Healthcare Capital Markets

Knight Frank

2024

Strong sentiment, consistent fundamental drivers and normalising conditions present a positive outlook for the sector.

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UK Macroeconomic Overview

Against a backdrop of improving economics, evolving geopolitics, and an end to ratcheting rate hikes, the United Kingdom (UK) economy fared better than expected in 2023.

UK GDP outperformed initial projections, despite falling into a technical recession in the latter half of 2023. Early signs of recovery are underway, with monthly GDP increasing for its third successive month in March 2024 and an upwardly revised growth outlook set for this year. Oxford Economics now forecast GDP to grow by 0.9% in 2024 before rising by 2.0% in 2025, 2.0% in 2026, 1.7% in 2027 and 1.7% in 2028.

A key component of the global macroeconomic environment over the last two years has been the elevated inflationary environment, to which the UK has not been immune. Inflation in the UK peaked at 11.1% in October 2022, a 41-year high, and has since moderated to 2.3% in April 2024. Looking ahead, Oxford Economics expects inflation to fall to 2.0% in Q3 2024, before rising to 2.5% by the end of the year. As inflationary pressures ease more swiftly than anticipated, UK wage growth is also slowing. The UK's annual growth in average pay (excl. bonuses) was 6.0% in the three months to June 2024, down from a peak of 8.5% in July 2023. The UK's unemployment rate stood at 4.4% in the three months to February 2024, slightly up from 4.3% in the quarter prior, but remaining comfortably below the 6.7% long-term average.

> "UK GDP outperformed initial projections, despite falling into a technical recession in the latter half of 2023."

In response to the global reflationary environment, central banks worldwide implemented rapid monetary tightening policies throughout 2023. The BoE increased its base rate to a peak of 5.25% in August 2023, a 16-year high. It has since voted to keep the interest rate unchanged five times, ending its run of 14 consecutive rate hikes. Similarly, the US Federal Reserve and the European Central Bank raised interest rates to a peak of 5.50% and 4.00%, respectively. As the rapid rate ratchets have reached a pause, the focus has increasingly shifted to how far the BoE will cut rates. Currently, there remains divergence in expectations between economists and money markets. Oxford Economics forecasts a cumulative 50bps of rate cuts from the BoE this year, while Capital Economics forecasts three 25bps rate cuts. Money markets are currently pricing in one-quarter point reduction in 2024. The pace and scale of rate cuts remain sensitive to Fed policy, with the Fed considered the bellwether rate to track global interest rates.

> "We predict there could be a six-to-nine-month window for investors to capitalise on current pricing."

The shift to a more dovish outlook for monetary policy in the latter half of the year, combined with the softening trend seen in swap rates at the start of the year, could encourage UK commercial real estate investment volumes to increase this year. We predict there could be a six-to-nine-month window for investors to capitalise on current pricing, amid thinner competition before the anticipated recovery becomes a widely accepted view, although this window could shorten across certain markets.

Introduction:
Slow...but steady...

Unsurprisingly, UK healthcare markets have felt various pressures over the past year; however, a broader lens ultimately shows this to be more of a real estate trend than a healthcare one. Despite this, the sentiment remains positive, and the view is that healthcare's fundamental drivers, such as demographics, long-term income, and ESG credentials, present an undeniable case. 2023 carried on 2022's trend of general uncertainty, with investors stepping back to gauge markets; we saw recorded volumes close at circa £1.2bn. We did, however, see the continued movement towards normality in operator trading. This, in line with improved operator trading in our annual Care Homes Trading Performance Review, is a welcome boost to sector confidence. Overseas capital dipped again this year, accounting for 25% of transactions, down from 31% and even further from its long-term average. Average annualised returns sat at 4.4% at the end of Q4 2023, up from 3.50% in the previous period. This, as always, highlights the healthcare sector's strength in terms of stability of returns. The overall outlook for the healthcare sector is undoubtedly positive, with key market participants already transacting in Q1 2024.

> "2023 carried on 2022's trend of general uncertainty, with investors stepping back to gauge markets."

2023 SUMMARY

£1.2bn
Total transaction volume

25%
The percentage of 2023 demand from Overseas Capital

4.40%
Average Annualised Returns *As at end of Q4 23

52%
Portfolio transactions

£14.7m
Largest single asset transaction

£2.11bn
Five-year average transaction volume

Source: Property Data, MSCI

Health is wealth

As with the previous two years, the 2024 *Wealth Report* presents compelling evidence of the growing recognition of healthcare as a leading sector (Fig. 1). Our Attitudes Survey highlighted that healthcare ranked second with 13.2%, just slightly behind the living sector's 13.8% in terms of investor demand. More interesting is that the living sectors demand comprises PRS, Senior Living, and Student, suggesting that healthcare remains a standout choice on an absolute basis.

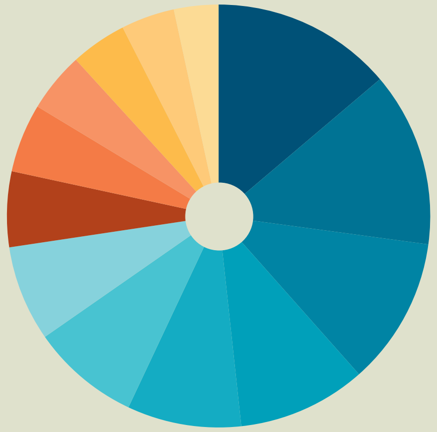
13.2%

of respondents expressed interest in healthcare.

Fig 1: Sectors in demand

% respondents

Living Sectors	13.8%
Healthcare	13.3%
Education	11.3%
Development Land	9.8%
Data Centres	8.7%
Logistics & Industrial	8.3%
Hotels and Leisure	7.3%
Farmland	5.8%
Life Sciences	5.3%
Offices	4.6%
Forestry	4.3%
Real Estate Debt	4.1%
Retail	3.4%



Source: Knight Frank

The case for healthcare as an investment

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.

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.

Investment performance

Total returns measured 4.4% in 2023, higher than many core property sectors.

Returns are historically stable, offering investors protection and diversification.

Structural change in real estate

Real estate investors already de-risking from traditional sectors such as retail into alternatives like healthcare.

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.

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 Volume:

Down but not out

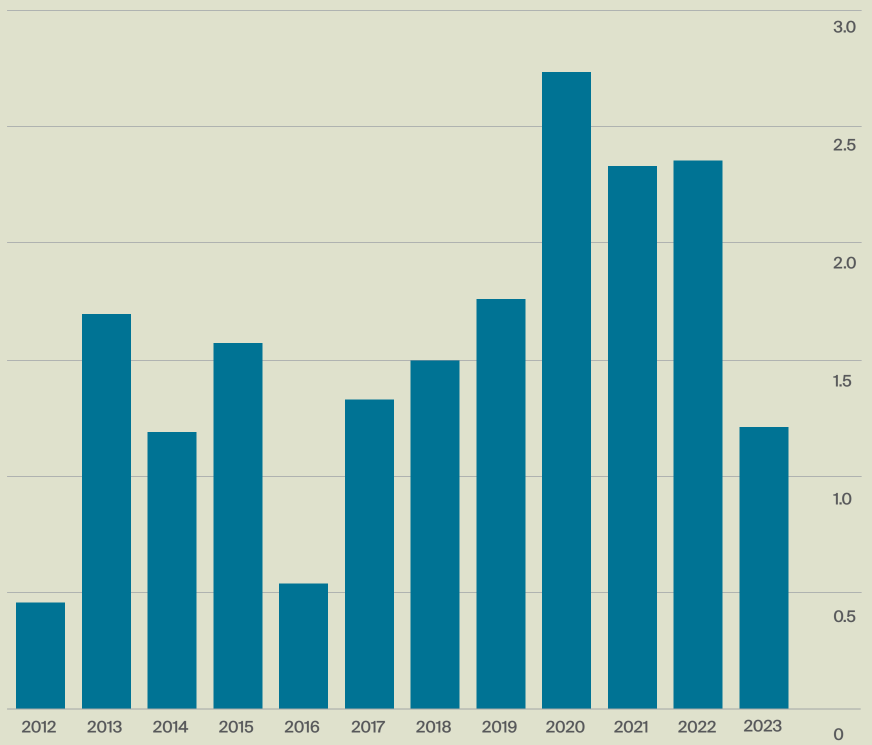
Recorded volumes for healthcare in 2023 stood at £1.2bn compared with £2.36bn in 2022 (Fig. 2). This is a combination of the sector mirroring the global downward trend in real estate volumes as well as a number of key market participants 'market gauging'. There has also been a lower percentage of overseas capital than we are historically used to.

However, the resilience of the healthcare sector and its lack of sensitivity to wider economic shocks is further illustrated when comparing the annual movement in healthcare volume to that of all property classes (Fig 3). Healthcare, which accounted for around 3% of all commercial property transactions, has historically seen a trend of growth in transaction volumes despite a slight dip in volume experienced by all property classes this year. Further highlights of the sector's consistency can be seen when assessing transaction volumes on a quarterly basis. A key trend emerging from this data is the lack of spikes from outlier transactions, which results in smooth volumes between quarters. This suggests we are experiencing a more sustainable and normalising level in healthcare real estate demand (Fig 5).

Investment by sub-sector is another area to consider when discussing market volume. Elderly care continues to generate the most interest from investors on all fronts, accounting for 83% of volume. In addition, adult care took some share of the reported volume, accounting for 11%. Notably, of this demand in elderly care, there is a circa 80/20 split between investment and occupier deals respectively. It continues to be helpful to understand where capital is being placed and how this differs from historic investing trends (Fig 4).

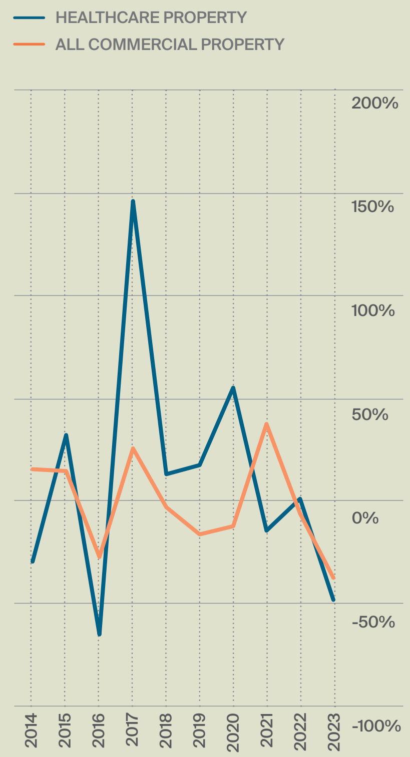
> "Recorded volumes for healthcare in 2023 stood at £1.2bn compared with £2.36bn in 2022."

Fig 2: Recorded healthcare investment volumes (£bn)



Source: Property Data

Fig 3: Percentage change in property investment volumes



Source: Property Data

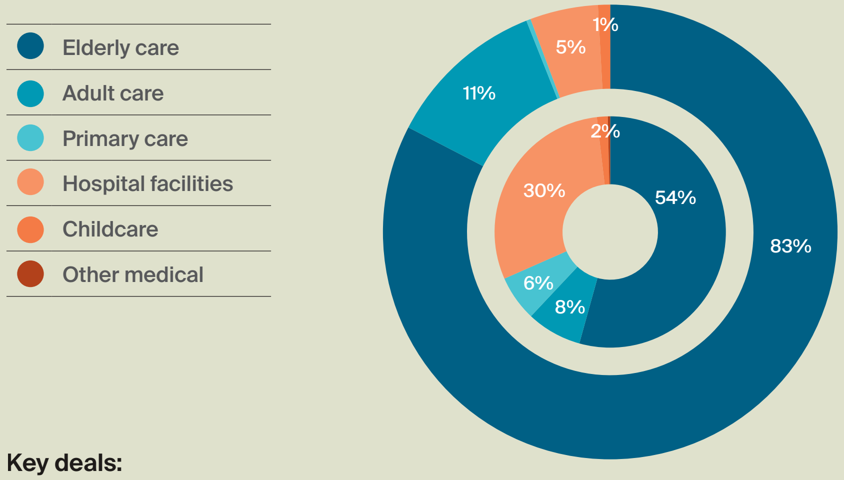
83%

Percentage of volumes attributed to elderly care

Stripping out of outlier deals (classified as any large transactions over £500 million), although there are few such transactions (three within the last ten years), the inclusion or exclusion of such deals can present a different picture or sentiment. The lack of major deals within the previous three years of volumes (Fig.6) should be considered positive where volumes are not skewed. We are seeing volumes moving towards a more organic state, built on many transactions instead of a few large outliers.

The return to more significant volumes will result from the normalisation of the sector, continued organic demand, and a few portfolio deals that will loosen the pockets of investors. For the year ahead, we anticipate the sector will regain its momentum in relation to recorded transactions. Figure 7 shows forecast volumes based on an average five-year growth, excluding major deals (above £500 million).

Fig 4: Healthcare property investment by asset type

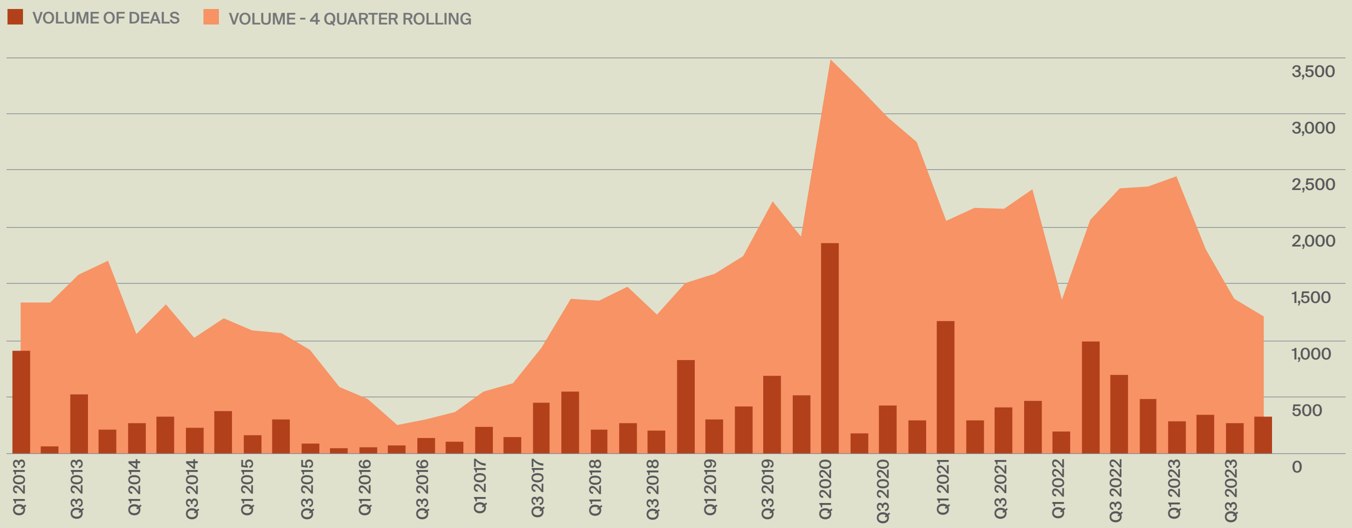


Key deals:

Category	Details	Price (£m)	Purchaser	Purchaser Type
Elderly Care	Priory sale & leaseback	800	Medical Properties Trust	Overseas
Adult Care	Portfolio	17	Every Sensation Care	Occupier
Primary Care	Primary care hub, pharmacy and offices	40	Primary Health Properties	REITS & LISTED
Hospital Facilities	Spire Cheshire	89	North West Healthcare REIT	Overseas
Childcare	Busy Bees Portfolio	48.17	Alpha Real Capital	Private Property Co

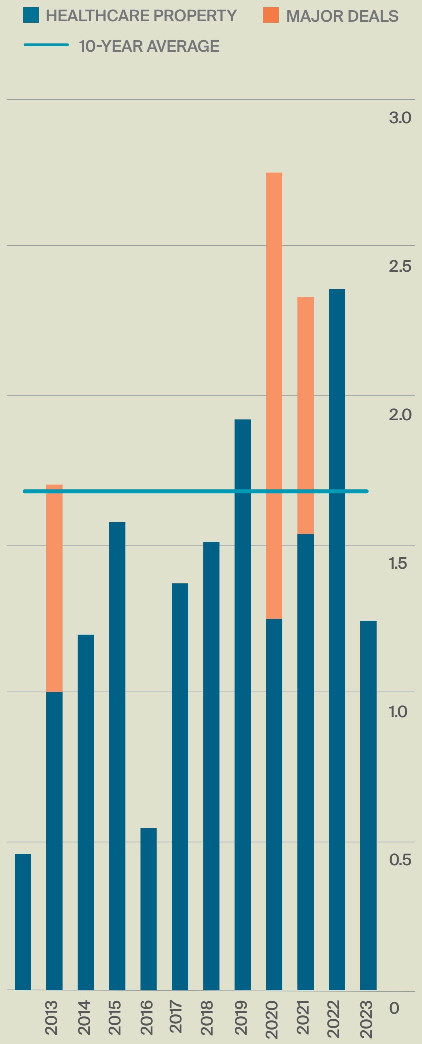
Source: Knight Frank, Property Data

Fig 5: Recorded healthcare property transactions (£m)



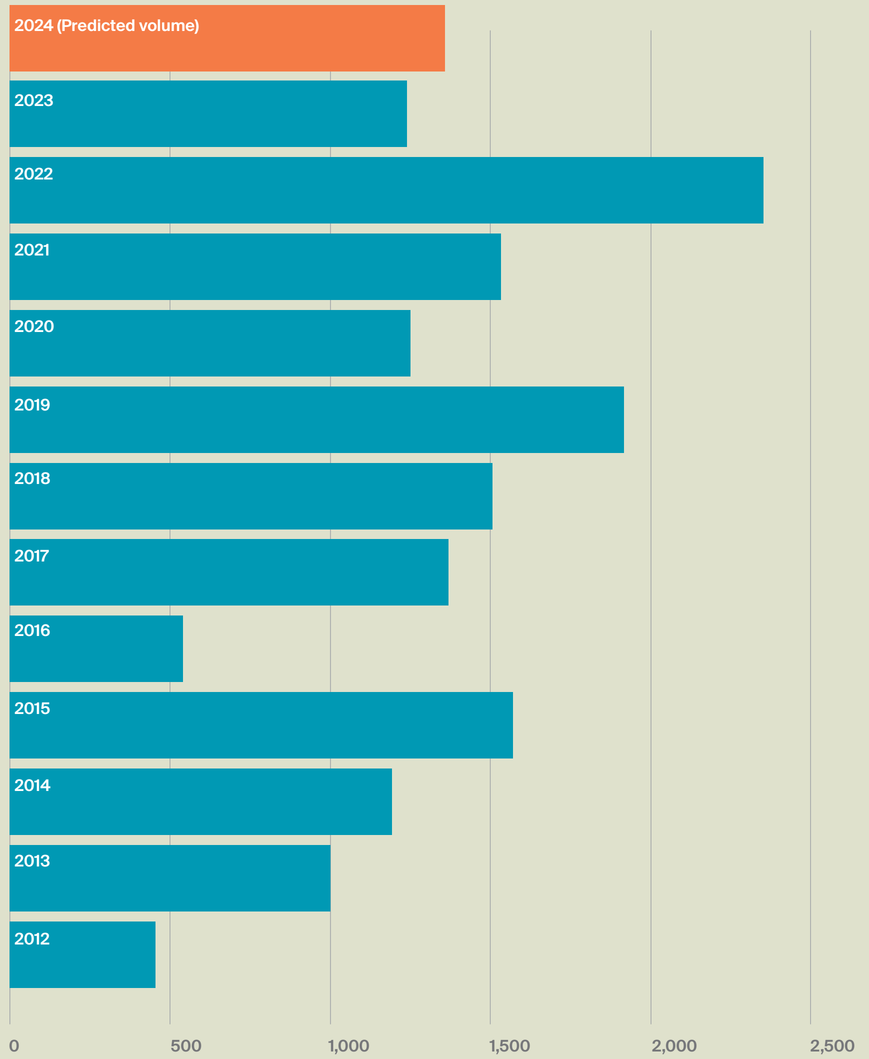
Source: Knight Frank, Property data. Please note, here we include recorded transactions for elderly care, adult care & supported living, primary care, hospital facilities and childcare.

