1
Transactions hit £1.76 billion in 2019

2
Domestic and overseas capital targets healthcare

3
Returns hold strong relative to core sectors

Knight Frank

Healthcare Capital Markets

Research 2020

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2019: THE YEAR IN SUMMARY

Healthcare performing well relative to the broader commercial property market

The healthcare sector showed resilience in 2019, ending the year strongly against a backdrop of political and economic uncertainty that disturbed other commercial real estate markets. Documented healthcare property transactions hit a record high of £1.76 billion in 2019, up a further 17% from the £1.49 billion seen in 2018 (Figure 1). This compares to a decline of -17% across all commercial property, with office, industrial and retail sectors experiencing falls in transaction activity. While the healthcare sector has not been immune from Brexit uncertainty, the effect has been more severe for traditional commercial sectors that are nearing their peak in the current investment cycle and are more sensitive to economic factors.

We continue to see demand for different healthcare assets and from a range of investors, including institutional funds, private property investors, REITs and overseas buyers. All of have taken note of the demographic fundamentals underpinning demand for care beds and healthcare services; the long-dated and index-linked income that makes healthcare a strong defensive play; and the diverse mix of healthcare property types in the UK.

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Overseas capital accounted for 32% of healthcare property deals in 2019

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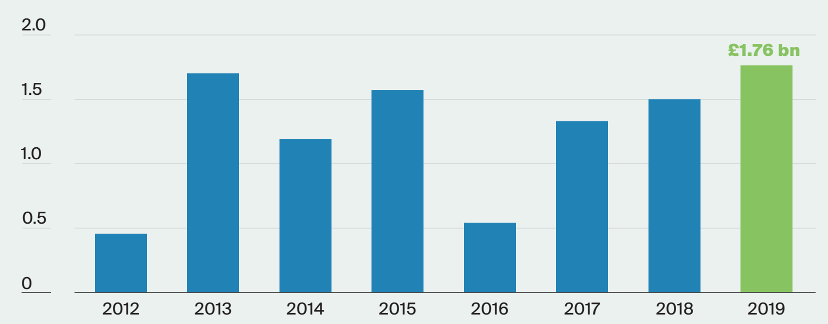
We have seen fierce competition for healthcare assets at the prime end of the market, but 2019 was a testing year with several large deals helping to keep year-end volumes elevated. Looking at 2020, the UK's election result has already helped other large healthcare deals get over the line, but the finalisation of Brexit gives reason to be cautious as we start a new decade. Furthermore, the outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a "global health emergency" on 30th January 2020, has inevitably impacted global financial markets. At the current time of writing, we believe it is too early to tell if the virus will materially affect the UK Healthcare market.

Major deals in the hospital and elderly care home market

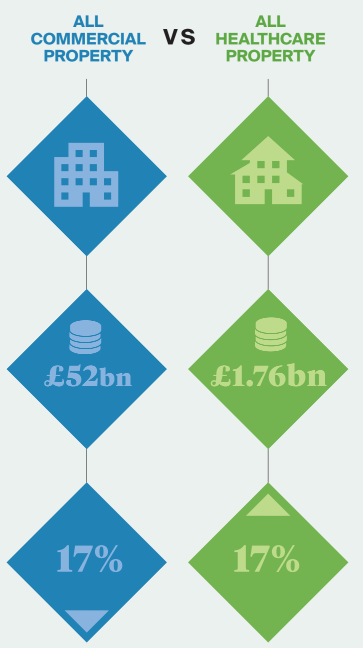
The largest deal of the year occurred in the private hospital market with specialist U.S. healthcare REIT, Medical Properties Trust, acquiring a portfolio of eight private hospitals for £347 million from Secure Income REIT. The portfolio is let to leading operator Ramsay Health with an unexpired lease term of 18 years and a yield of 4.3% (NIY). As a sign of overseas confidence in UK healthcare, Medical Properties Trust have since acquired a further 30 BMI hospitals for a fee of £1.5 billion – the mega deal was finalised in early 2020.

