemic, the healthcare sector has received a significant level of investment. As shown in Figure 1, recorded property transactions across the healthcare arena reached £2.7 billion in 2020, making it a record year. This end-year figure owes much to some significant portfolio deals within traditional healthcare sectors like private hospitals and care homes, but there has also been growing activity in more specialised subsectors, including assets supporting mental health, disability housing, childcare and specialist schools.

The breadth of assets within healthcare is matched by a growing breadth of investor types. This includes an increasing weight of institutional capital, a strengthening selection of real estate investment trusts (REITs), and intensifying demand from overseas investors targeting UK healthcare. With a growing pool of investors and asset types, healthcare transaction volumes have increased year-on-year since 2016 and were up 55% in 2020. In contrast, deal volumes in the wider commercial real estate market have stagnated and fallen in recent years (Figure 2).

The operational impact of the pandemic

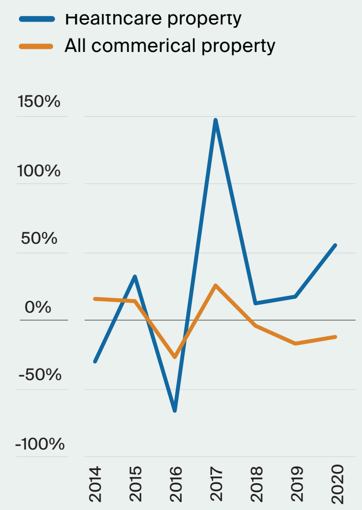
Despite healthy investment flows, the pandemic has posed an unprecedented operational challenge to the sector. Hospitals, care homes, GP practices and other specialist healthcare facilities have had to adopt stringent infection control measures, often at a cost, and private sector workforces have been stretched in many of the same ways as our NHS.

The greatest concerns were focused on the elderly care home sector, with its population base of over 85s at greatest risk of mortality. This had some impact on transactions in 2020 with the elderly care sector representing 18% of all healthcare property investment, compared to 39% across the last five years (Figure 3). The data show that as of January 2021, UK care home occupancy was just below 80%, reflecting a 9-10% fall since the onset of the pandemic.

Increasing mortality levels and a reduction in admissions have had an effect but the independent care sector has been hugely resilient in the face of an unprecedented challenge. Encouragingly, many investors continue to favour the long-term investment case for the sector – a view vindicated now that the vaccine has been deployed and a recovery is expected.

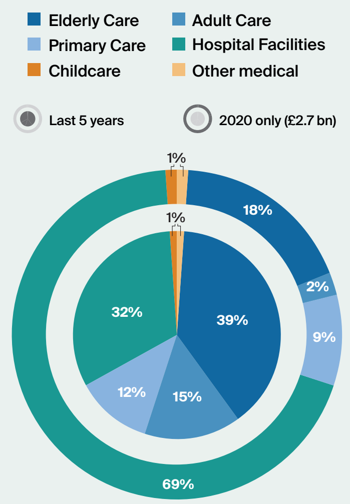
The way healthcare operators have handled the crisis has helped to maintain confidence in the sector, but there is a much broader investment case which is driving capital toward the sector. This is outlined below.

Fig 2: Percentage change in property investment volumes



Source: Property Data

Fig 3: Healthcare property investment, by asset type



Source: Property Data

THE INVESTMENT CASE FOR UK HEALTHCARE PROPERTY

DEMOGRAPHIC SHIFT

With the UK over 85 population set to increase from 1.7 million to 3.7 million by 2050, there will be increasing demand for residential care, primary care and acute hospital services.

SECURE INCOME

Operator revenue and rental income is reinforced by traditionally high occupancy rates as well as a healthy mix of self-funded care and public-funded care.

LONG-TERM INCOME

Weighted average unexpired lease terms (WAULT) are around 25-30 years in the residential care and hospital sectors. Leases are commonly indexed-linked to inflation.

INVESTMENT PERFORMANCE

Total returns are historically stable, giving investors protection and diversification. Returns measured 6.3% in 2020, higher than many core property sectors.

DEMAND FOR SAFE-HAVENS

Broader UK real estate typically offers security and liquidity in a global downturn and healthcare's long-dated income offers further safety.

STRUCTURAL CHANGE IN REAL ESTATE

Real estate investors were already de-risking from traditional sectors such as retail, prior to Covid-19. The pandemic is expected to accelerate this trend.

SOCIAL IMPACT

Many investors now have ESG requirements and are targeting social infrastructure investments with healthcare very much a part of this agenda.