Fig 6: Recorded healthcare property transactions (£bn)



Source: Property Data
* 10 year average incorporates major deals also

Fig 7: Anticipated transaction volumes



Source: Knight Frank Research, Property Data

Table 1: Notable deals in 2023

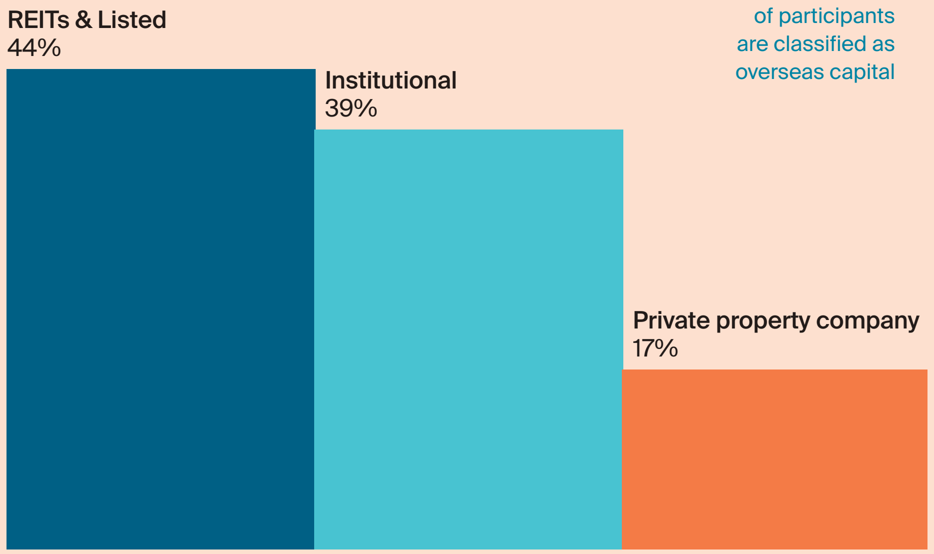
Deal type	Price £m	Date	Details	Properties	Purchaser	Purchaser Type	Sector
PORTFOLIO	61.3	Jan-23	8 property portfolio.	8	Welltower Inc	REITs & Listed	Elderly Care
PORTFOLIO	56.0	Jan-23	6 property portfolio.	6	Impact Healthcare REIT	REITs & Listed	Elderly Care
SINGLE ASSET	9.7	Jun-23	64 bed care home	1	Swiss Life (Mayfair CIM)	Institutional	Elderly Care
SINGLE ASSET	30.0	Aug-23	Adanac Health and Innovation Campus	1	Macquarie Group, Just Group PLC	Overseas	Hospital
SINGLE ASSET	2.5	Oct-23	SEN school as part of 3 property deal	1	NewCore Capital Management	Institutional	Childcare

Source: Knight Frank Research, Property Data

Market view

As with last year's report, given the various factors impacting the sector, it is crucial to understand investor sentiment to understand the market's state. While extensive resources and in-house data provide a robust overall view of the market, the first-hand investment experience and strategies utilised by those involved provide invaluable insights. Therefore, We have surveyed most of the key UK market players, including major REITs, institutional and overseas investors.

Composition of survey participants



38% of participants are classified as overseas capital

Source: Knight Frank Research

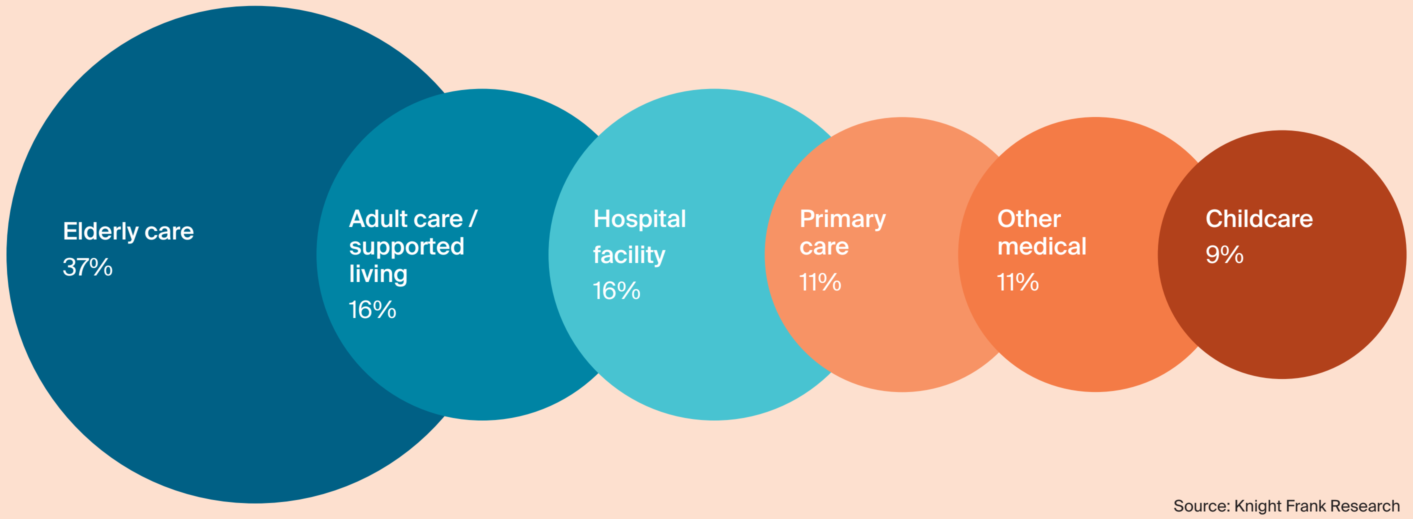
3,984
Total care assets

£86.6bn
Approximate value of care assets under the management of survey participants globally

£14.6bn
The amount of capital currently available and committed for surveyed investors to deploy on care assets

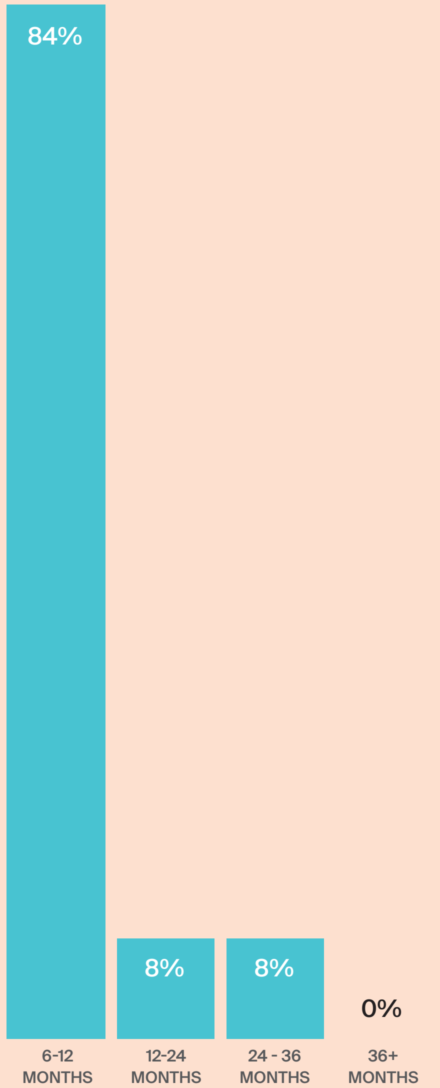
Source: Knight Frank Research

Which areas of healthcare do you currently have exposure to? (% of respondents)



Source: Knight Frank Research

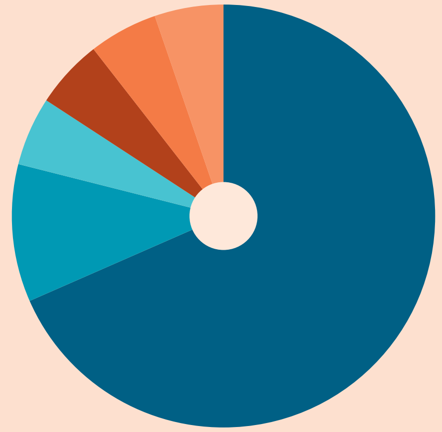
How far is the healthcare sector from normality, following Covid-19?



Source: Knight Frank Research

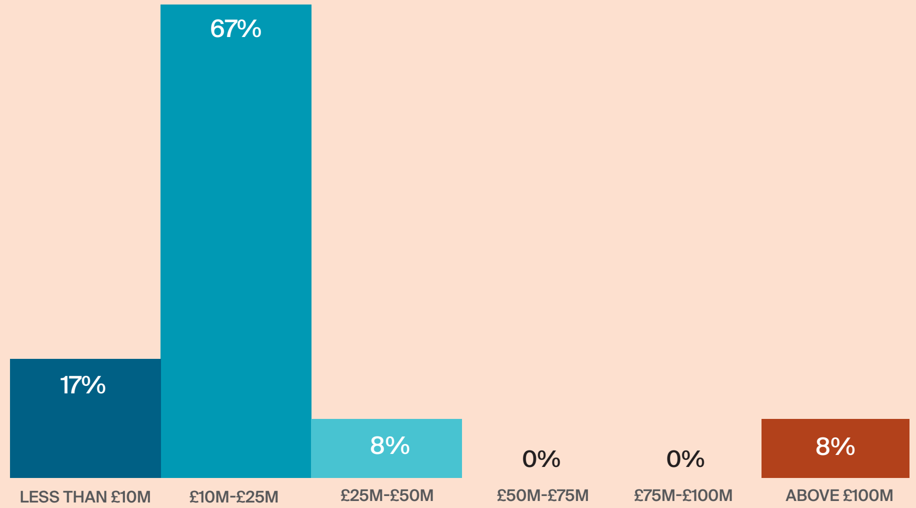
Most important driver of demand for UK healthcare

Demographic shift	69%
Secure income	11%
Long-term income	5%
Demand for safe-havens	5%
Structural change in real estate	5%
Social impact	5%



Source: Knight Frank Research

Primary lot size sought by respondents for acquisitions



Source: Knight Frank Research

100%
Average rent collection percentage for participants' portfolios

4.6%
Average cost of debt among survey participants

34%
Average loan to value among survey participants

5.0
Average years remaining on term of survey participants' debt facilities

2.20x
Average rent cover across survey participants' portfolios

94.3%
Average percentage of survey participants' debt that is hedged

33%
Percentage of survey respondents that report no use of debt

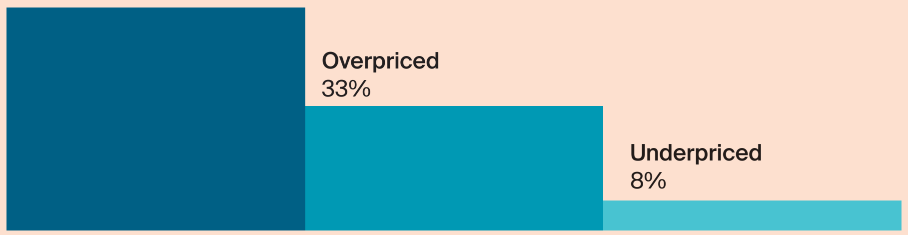
Source: Knight Frank Research

What would you suggest is a major issue with the current quality of stock?

Size	8%
Lack of en-suite	17%
Lack of full wet room	25%
ESG credentials	42%
Scope for repurposing	8%
Other	0%
Location	0%

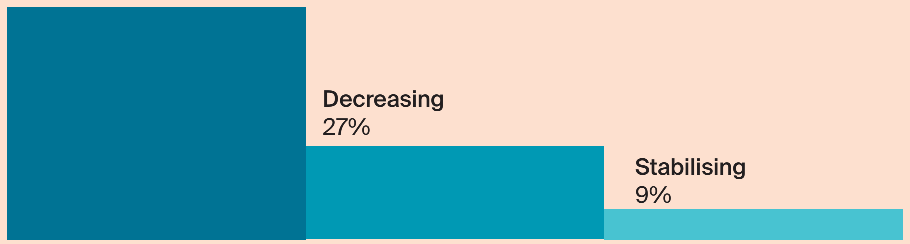
Source: Knight Frank Research

What are your thoughts on the general pricing tone of the market?



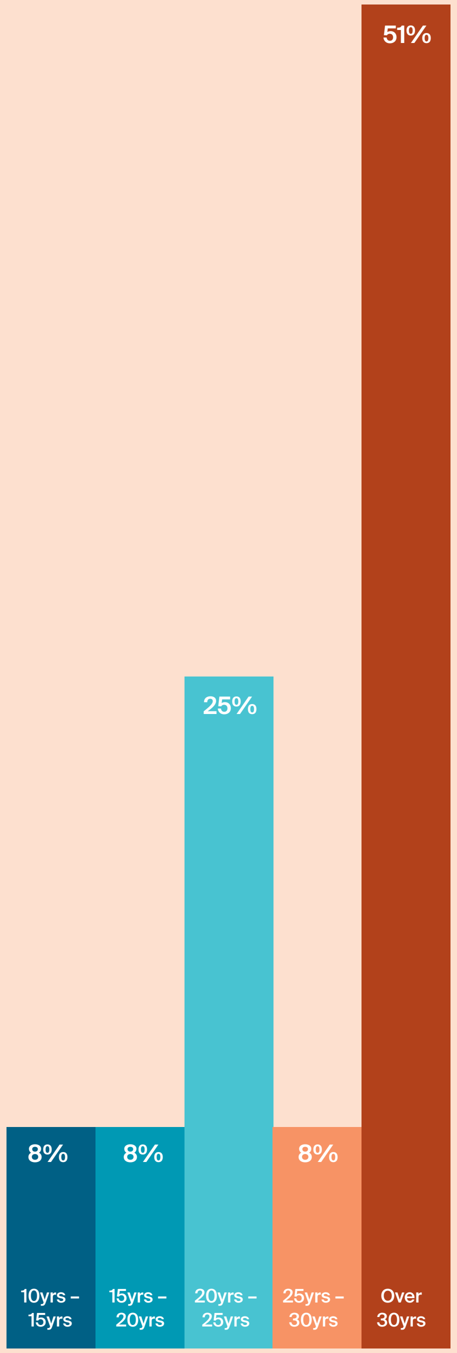
Source: Knight Frank Research

Do you see demand from overseas capital for UK care assets increasing, decreasing or stabilising?



