1

Healthcare property transactions hit £2.34 billion

2

Overseas Capital a prominent feature once more

3

Healthcare returns maintain their consistency

Healthcare Capital Markets

Research 2022

KEY FINDINGS

2.34bn
TOTAL TRANSACTION VOLUME

67%
PORTFOLIO TRANSACTIONS

51%
THE PERCENTAGE OF 2021 DEMAND FROM OVERSEAS CAPITAL

89m
LARGEST SINGLE ASSET TRANSACTION

9.5%
AVERAGE ANNUALISED RETURNS *AS AT END OF Q4 21

£1.5bn
5 YEAR AVERAGE TRANSACTION VOLUME

2021 SUMMARY

RYAN RICHARDS, SENIOR ANALYST

With an estimated value of approximately £245bn, the market for UK care assets continues to pull the attention of both domestic and overseas investors due to its strong demand drivers such as long leases and an ageing population. This year's report focuses on the healthcare investment market trends from the past year, as well as covering our thoughts for the year ahead.

2021 was set to be a year of assessment in terms of the resilience and bounce back capabilities of many sectors. We are beginning to see operators trade at pre-pandemic occupancies once more, development has held steady and investment volumes have been stronger than initial expectations. It is, therefore, safe to say that across most, if not all, aspects of healthcare, we have seen just how robust the sector can be.

Whilst transaction volume did not see the highs recorded in 2020, it was not far behind, totalling £2.34bn across the sector. Much like in 2020, volume was aided by a major transaction in the form of Medical Properties Trust's acquisition of a portfolio of Priory homes by way of sale and leaseback.

Overseas capital was once again a factor, accounting for 51% of transaction volume with a mix of European operators and REITs such as the likes of Korian and Cofinimmo entering the market with acquisitions within the elderly care space.

Average annualised returns sat at 9.50% at the end of Q4 21, once again showcasing the sector's stability and return potential. This, along with many of the other sector fundamentals, are likely to solidify the trend of investors pivoting away from conventional classes into the alternatives.

Another major topic of discussion is ESG. Investor and occupier demand for sustainability is on the rise, which organically builds the case for green finance as well as overall ESG strategies. The social aspect of ESG is the most relatable to the sector and will direct attention to how operators and investors develop a commitment to social impact.

Overall, the caution and reservation seen by investors early on during the pandemic seems to have passed and the long-term drivers of the healthcare market remain, creating a generally positive sector sentiment. The outlook for healthcare as a sector is therefore a positive one and we can expect an active market for care assets in 2022.

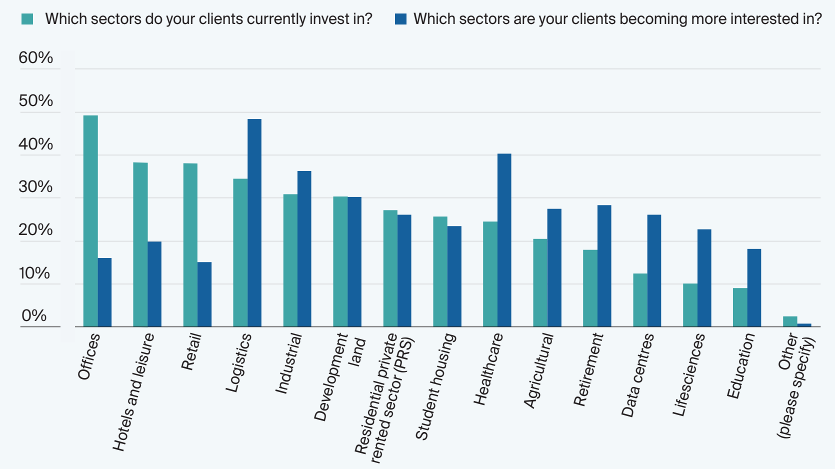
PRIVATE INVESTOR SECTOR FOCUS

Private capital is becoming increasingly important within the market for commercial real estate. Investment volumes from private capital saw a 52% rise in 2021.As a comparison, institutional investment volumes rose by 29% over the same period.

The 2022 Knight Frank Wealth Report highlights that whilst the private investors surveyed are well diversified across the various real estate sectors, with sectors such as office and retail accounting for most of the composition, we are beginning to see a shift in interest towards more non-conventional sectors.

Generally considered an alternative asset class, Figure 1 presents a compelling view of healthcare's growing recognition as a sector within real estate. With 24% of surveyed private wealth advisors saying their clients' already have healthcare exposure and 40% of respondents expressing their clients have increasing interest in the sector, it seems as though these investors are now looking to follow the path laid by the institutional and private equity capital. Further to this, 37% of UHNWIs became more philanthropic in 2021. 83% of which reported an interest in healthcare and disease prevention, which again highlights a fundamental driver of healthcare with individuals pursuing social impact.

FIG 1. **SECTOR FOCUS SHIFT AMONGST PRIVATE INVESTORS** (% of respondents)



Source: The Wealth Report 2022 Attitudes Survey

THE INVESTMENT CASE FOR UK HEALTHCARE PROPERTY

DEMOGRAPHIC SHIFT
UK over 85 population is set to increase from 1.7 million to 3.7 million in 2050.
An ageing population means increasing demand for residential care, primary care and acute hospital services.

SECURE INCOME
Operator revenue is reinforced by a healthy mix of self-funded care and publically-funded care.
Income is supported by high occupancy and patient demand across the healthcare arena.

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

INVESTMENT PERFORMANCE
Total returns measured 9.5% in 2021, higher than many core property sectors.
Returns are historically stable, offering investors protection and diversification.

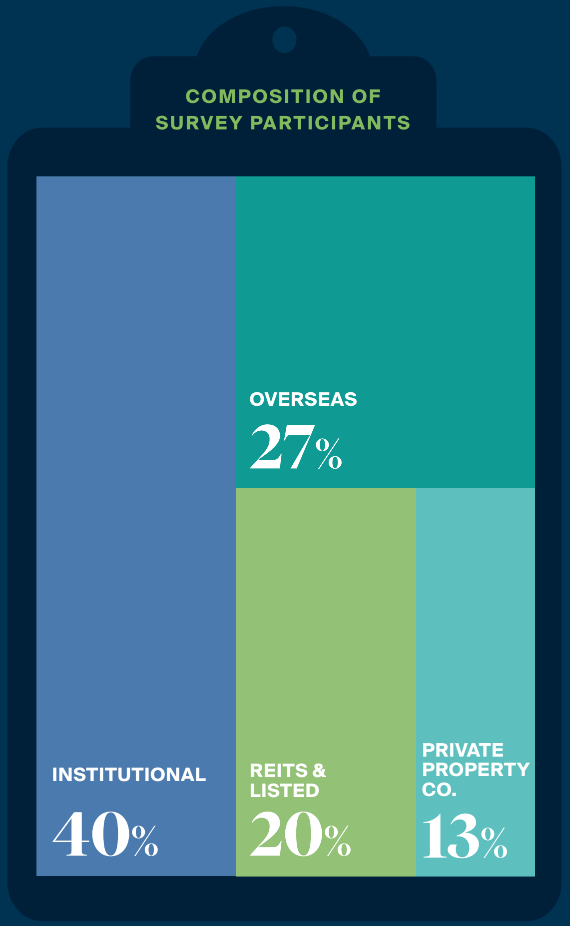
DEMAND FOR SAFE-HAVENS
Broader UK real estate offers security and liquidity in a global downturn.
UK healthcare's long-term and often government-supported income offers further defence.

STRUCTURAL CHANGE IN REAL ESTATE
Real estate investors already de-risking from traditional sectors such as retail into alternatives like healthcare.

SOCIAL IMPACT
The influence of impact or ESG investing in real estate is growing at a faster pace than ever.
A range of investors are now focusing on social infrastructure investments, and healthcare is part of this.

MARKET VIEW

For this year's report, given the various factors impacting the sector, it was extremely important to drill down into the sentiment of investors to truly understand the state of the market. Whilst the extensive resources and in-house data provide a strong overall view of the market, the first hand investment experience and strategies utilised by those involved is invaluable insight to this. We have therefore surveyed several key UK market players including major REIT, institutional and overseas investors.



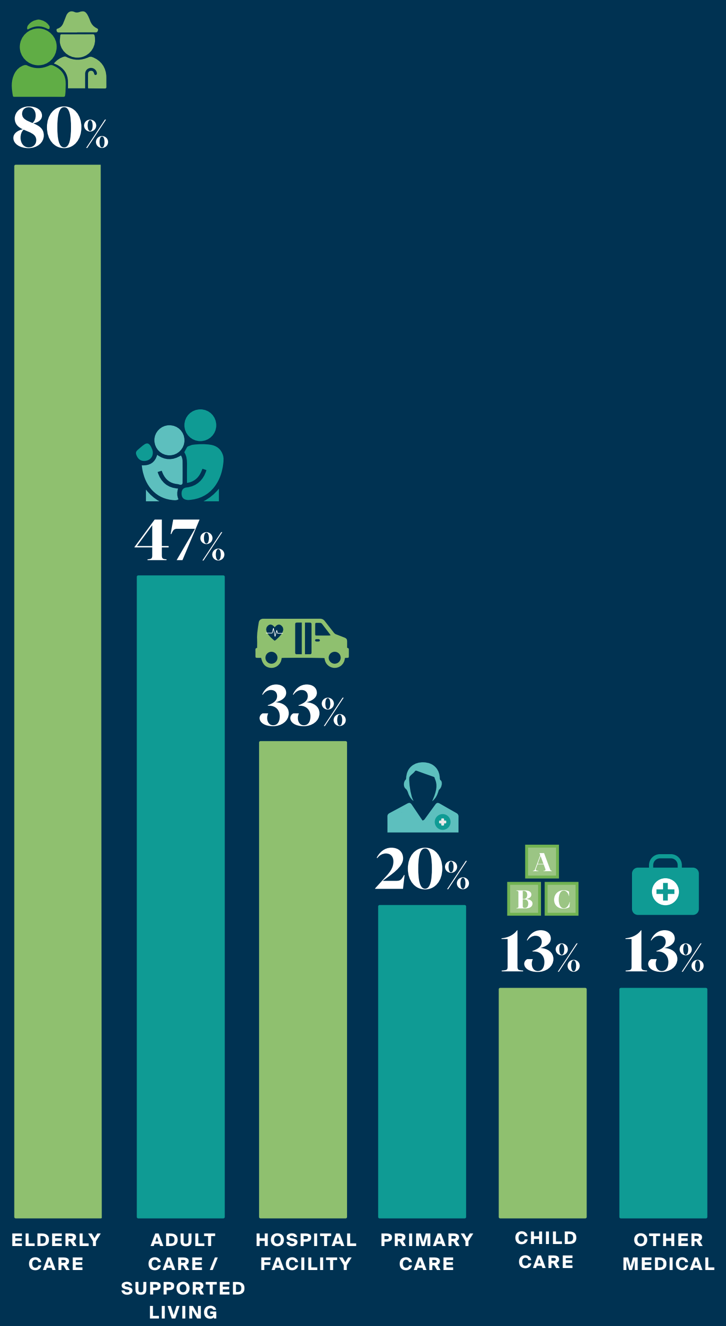
THE APPROXIMATE VALUE OF CARE ASSETS UNDER THE MANAGEMENT OF SURVEY PARTICIPANTS GLOBALLY

£49.9bn

TOTAL CARE ASSETS

5,365

WHICH AREAS OF HEALTHCARE DO YOU CURRENTLY HAVE EXPOSURE TO? (% OF RESPONDENTS)



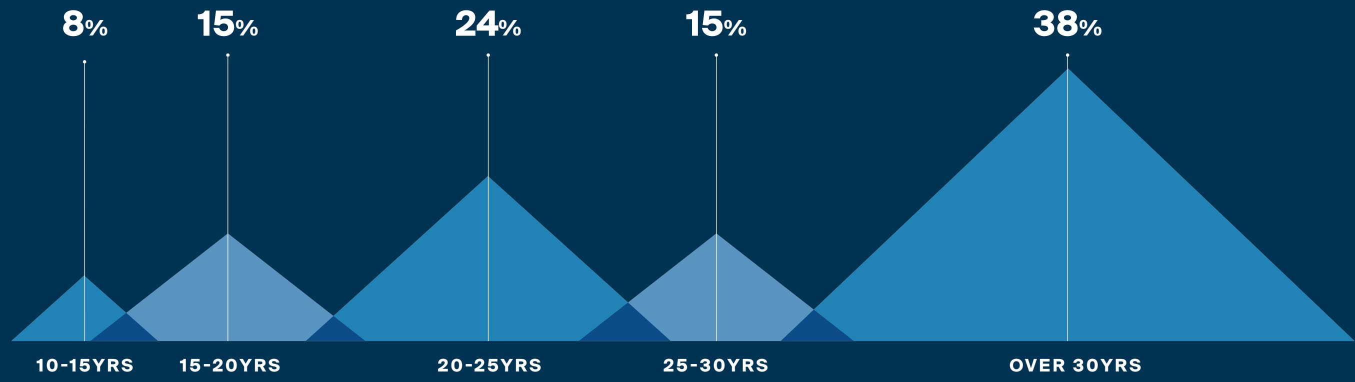
CAPITAL AVAILABLE

With many of the investors surveyed confirming no specific limit and that there is capacity available for the right acquisition.

