Research

Knight Frank

Healthcare

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Contents

Priscilla Wakefield House (Precious Homes) nominated for the 2008 Healthcare Design Awards

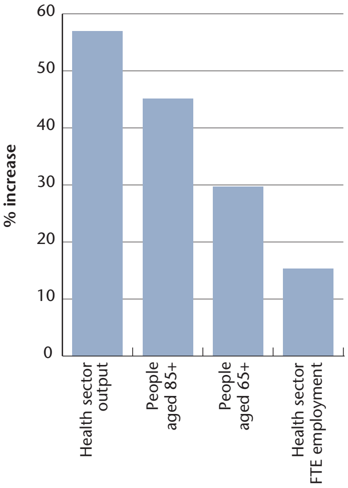
Executive summary

- By 2020, one fifth of the UK population will be aged 65 or over, with almost 2m people aged 85 and over. As such, an increase in the number of care home beds will be needed to meet this future need.
- New build development opportunities are increasingly being sought by corporate operators, with pre-letting an emerging trend. Investor appetite for quality, fully compliant stock remains strong despite limited supply.
- Across Europe, long-term care (LTC) provision varies significantly. As Europe's population ages changes are occurring to the delivery of LTC, leading to increased opportunities for corporate operators keen to expand abroad.
- In the UK, extra-care schemes are one of the newest care models on the market. The emergence of the concept has created confusion and delay at the planning stage, with a lack of consistency regarding its use class classification.
- Having updated its Healthcare Hotspots ranking model, Knight Frank Research has identified Cambridgeshire as the leading development location within England. The ranking model employs a number of key variables and provides a valuable insight into the diversity of opportunity available across the Healthcare sector.

Knight Frank Newmark Global

Figure 1

Projected increases in healthcare output, employment and older people to 2020



Source: ONS/Experian Business Strategies

Economic overview

The UK economy grew by 0.6% in the final three months of 2007 according to ONS data, down from 0.7% growth during the previous three months. Over the whole of 2007, GDP grew by 3.1%. Experian are forecasting GDP growth of 1.5% for 2008 followed by an improvement in growth in 2009.

By 2020, the number of people aged 65 and over is predicted to increase by 30%, to represent one fifth of the population. Life expectancy is increasing but so is the period of dependency. Typically, this means that greater numbers of people in their eighties are spending an increasing proportion of their lives in need of some care and/or support. By 2020, the number of people aged 85+ will have risen 45% to almost 2m. Partly as a result of such demographic drivers, Experian Business Strategies are predicting a 57% increase in output from the healthcare sector, from £75bn in 2007 to £117bn in 2020.

According to Family Spending estimates from the ONS, the average household spends £307 a year on healthcare. There are wide variations however, with households containing people aged less than 30 spending just £109 a year, whereas the 50 to 64 age group, at £458 a year, spends the greatest amount on healthcare. Yet, more important than age is affluence. When ranked by income, the top 10% of households spend an average of £827 a year, more than two-and-half times the national average.

Market overview – UK

Average elderly care home land values in the UK range between £15,000 to £26,000 per bed although, at the prime end, prices around £60,000 per bed have been achieved with end values in the region of £145,000 to £180,000 per bed. Operators with a portfolio of 2,000 beds or more are increasingly focusing on development opportunities as the potential to buy, upgrade and extend existing care facilities diminishes. Although growth in the residential market is softening, target development areas are still often where residential prices are high and operators continue to compete against national house builders.

Yet, where residential values are compromised by either an oversupply of apartments, affordable housing requirements or a Section 106 agreement, developers are increasingly seeking Knight Frank Healthcare to advise on care home land values. The net result is that Knight Frank has advised on significant levels of C2 development sites over the last 12 months.

Pre-letting is an emerging trend. Developers are now signing up corporate operators on a leasehold basis prior to development or even prior to planning. Leasehold pre-lets allow operators to have purpose-built facilities developed, at the same time as reducing capital outlay.

Salisbury: leasehold disposal

86 bed purpose-built nursing home with a proposed 30 year lease.

The appetite for care homes has remained strong over the last six to 12 months with strong purchaser demand for quality stock hampered by limited supply. Much of the product currently available on the market is inferior stock and a number of small group sales have failed to attract a buyer.

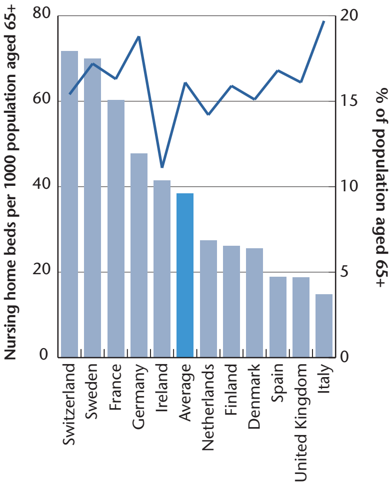
There is now a three-tier market in operation:

- Top-tier: Care homes in excess of 60 beds that are fully compliant with National Minimum Standards, in preferred locations, where supply is restricted
- Mid-tier: Period property with in excess of 35 beds and build extension, broadly meeting National Minimum Standards, in areas of reasonable demographics
- Lower-tier: Smaller conversions (25-beds or less) and not fully compliant with National Minimum Standards

Product in the top-tier is aggressively sought by the corporate sector and many transactions are currently taking place by transfer of shares rather than by private treaty in order to avoid Capital Gains Tax liability. In the short-term, changes to the Capital Gains Tax and Taper Relief regimes have resulted in a number of operators of both individual and smaller groups going to market.