Source: Knight Frank Research

Current WAULT of survey participants' healthcare portfolios



Source: Knight Frank Research

Area of healthcare that presents the greatest investment opportunity

Childcare 0% | Primary care 0% | Other medical 0%

Source: Knight Frank Research

4.9%–10.8%

1 year total returns (achieved by survey participants' portfolios)

5.2%–8%

3 year annualised total returns (achieved by survey participants' portfolios)

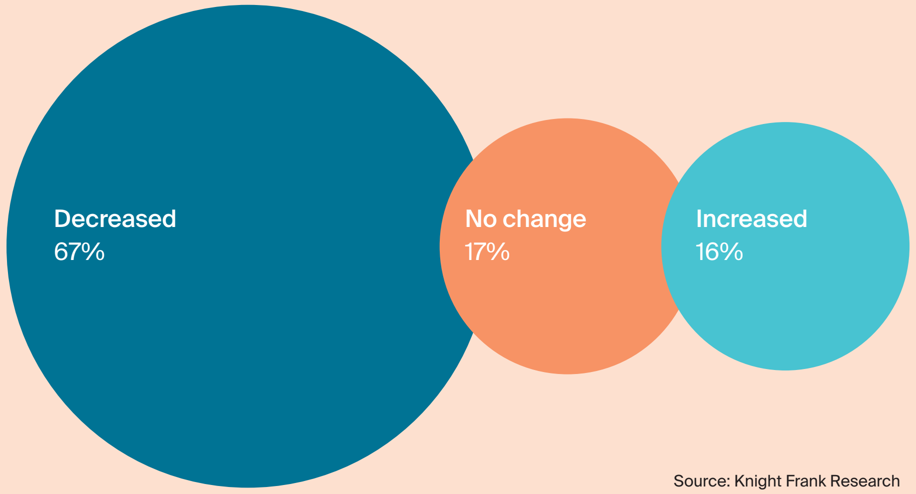
7.4%–9%

5 year annualised total returns (achieved by survey participants' portfolios)

6.9%–9%

10 year annualised total returns (achieved by survey participants' portfolios)

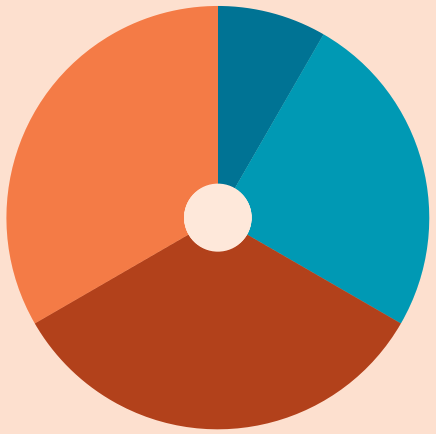
How has the current climate impacted your current appetite for risk?



Source: Knight Frank Research

What has been the greatest obstacle in the ability of investors to implement ESG into their strategy?

Lack of ESG understanding	9%
Lack of set standards/ guidelines	25%
Difficulty in enforcing among operators	33%
Other	33%
Lack of ESG opportunities	0%
Lack of access to expert advice	0%

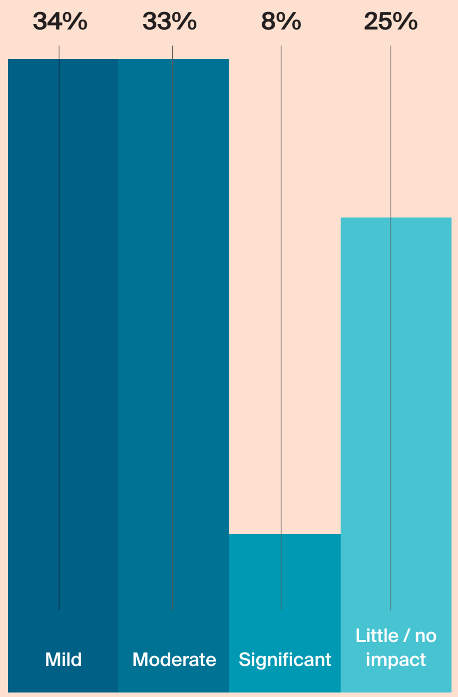


Source: Knight Frank Research

100%

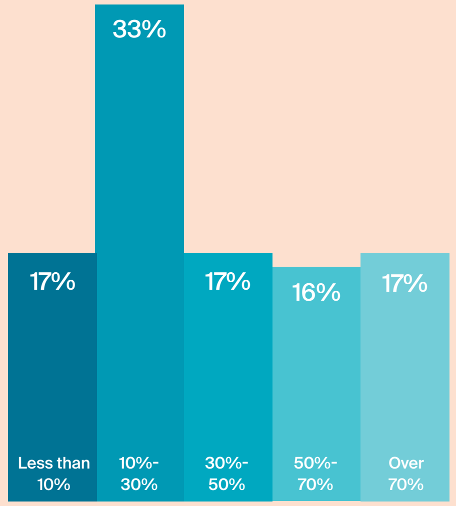
of survey participants have begun to implement ESG into their current strategy

How would you describe the impact of current economic conditions on the performance of your portfolio of care assets?



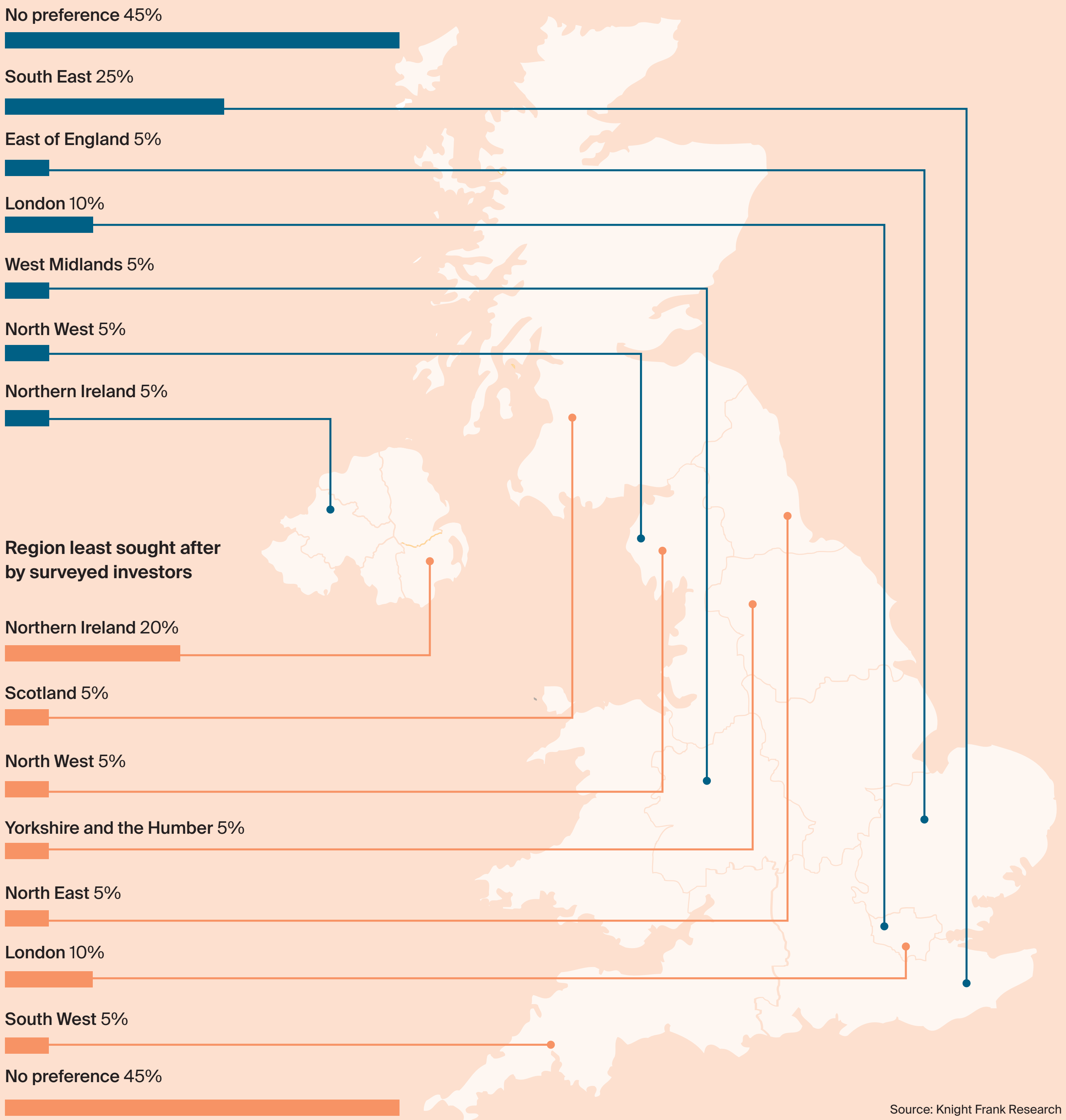
Source: Knight Frank Research

Percentage of survey participants' current strategy attributed to development



Source: Knight Frank Research

Region most sought after by surveyed investors

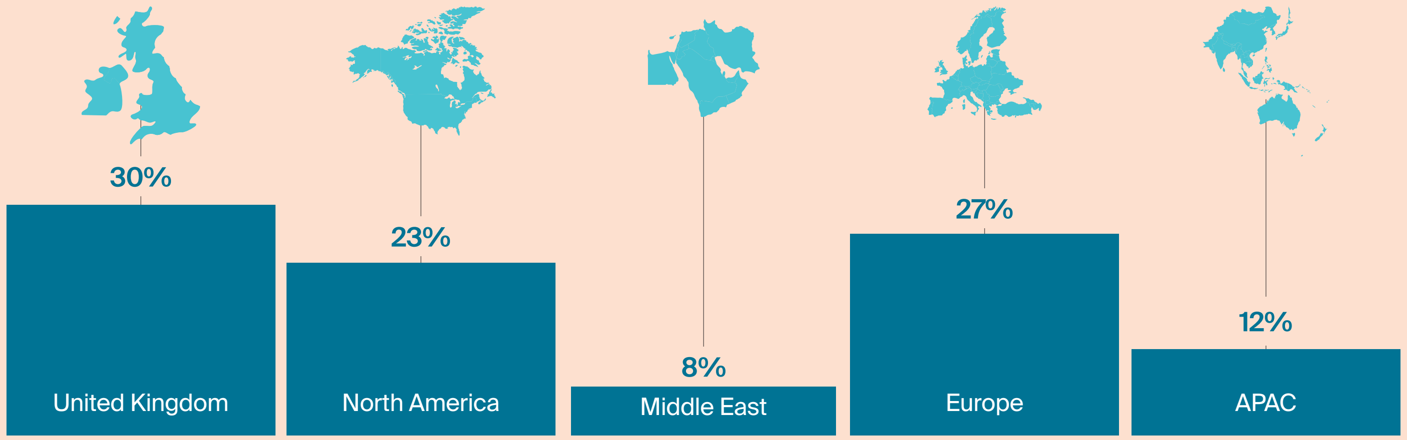


Source: Knight Frank Research

What would you suggest is the greatest cost pressure on operators at present?

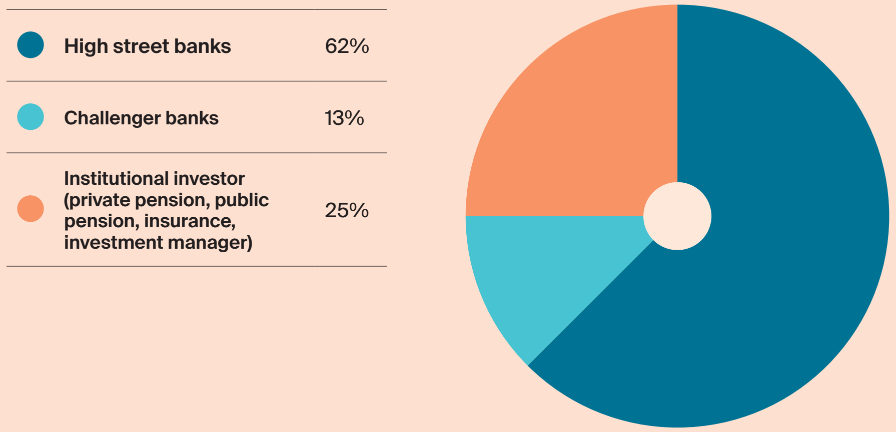
Source: Knight Frank Research

What geography do your equity investors typically fall into?



Source: Knight Frank Research

What category do your lenders typically fall into?



Source: Knight Frank Research

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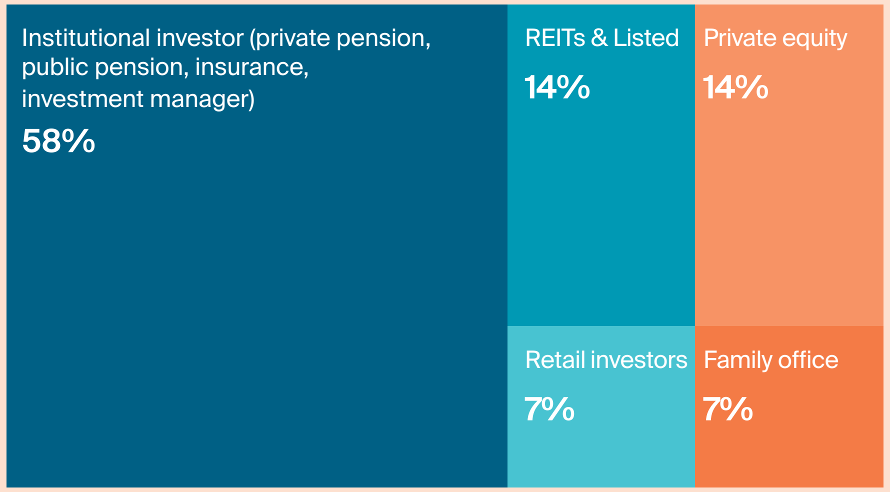
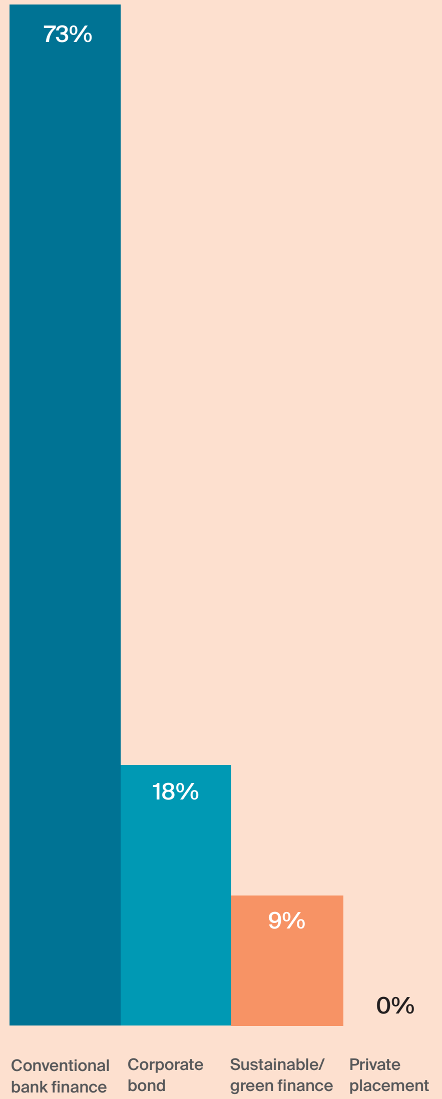


Source: Knight Frank Research

Type of debt



Source: Knight Frank Research

Elderly Care

The third quarter trading figures for 2023 across our portfolio demonstrated the strongest level of rent cover in our fund's history, exceeding 2.3 times. Whilst Q4 was a little lower, at over 2.0 times cover it remained strong. This has given us comfort in the early part of 2024 after the challenges of 2023. Looking back, what were those challenges? Looking forward, what happens next?

MARTIN ROBB
Managing Director
Impact Health Partners

Interest Rates

The era of ultra low interest rates was always going to come to an end at some point, with a resultant risk of a dislocation between buyer and seller expectations driven by cost of capital adjustments. Our experience of 2023 was of exactly that. Not all buyers rely on leverage to an equal extent though and so the practical application of the dislocation varied across different parts of the market.

Looking ahead further into 2024, whilst we are not economic forecasters, we are not anticipating any rapid change in circumstances in the macro-economic backdrop. As the market steadily adjusts, some businesses will cope better than others, which traditionally creates opportunity.

Inflation

For many, 2023 will be remembered as the worst year for rising prices for goods and services in decades. However, with the energy market and food prices in particular stabilising as the year wore on, some of the inflationary pressure was relieved. This trend has continued through Q1 of 2024.

In the care sector, for the first time in a long time, fee rises were significant as both private and publicly funded markets recognised and accepted increased operating costs. With further wage inflation inevitable in 2024 due to the Government's increase in the minimum wage, announcements regarding publicly funded April fee rises have been eagerly awaited. Early indications at the time of drafting suggest mid to high single digits is a realistic expectation for many of our tenant operating partners.

Investment

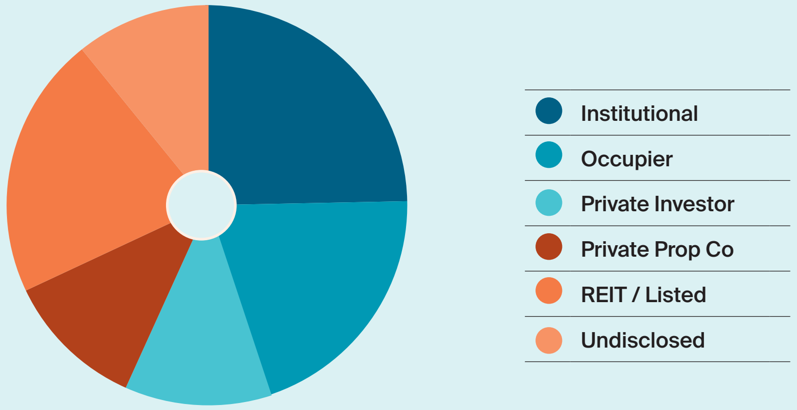
Our fund plans for growth. The more detailed tactics reflect acquisitions in part but also active asset management through capex spend. We see opportunity in the value add layer of the market, where a multitude of factors play to both our, and our tenants', core strengths.

Buying existing buildings and businesses mitigates the fill period otherwise required in a new building, thus assisting cash flows, whilst extending an existing home onto land already owned reduces total development costs. Improving EPC ratings on existing buildings helps our tenants' operational expenditure and also continues to make use of embodied carbon.

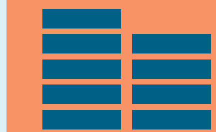
Typically, we have purchased assets at below replacement cost, with an acquisition price that keeps rents down and supports longer term affordability for the tenant. Finally, we will continue to support well managed businesses with a strong local reputation that are positively contributing a social return to their catchment area, for both public and privately funded residents, meeting a range of needs and providing employment opportunities for both qualified and unqualified staff.