Fig 1: Recorded healthcare investment volumes, £ billions



Source: Property Data

2019 TRANSACTIONS

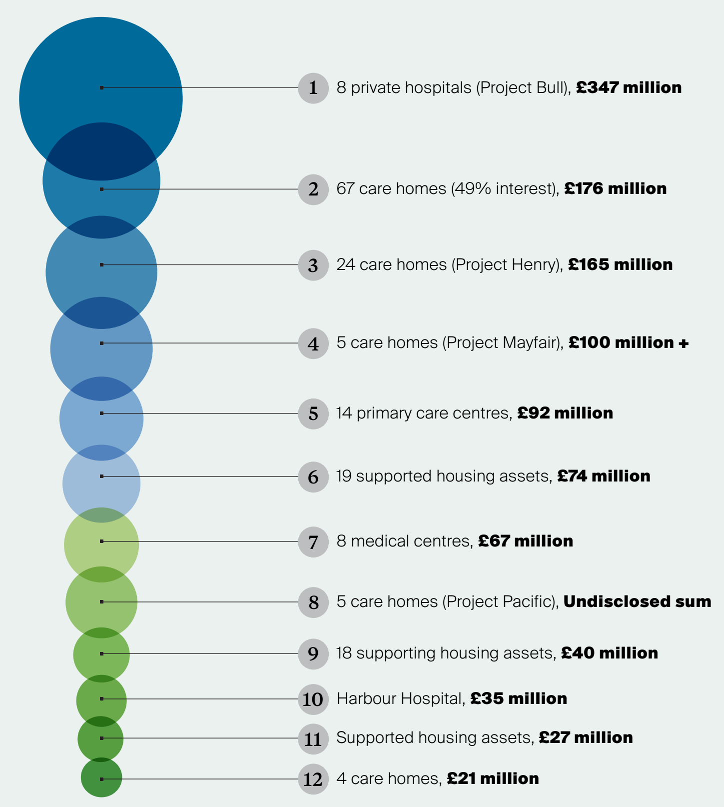


HEALTHCARE CAPITAL MARKETS 2020

Overseas capital was also deployed in the elderly care market in 2019. Most notably, a joint venture between Chinese private equity group Cindat Capital and US healthcare REIT Omega Capital purchased a 49% stake in a 67 care home portfolio for a sum of £176 million. The homes are let to leading operators HC-One and Maria Mallaband Care Group.

Leading UK care home operator, Barchester Healthcare, also acquired 24 Brighterkind care homes from private equity giant Terra Firma for £165 million. The purchased homes sat outside the Four Seasons Healthcare High Bond Yield Group and traded as a going concern, with real estate assets and operations being transferred to Barchester. At the super prime end of the market, Aviva (Lime Fund) purchased five care homes from developer Hadrian Healthcare for comfortably over £100 million, the fee breaking records on a per bed basis. The luxury homes are let to Anchor Hanover on 35-year lease terms and the yield was reflective of this.

Fig 2: Major Deals 2019



Source: Property Data

Table 1: Major Deals 2019

	ASSET/PORTFOLIO	SECTOR	PURCHASER	ASSETS	SELLER	OCCUPIER	PRICE (£M)	YIELD (NIY)	DATE
1	Project Bull	Private hospitals	Medical Properties Trust	8	Secure Income REIT	Ramsay Health Care	347	4.3%	Jul-19
2	Care Home Portfolio (49% interest)	Elderly care homes	Cindat Capital & Omega Healthcare	67	Healthpeak Properties	HC-One/MMCG	176	undisc.	Dec-19
3	Project Henry	Elderly care homes	Barchester	24	Terra Firma	Brighterkind	165	undisc.	Dec-19
4	Project Mayfair	Elderly care homes	Aviva (Lime Property Fund)	5	Hadrian Healthcare	Anchor Hanover	>100	undisc.	Jul-19
5	GPI portfolio	Primary care	Assura	14	GPI	Undisc.	92	undisc.	May-19
6	Supported housing portfolio	Supported living	Civitas Social Housing	19	Undisc.	Multiple Housing Ass.	74	undisc.	Mar-19
7	Medical centre portfolio	Primary care	Assura	8	Undisc.	Undisc.	67	undisc.	Jan-19
8	Project Pacific	Elderly care homes	Target Healthcare REIT	5	Darrington Healthcare	Bondcare	undisc.	undisc.	Nov-19
9	Supported housing portfolio	Supported living	Triple Point Housing REIT	18	Housing Associations	Multiple Housing Ass.	40	undisc.	May-19
10	The Harbour Hospital	Private hospitals	Medical Properties Trust	1	BMI Healthcare	BMI Healthcare	35	5.1%	Apr-19
11	Project Orion	Supported living	Triple Point Housing REIT	40	Voyage Care	Voyage Care	27	5.9%	Sep-19
12	Care Home Portfolio	Elderly care homes	Impact Healthcare REIT	4	MMCG	MMCG	21	7.4%	May-19