Figure 2

Nursing home beds provision across key European markets

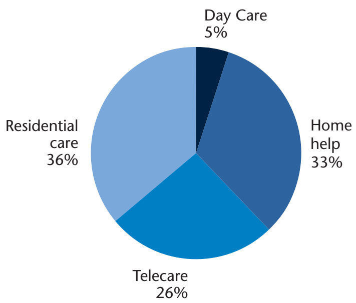


Source: OECD/WHO

"Europe's shift towards private long-term care should provide profit opportunities."

Figure 3

Spain's publicly funded long-term care services



Source: Libro Blanco de la Dependencia

It is predicted that the number of care home places in the UK should begin to rise in the near future. This is despite the government's desire to promote domiciliary care, which could detrimentally impact the residential care market. In truth, however, it is likely that any impact will be limited due to practical, financial and quality of care issues.

Over the last 12 months little consolidation has taken place in the Healthcare sector as corporate operators continue to focus on acquiring or developing 'future proof' elderly care homes that are constructed well in excess of the current National Minimum Standards. At Knight Frank we anticipate corporate demand to continue to focus on new build opportunities. Such opportunities will need to be purpose-built and exceed current physical standards. They are likely to be 100% single en-suite rooms and well in excess of the minimum requirement of 12 sq m.

Market overview – Europe

OECD data highlights the wide disparity in nursing home beds provision across Europe; ranging from Switzerland and Sweden providing over 70 nursing home beds per 1,000 population aged 65 and over, through to Italy with less than 15 such beds. Such a range in provision is partly a reflection of differences in the type and amount of healthcare funding and partly the result of variations in the balance between public and private sector provision and formal/informal care arrangements.

By contrast, the proportion of each country's population aged 65 and over is broadly similar – the EU-15 average being approximately 17% – although country-specific variations exist. By 2050, it has been forecast that the average proportion of people aged 65 and over will rise to roughly 27%, with countries such as Spain, Italy, Ireland and Germany due to experience the greatest increases in older people.

Across mainland Europe, variations exist not only in provision but also in healthcare legislation. Over recent years, the provision and finance of long-term care (LTC) has become a very real policy issue for many European governments; driven not only by an ageing population and declining family support but also rising living expectations among older people. In general, healthcare legislation is increasing the onus on the individual, encouraging older people to remain as long as possible outside state-funded institutions. This shift in emphasis from public to private LTC structures is providing corporate operators with growing opportunities for profit.

There are several examples of recent legislative initiatives by governments regarding the funding of LTC. These include the introduction of new Health Insurance Acts in France (in 2004), Germany (2007) and the Netherlands (2006) and a reform of relevant administrative structures in Denmark (2007). In Spain, the introduction of a law promoting independent living and help for dependent individuals occurred during 2006. The new law guarantees the right to LTC services funded through taxation but subject to means testing.

To date, public coverage of LTC in Spain has been insufficient and dependent on the capacity of decentralised and under-funded social services. Yet, total Spanish public expenditure on LTC is set to increase from 0.33% of GDP in 2007 – approximately €400m – to 1% by 2015 (circa €2bn). The size of the Spanish LTC market is currently around €2.5bn and there are approximately 290,000 residential care beds, over 60% of which are private. Ownership remains fragmented with 50% of supply in the hands of small operators. Spain is forecast to see a doubling of its dependent elderly population in the next 50 years and with the supply pipeline remaining full market maturity is still several years away.

Countries such as Sweden and Finland are also experiencing a movement away from institutional care. Both countries are experiencing a decline in the number of LTC beds in hospitals and nursing homes when compared with the overall size of the elderly population. Despite still having more than four times the number of LTC beds than in Italy, Sweden has recently undergone an increase in the share of its elderly population who receive long-term care at home.

Stokenchurch: leasehold disposal

90 bed purpose-built nursing home with a proposed 30 year lease.

UK corporate trade, property companies and private equity firms are increasingly active in the European care home market. On behalf of UK-based clients Knight Frank has valued and advised on healthcare portfolios throughout Europe. We fully anticipate a continuation of this trend. In addition to changes to both care provision and demographics, interest in Europe is being fuelled by the ability to buy comparable stock to the UK, but at cheaper prices (either in terms of investment yield or valuation multiples) and at times enhanced by favourable exchange rates.

