

UK Healthcare Property 2019

SPRING-SUMMER OVERVIEW





Market Summary

2019 has been an eventful year so far for the healthcare sector. Investment interest in the sector has never been stronger with a range of stakeholders seeking exposure to UK healthcare assets. That aside, many care operators continue to face a fairly prominent set of challenges which cannot be ignored if we are to continue advancing standards of care. While there are diverging stories, the market is looking healthy at a broad level and especially so when viewed in the wider context of commercial real estate.

From an operational perspective, staffing remains the number one challenge. Data from our Care Home Trading Performance Index shows that staff costs have risen 44% over the last decade and now represent on average 58% of income. These salary increases are impacting the bottom line for many operators but are arguably a necessary step if the sector is to attract more workers and address the concerning shortage of carers and nurses. Operators will also be looking for clarity on Brexit, and how this will impact the migrant workforce that many homes depend on.

As mentioned in our previous overview, it is worth noting the differing financial performance of local authority funded homes versus the independent private-pay market. The profitability of LA-funded homes has been restricted by stagnant fee levels in many regions, whereas the private-pay market reported EBITDARM as high as 39% in 2018. Knight Frank's next Care Home Trading Performance Survey will be conducted in late-2019 and will report on the latest operational performance relative to both funding types.

From an investment perspective, 2018 was another strong year for fixed income transactions with £1.5 bn exchanging hands. Specialist healthcare REITs and niche funds have continued to raise capital and grow their portfolios over the last year. This has been the case in both the elderly care sector but also in the supported living and primary care sectors, which are significant segments of the market. The merger of Primary Health Properties (PHP) and MedicX at the start of 2019 could be viewed as an indicator of the growing scale of privatised healthcare.

The last six months has also seen escalating interest from overseas investors. While there are many challenges facing operators, in a global context the UK's mature healthcare infrastructure (both NHS and private) and ageing population make it an attractive long-term prospect to global investors. This trend was epitomised at the back end of 2018 when pan-European REIT, AEDIFICA, acquired a 93-home portfolio for £450 million. We expect to see more global capital targeted towards UK healthcare going forward and from a mixture of regions, highlighting the increasing globalisation of healthcare as an asset class.

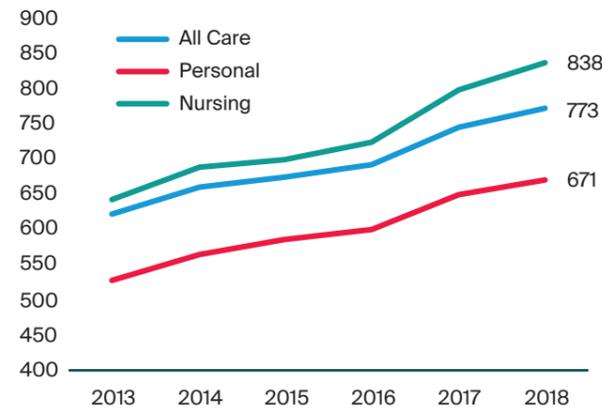
With new investors entering the market and an increasingly broad range of specialist healthcare segments rising to the fore, we expect due diligence and market insight to become increasingly important in 2019 and beyond. As healthcare continues to move into the investment mainstream, it is important that we do not neglect the challenges facing many operators. Increasing staff costs, carer and nurse shortages and restricted local authority budgets are all factors affecting care operators at a time of continuous political and economic uncertainty. At Knight Frank, we recognise the growth opportunities but aim to be equally aware of the risks facing the sector.



Julian Evans, FRICS
Partner, Head of Healthcare

Elderly Care Market

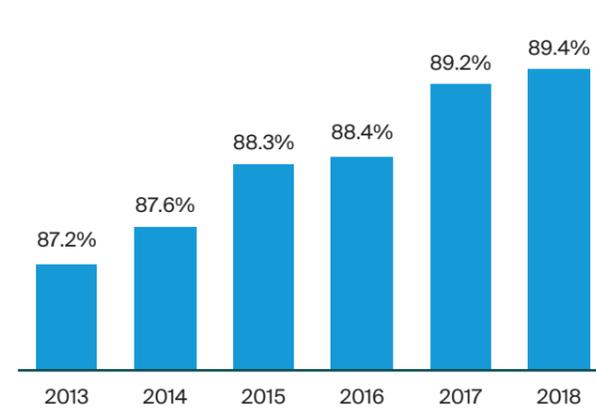
AVERAGE WEEKLY FEES (£)



Source: Knight Frank Trading Performance Index

Elderly care home fees continue to increase year on year while the gap between nursing care and personal care has also widened. Increasing staff costs, but also increasing medical costs have been significant drivers of fee inflation in recent years.