THE AMOUNT OF CAPITAL CURRENTLY AVAILABLE AND COMMITTED FOR SURVEYED INVESTORS TO DEPLOY ON CARE ASSETS

£6.27bn

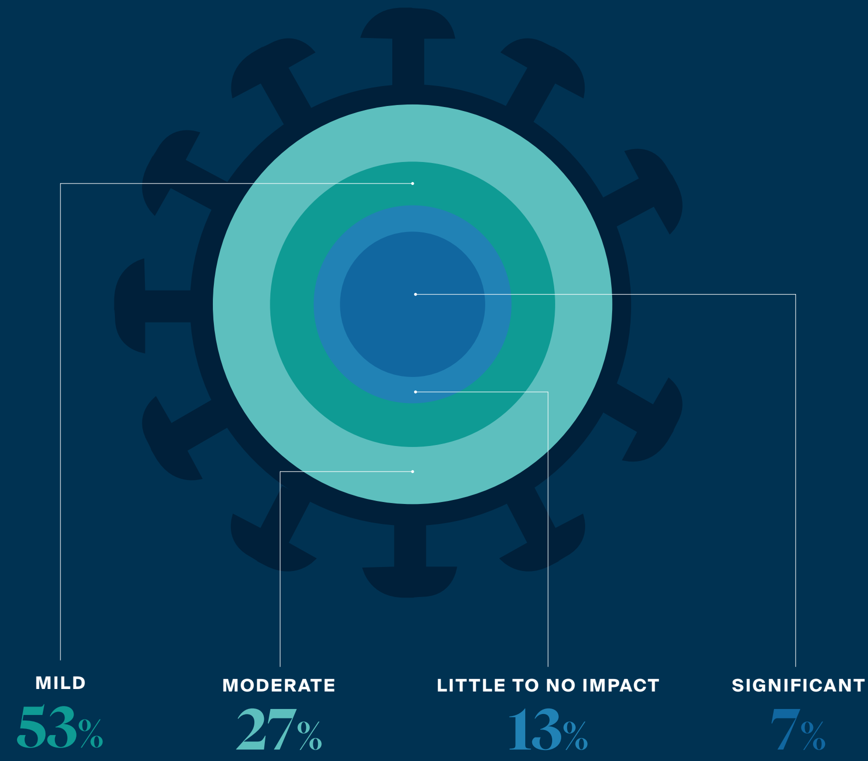
CURRENT WAULT OF SURVEY PARTICIPANTS HEALTHCARE PORTFOLIOS



IMPACT OF COVID

Whilst the reported impact to the real estate portfolios of surveyed investors was considered mild to moderate, respondents agreed that Covid had a significant operational impact for tenants. However, performance proved resilient with rent collection has remaining strong throughout.

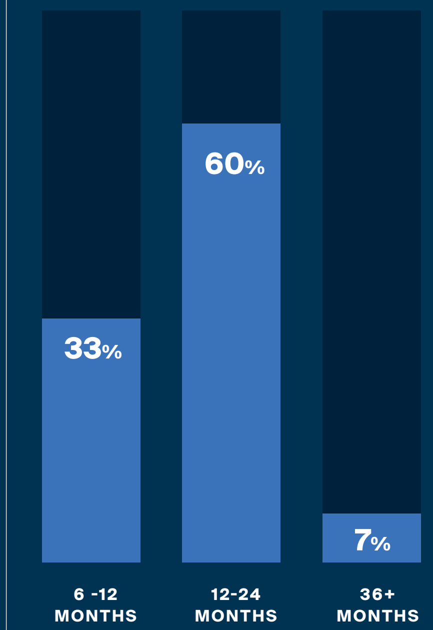
LEVEL OF IMPACT OF COVID 19 ON THE PERFORMANCE OF PORTFOLIOS



RETURN TO NORMALITY

Investors are generally optimistic about the market's health following the pandemic. This is due to recovering operator occupancies and promising rent covers.

HOW FAR IS THE HEALTHCARE SECTOR FROM NORMALITY FOLLOWING COVID 19

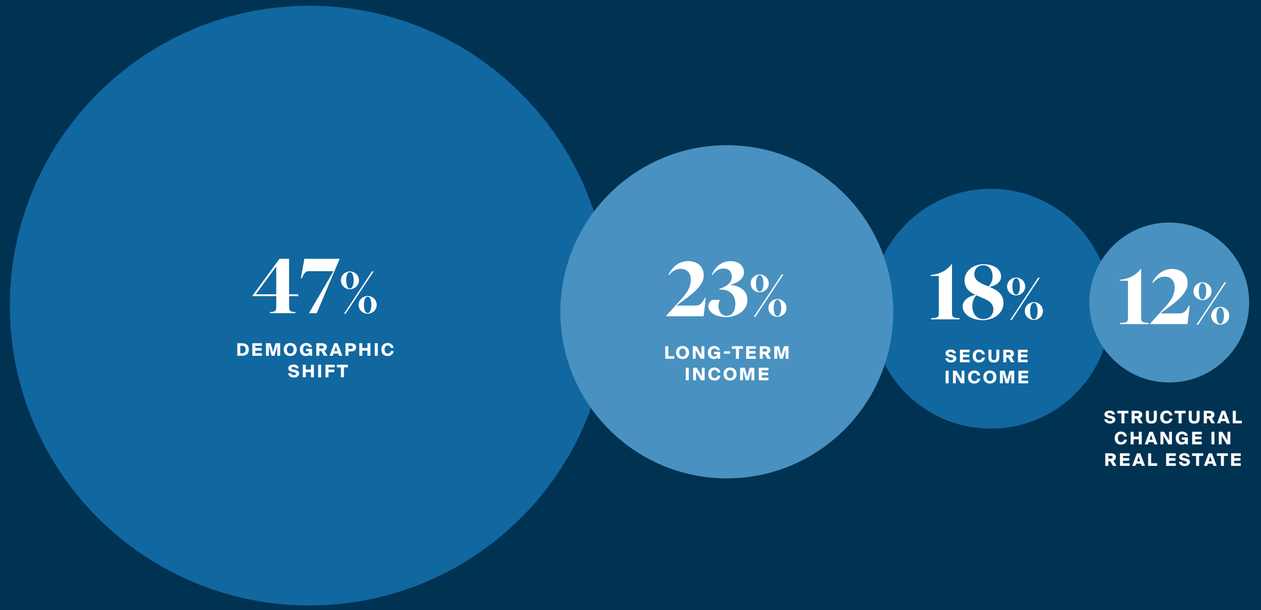


24 - 36 MONTHS **0%**

KEY DRIVER

In line with the narrative that has been present for some time now demographic shift has emerged as the standout driver, with undersupply and needs based demand all falling into play.

MOST IMPORTANT DRIVER OF DEMAND FOR UK HEALTHCARE

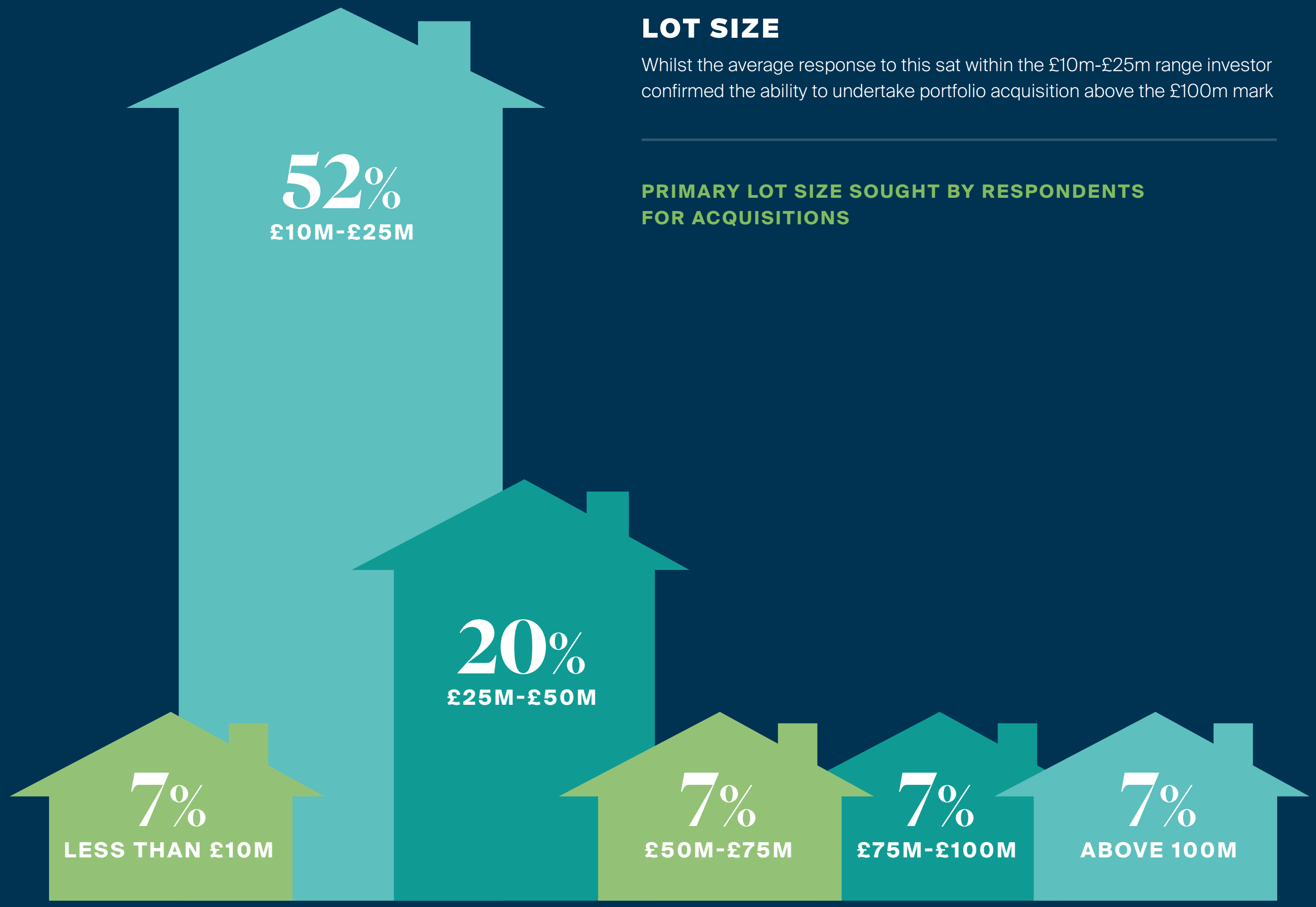


INVESTMENT PERFORMANCE **0%**, DEMAND FOR SAFE-HAVENS **0%**, SOCIAL IMPACT **0%**

LOT SIZE

Whilst the average response to this sat within the £10m-£25m range investor confirmed the ability to undertake portfolio acquisition above the £100m mark

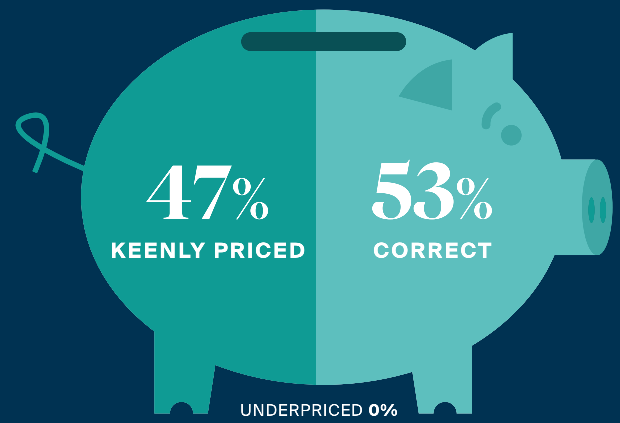
PRIMARY LOT SIZE SOUGHT BY RESPONDENTS FOR ACQUISITIONS



PRICING

Although several respondents suggested that the market is currently keenly priced, many believe this to be with respect to the prime new build end of the market and that there is still ample opportunity to find value, with the UK offering strong yield in comparison to rest of Europe.

