RESEARCH

2013

UK HEALTHCARE

Development opportunities

Knight Frank

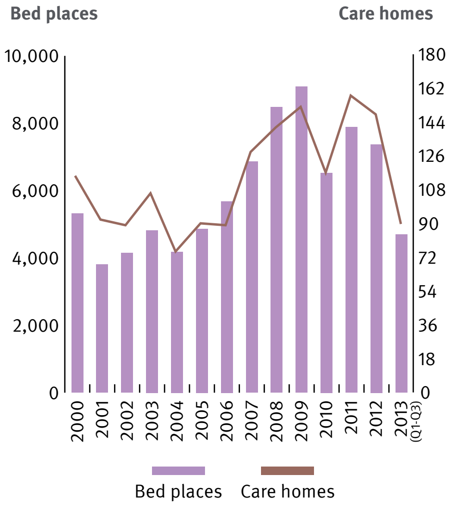
HIGHLIGHTS

- Care home development activity is expected to increase over the medium term, stimulated by the recent influx of overseas capital to the UK care sector and an improvement to the lending environment.
- However, until political uncertainty over publicly funded care is properly addressed, development will remain weighted towards those areas that are characterised by a high exposure to the self-pay market.
- This is echoed by our care home development hotspots analysis, which reveals that 11 of the top 12 counties in England and Wales are located in the UK's southern regions. This year sees Bedfordshire replace Berkshire as the top-ranked county.
- The Scotland hotspots assessment reveals the Borders as 2013's top-ranked area for care home development, a position unchanged from last year.

Development trends

The development of elderly care homes in the UK remains reasonably active by historic standards (Figure 1). While the 90 new care homes registered during the first three quarters of 2013 appears significantly down on 2012, the final figure for 2013 is likely to be broadly in line with last year, given the typical lag between development completion and registration.

Figure 1
Elderly and dementia care registrations



Source: Knight Frank, Laing & Buisson

Moorlands Lodge in Hindhead, Surrey. The 60-bed care home is operated by Signature Senior Lifestyle and opened in February 2012.

However, since we last reported, the net increase in UK bed supply stands at c. 2,250 bed spaces, equivalent to just 0.5% of total stock. With a sizeable 35% growth in the UK's population of over 65s forecast in the next 15 years, and an ever increasing share of the UK's care home stock approaching obsolescence, the current rate of development is arguably not sufficient to meet the long-term requirement for future-proofed care facilities.

The use of forward funding and pre-letting agreements is steadily emerging as a key mechanism for care providers to expand their portfolios, with circa 15% of care beds registered in 2013 to date being realised via this route. Specialist healthcare funds are growing in prominence, with funds such as MedicX, Apache Capital and Bridges Ventures providing a key source of finance for site acquisition and construction, albeit to the major care providers.

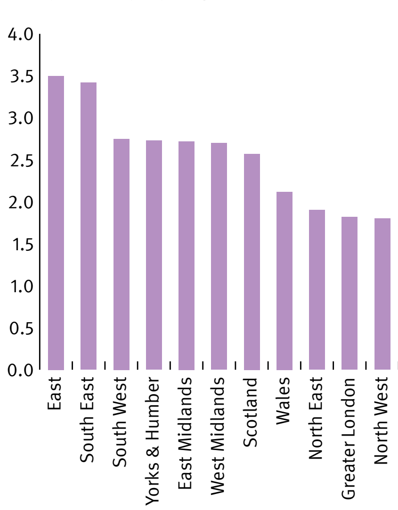
On a positive, the appetite for new care home development is expected to increase moving forward. Firstly, the UK's leading high street banks are now better-placed to provide development finance, having made significant strides in deleveraging. Secondly, the recent influx of overseas investment to the UK care sector, particularly from the North American Healthcare REITS, has substantially improved the financial position of some of the UK's leading care providers, which should also facilitate new development.

That said, lenders remain risk averse, which is reinforcing the geographical polarisation of the market. Care home development continues to be focused in the robust locations, typically characterised by a strong self-pay market and underlying demographics, where higher fee rates provide investors with a more respectable return on capital.