We also continue to appraise potential acquisition opportunities where we see a value trend, whilst also seeking to unlock development opportunities in a higher build cost environment. Whilst headwinds persist in certain areas, our markets are needs driven and we have ongoing conviction regarding our investment thesis as a result.

Elderly care buyer composition

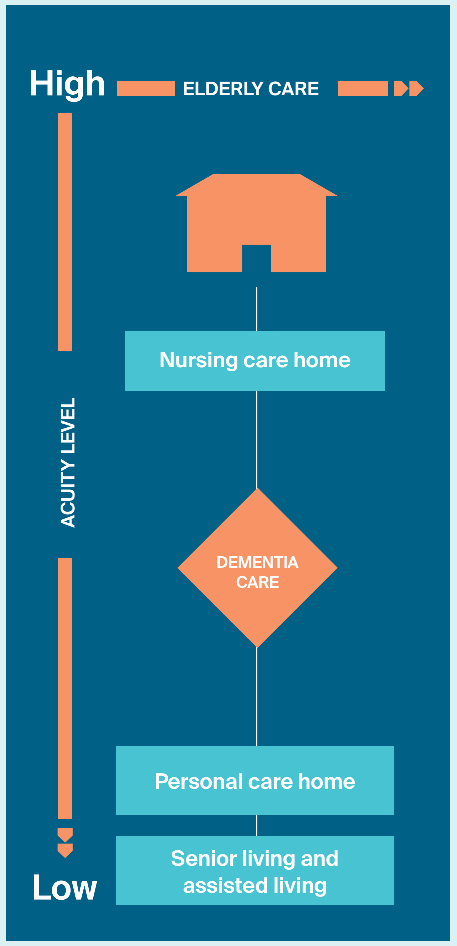


Key transaction



£56m

DATE Q2 2023
DEAL VALUE £56,000,000
BUYER NAME Impact Healthcare REIT
BUYER TYPE REIT / Listed
NOTES 6 care homes across Shropshire and Cheshire – 438 beds
VENDOR TYPE Occupier
ASSET TYPE Elderly Care
TRANSACTION TYPE Domestic



Yields

Elderly Care	2024	2023	2022	2021	2020	2019	2018
Prime	4.5-4.75	4.25-4.5	3.25	3.75	3.5	3.75	4
Prime (SPV)	5.5	5.5					
Secondary	6+	5.5-6					
Tertiary	7.5+	7-7.5					

Transaction composition

The composition of transactions is vital to understanding the sector's direction regarding capital flows, investor type, target areas, and much more.

Figure 8 illustrates that in 2023, portfolio deals accounted for 52% of transactions, compared to 2022, where single assets and portfolio deals accounted for 28% and 72% of transactions, respectively. This can be attributed to the fact that a number of the key market players that have been more active in previous years have stepped back to assess pricing. Therefore, there has been a shift in the type of transaction and the relative lot size sought by the active capital.

2023 has continued from 2022's trend, which saw a dip in the share of transaction volume attributed to overseas capital. While we have seen a reasonable fall in overseas capital deployed lately, this repositioning has also been influenced by more active institutional capital, which is taking a share of volume. We can see in Figure 9 how transactions by overseas investors in 2023 compared with the five-year total.

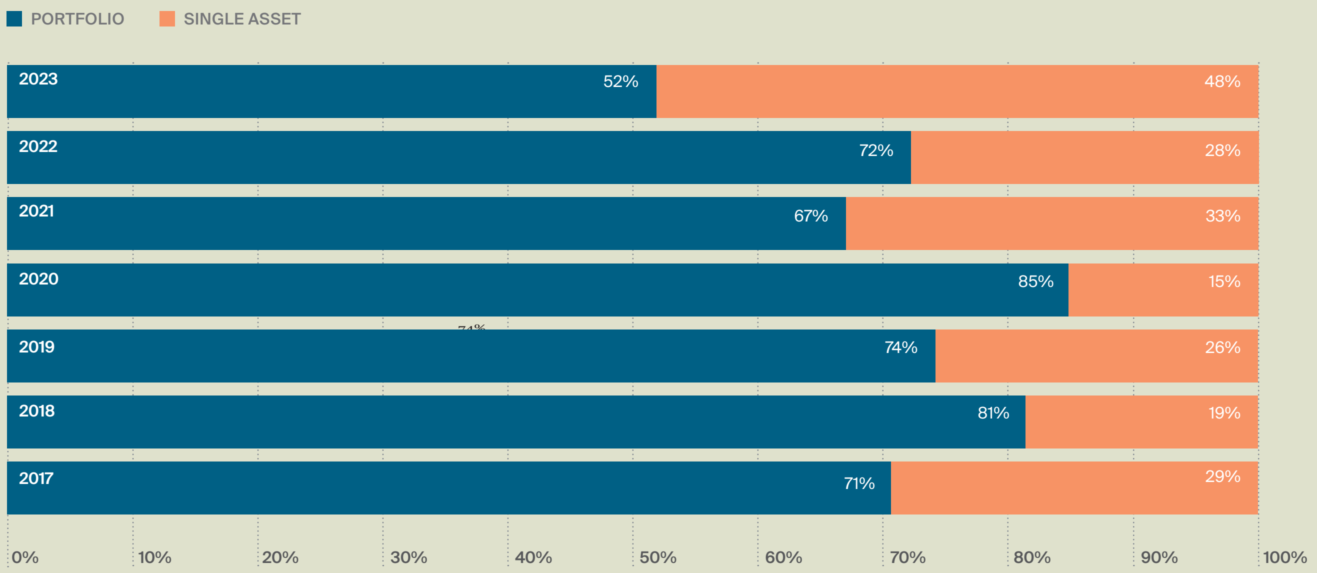
US-based capital has historically been split between elderly care and private hospital assets, whereas European-based capital has been more elderly care-focused. Figure 10 provides an insight into the target market areas from overseas capital over the last two decades. This analysis focuses on the location of capital and the sub-sector of healthcare it flows into. We are also witnessing an interest in specialist and childcare facilities. However, these are less prominent within the analysis due to less maturity in the space compared to elderly care and hospital facilities.

As in previous years, North American capital is a significant component of transaction volume, a trend not only seen in care but also within all broader property capital flows. Healthcare has, this year, closely mirrored the split between European and North American capital seen in all property, which is responsible for 33% and 53% of overseas flows respectively. Historically, this hasn't been the case, and there may be a significant shift in geographical sentiments amongst investors. Figure 11 provides an insight into the source of overseas capital in 2023.

Healthcare remains diverse in its own right. From elderly care to childcare, investors benefit from the sector providing a vast spectrum of

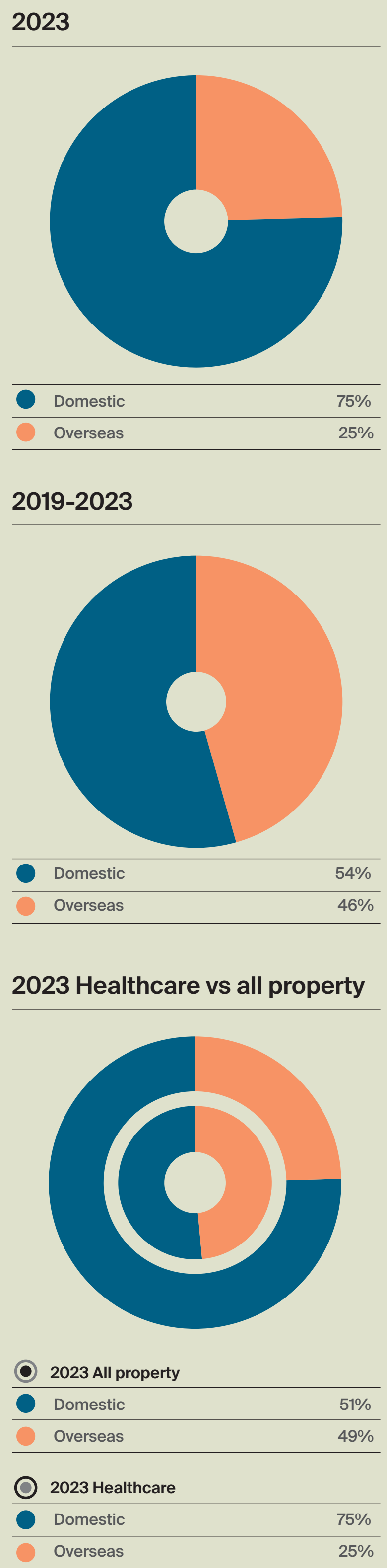
> "2023 has continued from 2022's trend, which saw a dip in the share of transaction volume attributed to overseas capital."

Fig 8: Portfolio vs single asset transactions



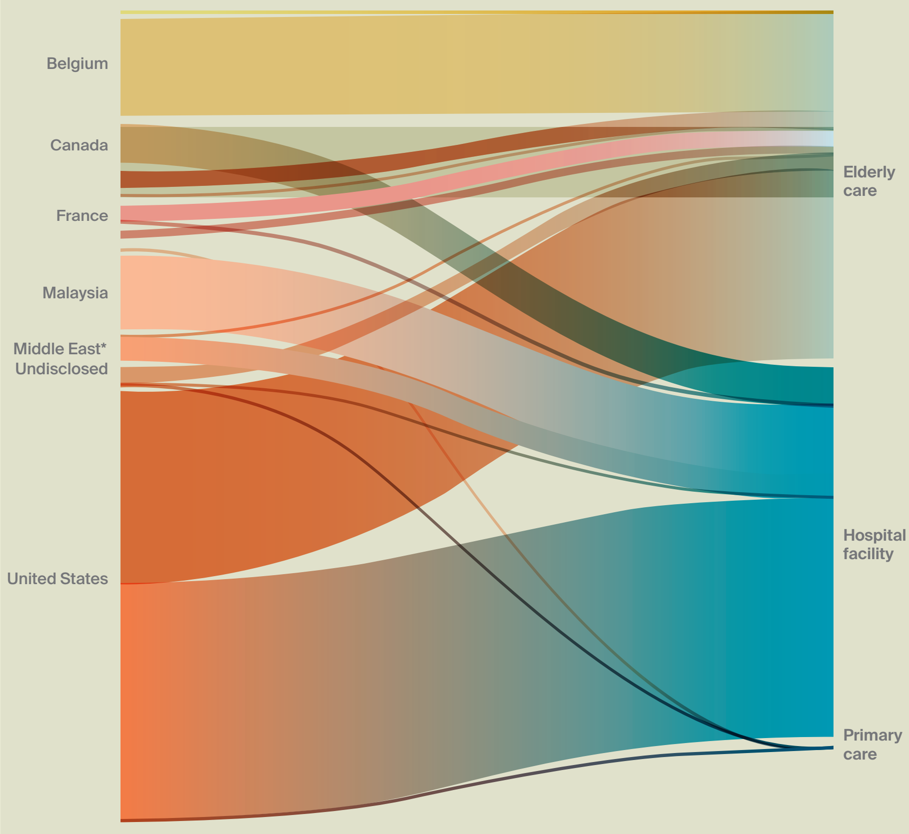
Source: Knight Frank Research, Property Data

Fig 9: Overseas share of healthcare property investment



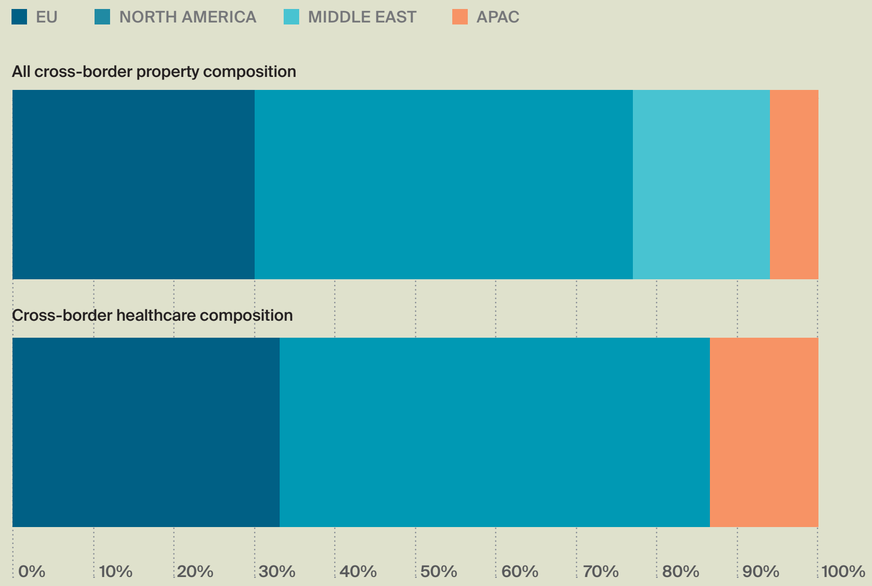
Source: Property Data

Fig 10: Placement of overseas capital into UK healthcare



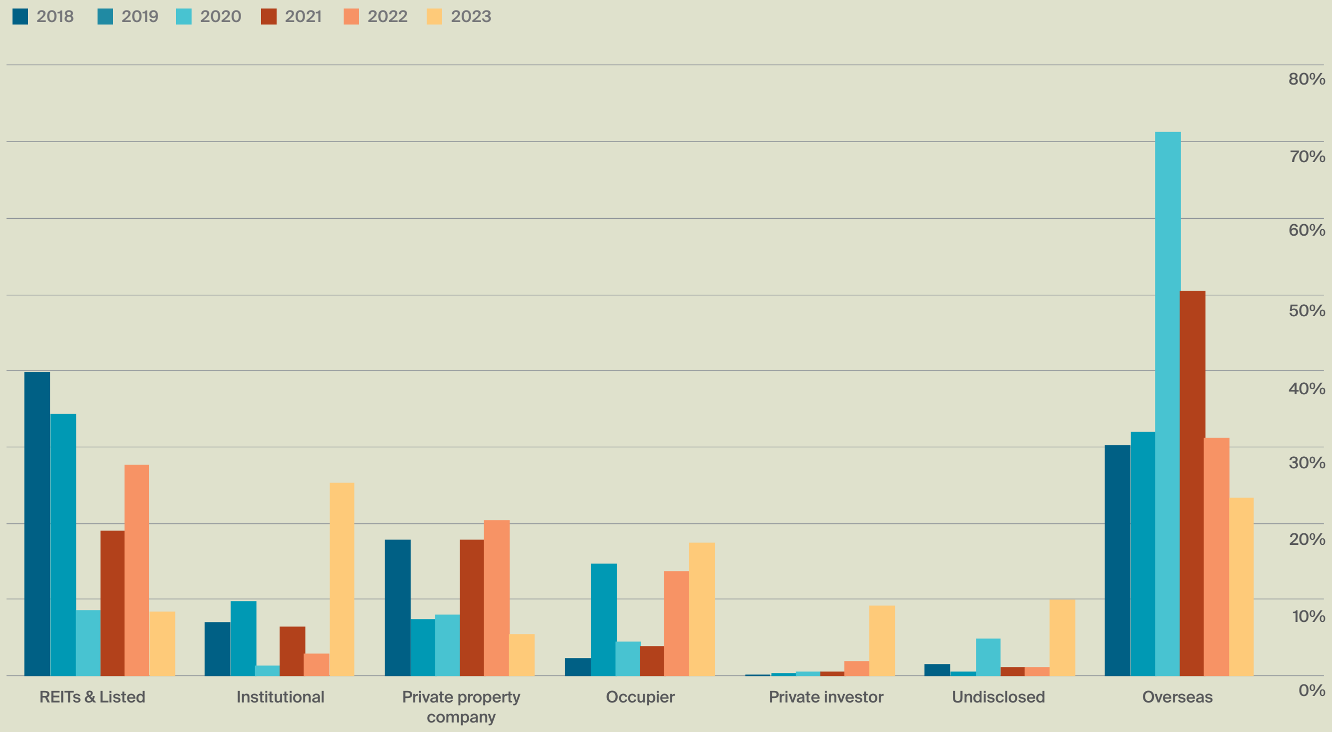
Source: Knight Frank Research, Property Data
*undisclosed

Fig 11: Cross-border composition



Source: Knight Frank Research, Real Capital Analytics

Fig 12: Healthcare property investment by buyer type



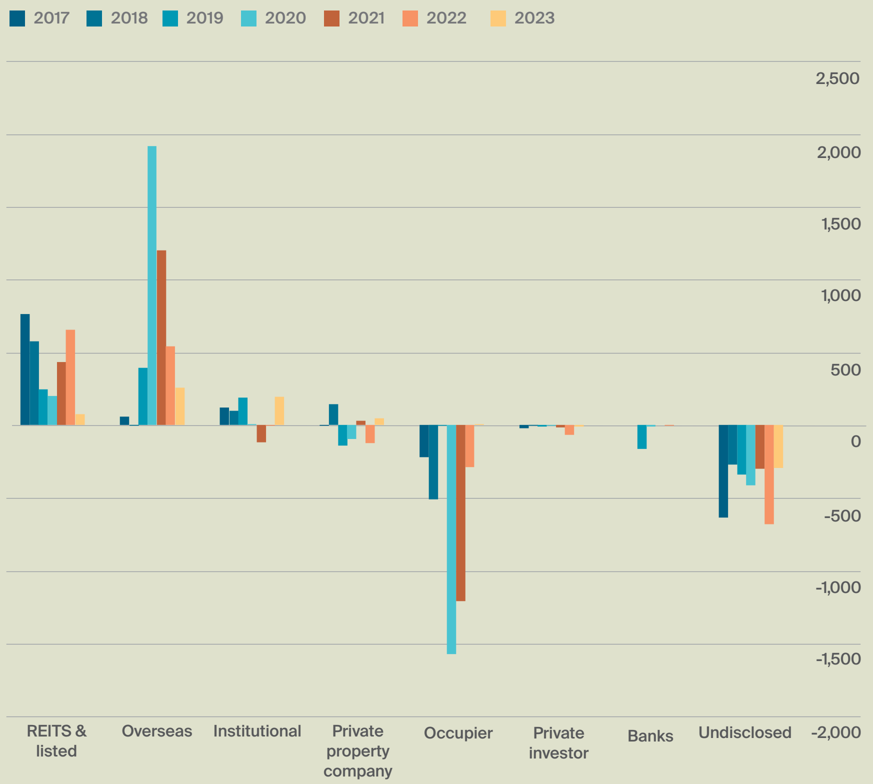
Source: Knight Frank Research

options. These options are seemly becoming more apparent to domestic investors, which continues to eat into the share of transactions attributed to overseas capital, snatching a further 7% of composition from overseas capital when compared against the previous year (Fig. 12).

