UK HEALTHCARE PROPERTY MARKET OVERVIEW

WINTER 2021/22

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MARKET SUMMARY

Whilst the stronger than expected margins in 2021 showcase the sector's resilience, they also highlight the combined efforts of operators, their teams, and the UK government in supporting the sector

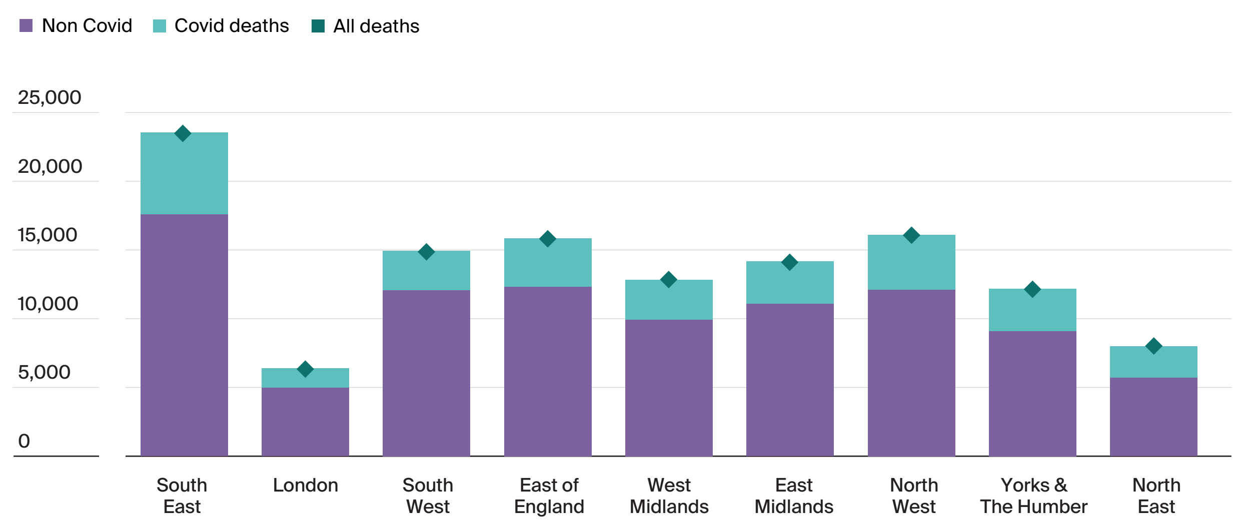
The 2021/22 Healthcare Market Overview will take a look at market trends over the past year as well as presenting a forward view. 2021 presented a number of standout factors which we believe will continue to trend over the coming year.

Covid-19

The outbreak of Covid-19 and the UK healthcare sector's response to such unprecedented circumstances has highlighted the continued resilience and robustness of the sector.

As per Figure 1, we can see the consistency in the management of care home deaths which occurred because of Covid-19 cases. This suggests that whilst occupancy was impacted by the virus the large fall is likely to be a result of the restrictions to admissions imposed during lockdown periods.
Considering the pandemic's impact on occupancy, all care EBITDARM as a percentage of income fell by less than initially expected in 2021. The average of 26.2% still suggests strong trading given the circumstances faced by homes. Operators will now have greater insight into their abilities to withstand future headwinds as well as being better prepared for any future shocks.
Whilst the stronger than expected margins in 2021 showcase the sector's resilience, they also highlight the combined efforts of operators, their teams, and the UK government in supporting the sector. The timing of reduced government intervention however will be an important factor during the sector's return to normal levels.

Fig 1: Care Home CV-19 Vs All Deaths



Source: Gov.uk

Covid-19 may indeed act to accelerate the closure of outdated homes and replace them with high-quality future-proofed assets. Providing further validation to the argument for en-suite rooms with the viewpoint that the benefits of this extend to improvements in home virus control. No doubt, the pandemic will have prompted a change in the way care homes are not only run but also configured moving forward, with particular emphasis placed on internal circulation, air quality and ventilation. Emphasis will also be on transitional space in order to support social distancing.

Occupancy

Average occupancies across the sector will certainly be a matter of interest. Whilst 2021 saw a substantial dip in care home occupancies following the outbreak of Covid-19, operators began to report recovering levels in the mid to latter part of the year. Whilst this recovery is a slow one, many operators are experiencing pre-pandemic occupancy levels once more.