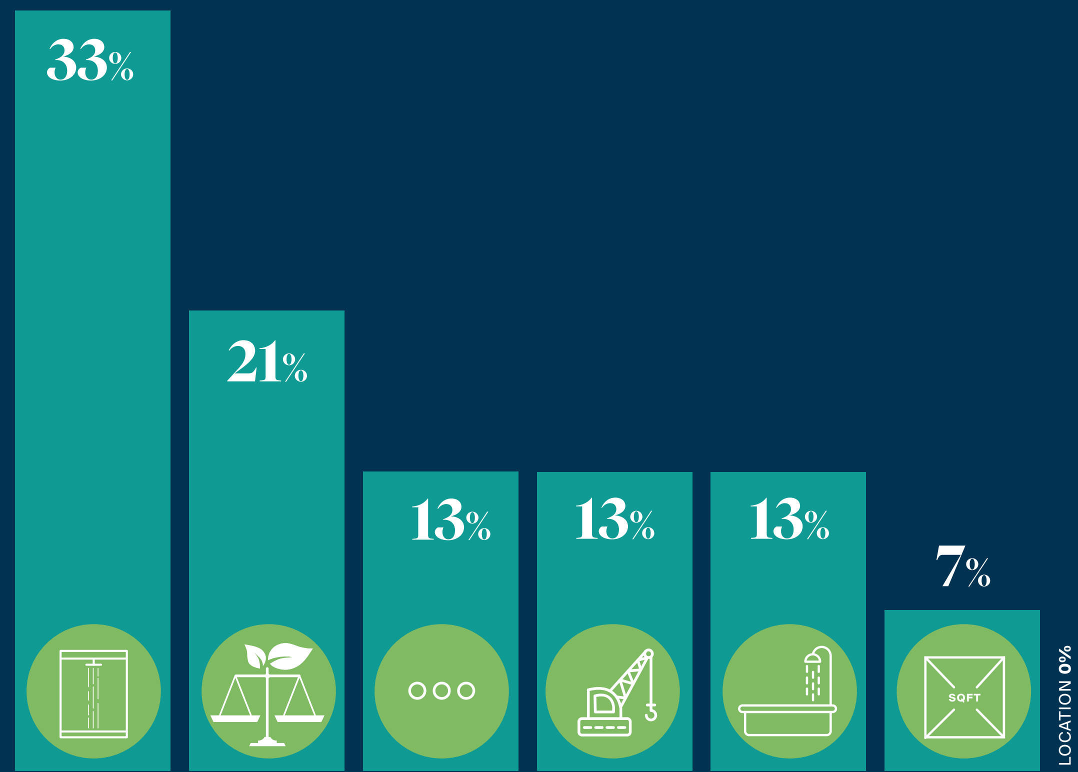
WHAT ARE YOUR THOUGHTS ON THE GENERAL PRICING TONE OF THE MARKET?



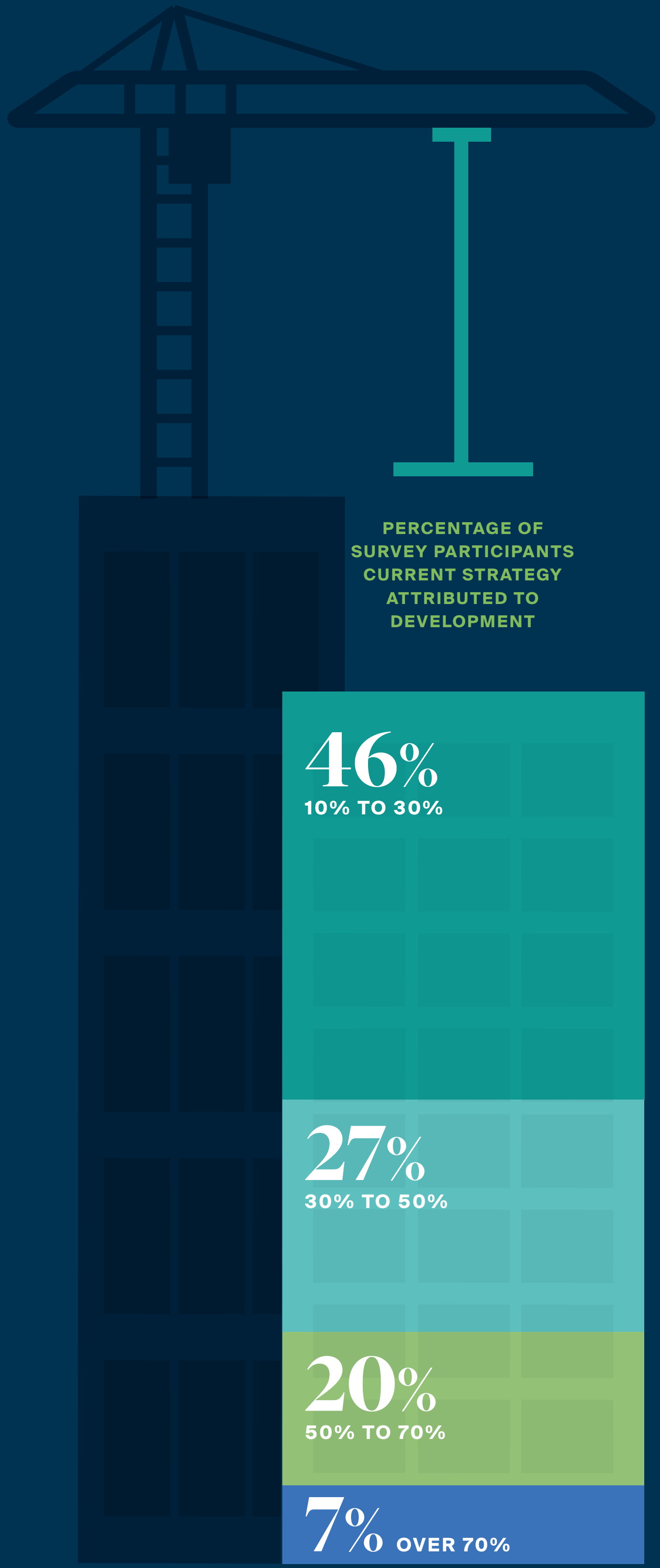
ISSUE WITH CURRENT STOCK

Whilst the standout issues relate to the percentage en-suite and wet room amongst the current supply. Other suggested issues include age of assets and the resulting issues on development, refurbishment, ESG and functional obsolescence.

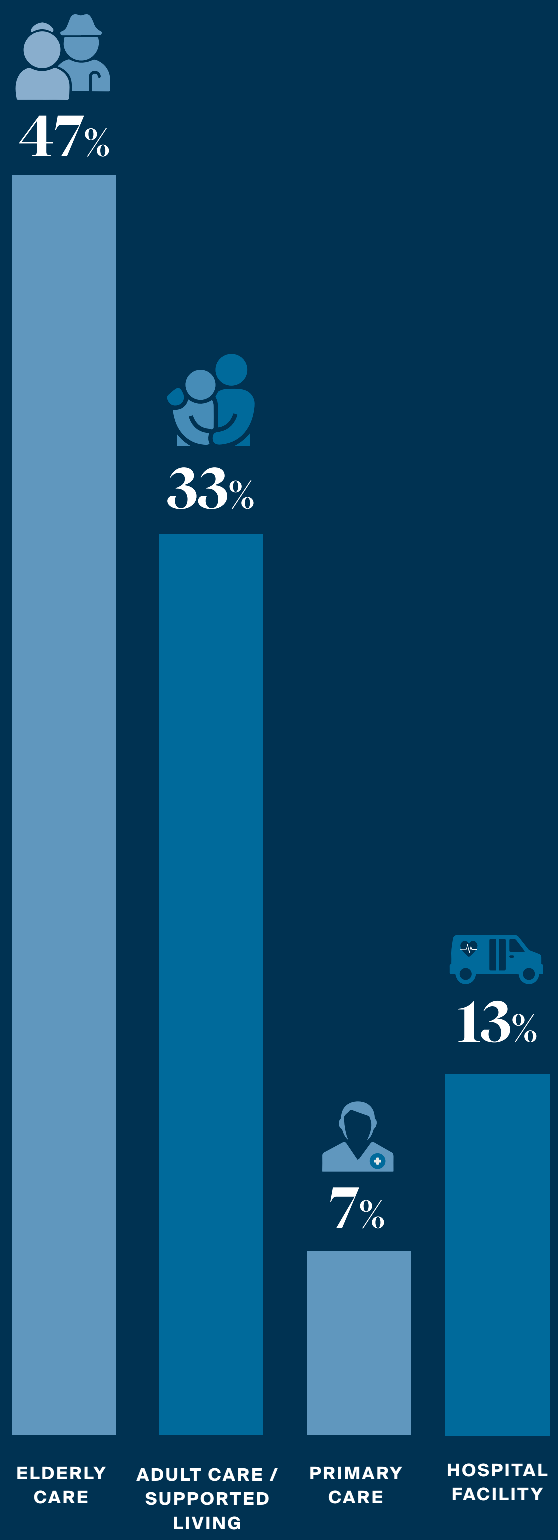
WHAT WOULD YOU SUGGEST IS A MAJOR ISSUE WITH THE CURRENT QUALITY OF STOCK?



DO YOU SEE DEMAND FROM OVERSEAS CAPITAL FOR UK CARE ASSETS INCREASING, DECREASING OR STABILISING?



AREA OF HEALTHCARE THAT PRESENTS THE MOST INVESTMENT OPPORTUNITY



RISK APPETITE

The Pandemic seems to have strengthened the case for the resilience of the sector whilst also opening the floor to enhanced infection control and improvements in care delivery.

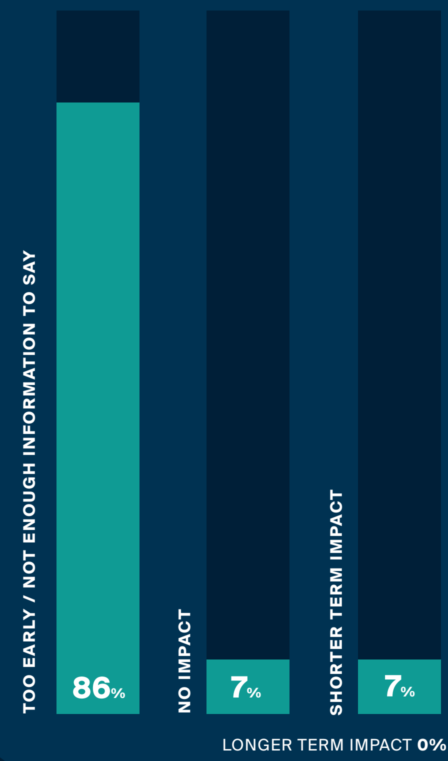
HOW HAS THE OUTBREAK OF COVID 19 IMPACTED YOUR APPETITE FOR RISK?

WILL RECENT PLANNING LAW REFORM PRESENT MORE OPPORTUNITY FOR THE SECTOR?