Source: Property Data

PROPERTY TYPES AND BUYER TYPES

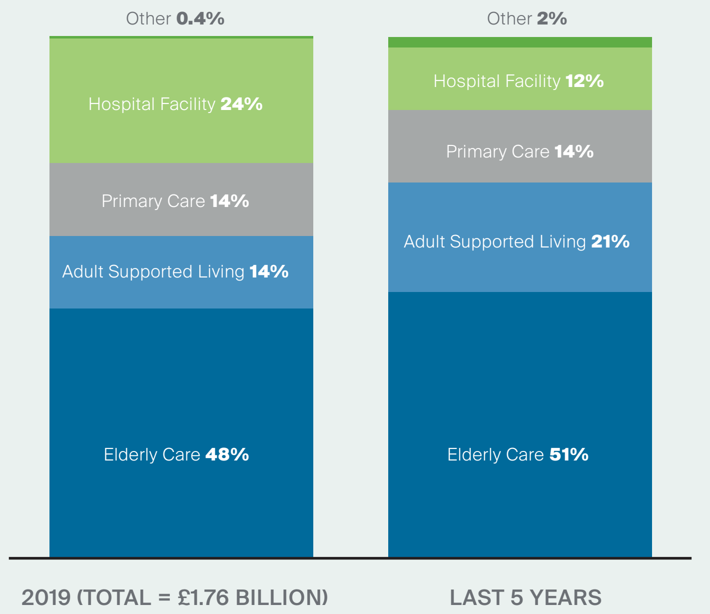
A healthy mix of assets types support a diverse sector

The mix of asset types traded in the healthcare sector is diverse and covers a range of acuity levels. With 95% of care home stock privately owned, elderly care is the largest investable market and has accounted for 51% of recorded healthcare transactions since 2015 (Figure 3). While investors remain keen on care homes, the lack of prime stock was a barrier in 2019. The adult supported living sector saw a smaller share of investment in 2019, but the market remains in a period of growth and transition with a shift away from large-scale homes into smaller community-based accommodation. A handful of specialist supported and social housing REITs have established investment models that target these assets.

Primary care and hospital facilities (acute care) are also a key part of the healthcare investment arena, despite the prevalence of government and NHS ownership of such assets. Deals in the private hospital sector are few in number but large in scale, as shown by the recent acquisitions made by Medical Properties Trust.

With demand for healthcare assets surging, new development investment is an increasingly common way to gain exposure to the prime end of the market. We are already seeing a high number of development site purchases and forward funding arrangements, especially in the elderly care home sector and the primary care sector where new stock is urgently needed. Major players like Octopus Healthcare, Assura Plc and Target REIT have made new development a key part of their investment strategies.