Bed supply

Bed supply remains a topic of concern, despite new beds being developed, the rate at which they are being built and the level of home closures means that supply is not keeping pace with demand. This, in line with the UK's ageing demographic, means that the elderly care market is now at risk of reaching capacity by the end of the decade.

Much of the market is also in need of an upgrade due to being made up of older converted stock that lacks essential en-suite facilities which are becoming increasingly unfit for purpose.

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Build costs

A combination of the global pandemic's effect on factory supply, ports and rising shipping costs has seen the cost of raw materials such as aggregates, timber, and steel with increased labour costs slow new build delivery over the past year.

Although this is a clear issue alongside the increasing cost of finance, appetite for UK healthcare is strong due to its underlying drivers of demand. We can therefore expect new care home development to remain active in 2022 whilst sale & leaseback / forward funding, challenger banks and conventional banks re-entering the market aid the unlocking of funding.

Staff costs

The 2021 Knight Frank Trading Performance survey has highlighted a growth in nurse and carer wages. Average nurse wages per hour sat at £17.38, up 2.9% from last year, whilst average career wages per hour were up 5.4% at £9.23.

Despite both growing at a higher rate than the National Living Wage per hour, which currently sits at £8.91, government announcements regarding the new National Living Wage of £9.50 from April 2022 is likely to impose further upward pressure on these averages especially in the hourly rate of carers. With labour shortages and Brexit also as contributing factors, this cost inflation may indeed filter through into weekly fees.

ESG

The 2021 Knight Frank Active Capital report highlighted the importance of sustainability as a fundamental of modern-day real estate strategies. The report suggests a 8-18% sales price premium for green-rated buildings.

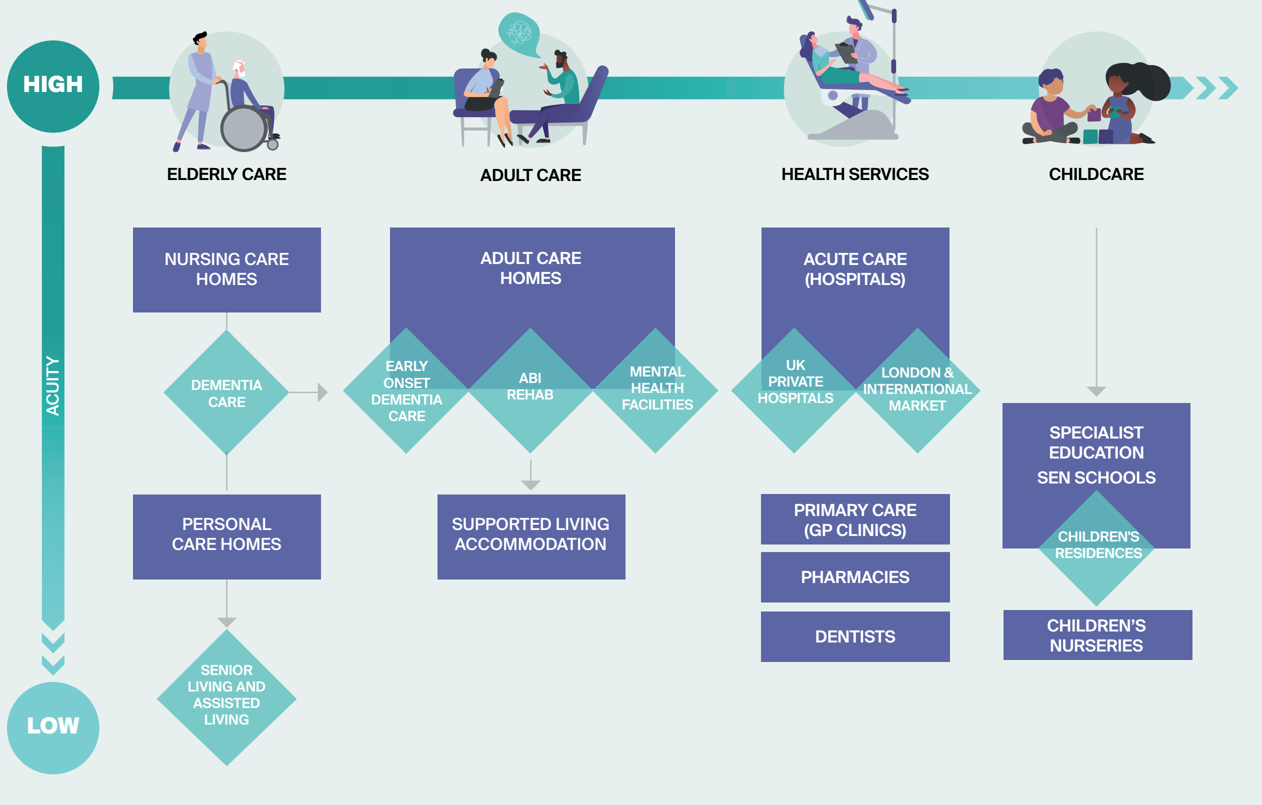
Global investor and occupier demand for sustainable buildings continues to rise, as does the proposition of sustainable / green finance from lenders, whilst the case for placing institutional money into ESG strategies grows.