With a growing pool of investors and a diverse range of different asset types, healthcare transaction volumes have increased year-on-year since 2016 and were up 55% in 2020

KEY DEALS AND TRANSACTIONS

Overseas capital targets UK healthcare sector

Across the healthcare sector, overseas capital was very active in 2020, accounting for 72% of transaction volumes. As shown in Figure 5, this was well above the 41% share seen across the last five years. The most significant deals were focused on the private hospital market, capital supplied by specialist North American REITs. In a mega deal valued at £1.5 billion, Medical Properties Trust acquired 30 BMI operated hospital facilities in early 2020. The real estate deal followed the buy-out of BMI by Circle Health, which has committed to a £250 million upgrade programme. Canadian-based NorthWest Healthcare REIT also acquired six BMI hospitals and four Aspen Healthcare hospitals for a total £358 million. These acquisitions look well-timed, not just because the dollar has since weakened against the pound, but because the NHS is expected to lean heavily on the private hospital sector in 2021 as it looks to deal with a huge backlog of non-Covid patients, especially cancer patients.

Deals in the elderly care home sector were broadly subdued in 2020, but there have been some hugely significant overseas entries into the UK and Ireland already in 2021. Korian, the giant French-based care operator, made its entry into the UK by acquiring Berkley Care group in Q1 2021. While Belgian REIT, Cofinimmo, purchased seven assets in the Irish market for a reported 100 million Euros. Both transactions will do much to restore confidence in this sector.

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With specialist healthcare services poised to see more users in the aftermath of Covid-19, we expect to see further investment interest in these niche sectors going forward

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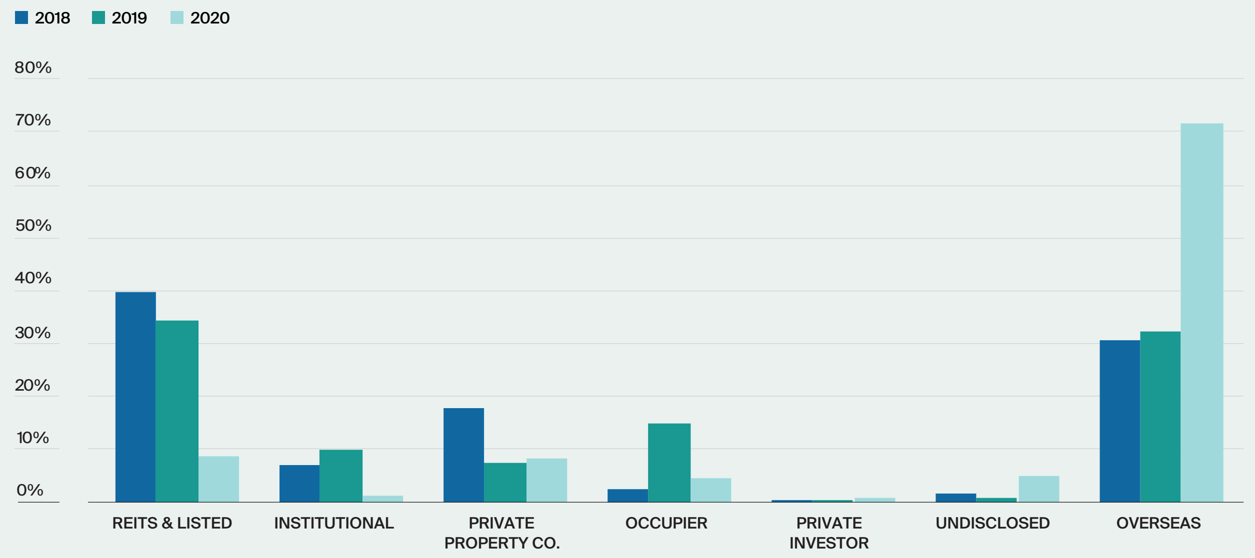
Investors moving towards specialist healthcare assets

The pandemic has fuelled greater investor interest in specialist healthcare sectors such as mental health, learning disability, children's nurseries and specialist schools. Not all that surprising, given that these sectors tend to be focused on users below the age of 65, for whom Covid-19 is much less of a threat[1]. There have been a number of large specialist healthcare opco's and real estate portfolios brought to market or in the pipeline. This includes specialist adult healthcare provider Exemplar Health Care, and mental health providers Elysium Healthcare and Priory Group – the latter being sold to private equity group, Waterland, for £1.1 billion at the start of 2021. With specialist healthcare services poised to see more users in the aftermath of Covid-19, infrastructure funds becoming increasingly active, and socially impactful or ESG investing becoming a growing priority, we expect to see further investment interest in these niche sectors going forward.