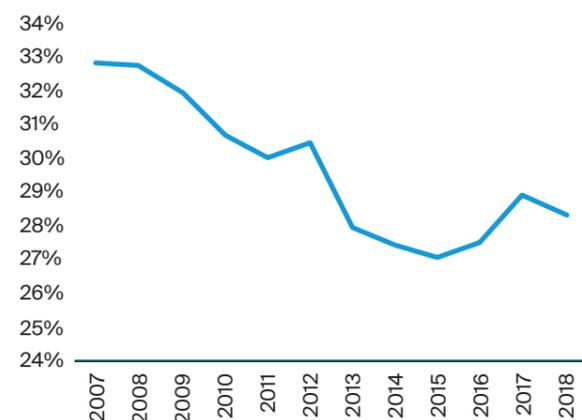
OCCUPANCY RATES - ALL CARE (%)



Source: Knight Frank Trading Performance Index

Occupancy rates are edging higher, reaching 89.4% in 2018. Nursing homes are seeing particularly high rates because elderly people are increasingly moving into care when they reach greater levels of dependence.

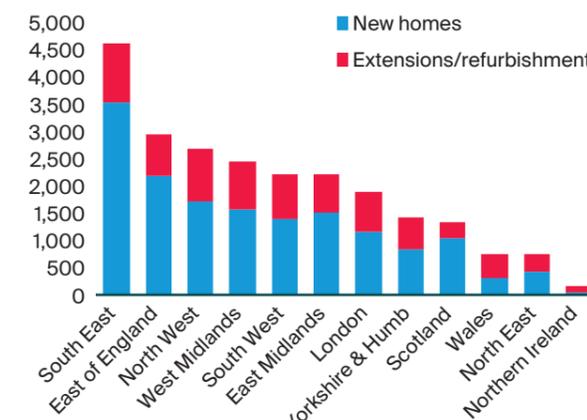
EBITDARM (% OF INCOME)



Source: Knight Frank Trading Performance Index

Profitability has been on a downward trend. This is largely attributable to increasing staff costs as operators absorbed rises in the National Living Wage (NLW). LA-funded homes have seen the biggest impact, but homes operating in the private-pay market are seeing EBITDARM in excess of 35% of income.

CURRENT SUPPLY PIPELINE (BEDS)



Source: Glenigan

Developers have begun to respond. The supply pipeline shows that there are around 23,000 beds in development or planned for completion in the next two to three years. Most of these projects are only in planning phase and more need to break ground to meet escalating demand in the approaching years.

For more analysis of key trends in operating performance please read our Care Home Trading Performance Review 2018.

Specialist Healthcare Markets

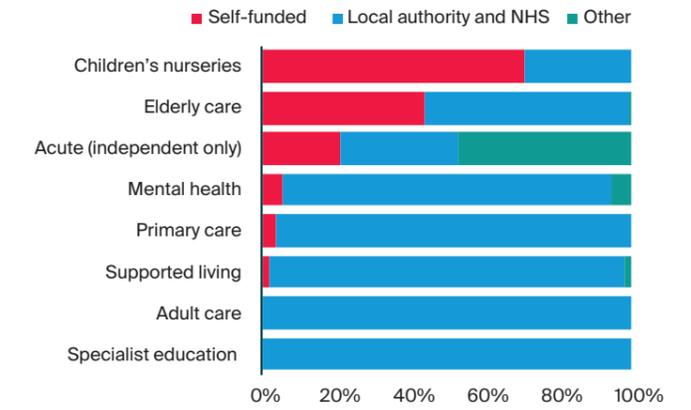
MARKET SIZES

	Properties	Service users
Elderly care	12.5K homes	430K residents
Adult care	8.2K homes	77K residents
Supported living accommodation	Unknown	22K to 30K residents
Acute care	280 hospitals (70% independent)	1.2M admissions
Primary care	10.3K GP practices	N/A
Children's nurseries	15.6K settings	746K children
Specialist education (England only)	1.6K schools	130K pupils

Source: Laing Buisson, MENCAP, Tomorrow's Guides

Users of all residential care services are growing, the exception being adult care where residents are moving out of institutional settings and into supported living accommodation. With the exception of elderly care, estimates are based on 2016/17 data and may be subject to variation.