This in tandem opens the discussion of the importance of ESG within the market for care related assets. Unlocking sustainable development of new homes will become more important whilst the social aspect of ESG will direct attention to how operators and investors align their investment and operational activity the UN Sustainable Development Goals.

Julian Evans, FRICS
Partner, Head of Healthcare

HEALTHCARE PROPERTY MARKET STRUCTURE

Fig 2: Market structure



Source: Knight Frank

As a sector, healthcare encompasses several subsectors spanning a range of acuity levels. This stretches from the more conventional care settings such as elderly care and residential care to childcare which includes nurseries and special educational needs.

Whilst broad in its coverage, the case for investment into the sector remains consistent across the various sub-sectors. Firstly, the emergence of a global pandemic has highlighted not only the robustness of healthcare as an asset class but also its genuine importance as a sector. Government intervention, nationwide appreciation of the NHS and a backlog of admissions all highlight its significance and its ever-steady demand. As Private Equity, REITS and institutional investors continue to chase the strong long income generated, there is growing interest in healthcare's capabilities to aid ESG investing strategies.

Figure 2 above presents us with a visual representation of the market's broadness, any relevant overlaps as well as where they sit in terms of acuity levels.

CHILDCARE:

Special educational needs relates to the provision of services to pupils with high learning needs. This is likely to be structured into smaller groups than that of standard schools. For-profit providers account for circa 75% of total independent school places, whilst college places are dominated by not-for-profit providers.

Special Educational Needs demand is driven by the growing number of young individuals being highlighted as needing additional educational support as well general population growth.

A recent gov.uk survey states approximately 1.5 million childcare places across childminders, group based and school-based providers. Like SEN, demand for Nursery has and continues to strengthen due to the growth in the general population. The sector continues to see interest in both the smaller independents and larger group operators from private equity lead capital.

RECENT DEAL

DEAL TYPE Portfolio	**VALUE (£M)** £34m	**PURCHASER** LXi REIT Plc
DESCRIPTION Nursery School Portfolio	**DATE** Q3 21	**CATEGORY** REITS & Listed

ADULT CARE:

Adult care focuses on the delivery of services including but not limited to, Learning Disability, Mental Health and Acquired Brain Injury (ABI) to those of working age (currently 18-64). As a sub-sector it is heavily dominated by independent operators who account for over 90% of the market.

RECENT DEAL

DEAL TYPE Portfolio	**VALUE (£M)** £17m	**PURCHASER** Achieve Together
DESCRIPTION Healthcare Portfolio	**DATE** Q4 21	**CATEGORY** Occupier

HEALTH SERVICES:

Health services as a subsector begin with Hospitals at the higher end of the acuity scale, with lower acuity services such as GPs, pharmacies and dental practices following on.

The pandemic has seen a growth in the remote aspect of consultancy-based service provision, mainly as a means of infection control. GPs have shifted towards telephone consultations as a first line of contact whilst the use of digital pharmacies has grown.

Primary care facilities despite having tighter yields than other areas of healthcare, continue to attract the interest of key players in the space, such as Primary Health Properties and Assura.

RECENT DEAL

DEAL TYPE Single asset	**VALUE (£M)** £5.34m	**PURCHASER** Primary Health Properties
DESCRIPTION Bersted Green Surgery	**DATE** Q4 21	**CATEGORY** REITS & Listed

ELDERLY CARE:

Ranging in acuity levels in this space means that we have elderly care homes that are either nursing or personal care-focused, both with the capability to support residents in need of dementia care.

With 480,072 beds across 12,034 homes in supply currently, elderly care continues to attract investors in search of an asset class with timeless demand. With the UK's over 65's set to reach 15.3 million by 2030 and 18.8 million by 2050, there will soon be significant undersupply which suggests investors can feel confident in the demand for both the real estate and operational businesses.