Fig 4: Healthcare property investment, by buyer type

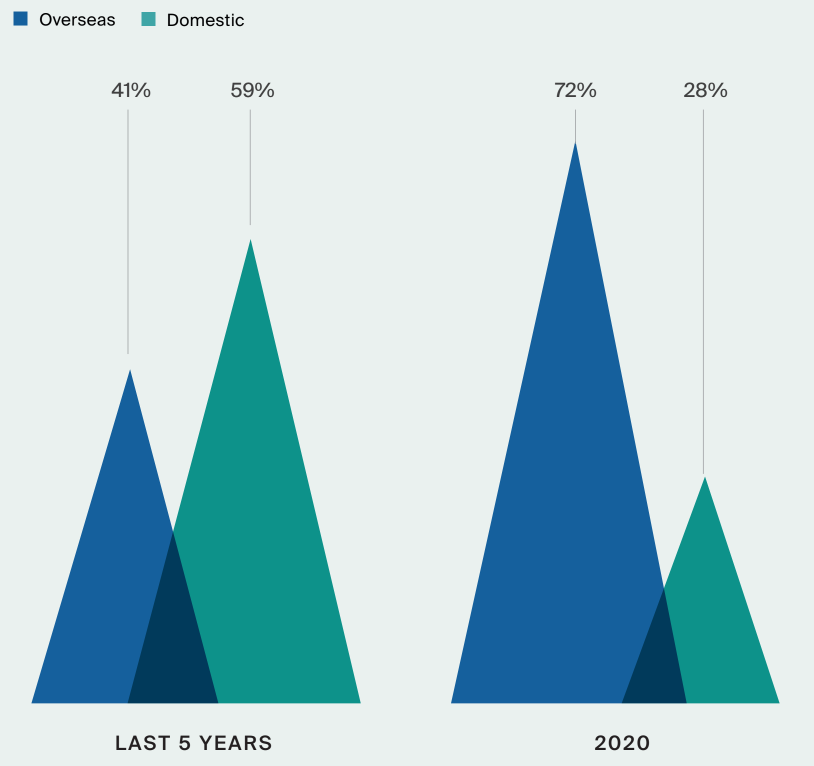


Source: Property Data

Forward-funding in the elderly care home sector

Belgian-listed Aedifica continued its expansion into the UK elderly sector, acquiring five trading care homes for £61 million. The purpose-built homes are let to two leading operators on 30-year leases, at a gross yield of 6%. Very few assets traded at the prime end of the market in 2020. While investors paused to digest the impact of Covid-19, the availability of prime quality stock is actually the bigger barrier. The forward funding of new care home developments is therefore becoming increasingly common among investors as a way to access prime stock and help the sector upgrade. Octopus RE's purchase of eight care homes from LNT Care Developments for £100 million in December 2020 is one such example of this – the specialist investor agreeing to buy five of the properties at practical completion and forward fund the remaining three.

Fig 5: Healthcare property investment – overseas share



Source: Property Data

Table 1: Major Deals 2020

SECTOR	ASSET/PORTFOLIO	PURCHASER	ASSETS	SELLER	OCCUPIER	PRICE (£ MILLION)	DATE
Hospitals	30 x BMI Healthcare Portfolio	Medical Properties Trust	30	BMI (Circle Health)	BMI (Circle Health)	1,500	Jan-20
Hospitals	Magnolia Portfolio	NorthWest Healthcare REIT	6	General Mixer Healthcare Partnership	BMI (Circle Health)	98	Feb-20
Hospitals	Aspen (London) portfolio	NorthWest Healthcare REIT	4	Undisclosed	Aspen Healthcare	260	Aug-20
Elderly care	8 x New build portfolio	Octopus RE	8	LNT Care Developments	Ideal Care Homes/ Elmfield Care	100	Dec-20
Elderly care	Southern England portfolio	Aedifica SA/NV	5	Undisclosed	Bondcare and MMCG	61	Jan-20
Elderly care	Holmes Care (Scotland) Portfolio	Impact Healthcare REIT	9	Holmes Care	Holmes Care	48	Mar-20
Primary care	20 x Medical Centres	Primary Health Properties	20	Undisclosed	GP & NHS	47	May-20
Primary care	7 x Medical Centres	Assura Group Ltd	7	Undisclosed	Undisclosed	35	Jun-20
Childcare	5 x London children's nurseries	Newcore Capital	5	Public sector vendors	Busy Bees, Bright Horizons and others	23	Mar-20
Childcare	Learning Experience Nursery (Finchley)	Undisc.	1	250 East End Road LLP	Learning Experience	2	Dec-20

Q & A: LATEST TRENDS IN THE DEBT MARKET

With the healthcare market in need of inward investment and financing, we asked Craig Wilson (Partner in Debt Advisory) for his latest summary on trends in the healthcare lending space.