This polarisation is partly reflected in the regional development pipeline for care homes. With regard to new-build developments, the East and South East regions each have over three beds in the pipeline per 1,000 over 65s population, significantly ahead of other regions (Figure 2). While Greater London was identified as the most profitable UK region in our recent Trading Performance report, its relatively restricted pipeline reflects the intense competition from C3 residential use in the capital.

> "The appetite for new care home development is expected to increase moving forward."

Figure 2
Development pipeline

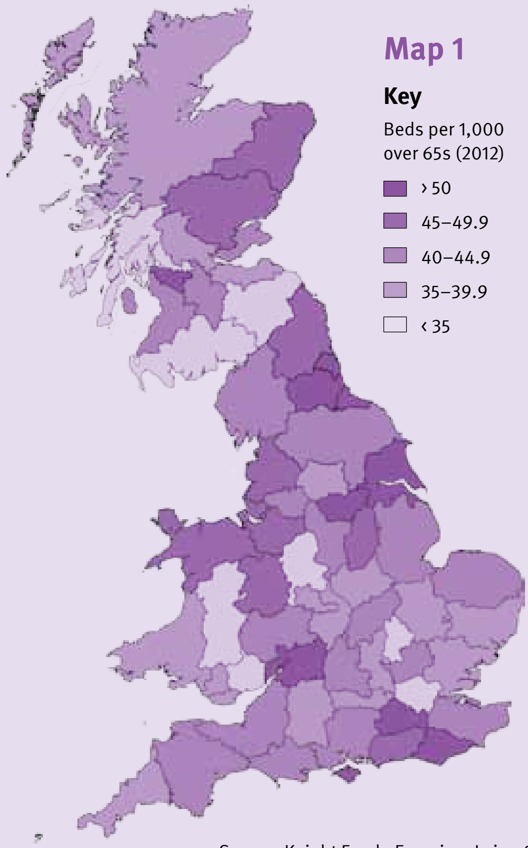


Source: Knight Frank, Laing & Buisson

Planning authorities continue to have an important role in delivering bed spaces in the care sector, particularly in those areas where operator demand is strongest and/or in areas of greatest need. It has been over 18 months since the adoption of the National Planning Policy Framework and the Coalition Government continues to streamline the planning process, albeit with the focus on housing and the economy.

As local authorities have continued to update their Local Plans, we have seen a number of references to care provision, but these are largely secondary measures rather than primary policy focus. It will be interesting to see how the updated policy frameworks deal with potential loss of care homes, or new facilities in areas of high residential value where competition from C3 residential use is more prevalent.

Underlying supply considerations



Map 1

Key

Beds per 1,000 over 65s (2012)

- › 50
- 45–49.9
- 40–44.9
- 35–39.9
- ‹ 35

Source: Knight Frank, Experian, Laing & Buisson

Current bed supply

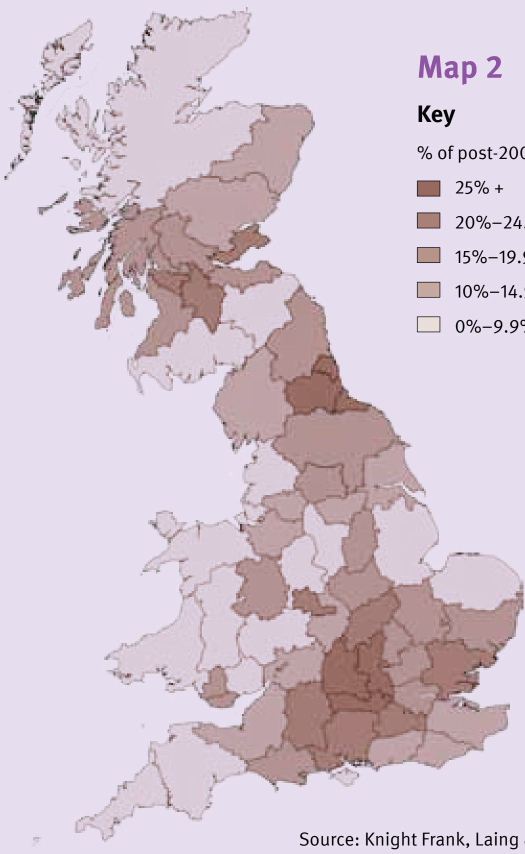
The adjacent map displays the current extent of residential care supply across the UK, expressed on a beds per capita basis. Notwithstanding important demand side considerations, such as prevailing fee levels, development interest should in theory be focused within those areas where the current supply of beds is relatively tight compared to the resident population of over 65s.