RECENT DEAL

DEAL TYPE Portfolio	**VALUE (£M)** £57m	**PURCHASER** Cofinimmo SA (Belgium)
DESCRIPTION Country Court Portfolio	**DATE** Q3 21	**CATEGORY** Overseas

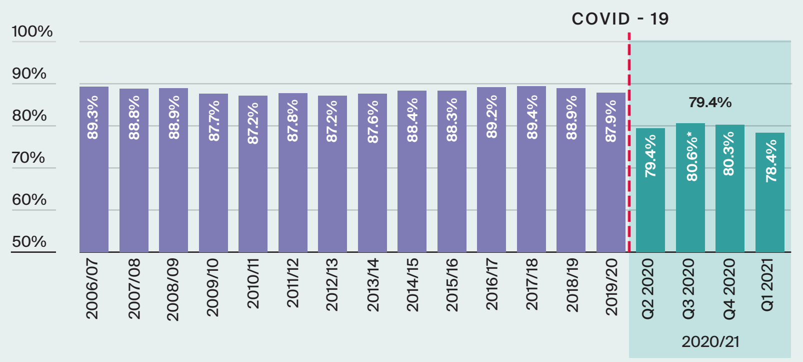
OPERATOR TRADING

Whilst both the Local Authority and Private Pay markets have experienced uplifts in their fee levels, Local Authority fees have seen stronger increases jumping by 8.8%

2021 occupancy levels were down year-on-year averaging at 79.4%. Figure 3 shows the quarterly changes in occupancy tracked since the outbreak of Covid-19 which sat consistently with the overall level for the 2020/21 financial year. This however was very much expected given the pandemic's effect on the sector amplifying the usual issue of care home mortality rates. Despite the dip experienced in 2020/21, operators are now generally reporting improving rates of occupancy and we are confident that this will continue towards the occupancy levels in the high eighties, experienced pre-pandemic.

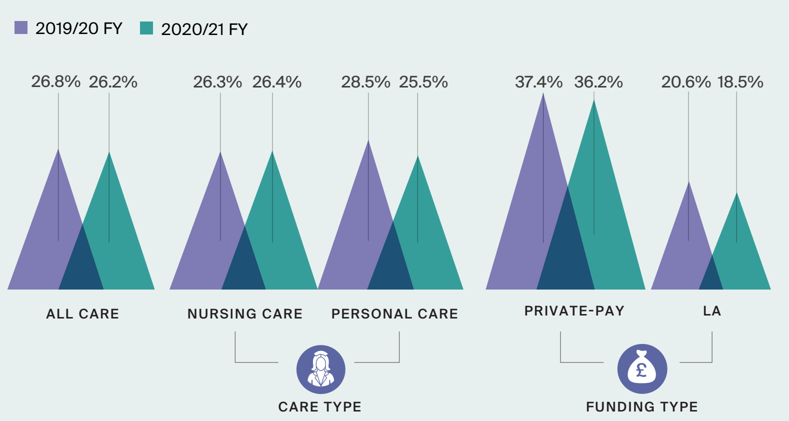
As per Figure 4, 2021 saw an overall downward trend in EBITDARM margins with the exception of Nursing Care where the margin improved slightly by 0.1% on the previous year. Whilst there was a general fall, it is important to note that EBITDARM margins held better than expected levels. An example of this is Private Pay homes which achieved margins at 36.2% of income, which can be considered extremely positive given the headwinds.

Fig 3: UK care home occupancy



Source: Knight Frank

Fig 4: EBITDARM margins, 2019/20 2020/21



Source: Knight Frank

SUPPLY & DEMAND

Positive sector sentiment remains intact

The long-term drivers of the healthcare market provide an attractive outlook for investors, as the UK demographic shift and a growing need for elderly care beds over the next 30 years will continue to attract investors seeking long income due to the 20-30-year lease terms available. Healthcare amongst other alternative assets will also interest those investors looking to adjust allocations and re-weight their portfolios away from the more conventional classes such as retail, for example. As well as ESG positively driving institutional capital into social care and senior living.

Whilst we did not see the record volumes recorded in 2020, Figure 5 highlights strong transaction volume given the conditions facing the sector. It is also important to note that volume in 2020 was aided by large portfolio sales such as Medical Properties Trust's acquisition of 30 BMI hospitals for circa £1.5 billion.

As well as domestic demand, overseas capital continues to feature prominently amongst transactions due to a mix of European operators and REITs such as the likes of Korian and Cofinimmo. The early investor caution seen at the outset of the pandemic seems to be fading as the sector slowly moves towards normality.