CRAIG WILSON, PARTNER,
KNIGHT FRANK CAPITAL ADVISORY

How would you summarise lender appetite for healthcare property at the moment?

Despite the impact of the pandemic, lender appetite across the UK healthcare sector has held up relatively well, particularly when compared to less resilient sectors such as retail and leisure. In the initial market shock in Q2 2020, liquidity in the healthcare debt market did diminish and senior debt pricing increased by 0.50% to 1.00%. But, debt pricing began to soften in Q3 2020 and has remained largely stable, albeit at rebased levels, over the past six months.

What is the profile of lenders and have there been any new entrants into the healthcare space in recent years?

The debt market in the sector is relatively niche, with around 20 established debt providers. Ultimately, lenders need to be comfortable with reputational risk within the healthcare market, particularly given the vulnerable nature of residents and end-users. High street banks have built a dominant position with large and diverse loan books. More recently challenger banks and debt funds have entered the market, gaining market share and targeting transactions higher up the risk curve.

What type of healthcare assets are lenders targeting?

Elderly care remains the most liquid healthcare sub-sector from a senior debt perspective, however lenders are also targeting more specialist care sub-sectors, such as mental health and brain injury. Since the pandemic, there has been a 'flight to quality' in the debt market, with stronger lender appetite for prime, purpose-built assets with reputable operators. Some established lenders are being increasingly selective in originating new-to-bank clients and may seek to churn the 'lower end' of their loan books on refinancing events.

New development is expected to play a huge role in the sector going forward. Would you say lenders recognise the opportunity?

Alternative lenders have certainly bolstered the availability of development finance in the healthcare sector over the past few years, taking note of the strong demand fundamentals driving the need for healthcare real estate. Finance is now available for a wide variety of deals across the capital stack. Senior, stretch senior, mezzanine and whole loan products provide a broad range of development financing options between 50-90% loan-to-cost and 40-75% of turnkey value.

What are your predictions for the debt markets in 2021?

The stabilisation of the debt markets looks set to continue with an increasingly positive economic outlook, driven by the vaccine roll-out. There is an expectation that leverage will return to pre-pandemic levels and debt pricing will reduce by up to 0.25% by Q4 2021 and Q1 2022. We will continue to see new opportunistic entrants into the debt markets in 2021, with capital previously invested into less resilient sectors redirected into higher yielding debt funds, including those exposed to healthcare.

INVESTMENT PERFORMANCE AND OUTLOOK

Yields stay low

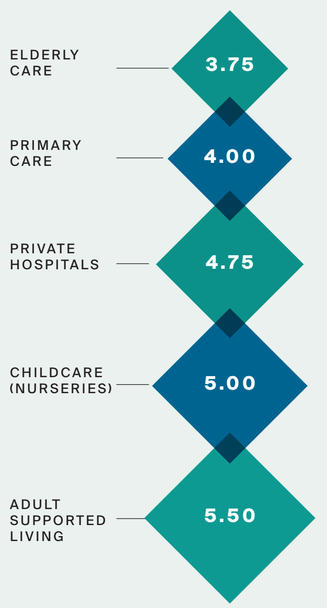
Yields across a range of healthcare asset types have remained compressed, despite the pandemic. In the elderly care home sector, there was a limited amount of prime stock coming to market but investor demand for such assets remains strong. Well capitalised bidders remain willing to pay a premium for well-located purpose-built homes positioned for the private-pay market. Prime elderly care yields are expected to remain below the 4% mark, especially with more institutional investors competing for long-term income-backed assets in safe-haven markets. Core market elderly care stock has been trading closer to 6% and above in 2020.

Elsewhere in the healthcare property market, there is wide variation in yields across different sectors and within each sector. However, all sectors are defined by growing investor demand, and a limited supply of prime grade assets. Prime yields across all sectors are therefore expected to remain compressed for the foreseeable future.