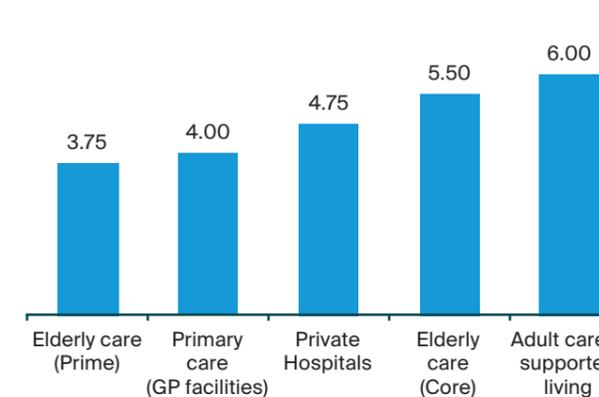
CARE FUNDING MIX



Source: Laing Buisson

The majority of funding for healthcare sectors comes from the public purse. The exceptions are children's nurseries and elderly care which have substantial self-pay markets. Independent hospital operators receive 47% of funds via PMI and a further 32% from the NHS which outsources a substantial amount of surgical procedures.

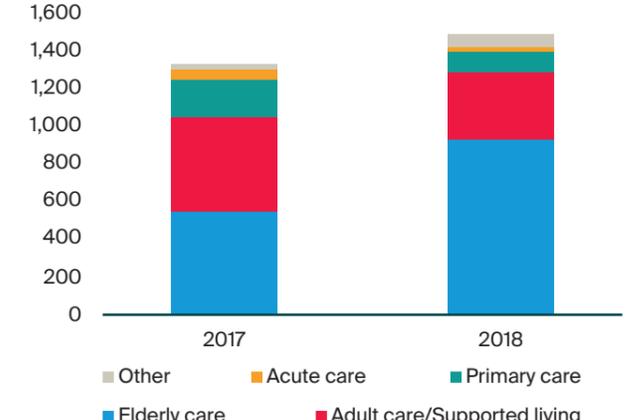
MARKET YIELD GUIDE (%)



Source: Knight Frank

Yields for different healthcare property types range from 4% to 6% with tenant covenant, the level of acuity, and the resident (or patient) profile being the main determining factors. Yields for prime elderly homes have edged as low as 3.75% in 2018.

PROPERTY INVESTMENT VOLUMES (£M)*



Source: Property Data, Knight Frank

Documented transactions finished 2018 at £1.49 billion, exceeding the level seen in 2017 by 13%. The elderly care sector is seeing the bulk of investment interest, but specialist healthcare sectors have seen significant inflows of capital in the last two years.

*Figures are for documented fixed-income transactions only. Hospital & primary care deals are typically underreported. Please Note: LaingBuisson data is drawn from LaingBuisson Healthcare Market Overview (30th Edition).