Fig 3: Share of recorded healthcare investment by property type



Source: Property Data

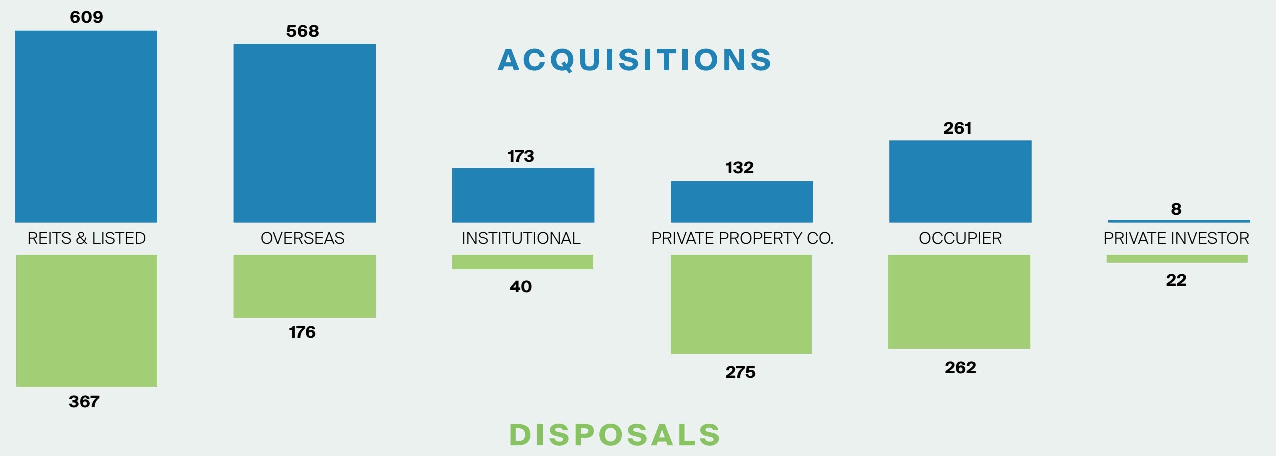
Specialist REITs continue to grow and institutional investors circle

Figure 4 shows that REITs and public listed buyers remained the most active in 2019. It's also worth noting that listed buyers from the U.S. dominated acquisitions from overseas. Primary care REITs, namely PHP and Assura, are the largest UK-based with portfolios valued in excess of £2 billion (Figure 5). Trusts specialising in care homes and supported housing are smaller but individually grew their portfolios by over 20% in 2019. Healthcare REITs have benefited from increasing preference for opco-propco business models among operators, whereby the property assets of the business are separated from the operating business. This allows operators to focus on delivering care and protect the interests of residents, with the option to sell off their property assets and raise capital if required. This has created a growing opportunity for investors (particularly REITs) targeting fixed income assets, with sale and leaseback deals common to the market.

While there were only a limited number of acquisitions involving institutional investors in 2019, the small amount of prime stock for sale was the key factor, rather than a lack of demand. A number of institutional funds have declared an intention to invest in healthcare, but are competing for a small pool of prime quality stock.