BUPA is a UK market leader in health and care with an increasingly strong international presence with 8m customers in 180 countries and 46,000 employees. BUPA are setting the trend towards internationalisation by expanding their presence overseas through the acquisition of Sanitas in Spain, HBA in Australia, IHI in Denmark and Amedex in the US. BUPA's recent acquisition of the Euroresidencia portfolio now makes Sanitas Residencial Spain's second largest provider of LTC with nearly 5,500 beds in 43 existing and planned care homes.

UK planning issues

By 2028 it is estimated that the number of people aged over 65 will have increased to 15m. In addition to the rapid increase in the ageing of the population there is an ongoing decline in informal care provision from family members as well as changes in government healthcare policy. Instead of 'institutionalised' care provision, community care and dispersed homecare services are being encouraged. Such trends are increasing the need for older people's accommodation with care services and facilities. In response, the concept of extra-care housing has emerged. Within the dependency spectrum, the concept sits somewhere between traditional sheltered housing and care homes.

Extra-care schemes provide integrated housing and care, offering residents the opportunity to live as independently as possible, while having access to intermediate care and rehabilitation services where necessary. Housing associations currently dominate the extra-care sector although the number of private operators is rising rapidly.

"The emergence of the extra-care concept has created confusion and delay at the planning stage."

Despite guidance contained within former ODPM Circular 03/2005 following the latest changes to the Use Classes Order, the emergence of the extra-care concept has to date created confusion and delay at the planning stage. Planning applications for extra-care developments are often being treated differently, dependent on the planning authority in question. Such schemes are either defined as having C2 (residential institution) or C3 (general housing) use class status. If a scheme is deemed C2 use class rather than C3 use class, then it is not required to provide affordable housing, potentially enhancing investment returns. Some local authority planners view older people's housing as general needs housing, although there are several key technical differences that differentiate extra-care housing.

Healthcare hotspots

The 2008 Healthcare Hotspots model has been developed with the key objective of providing an assessment of development opportunities and investment prospects in the Healthcare sector within England. Knight Frank's assessment is based on an analysis of eight different criteria including demographic, economic and Healthcare sector-specific factors and ranking them accordingly. In all, 42 English counties were assessed, highlighting the range and diversity of opportunity currently available. The top 15 counties are listed in table 1.

In particular, the Healthcare Hotspots model focuses on potential growth in demand for Healthcare facilities, economic fundamentals, current and future supply, the cost of buying land for development and the anticipated return each bed may produce.

Aylesbury: leasehold disposal

85 bed purpose-built nursing home with a proposed 30 year lease.

Table 1

Healthcare Hotspot rankings 2008 versus 2007

	2008 rank	2007 rank	Change
Cambridgeshire	1	1	No change
Cornwall & Isles of Scilly	2	3	Up
Northamptonshire	3	5	Up
Warwickshire	4	7	Up
Oxfordshire	5	11	Up
Leicestershire	6	10	Up
Berkshire	7	4	Down
North Yorkshire	8	15	Up
Devon	9	=16	Up
Somerset	=10	=16	Up
Buckinghamshire	=10	2	Down
Worcestershire	12	25	Up
Shropshire	13	11	Down
Wiltshire	14	6	Down
Lincolnshire	15	14	Down

Source: Knight Frank Research

"For the second year running Cambridgeshire is the number one healthcare hotspot."

For the second year running Cambridgeshire has been identified as the top development hotspot for Healthcare provision within England. The county has a below average number of care home beds, both in terms of total number of beds compared to other English counties, as well as on a per head of population aged 65+ basis. In addition, Cambridgeshire has been forecast to experience significant economic growth, as well as considerable growth in the number of people aged 65+. A number one ranking in future supply, as well as places in the top third of counties for all other key variables, has resulted in Cornwall and Isles of Scilly moving up one place to second place, from third place last year. Cornwall and Isles of Scilly currently has one of the lowest provision of care home beds per head of population aged 65+, as well as a significantly below average development pipeline. Meanwhile, Northamptonshire rises to third place, on the back of a strong economic outlook and positive demographics.

Guildford: leasehold disposal

70 bed purpose-built nursing home with a proposed 30 year lease.

Table 2

Healthcare Hotspot rankings 2008 – comparative variables

County	Growth in 65+ population	Economy	Current Supply	Future Supply	Final Rank
Cambridgeshire	3	1	10	18	1
Cornwall & Isles of Scilly	9	8	14	1	2
Northamptonshire	2	4	12	16	3
Warwickshire	21	20	4	2	4
Oxfordshire	28	7	5	17	5
Leicestershire	10	=25	18	7	6
Berkshire	34	2	6	27	7
North Yorkshire	7	=17	19	13	8
Devon	12	10	37	20	9
Somerset	6	27	16	4	=10
Buckinghamshire	31	3	8	30	=10
Worcestershire	15	=25	9	11	12
Shropshire	5	31	7	12	13
Wiltshire	8	16	11	29	14
Lincolnshire	1	=11	32	10	15

Source: Knight Frank Research

Note: The above represents only a sample of the variables which contributed to the final rankings

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