Figure 13 presents a trend for occupiers to present themselves as net sellers, further supporting the narrative of exiting longer-standing, family-owned operators.

Assessing the way in which target areas have changed and remained consistent for each investor type over the past few years. (Fig. 14) While there has always been a substantial interest in private hospitals and adult specialist care, this year, elderly care has emerged as a clear target area for most investors. This also highlights a growing trend for sale and leaseback transactions between operators and investors as a capital release or outright exit strategy, with some savvy investors opening up their strategies to the operating platforms and not just the real estate.

Fig 13: Net acquisitions or disposals by investor type



Source: Knight Frank Research, Property Data

Fig 14: Sector investment by investor type 2019-2022

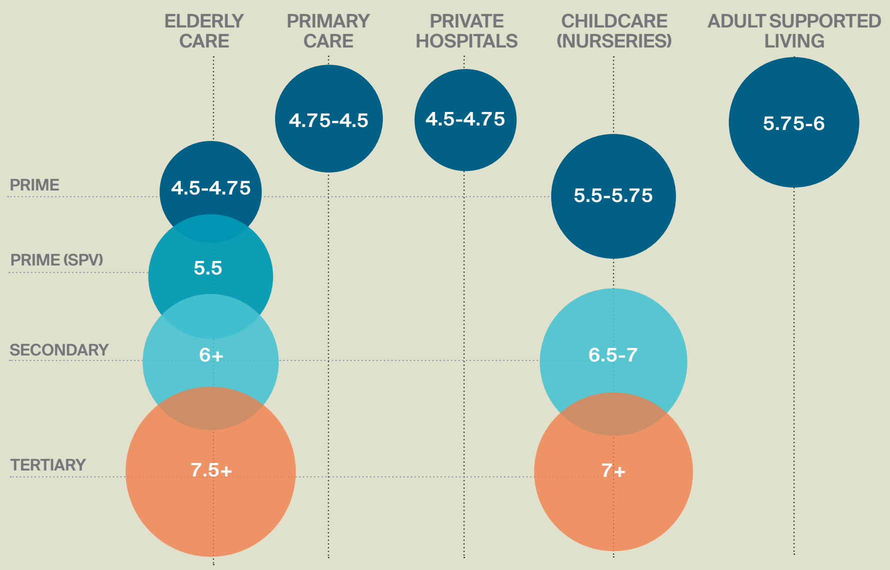
Source: Knight Frank Research

Investment Performance:
Consistency is key

Despite following the trends seen in global transaction volumes, the sector has shown a robustness in holding returns and performance for the year.

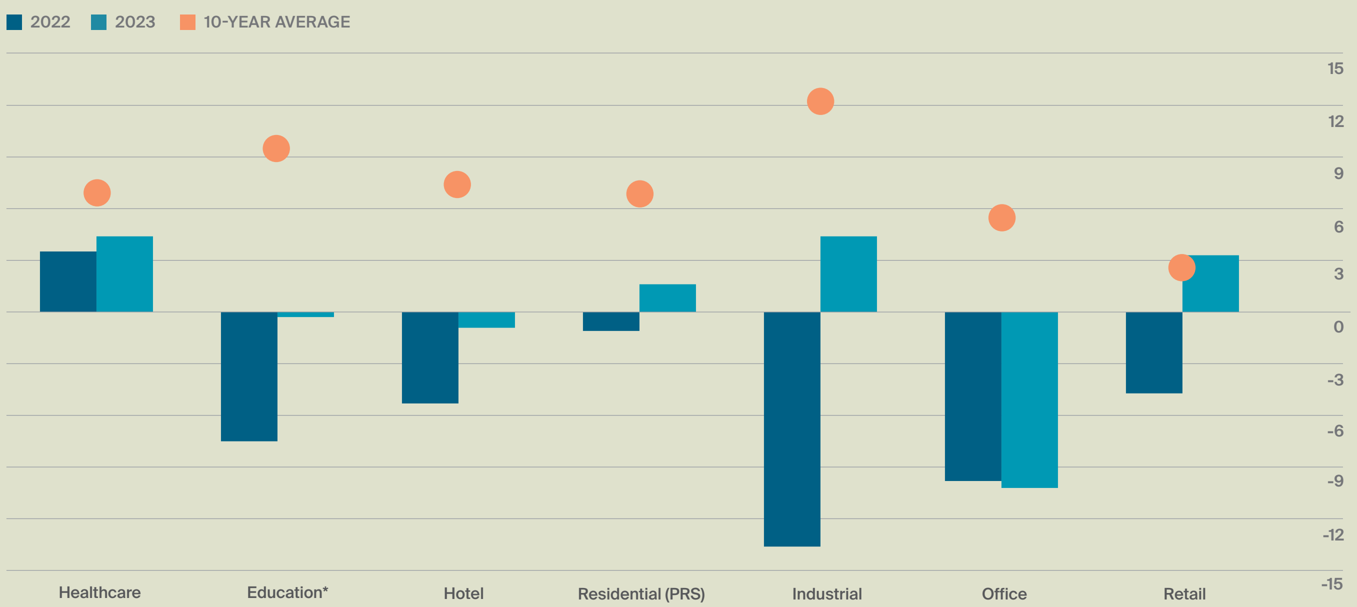
Overall, returns and the sector's general performance continue to justify the fundamental drivers associated with healthcare, be it demographics or long income capabilities. Figure 15 presents a view of yields for the various sub-sectors within healthcare, while Figure 16 highlights total returns across several sectors at the end of 2023. Although several other sectors are demonstrating higher returns than healthcare's 4.4% annualised average return, it is essential to note that while healthcare sits below its long-term average, there have been some more significant variances among other sectors. This is due to substantial dips and sharp recoveries within the cycles of the sectors in

Fig 15: Healthcare yields by sub sector



Source: Knight Frank Research, MSCI

Fig 16: Total returns (%)



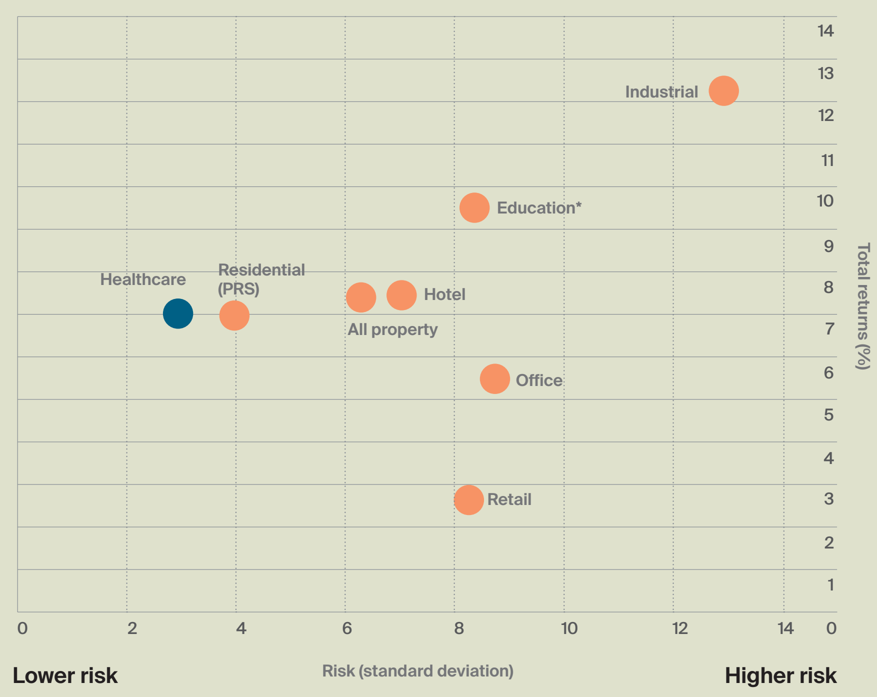
Source: Knight Frank Research, MSCI

"It is essential to note that while healthcare sits below its long-term average, there have been some more significant variances among other sectors."

question. This feeds into the fact that healthcare generally presents a lower risk/return profile due to its lack of variance or deviation from its longer-term averages (Fig 17).

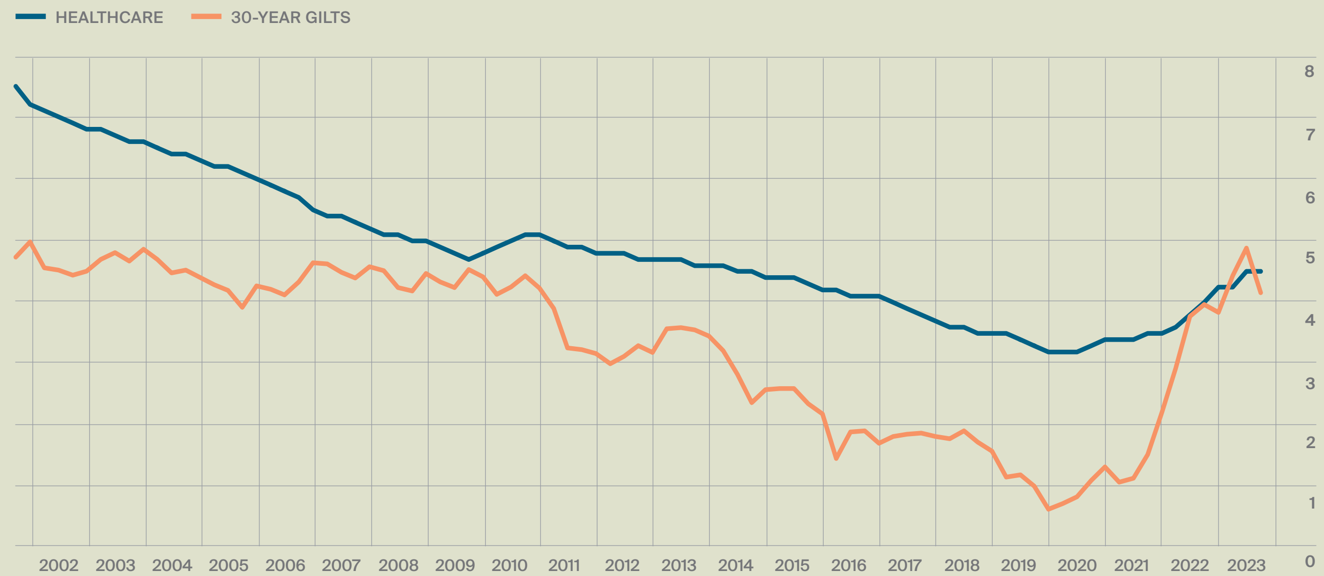
As conventional healthcare leases benefit from longer and index-linked terms, the sector presents as having almost "bond-like" long-income capabilities for investors. This opens the floor to comparing average healthcare capital rates and 30-year gilts, with an average spread of 0.36% between the two (Fig. 18).

Fig 17: Risk vs returns (10-year history)



Source: Knight Frank Research, MSCI

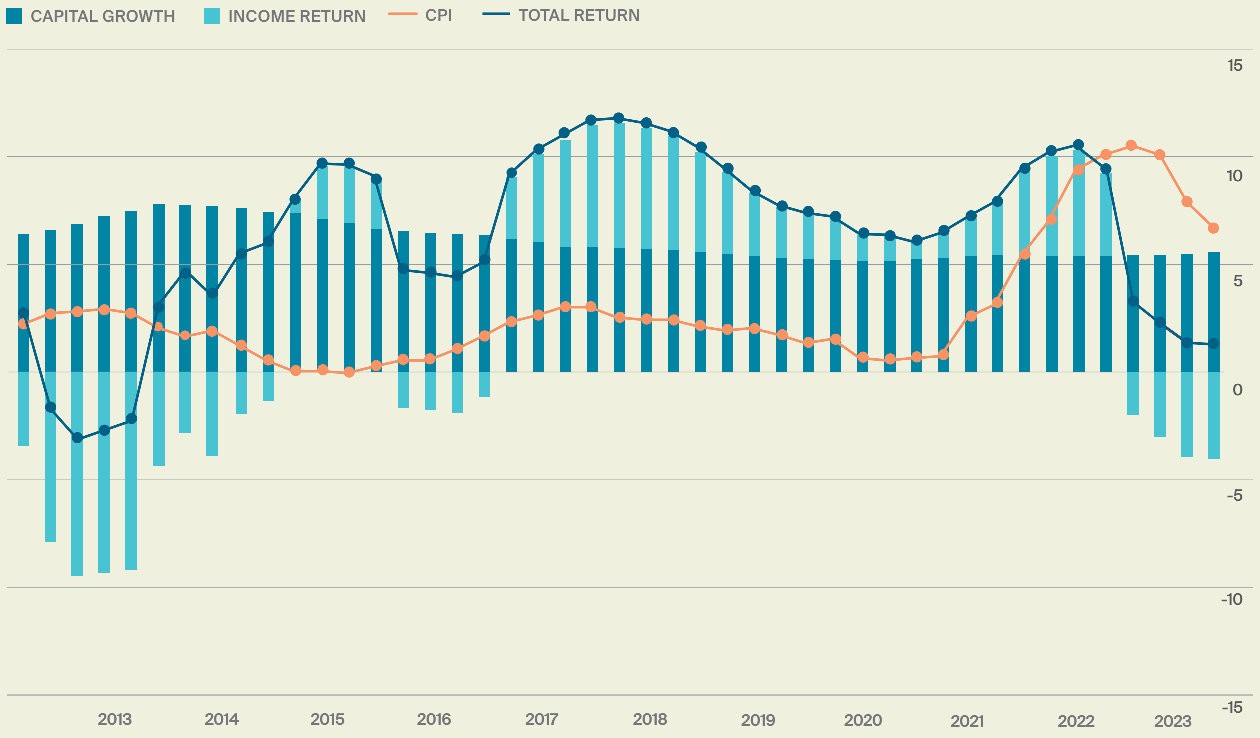
Fig 18: Healthcare vs 30-year gilts



Source: Knight Frank Research

Seeing the bigger picture

Fig 19: Healthcare returns vs CPI (2012–2023)

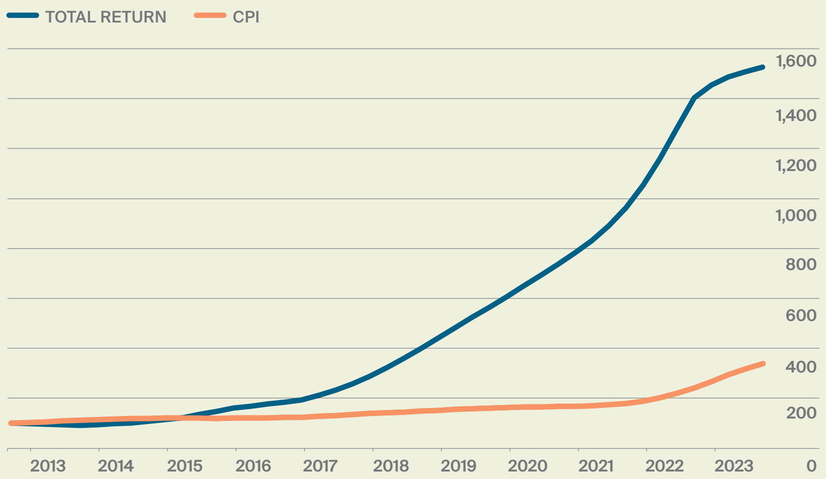


Source: Knight Frank Research

Following the trend in healthcare's total returns from 2012 (Fig 19), and the contribution of income and capital returns towards this. Income return has been a fundamental factor in total returns able to trend above CPI, except for two periods. This consistency is a further testament to the sector's long-term income credentials.

Further analysis through indexation of total return and CPI over the same period (Fig 20) highlights the extent to which total return substantially outpaces inflation. Again, this is yet another supporting factor in the case for healthcare as a stable investment class.

Fig 20: Healthcare total returns vs CPI (indexed)



Source: Knight Frank Research

Health services

Primary Care

HARRY HYMAN
Non Executive Chair
Primary Health Properties PLC

The relatively benign economic backdrop of the last few years was shattered by the twin forces of inflation and the political uncertainty following the Truss/Kwarteng budget in the autumn of 2022.

Like all property subsectors in 2023 and especially covenant led transactions Primary Care saw significant reductions in transactional volumes while investors considered where interest rates will settle, what the knock-on effect for yields is and what represents value.

The recent reduction in SONIA rates and continued gradual retrenchment of inflation could signal that 2024 may see more positivity translating into more transactional activity, but we shall likely need to see some more consistency in these themes before confidence returns.

Development in the Primary Care space continues to face headwinds as yields have softened and build cost inflation has put significant upwards pressure on the rental levels required to enable scheme viability.

As a result the modernisation of the primary care estate which is so crucial to the delivery of the NHS strategy – by allowing much more care to be carried out of the hospital environment – is under significant threat with many new schemes being lost to alternative land uses.

The challenge now rests on progressing the rental tone in the sector, which is improving, but has a long way to go to achieve viability given the long period of benign rental growth experienced until recently.

Rents in the sector are effectively set by the District Valuer's office, a part of HMRC, and because of their reluctance to accept much higher levels of rent, akin to that of other sectors, primary care development is currently stalled. There are various initiatives at play to try to unblock this impasse but so far progress has been slow. This is also impacting urgent refurbishment and improvement projects.