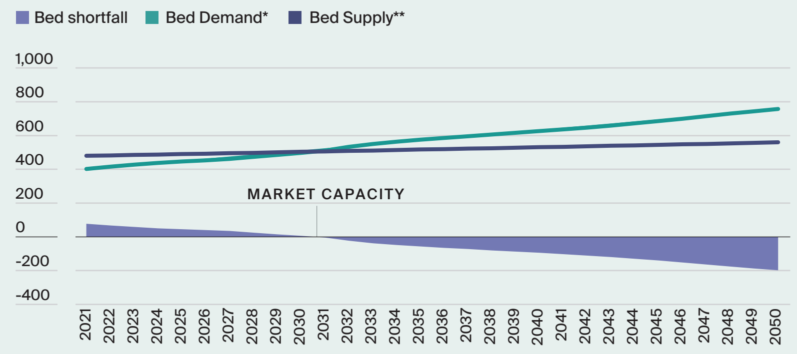
Supply of bedspace remains a concern amongst ageing demographic

Current projections continue to suggest that we must build more care homes to service future demand. Figure 6 shows the growth in our elderly population will potentially lead to an additional demand for care beds of around 350,000 people by 2050, almost doubling current demand. Despite new beds being developed, continued home closures mean that supply is not keeping pace with demand, with the UK elderly care market at risk of reaching capacity by the end of the decade. It is vital that we build more care homes as well as provide support for existing homes and operators to future proof the current residential elderly care system.

Fig 5: Recorded healthcare property investment

Source: propertydata.com

Fig 6: Projected shortfall of elderly care beds (000s)



Sources: Knight Frank, Laing Buisson, Tomorrow's Guides, ONS, BMJ * Excess deaths in 2020 have been built into this projection. ** Future supply is based on the growth rate seen between 2011 and 2021.

KNIGHT FRANK: HEALTHCARE SERVICES

Knight Frank's Healthcare team annually advises on in excess of £12bn of healthcare assets and act for the vast majority of the UK's major operators, funds, investors and lenders in the sector.

Healthcare property specialists

The healthcare industry remains one of the fastest growing markets across the globe. Knight Frank's Healthcare team is valuer to the majority of the UK's major operators, funds, investors and lenders in the sector. Our network of UK offices enables our team to act for care providers, investors, developers and lenders to offer real estate services to the healthcare industry that are second to none. Knight Frank's dedicated and highly experienced team provides a discreet and efficient consultancy service, advising on the full spectrum of healthcare assets including:

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- Specialist adult care homes
- Independent hospitals
- Acute hospitals
- GP Surgeries
- Dentists and pharmacies
- Schools and day nurseries
- Supported living and retirement villages
- Development sites

Our services

- Strategic consultancy
- Development consultancy
- Sales & acquisitions
- Valuation
- Portfolio consultancy
- Research and feasibility studies
- Building consultancy and surveys
- Planning consultancy
- Lease advisory
- Property asset management

Why choose us?

Our award winning Healthcare team continues to be recognised as leaders in their field. In taking time to understand the needs and objectives of our clients, we continue to provide uncomplicated property advice and solutions that add value at every stage.

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Healthcare Capital Markets – 2021

European Healthcare – 2021

Healthcare Development Opportunities – 2021

Care Home Trading Performance Review

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We believe personal interaction is a crucial part of ensuring every client is matched to the property that suits their needs best – be it commercial or residential.

Operating in locations where our clients need us to be, we provide a worldwide service that's locally expert and globally connected. As a partnership, we are independent, debt free and not beholden to external shareholders. We believe that inspired teams naturally provide excellent and dedicated client service. Therefore, we've created a workplace where opinions are respected, where everyone is invited to contribute to the success of our business and where they're rewarded for excellence. The result is that our people are more motivated, ensuring your experience with us is the best that it can be.

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Our prime sales network is involved with the most prestigious residential properties around the world. Our integrated global network and ability to identify unique investment opportunities, combined with our unrivalled access to HNWIs, places us in an unparalleled position of strength.

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Occupier services & commercial agency

At Knight Frank we offer a different approach, providing expert advice to tenants and landlords across the global office market. We deliver real value through carefully formulated property strategies and robust negotiation, in prime business districts for landlords, multinational businesses and local occupiers.

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Global Corporate Services (GCS) provide a full suite of portfolio management, consulting and transactional services to multimarket corporate occupiers, globally. Our account teams in London, New York and Hong Kong manage service delivery through the expertise in our local offices, across all service lines.