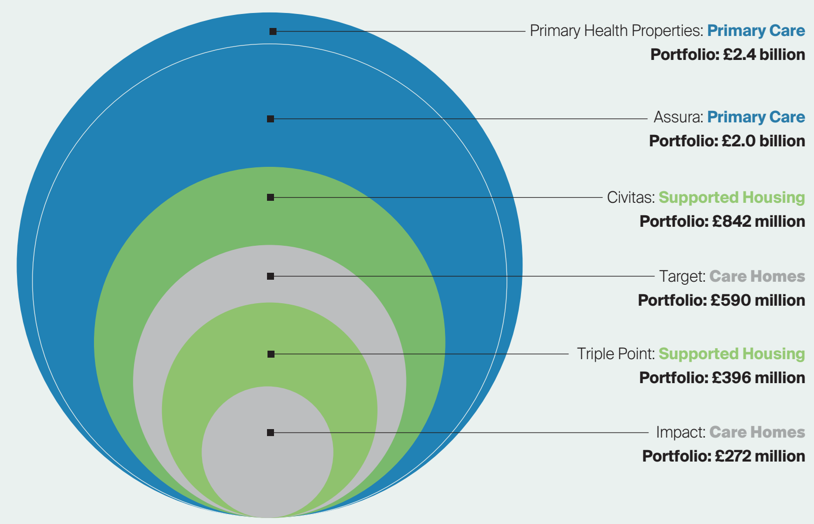
Lindsey Hall, Grimsby, Yorkare

Fig 4: Acquisitions vs disposals 2019 by investor type, £ millions



Source: Property Data; excludes undisclosed deals

Fig 5: Major UK healthcare REITs



Source: Latest company report, as of February 2020

INVESTMENT PERFORMANCE

Yields reflect demand for UK healthcare assets

Institutional interest is particularly strong at the prime end of the care home market with bidders willing to pay a premium for well-located, purpose built homes positioned for the private-pay market. This has driven yields to record lows with average super-prime and prime assets trading as low as 3.5%-4.0% (Figure 6). Pricing looks justified when you consider that private-pay homes across the UK averaged EBITDARM margins of 38% in 2019[1]. Core market stock, which tends to be well occupied but reliant on a more even mix of private-pay and local authority funded residents, is trading at yields of 5-6%.

Care home yields in the UK are lower than those observed in other developed and mature markets across the globe (Figure 7). For example, the Australian elderly care sector has an international reputation for care quality but reports yields of around 200 basis points higher than the UK. In a global context, UK healthcare is highly attractive, favoured for its established healthcare infrastructure, high standards of care and mix of public and private funding.

8.7%

average total returns in the healthcare sector over the last five years.

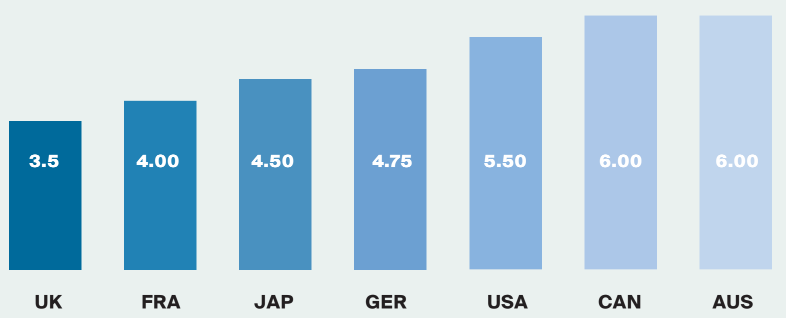
Healthcare and alternative sector returns look strong vs core property

Total returns fell across all UK commercial property sectors in 2019 with capital growth limited by uncertainty in the market. Healthcare returns in the MSCI index fell to 7.4%, but currently rank higher than all core property sectors, overtaking industrial returns for the first time. Declines were most severe in the retail and industrial sectors, with the investment cycle beginning to cool off for the latter. Alternative sectors like residential (PRS) and healthcare held strong in 2019 with assets comprising "anything with a bed" touted as a reliable strategic play going forward[2]. Fuelled as much by demographic trends as economic factors, these sectors are increasingly sought after for their perceived low risk and long-dated income.

Healthcare property is looking favourable in terms of risk and return

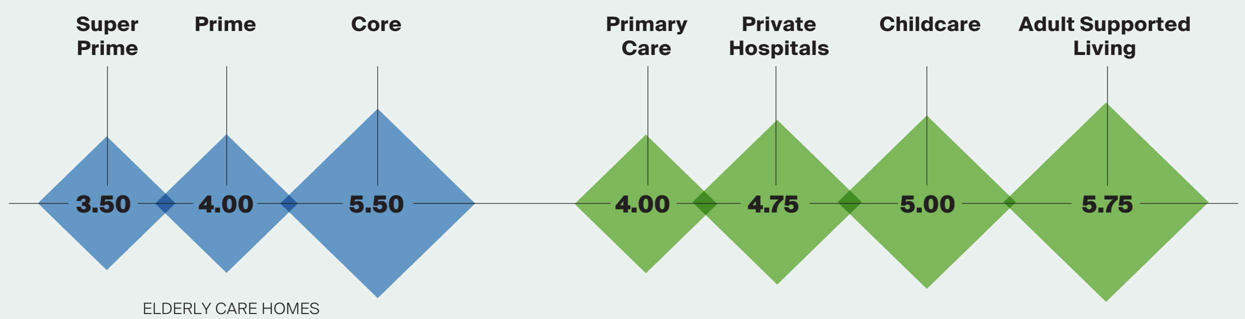
Figure 9 shows how strong the risk-return trade-off for healthcare property has been over the last five years. In this period, total returns in the sector averaged 8.7%, outperforming office and retail sectors. Healthcare returns have also been the most consistent and least volatile since 2015, indicated by a standard deviation of 2.6. With allocations to alternative and specialist sectors predicted to increase and healthcare property providing one of the most stable income streams, we expect to see a similarly strong profile of performance in 2020.