Supported Living: Civitas Social Housing PLC



Elderly Care: Grosvenor Manor, New Care Homes



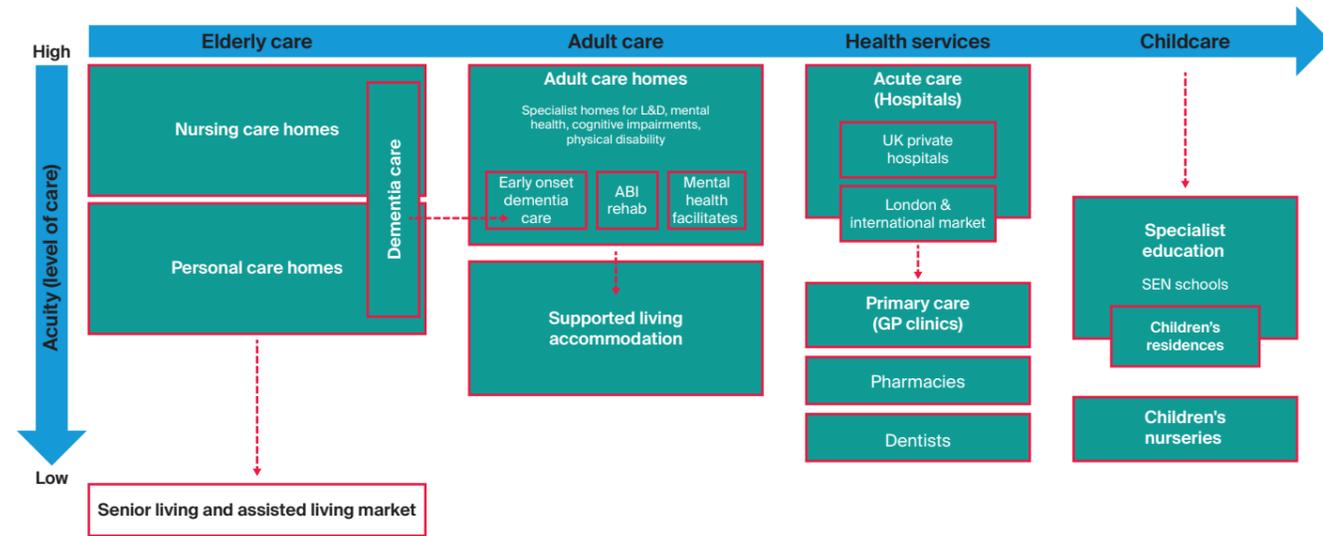
Elderly Care: Grosvenor Manor, New Care Homes



Primary Care: Stratford Healthcare Centre, Assura PLC

Market Characteristics

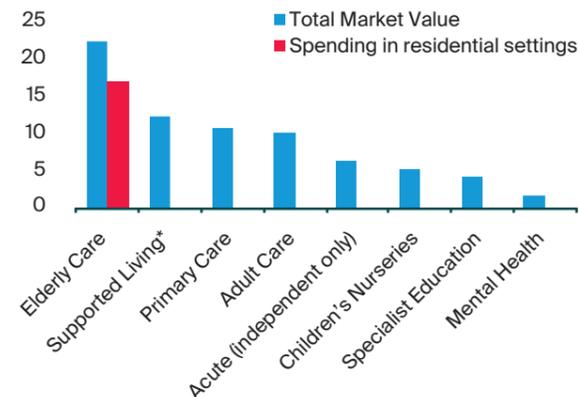
HEALTHCARE PROPERTY MARKET STRUCTURE



Source: Knight Frank

The complex healthcare property market continues to evolve and interconnect but is broadly split into the above sectors as illustrated above. Please note, this diagram is not to scale or reflective of market sizes and is intended only as a guide to property market structure.

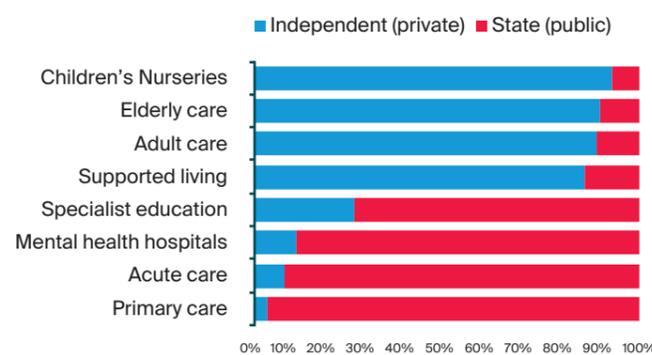
MARKET VALUES (SPENDING, £ BN)



Source: Laing Buisson

The elderly care market is the largest healthcare market by spending on care services. Even after excluding spending on home care services, £17 billion is still spent in residential settings.

INDEPENDENT (PRIVATE) SECTOR SHARE



Source: Laing Buisson

Private operators dominate the elderly, adult and childcare sectors as well as supported living. In contrast, acute care and primary care services are state controlled and fall within the boundaries of the NHS. The independent market for acute care is still large at over £6 billion.