There is clearly a marked variation in supply levels between individual counties. In some cases, counties with strong concentrations of supply sit immediately adjacent to counties with relatively limited supply, with examples including Surrey vs Greater London, Gloucestershire vs Wiltshire and Glasgow & Renfrewshire vs Dunbartonshire. In broader geographical terms, areas of relatively high per capita supply are evident in the North East, North West and Yorkshire & Humber regions.

Proportion of post-2002 bed supply

This map displays the proportion of current supply built after 2002, the year in which the Care Standards Act 2000 was enacted. This consideration is arguably of equal importance to prospective care home developers and operators, as it shows how the supply of more modern care homes varies between areas.

Some parts of the UK possess both a relatively high level of existing supply as well as a strong proportion of post-2002 registered supply. This is particularly evident in Glasgow & Renfrewshire and for much of the North East region, which is generally regarded as being over-bedded following a high level of development during the last decade. Conversely, the Isle of Wight is a clear example of an area which possesses a high per capita supply but a small proportion of recently-built stock.



Map 2

Key

% of post-2002 supply

- 25% +
- 20%–24.9%
- 15%–19.9%
- 10%–14.9%
- 0%–9.9%

Source: Knight Frank, Laing & Buisson

England & Wales Hotspots

In addition to outlining current development trends, the Knight Frank Healthcare Hotspots model seeks to identify those locations which may offer the best future prospects for care home investment and development. The county-based model employs a matrix of eight equally weighted criteria, incorporating economic and demographic projections plus other healthcare property factors, including care home bed values and the typical cost of land for development.

Maplewell Manor, South Yorkshire. The 83-bed care home is operated by Silk Healthcare and opened in April 2013.

As shown in Table 1, Bedfordshire replaces Berkshire as the top ranked county in England & Wales for 2013, rising from third place in 2012. The county, which includes Bedford, Luton and a number of smaller towns, has an overall index score at 80% above the all-county average and also scores above average for all but one of the eight criteria, namely the lower than average typical bed values.

While the rankings have changed, the same six counties from last year occupy the top six positions in 2013. Within this group, Greater London is the most notable riser, moving from fifth to second place. London's ranking benefits from having the highest bed values of any county, together with relatively limited supply. That said, London's performance is partly compromised by having the highest typical land values, which acts as a barrier to development.

The main drivers of performance for the top 12 counties vary between those on the demand side and those on the supply side. For example, on the supply side, Greater London (2nd) and Cornwall (10th) benefit particularly from relatively restricted current and pipeline supply of care beds. In contrast, Berkshire, Buckinghamshire and Cambridgeshire owe much of their performance to the demand side factors, with each ranked in the top ten counties for forecast growth in over 65s population and economic prospects.

Viewed in broad terms, it is notable that none of the top 12 counties are located in the North of England or Wales. Indeed, England's southern and eastern regions dominate the rankings for 2013, accounting for 11 of the top 12 counties. This is closely in line with our expectations, as it is in these areas that demand is typically strongest, with relatively high bed values together with stronger prospects for economic and population growth. The sole exception is Northamptonshire in the East Midlands, whose sixth placed ranking largely derives from having the strongest forecast growth in over 65s population of any county.

"England's southern and eastern regions dominate the rankings for 2013."