This is a great shame as primary care offers a community based environment within which to treat patients releasing pressure on our over crowded hospitals while offering a cheaper setting for the NHS to provide care in a more appropriate environment.

A growing and ageing population with an ever higher incidence of chronic diseases means that demand for primary care and healthcare is rising inexorably.

Primary care infrastructure needs to be modernised and the current impasse is short-changing the population.

Key transaction

£310k

DATE Q1 2023

DEAL VALUE £310,000

BUYER NAME Hnsprop Ltd

BUYER TYPE Private Investor

NOTES Carrfield Medical Centre

VENDOR TYPE Undisclosed

ASSET TYPE Primary care

TRANSACTION TYPE Domestic

Primary Care buyer composition

Yields

	2024	2023	2022	2021	2020	2019	2018
Primary Care	4.75-5	4.25-4.5	3.5	4	4	4	4

Health services

Private Hospital

NICHOLAS WEST
Head of UK
Northwest Healthcare Properties REIT

Operational Performance

Private hospitals demonstrated strong operational resilience in 2023, despite the impact of cost inflation (wages and energy prices) and rising interest rates.

Top-line performance has been supported by (i) the growing NHS backlog, with national waiting lists now estimated at 7.8m people, fueling demand from the public sector for private sector capacity (ii) growth in the self-pay market with more individuals prepared to pay-up in order to 'skip the line,' and (iii) higher levels of Private Medical Insurance (PMI) as patients seek alternative ways to reduce the waiting period for treatment. Indeed, data from Private Healthcare Information Network indicates that the PMI market is growing rapidly, with Q2 2023 activity at the second highest level on record. The combined effect of the above has resulted in record levels of demand for private hospital services and higher revenues across the sector.

Northwest Healthcare Properties REIT saw an increase in cost base within our major operators of c. 25% in 2023, predominantly due to a rise in staffing and energy costs. However, growth in private hospital revenue has typically outstripped costs, and profitability across the sector therefore remains strong. Across the Northwest Healthcare Properties REIT portfolio, we have seen robust rent cover growth of c. 10% in 2023, despite leases hitting their rent review caps.

We are also seeing an emerging trend of operators reinvesting profits into major capital expenditure projects at their hospitals, such as construction of new operating theatres, upgrading of diagnostic equipment and other building fabric improvements. For example, in 2023 Spire undertook £2.8m of capital expenditure to repurpose admin space to a new minor operations theatre at their asset in Sheffield. We anticipate that these improvements will boost operator profitability and energy performance credentials going forward.

Investor Demand

Location is critical to the operational performance of a hospital. Access to top quality consultants, proximity to NHS feeder sites and patient affluence profiles are some of the key criteria which are important to hospital operators. For this reason, operators in high quality locations seek long term leases, typically 20 – 30 years in duration, with index linked rent reviews.

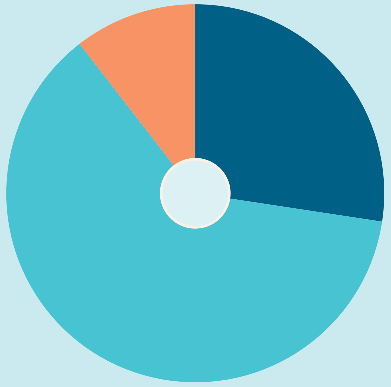
Investors are increasingly looking to diversify away from offices and retail. The Healthcare market offers an attractive alternative, characterised by investment grade operator covenants on single-let, long-term and index-linked leases. We are therefore seeing increasing levels of both domestic and international capital entering the sector, as has been the case with HCA Great Portland Street, which was acquired by an Asian family office, and UAE-based Purehealth's acquisition of Circle Healthcare from Centene.

Private Hospital Outlook

In the short to medium term, we forecast that the NHS backlog will remain high, due to the unprecedented levels of doctor and NHS staff strikes, which will continue to drive private hospital revenue streams. The high levels of staff and energy cost inflation are anticipated to subside, albeit will remain at elevated levels for some time, and EBITDA should therefore grow in-line with the revenue performance of the sector.

On a longer-term basis, we forecast that the private hospital sector will also outperform the all-sector real estate benchmark, due to the structural sector tailwinds, including the growing prevalence of multi-morbidities and the ageing population.

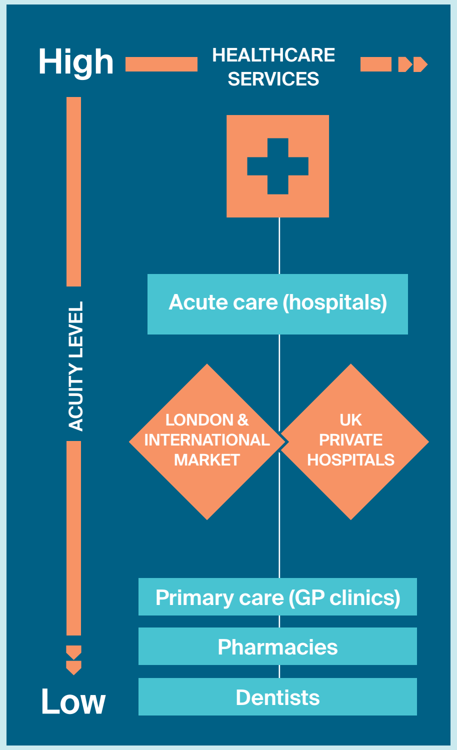
Private hospital buyer composition



Key transaction

£30m

DATE Q2 2023
DEAL VALUE £30,000,000
BUYER NAME Macquarie Group, Just Group
BUYER TYPE Private Investor
NOTES Hospital
VENDOR TYPE Private prop co
ASSET TYPE Hospital
TRANSACTION TYPE Cross-Border

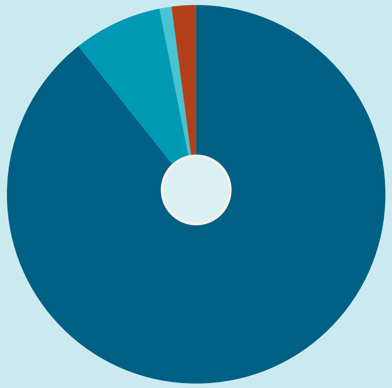


Yields

	2024	2023	2022	2021	2020	2019	2018
Private Hospitals	4.5-4.75	4.5	4.25	4.75	4.75	4.75	4.75

Adult care

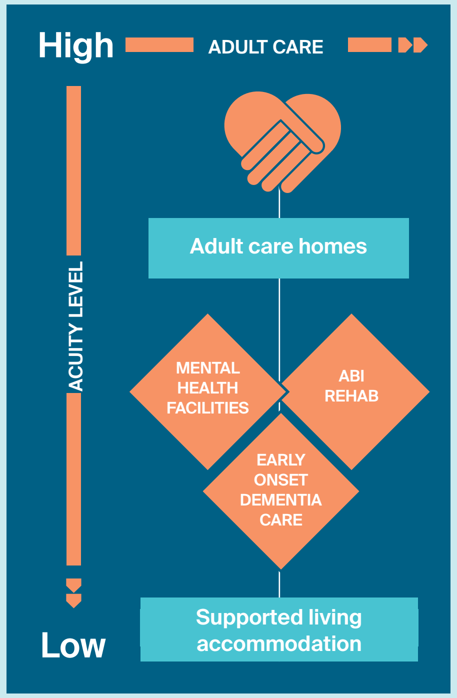
Adult care hospital buyer composition



Key transaction

£3.5m

DATE Q2 2023
DEAL VALUE £3,547,604
BUYER NAME Civitas
BUYER TYPE Institutional
NOTES Alexandra Road
VENDOR TYPE Institutional
ASSET TYPE Adult care / Supported living
TRANSACTION TYPE Domestic



Yields

	2024	2023	2022	2021	2020	2019	2018	2017	2016
Adult supported living	5.75 - 6	5.5 - 6	5.5	5.5	5.75-6	6	5.5-6	7	7

REITs in the spotlight

With the growth in demand for healthcare assets over the years, we have also seen the emergence of more specialist REITs within the sector

2023, however, was an outlier year, with domestic REITs only accounting for 8% of transaction volume. This is mainly the result of several key players gauging the market despite being well-capitalised.

With the delisting of Civitas by CK Assets, we have fallen from seven key healthcare REITs to six, which now officially includes Aedifica UK. At the date of their 2023 interim reports, these REITs had a combined portfolio value of £8.68bn across 1,973 care assets, producing a total rent roll of circa £510 million per annum.

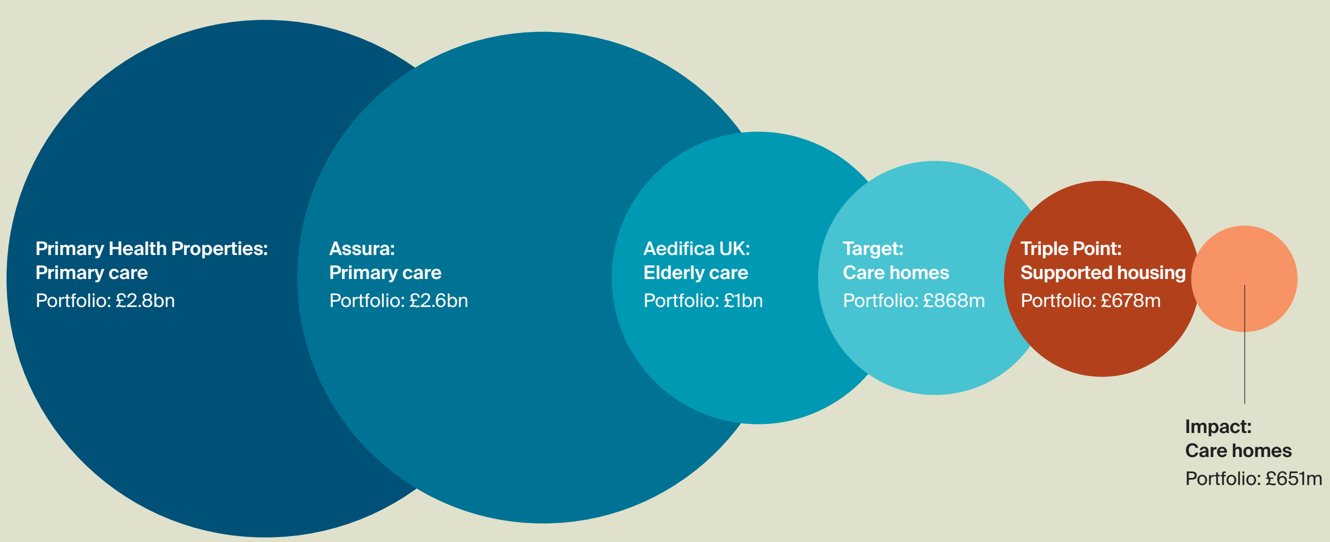
We have seen continued growth in terms of portfolio values. Primary Health Properties is the largest UK healthcare REIT by AUM (Fig 21), reporting a valuation of £2.8bn as of 2023. In terms of combined value, due to a mixture of acquisition and organic growth, this has increased from £6.99bn to £8.68bn between 2019 and 2023, an approximate 24.3% growth over the period or 5.6% on a compounded annual growth rate (CAGR) basis. Adjusting our calculations for the Civitas delisting, those metrics sit at 41.3% and 9%, respectively, a testament to the activeness of these investors and the consistency healthcare provides as a strategy.

Notably, there is substantial deployment ability for healthcare REITs globally. For this reason, we have for the first time, looked at some of the key overseas REITs that have built a holding in the UK. Including the likes of Welltower and Omega Healthcare investors, these global REITs are responsible for £106.3bn in global healthcare assets spread over a mix of strategies.

As seen by the overall healthcare returns relative to other sectors, figure 23 represents the performance of healthcare REITs compared to all property REITs and the FTSE 250. Following these trends, we had seen healthcare REITs' continued divergence away from the "all REIT" line. In 2023, we see the all-REIT line trend above healthcare, which will be a result of strong industrial performance and retail's recovery.

The FTSE 250 line continues to trend above REITs overall, but this will be down to the strong performance of financial services and energy equities due to the capitalising on high base rates supporting their lending activity and inflationary pressures boosting utility providers' profits. Notably, the consistency in healthcare's trend line is a significant argument for its long-run robustness.

Fig 21: Healthcare REITs by AUM



Source: Company websites, data based on 2023 mid-year or interim reports

Fig 22: Global healthcare REITs With UK presence AUM(£)*

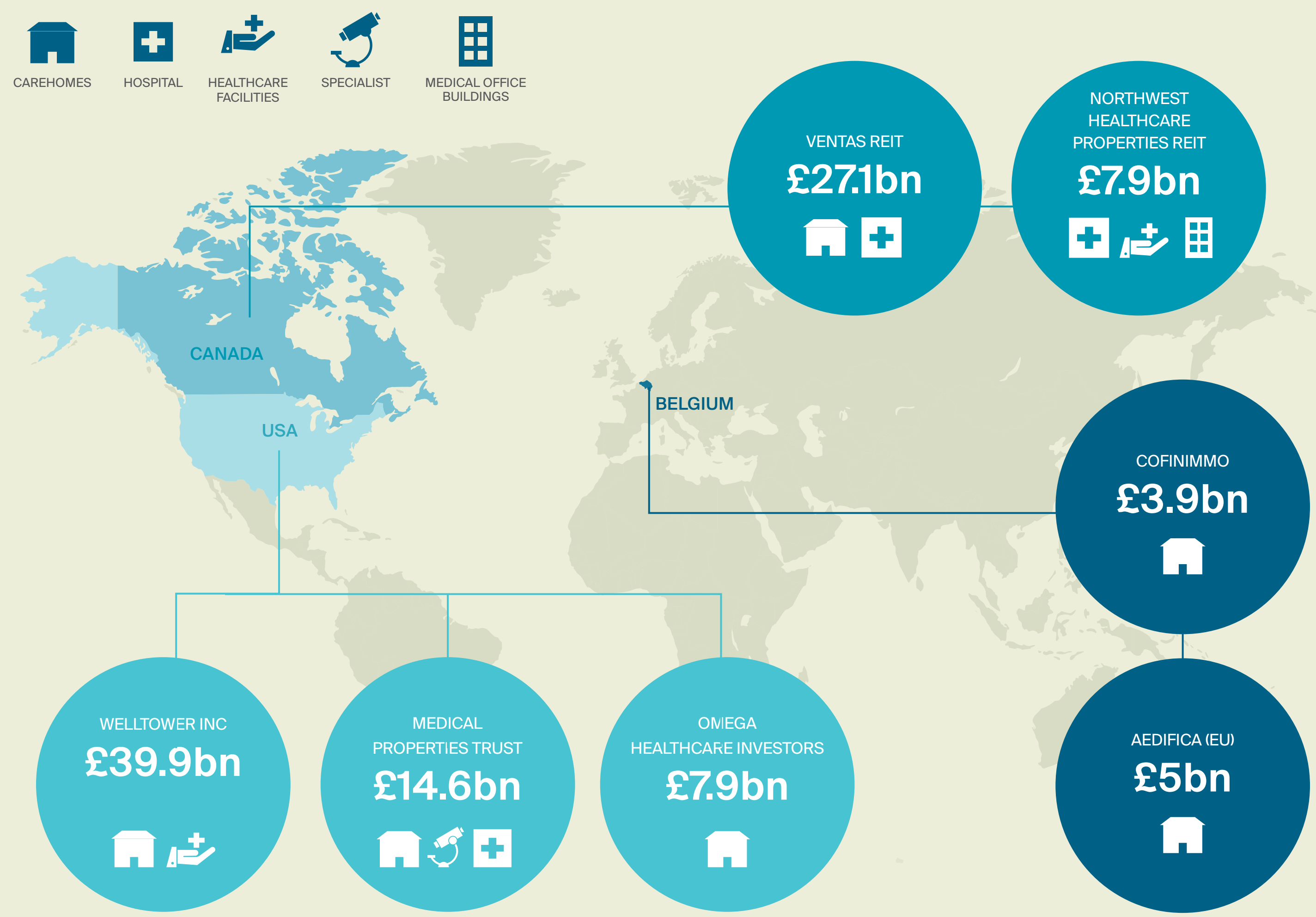
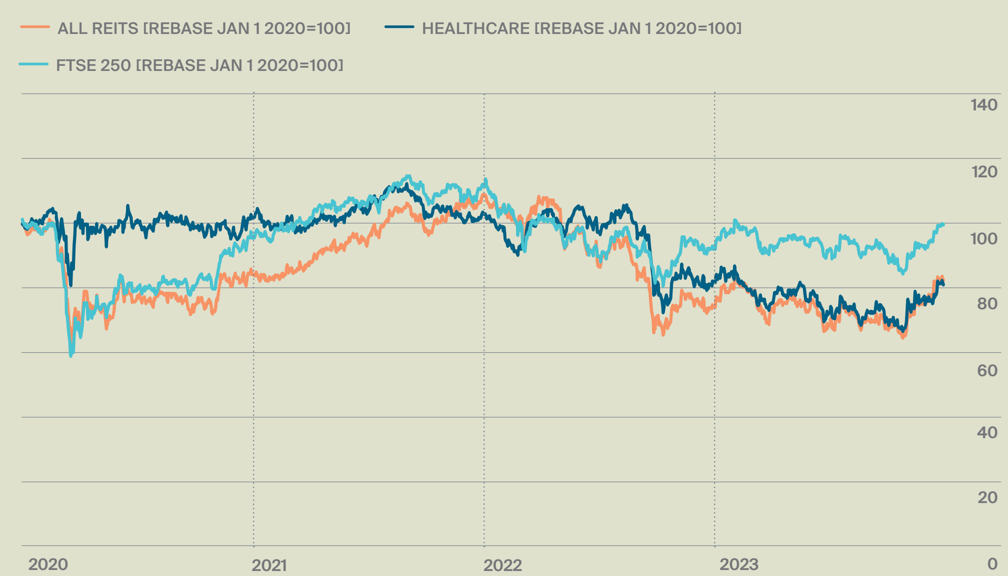


Fig 23: Healthcare REITs vs all REITs vs FTSE 250



Source: Macrobond, Knight Frank

UK HEALTHCARE REITS IN NUMBERS

- **6** Key UK healthcare REITs
- **1,973** Combined number of assets
- **£8.68bn** Combined asset value
- **£510m** Combined annual rent roll
- **16.3yrs** Average WAULT

Childcare

Does investment in Education add up?