Market Descriptions

ELDERLY CARE HOMES

- Provide 24-hour care and accommodation to older people typically aged 65 and over. Homes are divided into;
 - Personal care homes; designed for lower-dependency residents requiring assistance with everyday living delivered by qualified care assistants.
 - Nursing care homes; designed for higher-dependency residents requiring full-time medical care delivered by qualified nurses.
- Dementia-specific services are typically provided across personal and nursing homes.
- Properties range from large purpose-built homes to adapted period-style residences.

ADULT CARE HOMES

- Provide 24-hour care and accommodation to vulnerable adults typically aged 18-64.
- Users typically include those with learning disabilities, mental health conditions, cognitive or memory impairments (including early onset dementia), and physical or sensory disabilities.
 - Acquired Brain Injury (ABI) care also fits within this category with varying levels of care.
- Properties range from large purpose-built homes to converted residential accommodation adapted for those with specific conditions.

MENTAL HEALTH FACILITIES

- Deliver a mixture of secure, non-secure and step-down mental health hospital treatment.
- Focused on patients with more severe short-term or long-term mental health illnesses that cannot be cared for within lower dependency adult care homes.
- 70% of beds are provided within NHS facilities and 30% in independent mental health hospitals.

SUPPORTED LIVING ACCOMMODATION

- Also known as Specialist Supported Housing (SSH). Provide community-based assisted living and care to vulnerable adults typically aged 18-64, usually in smaller scale residences.
- Users include those with similar conditions to those within adult care homes but typically have lower dependency.
- Properties are typically owned or managed by Registered Social Landlords (RSL's) with care providers contracted to provide on-site care on a full-time or part-time basis.

ACUTE CARE FACILITIES (HOSPITALS)

- Broadly defined as the property market for hospitals and clinics, typically provide a wide range of secondary care treatment services within a clinical and specialist healthcare setting.
- Users include (but are not restricted to) inpatients requiring surgical procedures, pregnancy and fertility treatments, and health screening.
- Facilities range substantially from large inpatient hospitals to smaller specialised clinical units.
- The London market for acute care is principally targeted at private-paying domestic and increasingly international patients.

PRIMARY CARE FACILITIES

- Provide community-based access to GP-services, acting as the first point of contact in the healthcare system for the UK population.
- Services are typically provided by NHS GPs operating under NHS contracts, but there are an emerging number of independent corporate sector GP's.
- GP facilities range from large purpose-built facilities to smaller converted residential premises.
- Facilities may also extend to community health services including (but not restricted to) pharmacies, dentists, occupational health clinics, mental health centres and other community services.

SPECIALIST EDUCATION SCHOOLS & CHILDREN'S RESIDENCES

- Schools provide specialist education for pupils with disabilities and Special Educational Needs (SEN).
- Properties vary in scale and specialism with some open all year round and others open only during term time (38 weeks).
- The market is made up of a mixture of state-funded 'maintained' schools and independent schools, the latter usually providing higher needs education.
- Independent schools require half of pupils to have SEN and at least 25% to have a Statement of SEN authorised by the Local Education Authority.
- Children's residences provide full-time residential care for children with SEN and/or able children requiring foster care.

CHILDREN'S NURSERIES

- Provide full day care services all year round, primarily to children under the age of 5.
- The vast majority of childcare workers are qualified professionals.
- The vast majority of operators are for-profit independent traders or incorporated companies.
- Properties are typically converted residential or commercial premises but the number of purpose-built facilities is growing.

*Supported Living is inclusive of special needs housing and general needs social housing

Please Note: LaingBuisson data is drawn from LaingBuisson Healthcare Market Overview (30th Edition).

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Research



CARE HOMES TRADING
PERFORMANCE REVIEW 2018



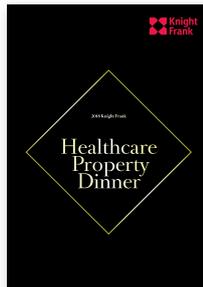
HEALTHCARE CAPITAL
MARKETS 2019



UK HEALTHCARE
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RETIREMENT LIVING



HEALTHCARE PROPERTY
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LUXURY CARE HOME
GUIDE

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