Table 1
Care home development prospects – top 12 counties of England & Wales in 2013

2013 Rank		Forecast growth in 65+ population	Forecast economic growth	Current supply	Future supply	Change in rank	Total score index
1	Bedfordshire	5	4	8	26	↑ 2	1.80
2	Greater London	36	3	5	8	↑ 3	1.68
3	Berkshire	9	1	10	35	↓ 2	1.67
4	Buckinghamshire	2	2	15	44	⇔	1.55
5	Cambridgeshire	4	9	9	46	↑ 1	1.39
6	Northamptonshire	1	11	27	33	↓ 4	1.31
7	Kent	15	14	29	13	↑ 4	1.28
8	Hampshire	18	6	25	36	↑ 7	1.26
9	Essex	21	20	14	23	↑ 5	1.22
10	Cornwall & Isles of Scilly	34	25	11	4	↓ 1	1.20
11	West Sussex	20	8	43	21	↑ 6	1.18
12	Hertfordshire	22	10	28	27	↑ 4	1.15

Source: Knight Frank

Artist's impression of Field Lodge Care home in St Ives, Cambridgeshire. The 72-bed facility is scheduled to open in February 2014 and will be operated by Care UK.

Scotland Hotspots

The Borders region retains its position as the highest ranked area for care home development prospects in Scotland (Table 2). The largely rural area, which includes the towns of Hawick, Kelso and Jedbugh, scored above the all-county average for all but one of the eight criteria, namely the lower than average typical bed values. However, the Borders area draws much of its strength on the supply side, having the lowest amount of care beds per capita as well as the smallest development pipeline of any area in Scotland.

If more importance is attached to demand side factors, it could be argued that the greatest level of opportunity lies in Lothian, one of the more densely populated parts of Scotland. With Edinburgh as its urban heart, the area is ranked first and second for the economic prospects and forecast growth in over 65s population respectively. Key supply side factors drag on Lothian's overall ranking, with the area continuing to show a relatively strong pipeline of supply and high land values compared with other areas.

Table 2
Care home development prospects – top five areas of Scotland in 2013

2013 Rank		Forecast growth in 65+ population	Forecast economic growth	Current supply	Future supply	Change in rank	Total score index
1	Borders	4	3	1	1	⇨⇦	1.30
2	Fife	7	2	7	11	↑ 2	1.26
3	Lothian	2	1	6	10	⇨⇦	1.23
4	Lanarkshire	6	4	9	7	↓ 2	1.20
5	Central	5	5	3	8	⇨⇦	1.15

Source: Knight Frank

St. Margaret's care home, Edinburgh opened in June 2013 and provides dementia care for up to 60 residents. The recently converted former independent school is operated by Four Seasons Health Care.

It is notable that the top five ranked areas of Scotland for 2013 all featured within the top five last year. Furthermore, only seven of Scotland's 12 areas have ever been placed in the top five since the Scotland rankings were introduced in 2010. Glasgow & Renfrewshire, Scotland's most populous area, is yet to feature in the top five, due in large part to the relatively high existing supply in the area.

"There are currently some exciting development opportunities in UK healthcare. Inward investment, relaxation of planning policy and the evolution towards more sophisticated care models are enabling operators to deliver improved built environments and importantly, high quality care."

Michelle Smith
Head of Growth & Development,
Bupa Care Services UK

Knight Frank view

- The recent influx of overseas capital to the UK care sector and the improving availability of finance bode well for increasing the number of modern, future-proofed care homes over the medium-term. With some of the market's leading operators having now undertaken sale & leaseback agreements, investment will increasingly be used to support organic expansion, via pre-let and forward funded developments.
- However, as long there continues to be a lack of clarity over the long-term public funding of elderly care, the development of privately operated care homes is likely to remain weighted towards affluent locations, characterised by a high exposure to self-pay relative to local authority-funded residents.
- Care providers with the best covenants, such as Bupa and Methodist Homes, will have greater access to alternative forms of finance. Consequently, these operators will hold an advantage over their competitors, entering into forward funding and pre-let agreements as a means of expanding their portfolios.
- The UK's elderly care arena is gradually evolving towards a more sophisticated and holistic model, as seen on the continent. We anticipate a greater share of care home developments to form part of a larger, integrated retirement community where opportunities for independent living are provided alongside residential care and educational facilities.

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