SOCIAL CARE LEVY

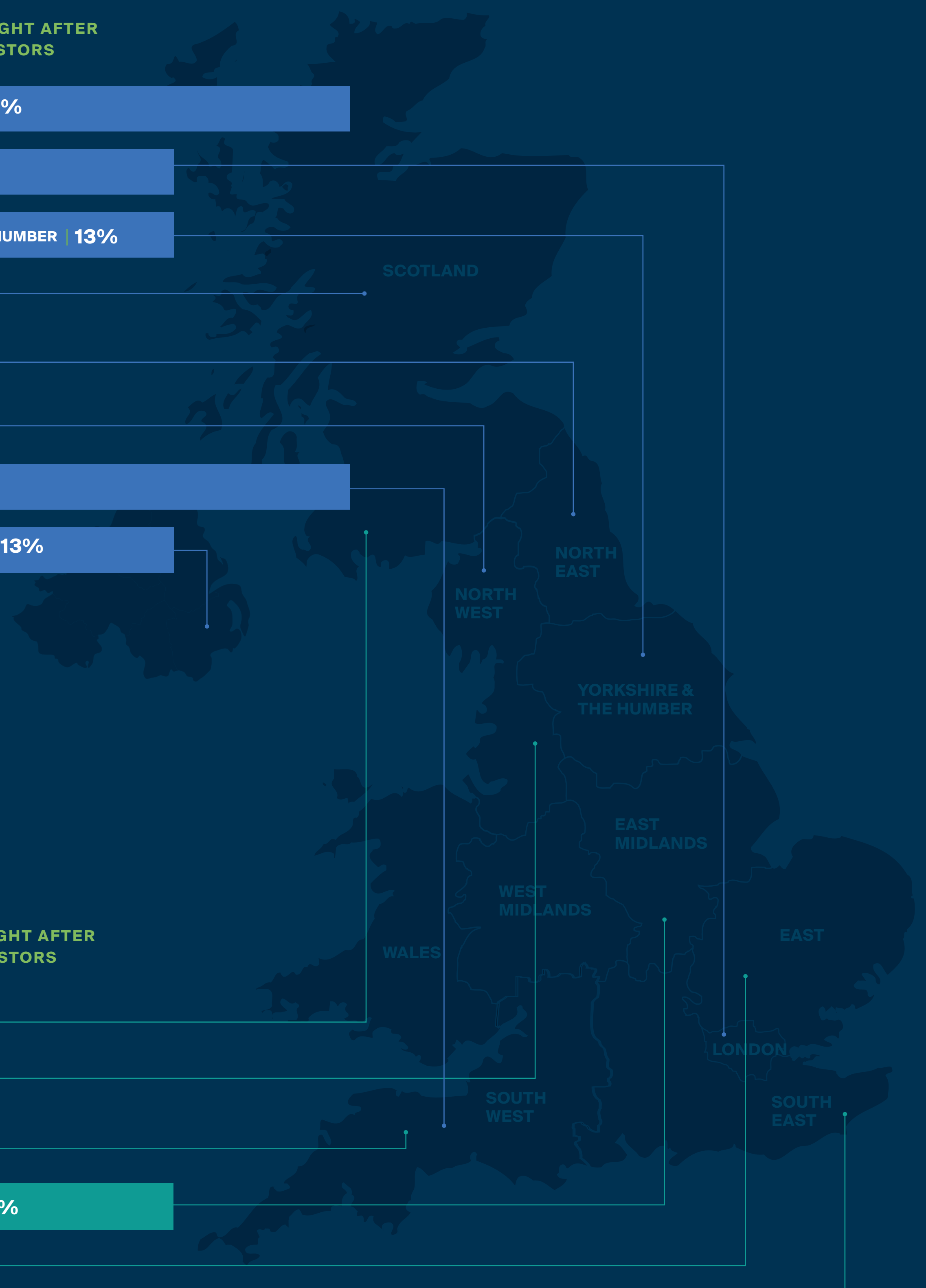
Although the general consensus amongst those surveyed is that it is far too early to assess, some believe that we will only see benefits for social care once the current NHS backlog has been addressed and funding therefore filters into social care.

WHAT LEVEL OF IMPACT WILL THE HEALTH AND SOCIAL CARE LEVY HAVE ON THE SECTOR?



REGION LEAST SOUGHT AFTER BY SURVEYED INVESTORS

NO PREFERENCE	20%
LONDON	13%
YORKSHIRE AND THE HUMBER	13%
SCOTLAND	7%
NORTH EAST	7%
NORTH WEST	7%
SOUTH WEST	20%
NORTHERN IRELAND	13%



REGION MOST SOUGHT AFTER BY SURVEYED INVESTORS

SCOTLAND	7%
NORTH WEST	7%
SOUTH WEST	7%
EAST MIDLANDS	13%
EAST	7%
SOUTH EAST	40%
NO PREFERENCE	20%

ESG IMPLEMENTED

ESG has been implemented in a number of ways by the survey participants including: ESG KPIs and targets used in asset underwriting, "Net Zero" commitments, working with tenants to encourage ESG, green bonds to raise to fund ESG type initiatives and mapping the social impact of healthcare investments using Social Profit Calculators

OF SURVEY PARTICIPANTS HAVE BEGUN TO IMPLEMENT ESG INTO THEIR CURRENT STRATEGY

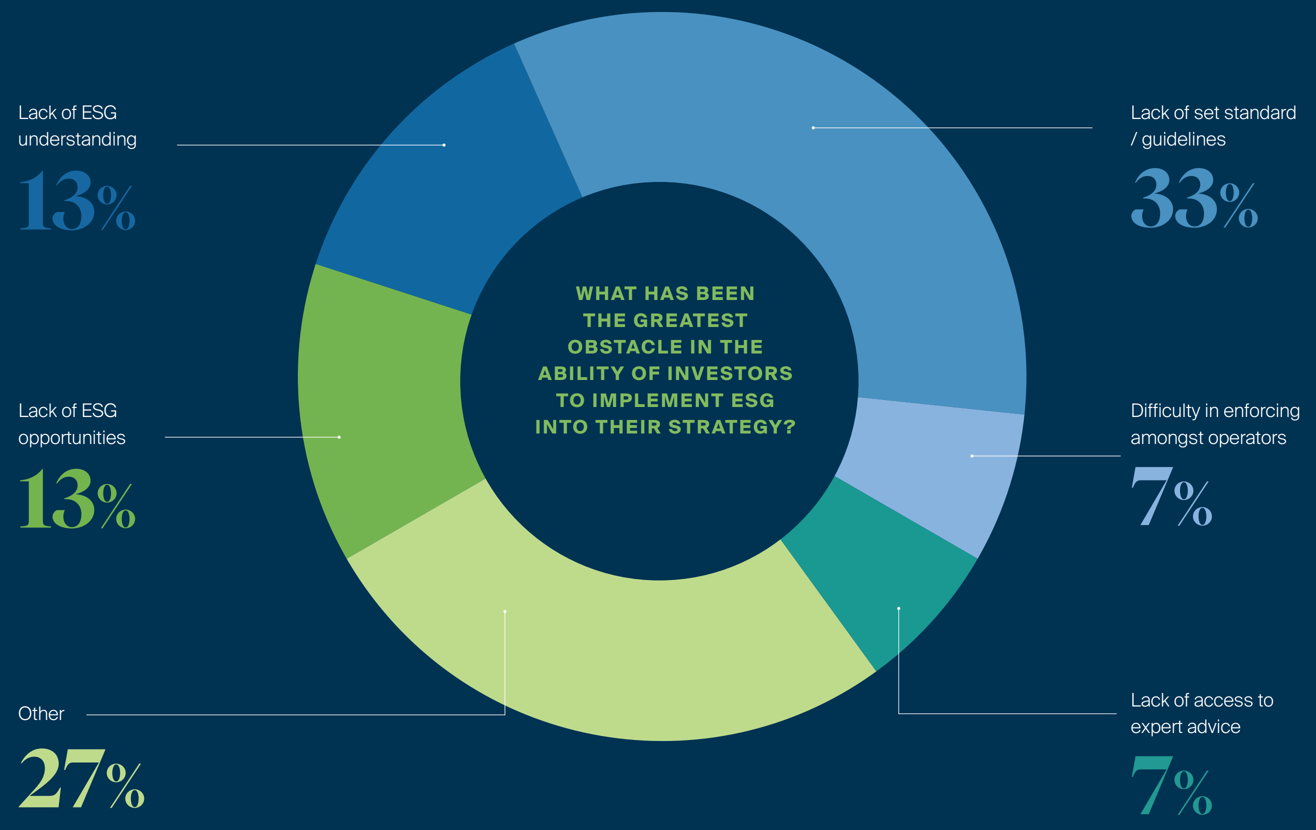
93%

ESG STRUGGLES

The greatest struggle has been the lack of a set standard with survey respondents pointing to a plethora of standard, regulations, and frameworks.

A number of other obstacles related to implementing ESG were presented including a Reluctance and lack of knowledge from developers to incorporate changes, agreeing ESG appropriate capex spends with tenants as well implementing such strategies across larger, more granular portfolios.

There is also a call for stronger correlation between asset ESG credentials and pricing needed in the market.



MARKET VOLUME

2021 was another strong year for healthcare investment, with transaction volume as per figure 2 recorded at £2.34bn, compared to £2.74bn in 2020. Although this presents a decline in volume, this is the second-highest recorded volume and suggests that the sector maintains a significant transaction level.

Figure 3 compares the annual change in healthcare volume to that of all property. Healthcare which accounted for around 4% of all commercial property transactions was down 15% on the year, in contrast to a growth in volume experienced by the all property volume. We must, however, note that the steep rise in all commercial property volume is likely a long overdue correction off the back of three years of declining volume possibly stemming from investor caution due to struggling conventional sectors such as retail.

Investment by sector is another area to consider when discussing market volume, in terms of where capital is being placed and how this differs from historic investing trends. Figure 4 presents the share of transaction volume attributed to each care sector in 2021 as well as over the last five years. The standout factor from the chart shows a strong year in 2021 for elderly care at 82% of volume. Another standout trend is the shrinkage of hospital facilities share in 2021 relative to the last five years, although this will be a direct impact of 2020's BMI portfolio transaction spiking the overall five year figure. We can also see from the largest deal in each sector that there has been a vast mix of purchaser types with substantial contribution to transactions over the year.

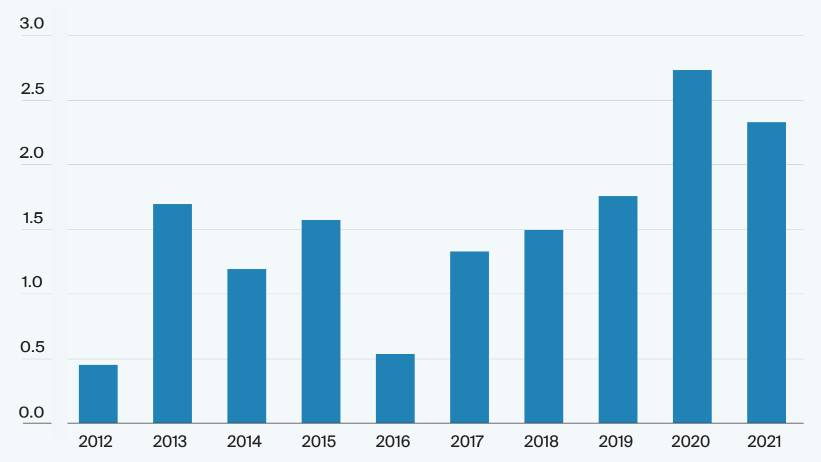
Figure 5 presents transaction volume on a quarterly basis as well as over a rolling four quarters. We can see from this that the first quarter has been the strongest in terms of value, however much of this can be attributed to major deals over the value of £500m with the longer term trends pointing to the latter quarters of the year as being the most active, albeit the two transactions which have skewed this trend may well have been initiated in Q3/Q4 with completion recorded early in the following year.

Following on from this, when assessing health and sentiment based on trends in transaction volume understanding spikes or anomalies are of great importance, especially after the unprecedented circumstances experienced over the last two years. For this reason, figure 6 strips out major deals, which we have classified as any large transactions over £500m. Although there are only a few of these transactions (3 within the last 10 years), excluding them presents a situation far different and in fact, more promising than with their inclusion. For example, whilst volume has been strong in both 2020 and 2021, with the removal of the respective major transactions, 2021 actually shows a growth in transaction volume rather than a decline. This is of course useful in assessing the recovery in investor confidence in the sector following the outbreak of Covid-19 as without drilling deeper, high-level statistics present a very different story.

Table 1 provides a view into the type of asset and the investor type featured in these "major deals" over the past 15 years. As we can see, the focus has been on elderly care and hospital through large portfolio deals such as Medical Properties Trust's purchase of 30 acute BMI hospitals for £1.5 billion in early 2020. Additionally, whilst there has been a significant presence of domestic demand among such deals, overseas capital has accounted for just over 64% of the transactions.

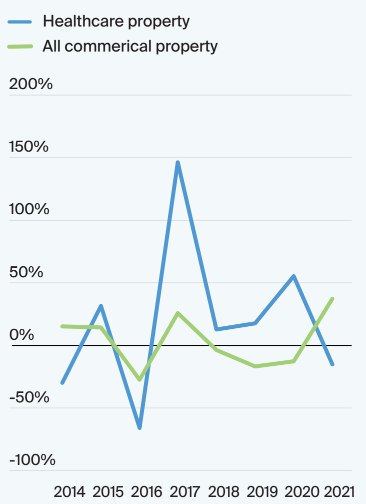
For the year ahead, we anticipate the sector will maintain its momentum regarding the volume of transactions. Figure 7 shows our forecasted volume based upon the general 5-year average growth and excluding any major deals (above £500m). Overall, the market has made a strong start with a number of significant deals already occurring in Q1 22, such as PGIM's purchase of 6 homes for circa £70m and Aedifica's acquisition of a 61 bed care home for £13m.