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Our Knight Frank Valuation experts provide a comprehensive range of single and portfolio valuations, market appraisal and consultancy services across both the commercial and residential sectors.

With a wide skill-set spanning from retail to student property, we have the ability to draw upon our significant global network of Capital Markets, Leasing, Occupier and Research industry specialists, allowing us to add value for our clients, rather than merely reporting. We provide extensive valuation services to financial institutions, private individuals, funds, property companies and the public sector.

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OUR MISSION

A fully integrated global healthcare and senior living real estate advisory team. Globally connected, locally expert.

In the developed world (Europe, North America, Oceania, and Japan) the percentage share of over 65s is expected to grow from **19% to 26.6% by 2050**

The global elderly population (over the age of 65) is projected to grow from circa **700 million to 1.5 billion by 2050** (United Nations Department of Economic and Social Affairs)

Mark Gallagher
Executive Managing Director

Todd Perman
Vice Chairman, Global Healthcare Services

Chad Lavender
Vice Chairman, Healthcare & Alternative Real Estate Assets

Norm LeZotte
Senior Managing Director

Our healthcare and senior living teams annually **advises on £150bn of healthcare and senior living assets** and act for the leading global operators, funds, investors and lenders

32% of global commercial real estate volumes are **attributable to private capital**

Shehzad Jamal
Partner, Healthcare

Saurabh Mehrotra
National Director - Valuation & Advisory

Julian Evans
Head of Healthcare

Tom Scaife
Head of Senior Living

Neil Brookes
Head of Capital Markets, Asia Pacific

Russell Allison
Head of Health, Aged Care & Retirement

22% of the world's billionaires are clients of Knight Frank

OUR PEOPLE

Agency and Development

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

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

Joe Munro, MRICS
Surveyor
+44 20 3866 7816
joe.munro@knightfrank.com

Rory Addison, MRICS
Surveyor
+44 20 7861 1063
rory.addison@knightfrank.com

Mandip Bhogal, ACCA
Associate, Development Consultant
+44 20 3869 4702
mandip.bhogal@knightfrank.com

Robert Stott
Analyst
+44 20 7861 1152
robert.stott@knightfrank.com

Julian Woolgar, MRICS
Partner, West End
+44 20 7861 1008
julian.woolgar@knightfrank.com

Alyssia Clare
Personal Assistant
+44 20 3967 7124
alyssia.clare@knightfrank.com

Megan Wright
Team Secretary
+44 20 3866 8002
megan.wright@knightfrank.com

Corporate Consultancy

Patrick Evans, MRICS
Partner
+44 20 7861 1757
patrick.evans@knightfrank.com

William Freston, MRICS
Associate
+44 20 7861 1564
william.freston@knightfrank.com

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

Deborah Joynt, MRICS
Consultant
deborah.joynt@knightfrank.com

Bianca Moore
Office Manager
+44 20 3826 0604
bianca.moore@knightfrank.com

Commercial Valuations

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

Rick Tarver, MRICS
Partner
+44 20 7861 1534
rick.tarver@knightfrank.com

Commercial Valuations Cont.

Iain McGhee, MRICS
Partner
+44 141 566 6026
iain.mcghee@knightfrank.com

Bela Chauhan, MRICS
Associate
+44 20 3897 0037
bela.chauhan@knightfrank.com

Joseph Hardy, MRICS
Associate
+44 20 3897 0018
joseph.hardy@knightfrank.com

Ella Davenport
Graduate
+44 20 3307 4138
ella.davenport@knightfrank.com

Genevieve Lewis
Team Secretary
+44 20 7861 1164
genevieve.lewis@knightfrank.com

Research

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

Senior Living

Tom Scaife, MRICS
Partner
+44 20 7861 5429
tom.scaife@knightfrank.com

Building Consultancy

Charles Ingram-Evans,
BSc Hons, MRICS
Partner, Project & Building Consultancy
+44 20 3826 0688
charles.ingramevans@knightfrank.com

Michael Brownsdon, MRICS, ATT
Capital Allowances Advisor
+44 20 3866 8046
michael.brownsdon@knightfrank.com

Debt Advisory

Lisa Attenborough, DipFS
Partner, Head of Debt Advisor
+44 20 3909 6846
lisa.attenborough@knightfrankfinance.com

Institutional Consultancy

Emma Cleugh
Head of Institutional Consultancy
+44 20 7861 5427
emma.cleugh@knightfrank.com

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