Returns holding, unlike other property sectors

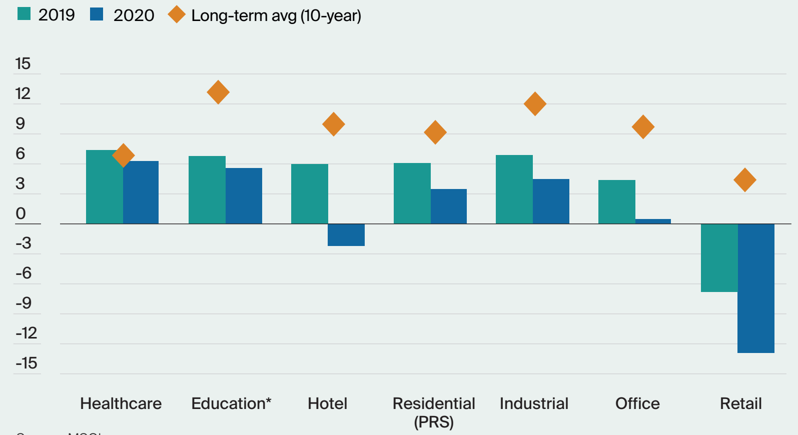
As shown in Figure 7, total returns fell across a mixture of traditional and alternative commercial property sectors in 2020. Moreover, returns are significantly below the long-term (10-year) average – a product of a mixture of factors including the pandemic, the current real estate cycle and structural change in the case of retail. The exception is healthcare, where returns held strong at 6.3% in 2020, matching the long-term average. With testing economic conditions ahead in 2021 and beyond, investors are expected to seek stability and healthcare fits this mould. As shown in Figure 8, which illustrates the risk-return profile of each sector over the last ten years, healthcare returns while not remarkable have been extremely stable. Not only that, with demand for healthcare services and accommodation fuelled by the unrelenting growth of our over 85 population, the sector is largely seen as a hedge against economic recession.

Fig 6: Prime healthcare yields (fixed-income, %)



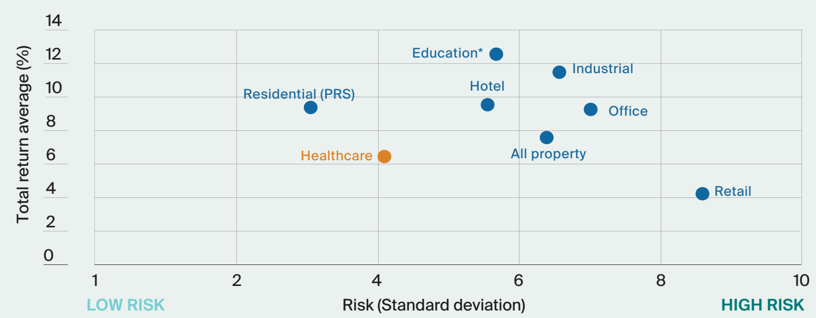
Source: MSCI

Fig 7: Total returns (%)



Source: MSCI

Fig 8: Risk vs Returns, 10-year history



Source: MSCI

*Education refers to schools and nurseries, not student accommodation

OUTLOOK FOR 2021 AND BEYOND

The year ahead will not be without its operational challenges for the healthcare sector. The elderly care sector will need to recover occupancy levels now that the vaccine has been deployed, private hospitals will be stretched by the backlog of non-Covid patients, and margins across the healthcare and education business space will be squeezed as government financial support retracts. Despite this, we expect to see increased global and domestic capital directed at healthcare real estate for a multitude of reasons.

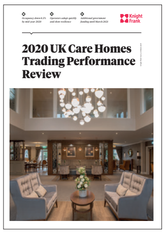
Investors will be seeking the safety provided by long-dated income, such as that provided by healthcare, more investors will be looking to de-risk and re-weight asset allocations out of retail and into alternative sectors, and the pandemic will likely accelerate investment into social infrastructure, of which healthcare, specialist housing and education are very much a part of. With no shortage of investor appetite, the availability and competition for healthcare stock is potentially the biggest challenge. As a result, we expect to see more investors target new development opportunities through both direct investment and lending. This inward investment is vital to the future of the sector.

Footnotes:

(1) Provisional figures on deaths registered in England and Wales, provided by the ONS, showed that only 10% of Covid-19 deaths occurred in those below the age of 65.

Front cover photo: Elworth Grange, Sandbach. LNT Care Developments and Ideal Care.

Recent Publications



Trading Performance Review

European Healthcare Report

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