FIG 2. **RECORDED HEALTHCARE INVESTMENT VOLUMES, £ BILLIONS**



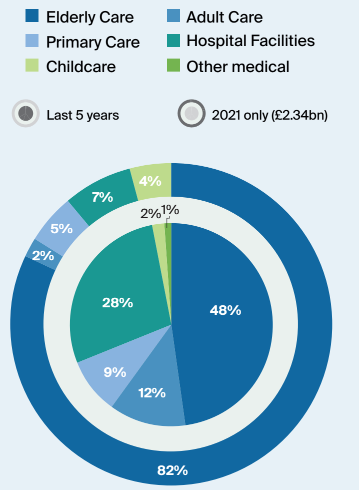
Source: Property Data

FIG 3. **PERCENTAGE CHANGE IN PROPERTY INVESTMENT VOLUMES**



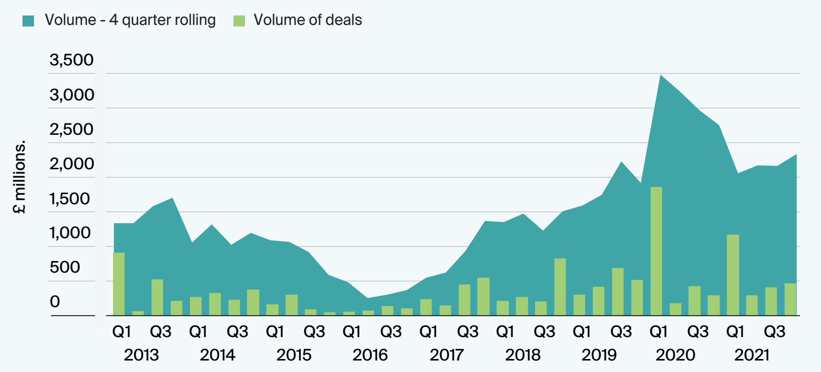
Source: Property Data

FIG 4. **HEALTHCARE PROPERTY INVESTMENT, BY ASSET TYPE**



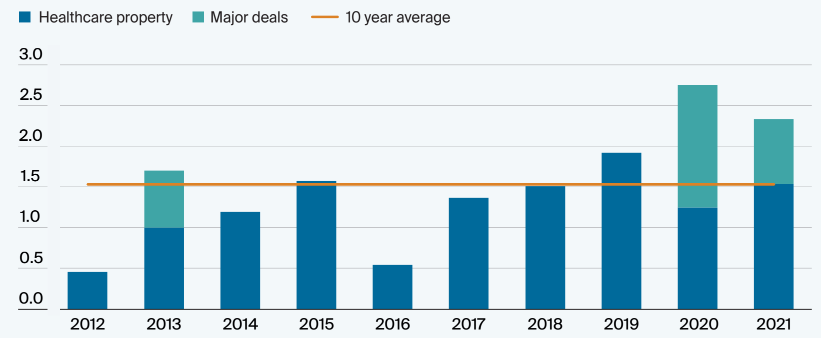
Source: : Knight Frank, Property data

FIG 5. **RECORDED HEALTHCARE PROPERTY TRANSACTIONS (£ MILLIONS)**



Source: Knight Frank, Property data. *Please note, here we include recorded transactions for elderly care, adult care & supported living, primary care, hospital facilities and childcare.*

FIG 6. **RECORDED HEALTHCARE INVESTMENT VOLUMES, £ BILLIONS**



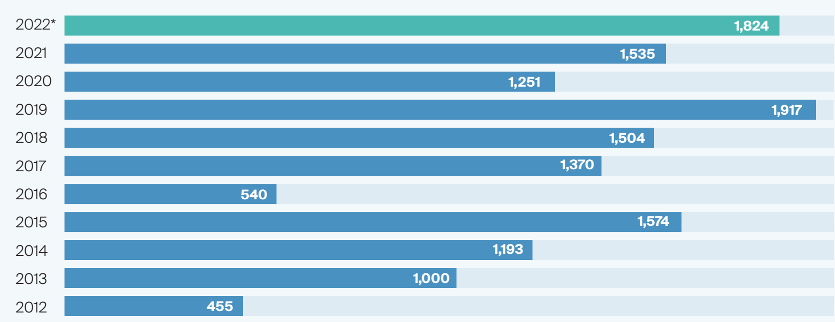
Source: Knight Frank, Property Data ** 10 year average incorporates major deals as well as elderly care, adult care & supported living, primary care, hospital facilities and childcare.*

TABLE 1. **MAJOR HEALTHCARE DEALS BY INVESTOR TYPE AND SECTOR**

	ELDERLY CARE	HOSPITAL FACILITY	TOTAL
BANKS	962		962
OVERSEAS	800	2,200	3,000
PRIVATE PROPERTY CO.		691	691
TOTAL	1,762	2,891	4,653

Source: Knight Frank

FIG 7. **ANTICIPATED TRANSACTION VOLUME**



Source: Knight Frank, Property data **Predicted Volume*

TRANSACTION COMPOSITION

With significant volume recorded, the composition of this is vital to understanding the direction of the sector in terms of key investor type, target areas and much more.

In 2021 single assets accounted for 33% of transactions compared to portfolio deals at 67%. This is an increase on last year's figure which suggests that whilst portfolio deals have been important to transaction volume over the years, single assets are still being considered. New build & development will undoubtedly be a factor in this, as well as smaller investors and operators choosing to exit the market.

Overseas capital instantly emerges in Figure 8 as the largest contributor to transactions. This is followed by REITs and private property companies each accounting for 19% and 18%.

All property and healthcare share similar trends in the ratio of overseas to domestic capital with overseas capital accounting for 51% of healthcare and 46% of all property transactions in 2021.

From figure 9 we can see how transactions by overseas investors in 2021 compares to the five-year total overseas we can see that over time overseas capital is becoming more prominent. With the biggest years occurring most recently in 2020 and 2021 with two major transactions.

We can also see from the charts that all property and healthcare share similar trends in the ratio of overseas to domestic capital with overseas capital accounting for 51% of healthcare and 46% of all property transactions in 2021.

Figure 10 gives us insight into where the overseas capital flows from. As with previous years, capital from the US is a large component of 2021s transaction volume. This is not only a trend seen in care but also within all property cross-border capital flows. Another trend that is mirrored closely when assessing all property and healthcare transactions is the contribution of European investors, responsible for 19% and 25% of overseas volume respectively.

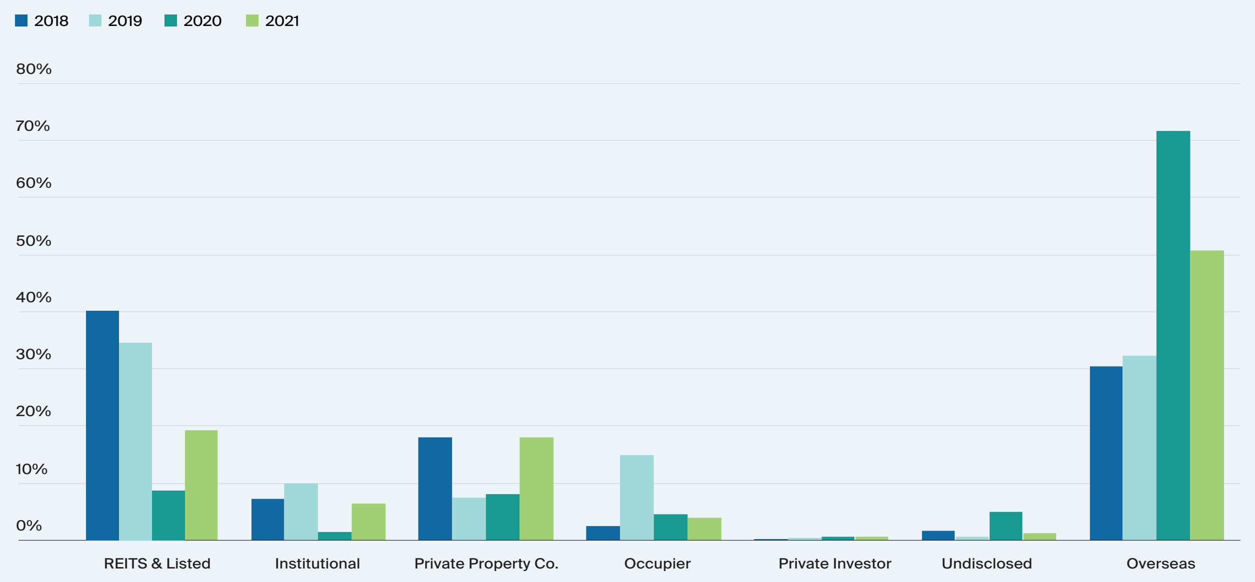
Overseas capital is also present through most standout deals, for example, medical properties trust's Priory asset purchase and North West's purchase of Spire Cheshire.

Martin Robb of North West Healthcare REIT, headquarters in Toronto, commented on the UK healthcare sector's appeal to overseas investors, stating that:

"Whilst the UK hospital market specifically is different to other territories, due to the NHS with its service delivery model, NWH considers there are key features of the UK market that can drive investment in a similar fashion to other countries. These include assets needing capital expenditure to meet changing operational requirements, plus increased demand driven by macro factors such as population growth and broader levels of health."

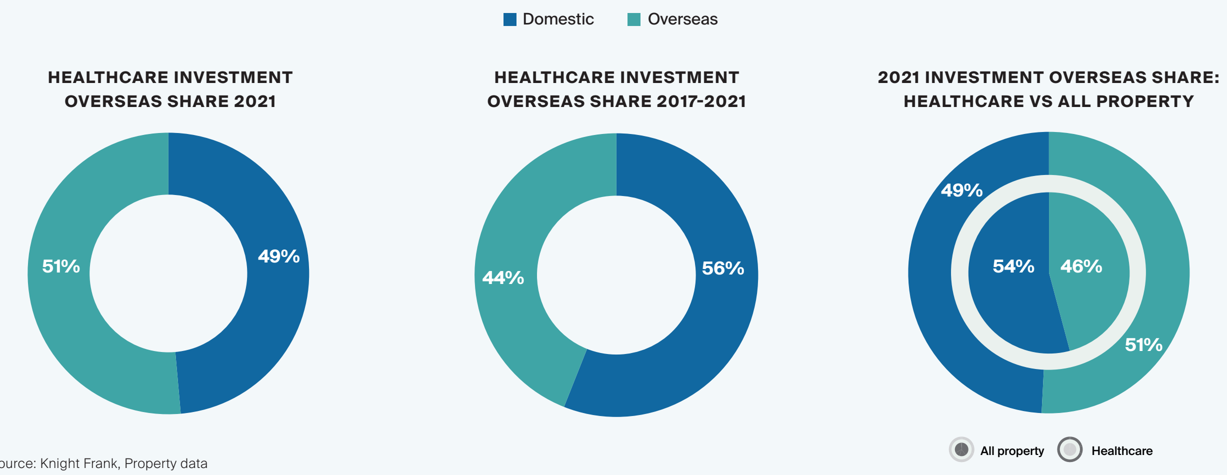
Overseas capital is also present through most standout deals for example medical properties trust's Priory asset purchase and North West's purchase of Spire Cheshire.