Fig 7 : Prime elderly care home yields (fixed-income, %)



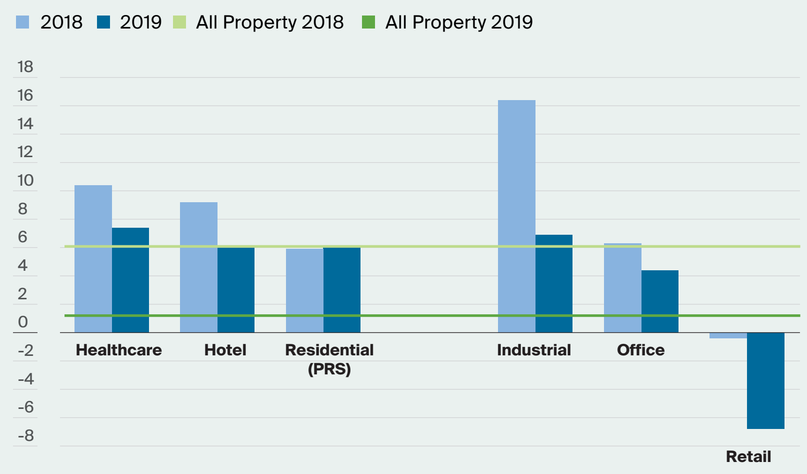
Source: Knight Frank Research

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



Source: Knight Frank Research

Fig 8: Total Returns, 2018 vs 2019 (%)



Source: MSCI

Fig 9: Risk vs Returns, 2015-2019

Source: MSCI

The Manor House, Knaresborough, Anchor Hanover

OUTLOOK

OPPORTUNITIES

- **Demand for healthcare** is set to continue with the over-80 population forecast to grow from 3.4 million in 2020 to 5.5 million in 2040. This will increase demand for residential care but also primary and acute care with the elderly leading users of such services.
- **The attractive risk-return profile** is a reason many investors are targeting the healthcare sector. Greater uncertainty in other capital markets and property sectors will continue to grow the appeal of secure and long-dated income providing assets.
- **New development** is key to the future and will create entry points for many investors. Major stakeholders are already focused on building new healthcare assets with forward funding and land acquisitions increasingly common.
- **International healthcare markets** present a growing opportunity, particularly those in developed countries with growing elderly populations and private sector ownership. Private equity and institutional investors are exploring the range of real estate opportunities across the globe.

CHALLENGES

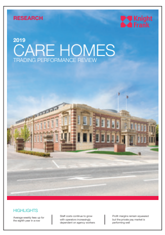
- **Availability of stock** was one of the biggest barriers to investment in 2019, especially in the prime care home market. Investor demand for healthcare assets is escalating at a time when more stock is needed.
- **The care funding crisis** which mostly effects care operators dependent on local authority or government funds, is not likely to be resolved soon. The government has initiated cross-party talks but a quick solution is unlikely.
- **Regulatory risk** is often considered a barrier to investment, not helped by newspaper headlines. While failing care standards are a significant cause of home closure, 80% of care homes are rated “Good” or “Outstanding” by the Care Quality Commission.
- **Staffing** remains the main operational challenge, representing 55-60% of income. Brexit carries the risk of disturbing the migrant workforce that many care operators depend on and a further 6.2% rise in the National Living Wage will take effect in 2020.

Footnotes:

(1) Knight Frank Care Home Trading Performance Review 2019
(2) PWC, Emerging Trends in Real Estate® : Europe 2020

Front cover phot: Beaumont House, Nottingham, Crown Care

Recent Publications



Trading Performance Review

European Healthcare Report

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