ANNE COPELAND
Non Executive Director

This market insight looks to demonstrate that:

- Education is an overlooked sector and has many of the same characteristics as Healthcare or Housing for an Investor.
- Alongside Health & Housing, Education can be part of the solution for investors seeking Impact.

Education is an overlooked, less well-understood sector.
Investors are looking beyond the return characteristics of real assets, and additionally seeking positive E, S & G outcomes. Investment in essential needs-based services in sectors comprising Health, Housing, and Education 'together' the "three pillars" of social infrastructure can be part of the solution. A key feature of investment in social infrastructure is a long and stable income return for investors through long-leases (typically 20yrs +) with annual index-linked rents. Successful investment is underpinned by the right alignment between the capital provider and the operator at the start, though the setting of appropriate rent with sustainable rent covers and rental increases with collar/cap.

But perhaps less is known or understood about the role an allocation to Education can play in building a social infrastructure portfolio. What are examples of education assets and what are the drivers to performance? AlphaReal estimate the unmet demand in education is circa £12bn, and overall, the un-met demand when combined with Health and Housing is circa £50bn.

Day nurseries providing accessible, quality early years education not only improve outcomes for children but also have a direct benefit to UK plc. In January 2023, the Centre for Progressive Policy (1) identified a lack of accessible, affordable childcare as a key barrier to growth and particularly to women's full participation in the labour market. It's noted that if women had access to adequate childcare services, and were able to work the hours they wanted, they would increase their earnings by between £7.6bn and £10.9bn per annum – generating up to £28.2bn in economic output per annum. The importance of the sector has been recognised by the Government in the extension of support to working families through the provision of an extension to free childcare coming into effect during 2024 and 2025.

SEND schools provision outside the mainstream school setting is tailored for those children and young adults with the most acute learning needs and disabilities. Indeed, SEND provision falls within local authority 'high needs budgets' through dedicated schools' grants. A lack of access to appropriate provision, especially at the higher acuity end has a detrimental impact on a person's working life and beyond in terms of their physical and mental wellbeing. Whilst there are concerns about the costs associated with SEND provision there is evidence of improved outcomes if we compare the proportion of individuals with SEND who in later life becomes NEETS (not in education, employment, or training). In discussions with specialist SEND operators the percentage of their cohort who go on to become NEETs is circa 20%. This compares very favourably with the outcomes for a similar cohort who are educated at mainstream school settings where the equivalent number is circa 80%.

Education can be part of the solution for investors seeking Impact.
Investors are now looking beyond the return characteristics of real assets, and additionally seeking positive E, S & G outcomes. And that is where investors capital has a key role. It is imperative that investors capital is allocated to impact strategies effectively and efficiently. Investing in sectors such as Education, alongside other essential, needs based sectors such as Health and Housing, with specialist managers, can deliver improved outcomes for individuals, their families, and wider society through better access to more appropriate facilities without compromising on investment returns.

For example for Day Nurseries, the key impact indicators could include increased attainment, all-round wellbeing, and behaviours, together with freeing up a parent/guardian to join/rejoin the labour market or increase hours, which positively contributes to GDP. For the child these can be measured and tracked through the Early Years Foundation Stage (EYFS) Early Learning Goals (0-5 yrs.)

For example for SEND schools SEND schools, the key impact indicators could include increased attainment, all-round wellbeing, and behaviours. For these children and young adults these can be measured and tracked again through independent regulator assessment with Ofsted reports focussing on 4 areas of performance being Leadership, Quality of Education, Behaviour & Attitudes, and Personal development.

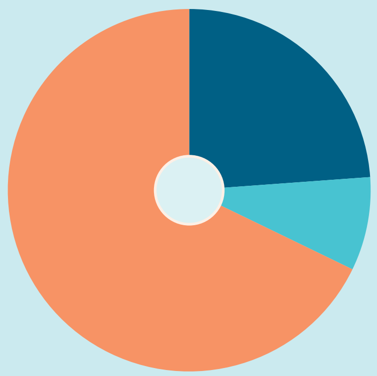
Looking beyond 'S'...'G' - Just like Health and Housing, Education is a highly regulated sector. Whilst regulation is never perfect, it has raised standards over the last twenty years or so. Moreover, the advent of 'friends and family' reviews has been widespread beyond healthcare into education sectors such as day nurseries. This provides a lens into which to judge the real time experiences of individuals and families using these settings.

'E' – Investment in education can allow a re-furnishment 'first' approach through taking vacant buildings and converting them into fit for future educational settings with long-term leases to operators. At AlphaReal this approach has led to more efficient buildings (through improved EPCs), lowering energy costs for tenants plus. The wider environment is boosted through re using existing buildings generating embodied carbon savings equal to 5-11 years energy in use. Given most buildings we see today will still be around in 20/30yrs time making these future fit for occupiers especially those delivering essential needs-based services such as in education (whilst protecting investment value) is a key challenge for UK plc.

This insight has shown that:

- Education is an under-represented sector for investment and has many of the same features as Healthcare or Housing for an Investor.
- Alongside Health & Housing it can be part of the solution for investors seeking Impact.
- A combined 'Three Pillars' approach provides investors with a diversified risk profile whilst maximising the range of impact delivered without compromising on returns.

Childcare buyer Composition

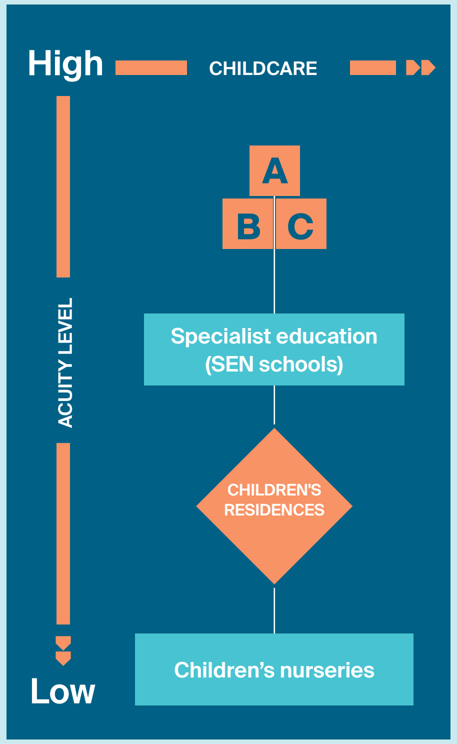


- Institutional
- Private Investor
- Undisclosed

Key transaction

£2.5m

DATE Q2 2023
DEAL VALUE £2,500,000
BUYER NAME NewCore Capital Management
BUYER TYPE Institutional
NOTES SEN school as part of 3 property portfolio deal
VENDOR TYPE Undisclosed
ASSET TYPE Childcare
TRANSACTION TYPE Domestic



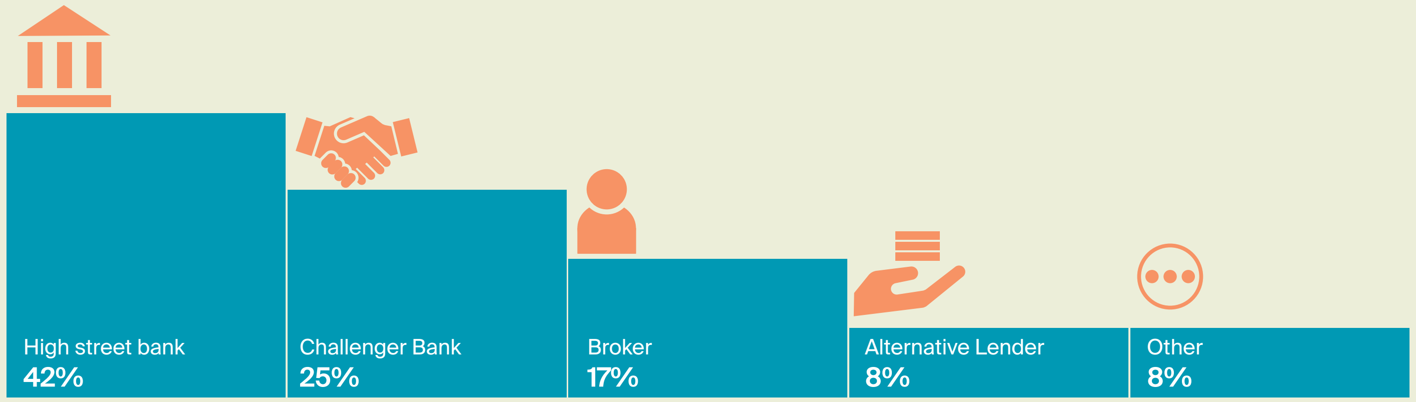
Yields

Childcare	2024	2023	2022	2021	2020
Prime	5.5-5.75	4.5-5	4.75	5	5
Secondary	6.5-7	5.75-6.5			
Tertiary	7+	7+			

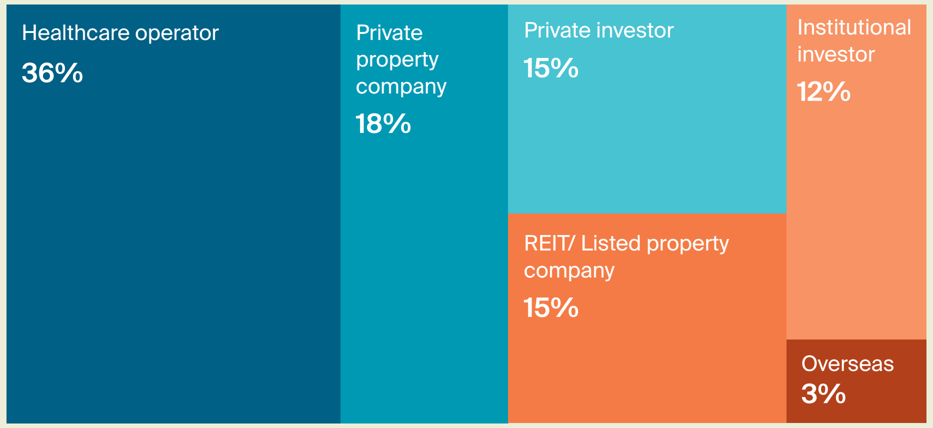
Debt survey

As always, on the ground data is extremely valuable in understanding the state of the market. We have therefore surveyed a number of the sector's participants on the debt side.

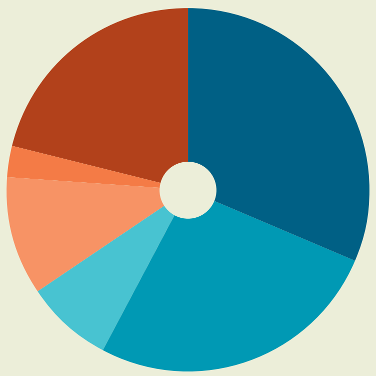
Type of Company



Key borrower categories

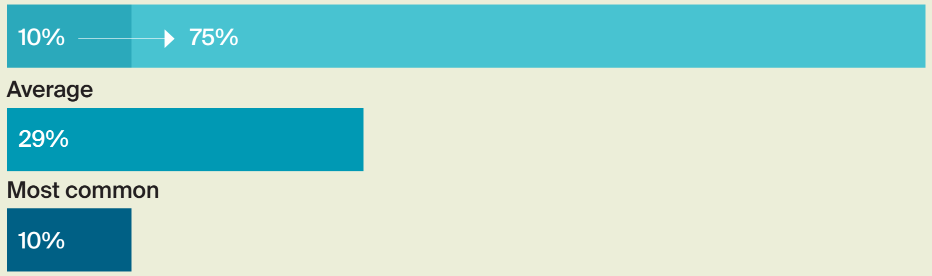


Subsector(s) of healthcare currently lending in to

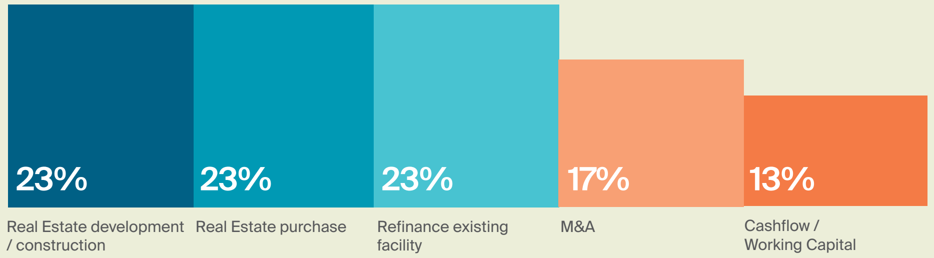


Elderly care	32%
Adult/Supported living	26%
Private hospital	8%
Primary care	11%
Children's Residential Services / SEN Schools	3%
Childcare	21%

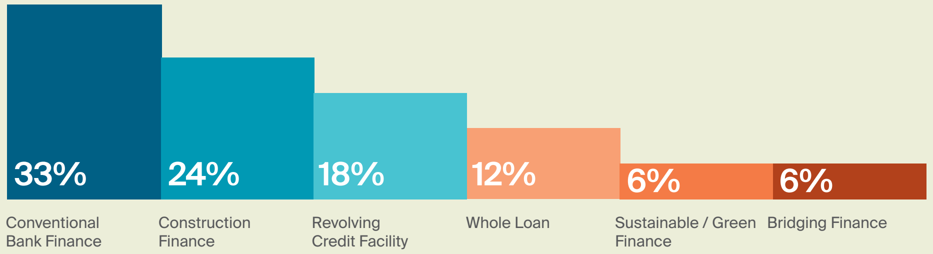
Approximate percentage of respondent's firm's lending work attributed to healthcare?



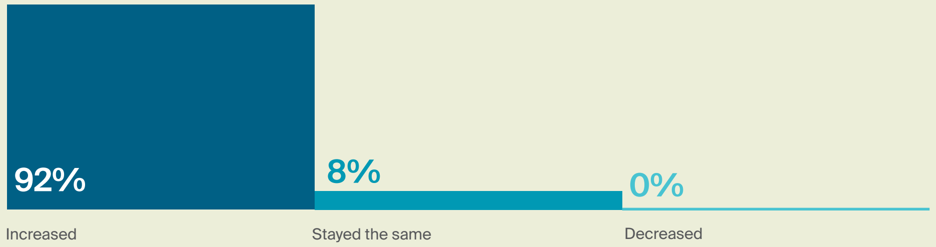
What is the general purpose of debt you provide to your borrowers?



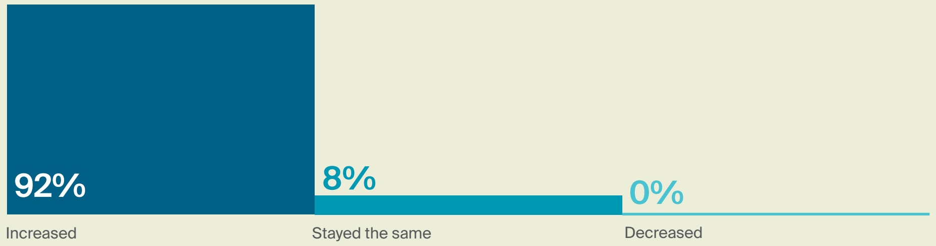
What type of debt facilities do you provide your borrowers?



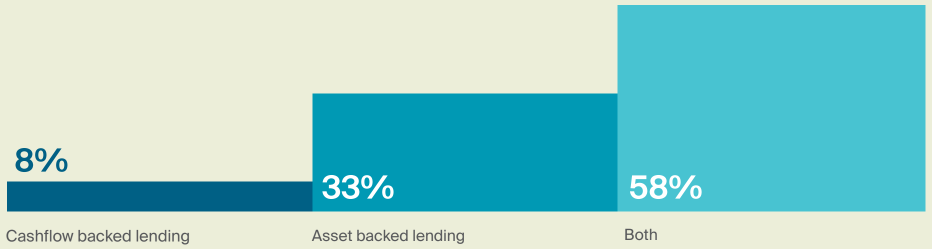
Over the last 5 years has your exposure to healthcare:



In terms of overall lending do you plan to increase or decrease exposure to healthcare?



Which category does your lending activity tend to fall into?



Average term across respondent's healthcare lending

4.6yrs

(5 year term the most common)

Respondent's approximate exposure to healthcare

£8.1bn

Average rate of interest across healthcare lending

Range:

2.6-8%

Average:

3.94%

'Interest Coverage Ratio' across healthcare lending?

1.5x-2x

'Loan to Value' across healthcare lending?

Range:

43%-70%

25-75bps

Where there has been a price increase. However, many have reported a 0% increase in the past year.