FIG 8. **HEALTHCARE PROPERTY INVESTMENT, BY BUYER TYPE**



Source: Knight Frank, Property Data

FIG 9. **HEALTHCARE PROPERTY INVESTMENT – OVERSEAS SHARE**



Source: Knight Frank, Property data

FIG 10. **NET ACQUISITIONS OR DISPOSALS BY INVESTOR TYPE**

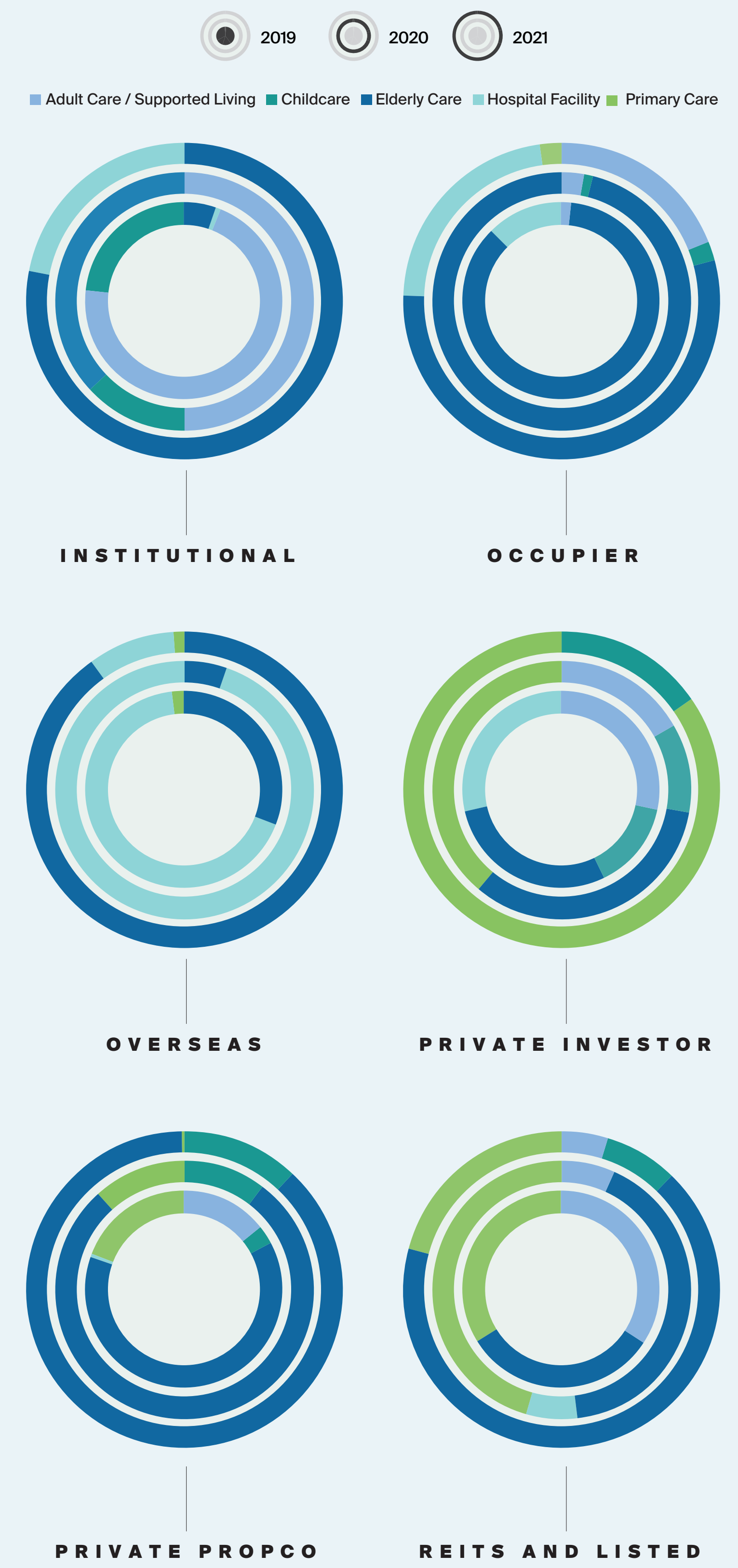
Source: Knight Frank, Property Data

Healthcare as a sector remains diverse in its own right. From elderly care to private hospitals, investor capital benefits from options. With this in mind, Figure 11 shows each investor type's changing or consistent target area over the past three years. Whilst elderly care's investment has come mostly from REITS, Prop Cos and occupiers, overseas capital shows a heavy focus on private hospitals. Overall, REITs and institutional investors generally show a more diverse appetite for targeting a mix of sectors with healthcare.

Figure 10 presents us with investor type's net acquisitions and disposals over the past five years. Unsurprisingly, we have a trend of occupiers and private investors emerging as net sellers, with REITs and overseas investors showing the strongest net buyer positions. This aligns with much of what we have seen in the market for care assets over the years, with smaller investors exiting and the longer standing family-owned operators selling up. This also highlights that a vast majority of the new purpose-built stock is targeting institutional, REIT and overseas capital. Finally, the data points to the growing trend of sale & leaseback transactions between operators and investors as a capital release strategy.

Healthcare, as a sector remains diverse in its own right. From elderly care to private hospitals, investor capital has the benefit of options.

FIG 11. **SECTOR INVESTMENT BY INVESTOR TYPE 2019-2021**



Source: Knight Frank

CAPITAL AND FUNDING

With the outbreak of the global pandemic as well as rising inflationary pressures on not only operational but build costs also, the state of the market for debt in terms of the availability of capital and overall lender appetite remains a matter of interest.

Capital and debt options are diverse within the care space. Over the past year, we have seen funding from numerous sources such as, conventional high street banks, challenger banks and institutional investors. Operators and developers also seek to raise capital via a range of strategic methods with investors, including but not limited to sale & leasebacks and forward funding / commitments. Finally, we have seen several alternative strategies emerge in the sector, such as Downing's development bonds, for example.

Within Figure 12, we assessed a sample of healthcare-related transactions and their source of funding over the given period. Generally, the chart shows a trend whereby traditional bank debt from the conventional lenders hasn't always been dominant within the space. Over the years covered by the sample, institutional capital from insurance and pension funds has maintained its presence in the market. However, the standout trend from this is the emergence of challenger banks since 2018, boosting overall all bank lending. Banks such as Oaknorth, Cynergy, and Clydesdale have all played a part in supporting lending to the sector. The 'Other' category refers to alternative fundraising such as capital from bond investors. Overall, the chart supports the view of the sector that we have grown accustomed to over time. There is a mixed pool of capital feeding the sector with more options opening up as market understanding grows and a structural shift toward healthcare as an asset class grows.

Debt sentiment for the sector moving forward seems positive. The past year has seen active support from lenders in terms of funding the operational business; for example Cynergy banks reported lending of £100m to the care home sector, and Puma Property Finance focused on bed sectors, bolstering its lending capabilities with additional funding lines. Forward funding and development continue to feature also, with the likes of Octopus Real Estate providing an £11m loan on the development of a 71-bed elderly care home in Hampshire.

In short, the diversity of options within the sector suggests that whilst it remains an alternative amongst the more conventional office and retail classes, we can remain positive regarding a maintained availability of capital to the sector. This is especially important for investors and developers at a time whereby the more well-known high street banks begin tightening up lending criteria and terms.

FIG 12. **FUNDING COMPOSITION**

Source: Knight Frank

Q&A: HEALTHCARE SECTOR OUTLOOK

John Flannelly is Head of Investment and co-founder at Target Fund Managers, a specialist fund management business that invests in healthcare real estate via a number of funds, including LSE-listed Target Healthcare REIT plc. The funds managed by Target currently own around 100 care homes valued at c.£900m and let to 31 different tenant groups.

JOHN FLANNELLY,
PARTNER, TARGET ADVISORS

What would you argue is the case for UK healthcare?

There is an existing undersupply of quality elderly care beds across the country. Only c.28% of care home beds in the UK have an en-suite with a wetroom, for example, and many homes have poor facilities for residents and staff. We also have an ageing population, and that demographic tailwind should drive significantly increased demand in coming years. Care homes are needs-based services rather than discretionary, a point highlighted by the relatively robust financial performance of the asset class during the pandemic in comparison to other real estate investment sectors.

How would you describe the current state of the market?

The care home occupier market has experienced hugely challenging conditions over the past couple of years dealing with Covid and staffing shortages. More recently, Covid cases remain low and less severe, and there are some green shoots in terms of occupancy growth and returning demand from the self-funding market. Staffing remains the key concern for us – the impact of Covid and other factors such as Brexit have exacerbated an already difficult labour market. This sector needs dedicated, caring staff and we welcome the decision that care workers are deemed to be 'skilled workers' and a slight opening up on restrictions to bring workers in from overseas. More needs to be done.

The supply of new investment opportunities is somewhat subdued. Operators are focussed on returning existing trading homes to normalised occupancy and profitability levels prior to taking deals to market. There has been a re-focussing of efforts on developing new assets timed to come on stream post-recovery. Investor appetite remains very strong with much competition for those scarce high-quality opportunities in the market.

What are your views on the flow of overseas capital into UK Healthcare?

Target have been investing in the UK care home sector for more than 12 years and in that time we have seen overseas capital come and go (e.g. US REITs). We are long-term investors with a focus on and commitment to the UK care home sector and we expect to continue to support existing and new tenants in their growth aspirations into the future. We believe that this sector requires a deep local knowledge of operators, markets and the regulatory environment. One aspect of some of the newer entrants that we have a concern about is rental levels being pushed to unsustainable levels. One of the key aspects of our investment approach is setting rent levels for each investment at a level suitable for the local market in which a home is situated. There have been some deals done in the recent past that we feel will result in very low rent covers and limited post rent profit for the tenants.

How has Covid-19 impacted the portfolio and your investment strategy / decisions.

The Covid-19 experience has largely proven to support our investment thesis of investing in modern, purpose-built homes with wet-room en-suites. We saw the benefits of residents being able to

self-isolate easier in their rooms and to help with infection control; large circulation spaces and public areas helped with social distancing; flexibility within buildings to allow operators to create Covid-safe visiting rooms etc.

Rental collection remained strong throughout, albeit we did support tenants in a number of ways, such as allowing monthly payments and re-setting covenants. Future investment decisions will see only minor adjustments to our previous investment parameters as we reflect on learnings about design features that worked relatively well/ poorly etc.

Do you feel Covid-19 has presented any significant opportunities?

We don't believe that Covid-19 has presented any significant opportunities – it was a hugely traumatic experience for so many in our sector with many lives lost and many terrible experiences for care staff who performed their duties so heroically. I guess one benefit is that awareness among the general public of the key role that care workers provide has increased hugely.

We created Target in 2010 with a mission to improve the quality of environments for residents to experience in care homes and a small benefit of the past couple of years is an acceleration of de-registrations of older, not fit for purpose, care homes from our sector.

What are your thoughts on the current supply of stock, and the extent to which it is future-proofed?

Notwithstanding my comment above, there is still an abundance of older, not-fit-for-purpose stock. Just 28% of beds have a wet room (up from 14% in 2014). Lots of really good care is being delivered by operators in many of these older buildings, but we strongly believe the care environment should support / enhance the care provided, not hinder it. Wetrooms / flexible communal space / wide corridors etc. We're a big advocate of outdoor space for residents in promoting physical and mental wellbeing – looking more and more to make sure our buildings allow easy access to outdoor space for all residents, even those on the upper floors.

What are your predictions for 2022 and beyond? Do you have any major concerns about the sector's real estate or operational aspects?

This is a needs-driven sector with compelling demographic drivers. Healthcare investments have outperformed most other real estate assets in recent times. We expect investor appetite to remain strong.

This sector needs dedicated, caring staff and we welcome the decision that care workers are deemed to be 'skilled workers' and a slight opening up on restrictions to bring workers in from overseas. More needs to be done.

Staffing remains the most concerning factor impacting the sector. There are many homes across the country with a waiting list of residents needing care that cannot admit new clients due to a shortage of available staff. Operators need more support from the government to open up access to available labour markets.

How important is ESG to your strategy, and how do you plan to implement this within new acquisitions and the existing portfolio?

Fundamental. We founded Target as a social impact fund with unwavering specification requirements to benefit residents, carers and local communities. These are delivered only by modern, purpose-built real estate which naturally comes with strong environmental credentials, evidenced by our portfolio's EPC and BREEAM ratings. There is always more that can be done though, and we are encouraging more green technologies to be incorporated into developments (e.g. heat pumps, EV charging points, solar panels, rainwater harvesting etc.) and using BREEAM assessments to consider what improvements can be made to the existing portfolio, with encouraging progress to date.

To what extent does development factor into your current strategy? How do you feel recent planning law changes will impact this?

Our interest is in owning very high-quality real estate that delivers sustainable long term rental income. Increasingly we have got involved in funding developments as a means to this end. We enjoy having the opportunity to contribute to the design of our buildings to ensure strong ESG credentials and to ensure excellent living spaces for residents. We always describe ourselves as a funder of developments rather than a developer. We don't, and do not ever expect to compete directly with developers / our tenants in this space.

Moving forward, what would you say are some of your primary focuses for the portfolio?

Ensuring continued stable and sustainable long-term returns and productive/ collaborative relationships with our 30+ tenants. Unusually for a fund manager, we don't set ourselves investment targets as we think they can encourage poor behaviours / investment decisions. We assess each home on its own merits, and the focus is always on getting the right care environment, at a sustainable rent, with operators that really care well for their residents. It's an investment strategy that has served us well over the last twelve years, and we think it will continue to do so.

INVESTMENT PERFORMANCE

As well as strong transaction volume in 2021, healthcare assets have also demonstrated significant returns and performance for the year.

Figure 13 showcases prime yields for assets across the various care sectors with many hardening slightly from 2020 levels. For example, prime elderly care shifting to 3.25%. Ultimately this is good news in regard to asset pricing for those already with exposure to the sector, whilst it also supports the case for healthcare's return credentials.

Figure 14 highlights the total returns across several sectors at the end of 2021. Although there are several other sectors demonstrating higher returns than healthcare's 9.5% annualised average return, it is important to note that healthcare sits comfortably in line with its long-term average whilst there have been some variances amongst other sectors.