£1m-£25m

Loan Sizes

Debt market update

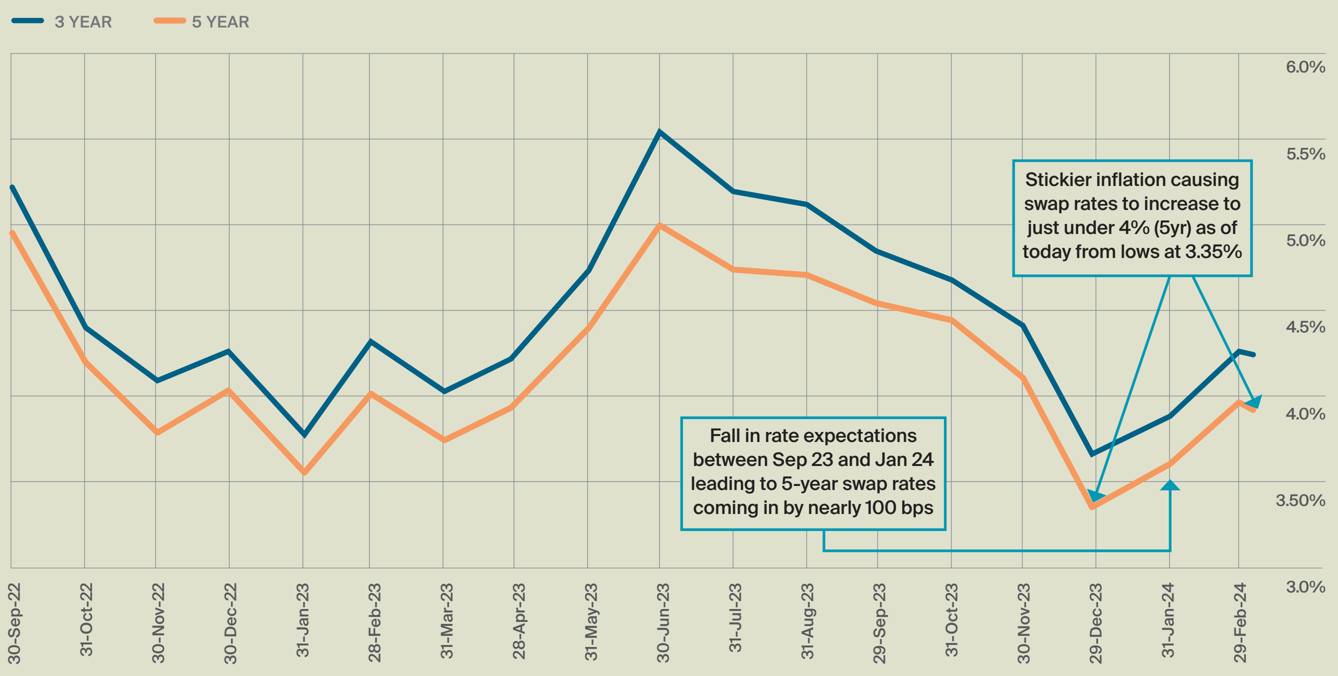
The UK debt landscape today is characterised by deep liquidity provided by a far broader range of lenders than the market has seen historically. The growth of the of non-bank lender has been a feature for a number of years however 2023's spike in interest rates spearheaded a significant uptick in new entrants driven by a range of tactical and strategic objectives. Meanwhile a few established players used the favourable conditions to raise significant funds, embedding themselves as today's relationship lenders of the future. As market confidence grows that rates will decline, this is underpinning greater transactional activity, which combined with the depth of liquidity in the debt market provides for compelling opportunities for investors.

Back in September 2023 the forward curve showed market expectations of rates peaking at 5.65% in December 2023, falling to a trough of 3.8% in December 2029. 5 year SONIA swap rates were 4.5%.

As at the end of January 2024 peak expectations had fallen to 5.21%, and trough expectations had also fallen to 3.3% but had come in by nearly two years to January 2028, bringing SONIA 5 year swaps down by nearly 100bps to 3.6%

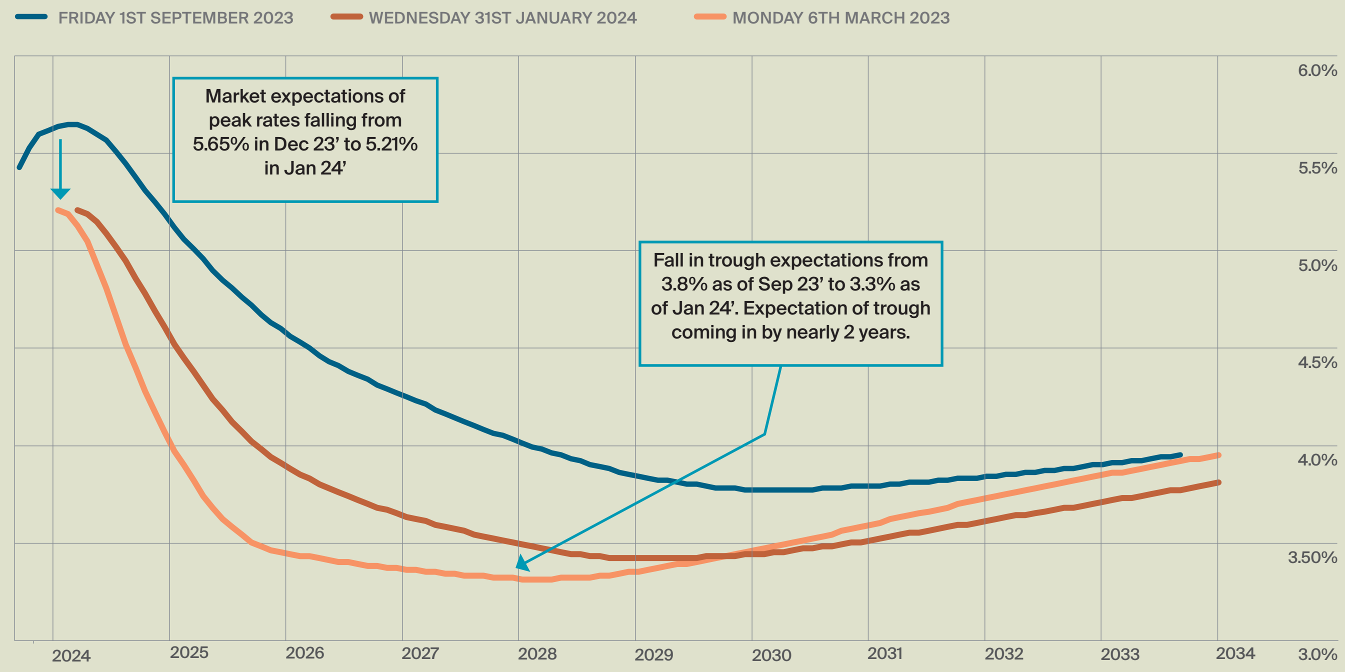
The swap rates actually bottomed in December 2023 with 3 year SONIA at 3.66% and 5 year SONIA at 3.35%, and today stickier inflation has caused rates and forward curve expectations to increase again to just under 4% for 5 year SONIA (as at the time of writing) however the underlying fundamentals of a pivot from a rising interest rate environment to expectations of a falling one, together with a wider market adjustment to what is now understood to be a new era of higher inflation and higher cost

Fig 24: 3 & 5 Year SONIA Historical Swap Rates



Source: Knight Frank Capital Advisory

Fig 25: SONIA Forward Curves Historical Data



Source: Knight Frank Capital Advisory

of debt has provided a backdrop which is underpinning confidence again in underwriting expectations with benefits to borrowers and lenders alike.

The impact of this new 'higher for longer' cycle has also supported significant fundraising from non-bank lenders, and renewed lending appetite amongst particularly high street banks. This depth of liquidity is enabling borrowers to obtain competitive terms on both pricing and structure.

Within the healthcare sector, different lender pools are servicing all parts of the risk spectrum and capital stack. For stabilised assets with leverage up to 50-55% LTV or up to 5.0/5.5x Net Debt / EBITDAR, and healthy coverage metrics, investment-grade senior pricing of around 200bps or even under is achievable from a range of lender types, but most typically the banking community and non-bank lenders which benefit from low-cost insurance capital. Higher leverage, up to 70/75% LTV and 6/6.5x Net Debt / EBITDAR, subject to a debt yield of 6.5-7.0% and a demonstrable upwards headroom trajectory is well serviced by the non-bank lender community but will typically attract margins of 400bps or above.

As rates begin to fall, we will see how this impacts non-bank lender pricing which, to date has been competitive. There will undoubtedly be a complex interplay between returns requirements, SONIA floors, competition, and the growing bifurcation between lenders who have access to low-cost insurance capital and those who do not. However as a defensive asset class benefiting from an operational risk premium, the healthcare sector is likely to benefit from these market movements as lenders lean into the sector for its inflation-protected cash flows, underlying supportive demographic fundamentals, and higher margins.

One area which we have seen less of recently, but which is expected to grow in the medium term is OpCo financing. The greatest depth of lender liquidity remains for transactions which retain security over the underlying real estate, where both PropCo and WholeCo structures are commonplace. However, as the sector's operational performance begins to show a demonstrable recovery back to pre-pandemic levels, we can expect that the traditional OpCo PropCo and sale and leaseback models, will begin to come back into the market, and OpCo financing liquidity will follow.

2.9%

Current expectations show inflation reducing to 2.90% by the end of the year, which will be hugely welcomed and should signal the end of monetary tightening.

Private equity in healthcare Q&A

David Porter
Founding Partner
Apposite Capital LLP

David has over 30 years of experience in private equity and investment banking. He has advised on a wide range of companies and at Apposite, he serves or has served on the Boards of Crestoptics, Habitus, 1Med, MC Care Holdings, NIMGenetics, Swanton Care, CancerPartnersUK, Ulthera, Zonare and Xthetix. Prior to co-founding Apposite in 2006, David worked on a number of large leveraged buy-outs with Nomura's Principal Finance Group. He then founded and headed Nomura International's healthcare investment and corporate finance groups. David has been the CEO of a number of companies, including CLF Municipal Bank, an authorised bank. David is very involved in the UK healthcare industry, having served as a member of the UK government's Health Reform Group looking at reforms to the provision of healthcare to NHS patients and on the London Health Commission. David has a degree in Chemistry from Oxford University.

Q: What would you describe as the key drivers that make the healthcare sector attractive for private equity investment?

Constant growth in demand (aging population, growth in chronic disease etc.)

Pretty recession proof (healthcare is an essential need)

Innovation leads to change that produces opportunity.

Lots of opportunity for operational improvement.

Regulation and the need for quality enables barriers to entry to be built.

High impact sector.

Q: What makes private equity a good fit as a strategic partner for operational care businesses?

Alignment of interests.

PE's ability to assist with operational improvement (automation, digitisation, professionalisation, staff quality etc.)

Focus on quality.

Buy and build expertise (DD, PMI etc.)

Focus on impact.

Q: As ESG and impact investing feature within your strategy. Is there, in your opinion, an optimal split between social impact and conventional investment returns. And, how do you go about achieving this?

There is no optimal split between impact and investment returns as achieving impact by high quality and growth of the service achieves impact aims and ensures increasing revenues and EBITDA.

High quality provision builds barriers to entry, commissioner, family and users support which assists with growth and margin etc.

Q: For a long time, more so in terms of the media and press there have been negative views on the relationship between health/social care and private equity. Firstly is this changing? And, how have you managed to avoid this and have there been any key lessons along the way?

The only way for us to improve this issue is to be laser focused on quality and hope that other PE investors do the same.

Q: What areas of healthcare present the most attractive proposition at the moment and how has this changed over time?

Social care is much more competitively priced now and offers value.

Healthcare services which target either NHS waiting lists or private provision, demand for which has been boosted by the high waiting lists will see on-going demand and are more sensibly priced.

Military health is an area of opportunity given current geopolitical issues.

Q: What does a good acquisition look like?

Sensibly priced.

With a clear path to value creation.

For a bolt on, synergistic.

Q: How does your approach differ when considering a service based vs a product based investment?

Different leverage profile (higher for service as usually recurring revenues)

Q: How do you navigate around the various risks within healthcare e.g. reputational risk.

Laser like quality focus.

Appointing management with the appropriate ethos.

Q: We have seen growing demand for healthcare real estate from private capital in recent years. While this is not a new space for private equity in terms of healthcare businesses and M&A, what are your views on the increasing presence of PE within Healthcare Real Estate?

Mildly positive as it should increase resource availability.

Q: What is next for healthcare investment?

Even more focus on automation.

Summary

While 2023 presented as a slow year, there is a silver lining in the fact that this was a trend present across global real estate, and with 2024 starting on a much more positive note, we are optimistic for the year ahead. The sector's fundamental drivers remain strong, and investors are seemingly aware of this, with a number of standout transactions already completed or pipelined for completion this year.

Another sign of the positive sector sentiment is the extent to which we see active domestic capital. 2022 saw REITs and private capital eat into the share of transaction volume attributed to overseas capital. However, 2023's volumes also saw more activity from institutional investors. Consistent and organic transaction levels without large outlier portfolio deals suggest the sector is experiencing sustainable demand. The change in composition between portfolio and single asset deals at smaller lot sizes indicates that investors are also considering upgrading or repurposing existing, less fit-for-purpose assets.

Inflationary pressures, such as staff, energy, and food costs, in addition to higher cost of capital, have been a point to watch for operators and investors alike. This lends a hand to explaining the fallback in overseas capital; however, as returns adjust and panic cools, it is seemingly only a matter of time before these investors look to deploy substantial amounts of capital again. Per our investor sentiment and debt surveys, investors and lenders are well positioned in terms of dry powder and cost of capital for an active year.

ESG continues to drive interest toward the sector, especially with reference to investing for 'Social Impact.' Investors and operators will be keen to service their sustainability targets through care settings and businesses with strong ESG credentials.

The sector remains well capitalised, which, in addition to robust operator trading and the underlying drivers we have mentioned, suggests that healthcare is in a strong position for the long run.

2024 PREDICTIONS

Strong healthcare demand and transaction volume to come

With 2024 starting off on a much more positive note we are optimistic for the year ahead.

Consistent and organic transaction levels in the absence of large outlier portfolio deals suggest the sector is experiencing sustainable demand.

Investors likely to increase activity

As per our investor sentiment and debt surveys, investors and lenders are well positioned in terms of dry powder and cost of capital for an active year.

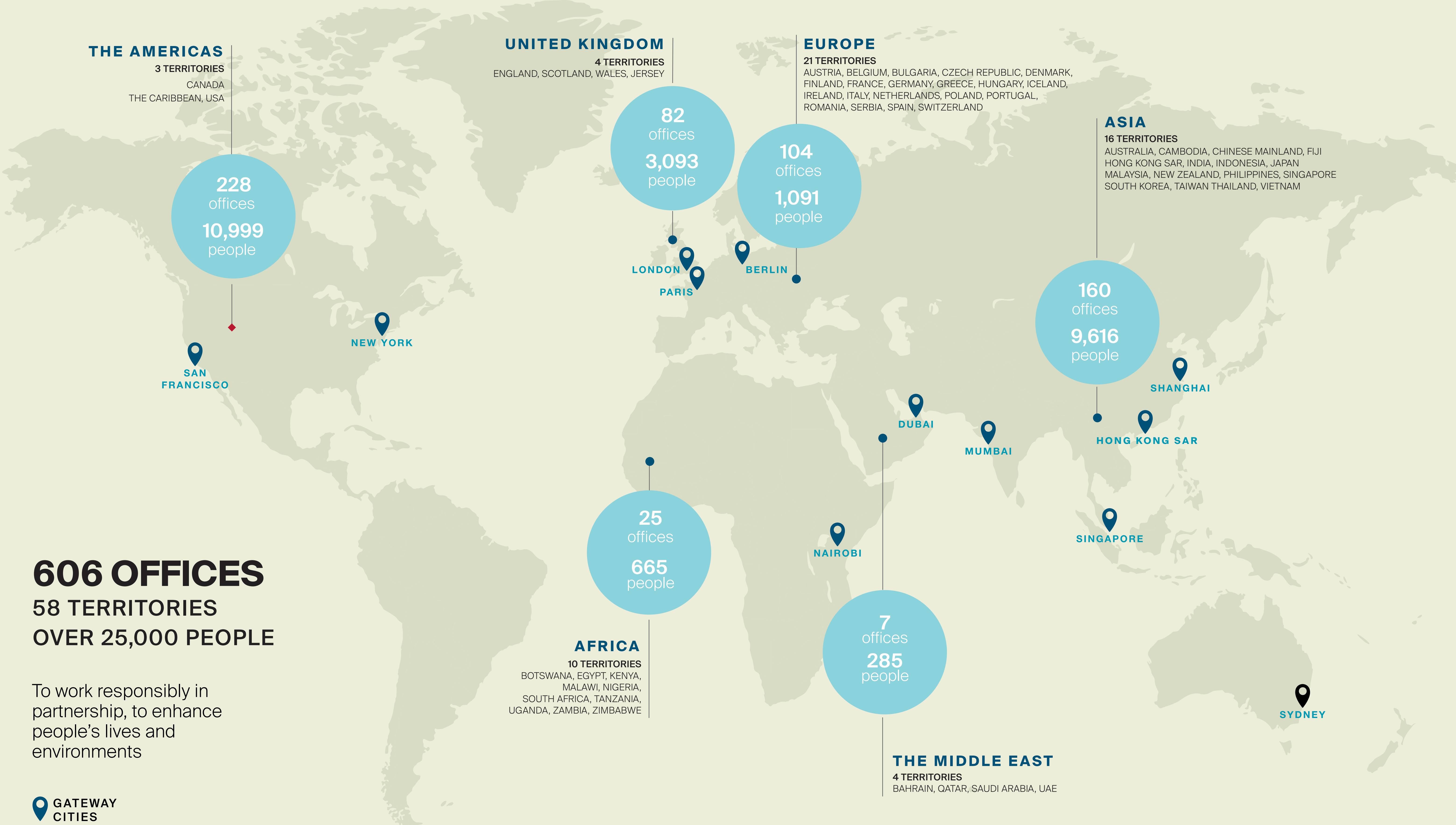
ESG to feature

Investors and operators will be keen to service their sustainability targets through care settings and businesses that boast strong ESG credentials.

Sector's reliance will continue to shine through

Well capitalised investors and lenders, in addition to robust operator trading and the underlying drivers we have mentioned suggest that healthcare is in a strong position for the long run.

Our global network



606 OFFICES

58 TERRITORIES
OVER 25,000 PEOPLE

To work responsibly in partnership, to enhance people's lives and environments

We like questions. If you've got one about our research, or would like some property advice, we would love to hear from you.

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