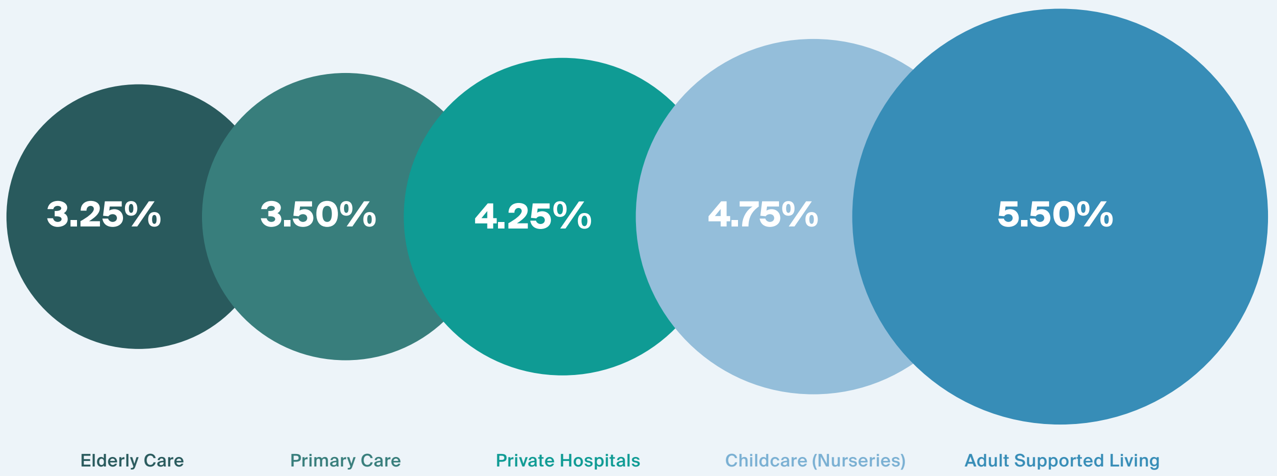
Whether it is its long income capabilities or demographic led demand, the sector certainly remains attractive to investors.

Off the back of the consistency in returns presented in Figure 14, Figure 15 takes this a step further by providing insight into the risk / return relationship, with healthcare maintaining a lower risk level due to its lack of variance.

Due to conventional healthcare leases benefitting from longer terms, the sector presents itself as a long income option for many investors. Figure 16 compares the average healthcare cap rates to that of 10-year gilts. From this we can see that on average there is a spread of 4.42% between the two.

Overall, the returns and general performance of the sector continue to justify the fundamentals associated with healthcare. Whether it is long income capabilities or demographic led demand, the sector certainly remains attractive to investors.

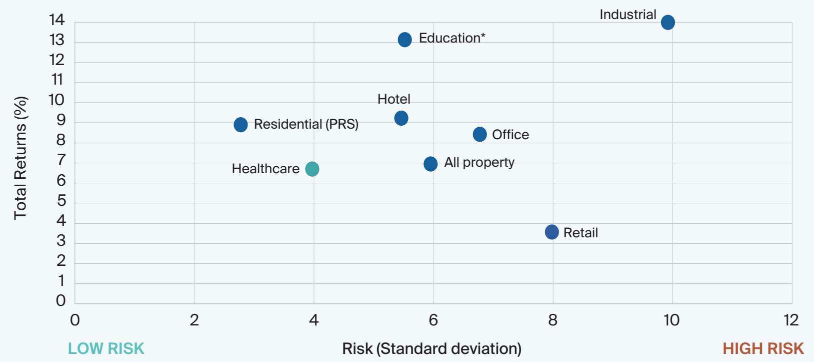
FIG 13. PRIME HEALTHCARE YIELDS (FIXED-INCOME, %)



Source: Knight Frank

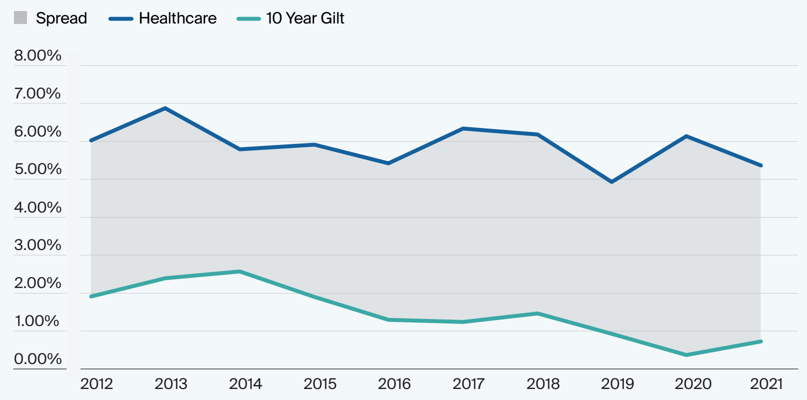
Healthcare is sitting comfortably in line with its long-term average whilst there have been some variances amongst other sectors.

FIG 15. RISK VS RETURNS, 10-YEAR HISTORY



Source: MSCI

FIG 16. CAP RATES VS UK 10 YEAR BOND



Source: Bank of England, Property data, Knight Frank

FIG 14. TOTAL RETURNS (%)

Source: MSCI

REIT SPOTLIGHT

Similar to the increase in demand for healthcare assets, the presence of healthcare REITs among investors has grown, with domestic REITs accounting for £448m or approximately 19% of 2021's transaction volume second only to overseas investors.

This section of the report looks into the six key UK healthcare REITs, which at the date of their 2021 interim reports had a combined portfolio value of £7.85bn across 2,433 care assets producing a total rent roll of circa £425m per annum.

Over the last five years, these REITs have continued to grow in terms of their portfolio values. Figure 17 presents the REITs by AUM with Primary Health Properties being the largest, reporting a valuation of £2.7bn as at June 2021. In terms of a combined portfolio value, due to a mixture of acquisition and organic growth this has increased from £4.25bn to £7.85bn between 2017 and 2021 an approximate 85% total increase over the period, or 16.6% on compounded annual growth rate (CAGR) basis.

As seen with the overall healthcare returns relative to other sectors, Figure 18 represents the performance of healthcare REITs relative to all property REITs and the FTSE 250.

Upon initial sight of the chart we can see that healthcare REITs have shown the least variance despite a dip at the start of the pandemic in 2020, with an almost snapback recovery compared to that of the FTSE and All Property which show a slower return from negative performance.

However, the chart does highlight the FTSE 250 overtaking healthcare REITs in Q3 21 and All Property REITs doing the same in late Q4. The FTSE overtake is likely due to the stock market's rally and bounce back, and the recovery in the All REITs line is likely to be heavily reliant upon logistics. Looking into early 2022, both have seen a dip whilst healthcare REITs have maintained returns in line with their longer-term averages.

Ultimately this presents a strong case for the resilience of the sector and its overall ability to absorb external shocks.

There have been several key transactions that have involved the REITs in question. As per Table 2, notable deals tend to be large portfolio transactions, for example, Target Healthcare REITs acquisition of 18 elderly care assets in the fourth quarter. Other standout transactions are Impact's £37m purchase of 12 homes and LXI's £34m purchase of 23 Kids Foundation Nurseries via sale and leaseback.

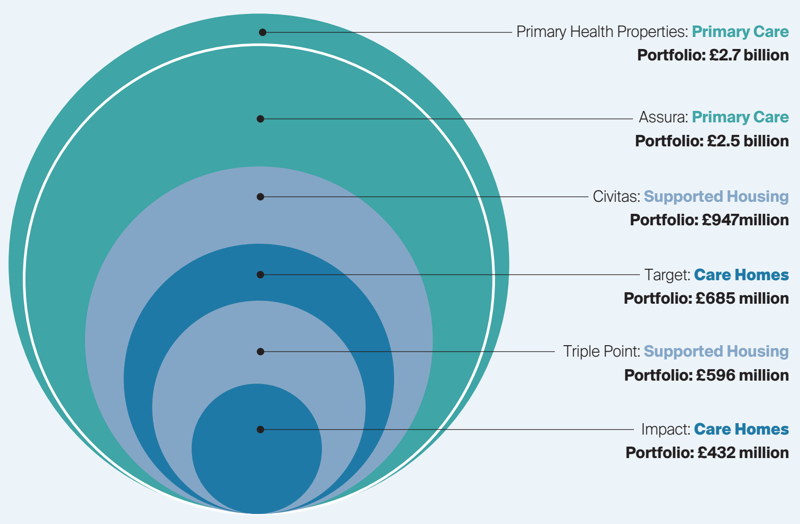
In terms of a combined portfolio value, due to a mixture of acquisition and organic growth this has increased from £4.25bn to £7.85bn between 2017 and 2021 an approximate 85% total increase over the period

UK HEALTHCARE REITS IN NUMBERS

6	2,433	£7.85bn	£425m	18.2 yrs	£6.15bn
Key UK Healthcare REITs	Combined Number of Assets	Combined Asset Value	Combined Annual Rent Roll	Average WAULT	Total Market Capitalisation

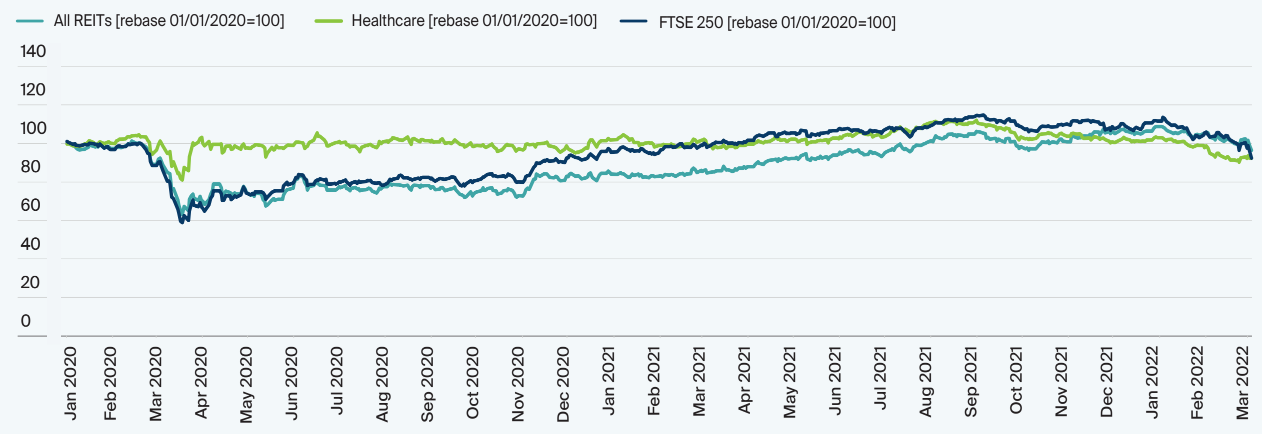
Source: Knight Frank, Company websites, data based on 2021 mid-year or interim reports

FIG 17. **HEALTHCARE REITS BY AUM**



Source: Company websites, data based on 2021 mid-year or interim reports

FIG 18. **HEALTHCARE REITS VS ALL REITS VS FTSE 250**



Source: Macrobond, Knight Frank

TABLE 2. **NOTABLE TRANSACTIONS COMPLETED BY REITS 2021**

DEAL TYPE	PRICE £M	DATE	PROPERTIES	PURCHASER	SECTOR
SINGLE ASSET	22	Jun-21	1	Assura Group Ltd	Primary Care
PORTFOLIO	34	Sep-21	23	LXi REIT Plc	Childcare
PORTFOLIO	37.5	Dec-21	12	Impact Healthcare REIT	Elderly Care
SINGLE ASSET	40	Aug-21	1	Primary Health Properties	Primary Care
PORTFOLIO	150.5	Dec-21	18	Target Healthcare REIT	Elderly Care

Source: Knight Frank

OPERATIONAL

Whilst we have seen a strong year of transactions for healthcare real estate, the operational aspect of the sector maintains strong demand from investors also.

Figure 19 is the result of our research into the various investor types that have been attracted to the sector. By assessing the top ten providers (by number of beds / spaces) in a range of sub-sectors such as private hospitals and elderly care and delving into the ultimate parent companies we are able to better understand the sector's operational exposure to various investor types.

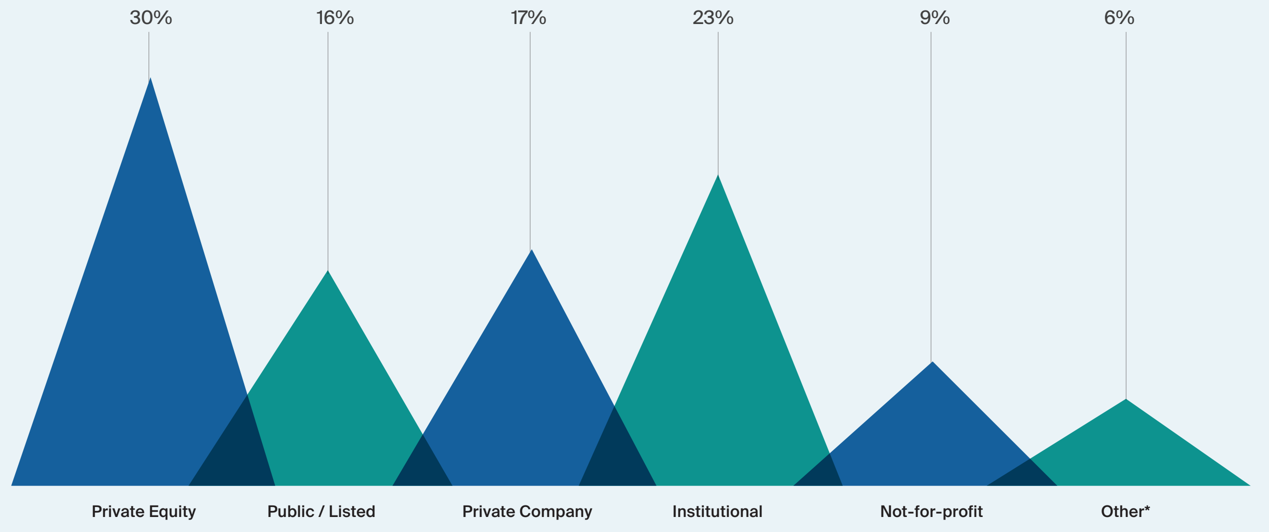
From the chart we can see a significant amount of private equity capital within the market. This private equity backing was most common in the adult care space with a vast majority of the top 10 operators having some element of private equity involvement. We also have a fair amount of institutional investment, which seems most present within the childcare sector, whilst the listed / public corporations tend to be found in the private hospital space.

Operator transactions

Corporate acquisitions remain a feature in the sector with various investor types, including institutional or private equity firms opting for equity stakes, as well as larger operator groups pursuing growth. Late 2020 / early 2021 saw a standout transaction in the purchase of Priory by Dutch private equity firm Waterland for £1bn. 2021 also saw European elderly care provider Korian make their entry into the UK care market with the purchase of Berkeley Care. This trend of operational transactions seems set to continue with recent news of the Reuben Brothers acquiring a 50% stake in Avery Healthcare from Welltower.

Corporate acquisitions remain a feature in the sector with various investor types, including institutional or private equity firms opting for equity stakes, as well as larger operator groups pursuing growth.

FIG 19. **TOP 10 OPERATORS COMPOSITION OF OWNERSHIP**



Source: Knight Frank

The case for ESG in healthcare

2021 has seen the topic of ESG (Environmental, Social, and Governance) investing continue to build traction. The 2021 Knight Frank Active Capital report highlights the importance of sustainability within modern-day real estate strategies, suggesting an 8-18% price premium for green-rated buildings. The past year also highlighted the growing trend of investors placing money into ESG strategies. Early Calastone reports suggest that 84% of capital flowing into equity funds was placed into ESG funds between 2019 and 2020.

With investor and occupier demand for buildings with viable ESG credentials on the rise, there is a growing number institutions opting for ESG based strategies in addition to a stronger case for sustainable / green finance. We are already seeing such changes in residential markets with lenders offering preferential terms for properties with EPC ratings of A-C. It is therefore likely that ESG will carry on its momentum through 2022 and beyond.

This opens the discussion of the importance of ESG within the market for care related assets. Whilst the subject hasn't always been as clear cut for care assets as the more conventional real estate sectors, there are aspects of the class that are well suited to the topic of ESG, especially with reference to its social impact credentials. There are a number of ways that investors are working in ESG to their current offerings such as fund policies, Net Zero commitment and green bonds. However, one of the main ways that investors have begun to incorporate ESG into their strategies is through the alignment of their strategies to the UN Sustainable Development goals.

Figure 20 highlights several of the 17 UN Sustainable Development goals with close relevance to the sector which investors, developers and operators could seek to align their strategies to. For example:

GOAL 3

Good health and wellbeing: healthcare settings such as elderly care homes provide person centred care essentially on a 24/7 basis. These settings also aid reduced loneliness whilst working to improve the physical and mental wellbeing of residents.

GOAL 8

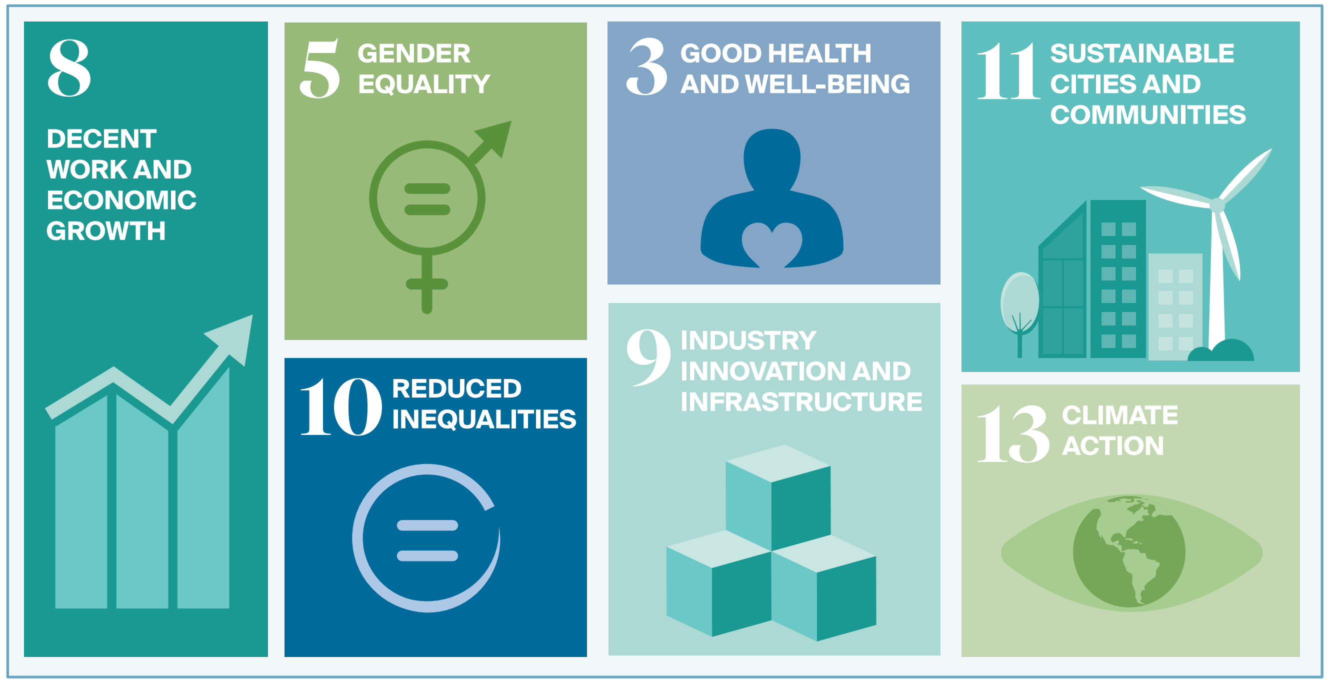
Decent work and economic growth: As the care industry is labour intensive, the sector provides long term employment prospects at all seniority levels together with the opportunity for progression.

GOAL 9

Industry innovation and infrastructure: As it states, the aim of this development goal is to build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation" The focus on the development of future-proofed care assets will be of benefit to both the carer and those cared for.

Unlocking sustainable development of new homes as well as repurposing / upgrading current stock where possible will become more important, whilst the overall matter of ESG will direct attention to how operators and investors continue to align their investment, development, and operational activity with the UN Sustainable Development Goals.

FIG 20. **ESG**



Source: United Nations, Knight Frank

FORWARD VIEW

With strong transaction volumes and positive reporting of occupancy data from operators in the final quarter of 2021, the outlook for healthcare as a sector remains positive. Whilst the continued demand for care beds off the back of the ever-aging UK demographic suggests that we can expect to see an active market for care assets in the coming year.

JULIAN EVANS, HEAD OF HEALTHCARE

Strong demand

The attractive risk-return profile, in addition to the longstanding drivers of demand, means many investors continue to target the sector. Fluctuations in the more conventional classes when compared to the resilience and consistency shown by healthcare assets over the past two years means the argument the sector's long and secure income capabilities are further supported. 2022 has started with the completion of a number of large transactions including PGIM's acquisition of 6 care homes for circa 70m and Allegra Care's acquisition of 2 homes with a combined 133 beds. This momentum will likely continue as overseas capital and REITs remain active along with institutional investors chasing social impact.

Overseas capital

Despite domestic demand holding strong in 2021, over 50% of 2021's healthcare transaction volume was a result of overseas capital. As these investors continue to show interest due to healthcare's underlying fundamentals, we anticipate this trend will indeed continue, placing more focus on the geographic origin of this capital and the extent to which it features within buyer composition for the year ahead.

Finance & debt

Although conventional lending via high street banks remains available, less desirable terms mean that the emergence of challenger banks as well as alternative funding methods have gained traction. Forward funding as well as sale and leaseback deals are likely to feature heavily over the coming year to aid funding to the sector. Green financing options may also begin to factor in as investors, occupiers and lenders all turn their focus to the subject of ESG.

Development

With demand for healthcare set to continue due to an aging population, development remains essential to meeting future demand levels. Development addresses the issue of quality stock availability, which can be considered a significant barrier by creating further entry points for investors.

ESG

With both investor and occupier demand for buildings with viable ESG credentials on the rise, a growing number of institutions opting for ESG based strategies and the emergence of the proposition of sustainable / green finance from lenders, it is likely that ESG will carry on its momentum through 2022 and beyond.

Cost inflation

Despite the growth in nurse and carer wages that we reported within our most recent trading performance report, the new National Living Wage of £9.50 from April 2022 will certainly apply further upward pressure on these averages, especially in the hourly rate of carers. The global pandemic's impact on the price of raw materials such as aggregates, timber, and steel as well as rising food and utility costs will also be major talking points in relation to the delivery of quality care facilities.

With labour shortages and Brexit also contributing factors, investors will need to focus deeply on these growing costs as they make their way into the P&L of operators. Finally, there will be a close eye on the sector with regards to the imminent social care levy and just how much support it begins to lend to the industry.

2022 PREDICTIONS

Strong healthcare demand and transaction volume

Early 2022 has already seen several significant transactions with circa £115m of reported healthcare transaction volume as of mid-February.

ESG to feature

Investors will continue to pursue ESG based strategies, with growing understanding of the social aspect, it is likely that healthcare assets will emerge as strong contenders in this space.

Forward funding & innovative financing will be key to funding the sector

Whilst conventional bank debt terms are becoming less desirable, forward funding as well as sale and leaseback deals are likely to remain the fundamental in unlocking further site development moving forward.

Development to play a role in unlocking opportunity

Current population and bed supply trends suggest that we are at risk of hitting capacity by the end of the decade and reaching a deficit of approximately 100,000 beds by 2040. For this reason, development is fundamental in supporting supply and therefore likely to continue in the year ahead.

Further overseas capital penetration

Overseas interest continues to grow from both operators and investors looking to gain UK exposure. With over 50% of 2021's volume attributed to overseas capital and healthcare's underlying fundamentals still intact we imagine the sector will continue to attract investment from outside of the UK.

Cost inflation to become a prominent factor

Inflationary pressures derived from staffing, food and utility costs are likely to be felt by operators going forward. It is possible investors will have to apply stricter underwriting of deals to insulate themselves and their portfolios from such pressures.

Recent Publications

Trading Performance Review

European Healthcare Report

Healthcare Development Opportunities Report

Market Overview Report

Front cover photo: Signature Hendon – Signature Senior Lifestyle

Please get in touch with us

Healthcare

Julian Evans FRICS
Head of Healthcare
+44 20 7861 1147
julian.evans@knightfrank.com

Nick Kempster, MRICS
Partner, Agency
+44 20 7861 5265
nick.kempster@knightfrank.com

Danielle O'Connor, MRICS
Associate, Corporate Valuations
+44 20 7861 5394
danielle.oconnor@knightfrank.com

Kieren Cole, MRICS
Partner, Commercial Valuations
+44 20 7861 1563
kieren.cole@knightfrank.com

Commercial Research

Ryan Richards
Senior Analyst, Healthcare
+44 20 3869 4575
ryan.richards@knightfrank.com

Knight Frank Research Reports are available at knightfrank.com/research