UK Healthcare Property 2018

AUTUMN-WINTER OVERVIEW
The UK healthcare market has continued to experience some headwinds in 2018. The social care funding crisis continues to impact many local authority funded homes with almost 7,000 beds deregistered in 2017/18, while increases in the National Living Wage (NLW) and a shortfall of nurses is presenting many operators across the healthcare sector with both increased staffing costs and a shortage of skilled labour. In response, new development remains focused on the private pay personal care home market where the effect of such challenges are less prominent.

The UK’s ageing population remains an unrelenting source of demand for the care home sector. Occupancy rates have now hit a high of 89.4%, surpassing the 89.3% recorded in 2006 when records began. At the same time, average fees outstripped inflation for the fifth consecutive year as operators looked to limit the impact of rising staff costs and generate the additional income required to invest in and improve the quality of care they provide.

Elderly care home profitability (measured as EBITDARM as percent of income) fell marginally during the 2017/18 financial year as the market endured increased costs. However, it is worth noting the differing financial performance of local authority funded homes verses the independent private pay segment. While margins for public funded homes are down to 15.9%, the private pay market is reporting profitability as high as 39.4% — a notable jump and a source of encouragement for operators and investors alike.

The adult specialist care home sector has faced a similar set of operating issues, but with around 90% of fees being paid from the public purse, this sub-sector remains heavily influenced by the restricted budgets of local authorities. One by-product of this has been the continued preference of commissioners to transfer users into non-residential supported living as opposed to full-time residential care. Care providers will welcome the recent Autumn Budget which announced a further £930 of funding specifically for social care over the next two years, but whether these funds will filter through to long-term residential care is unclear.

The primary care and acute hospital care markets continue to gain interest from specialist property investors looking to capitalise on the inherent need for such assets across the UK — as expressed in the NHS five-year forward view. Knight Frank sees the lack of available stock as the biggest barrier as opposed to a lack of investor appetite. Much like other healthcare asset classes, long-term income streams and secure yields below 5% continue to look favourable in the uncertain economic environment.

Healthcare sector investor volumes have been moderate so far in 2018, but there remains potential for a late end-year surge. This was the case in 2017 when c.£560m of deals transacted in the fourth quarter of the year alone. As at Q4 2018, Knight Frank are live on c.£6BN of healthcare mandates, predominantly sell side. We’ve also observed a clear change of investor profile into the UK with US REITs accounting for only 6% of all major UK care home transactions since 2015, compared to 46% between 2013 and 2015; APAC and infrastructure funds are now firmly the new money in town. Debt markets arguably remain cheap, and cap rates seemingly at record pricing, but as open ended funds and institutions divest out of retail to focus on ‘alternative’ sectors, combined with overseas capital, UK healthcare will remain a very competitive sector to invest in.

Julian Evans, FRICS
Partner, Head of Healthcare
Market Performance

2017/18 AT A GLANCE

OCCUPANCY
- All Care: 89.4%
- Personal: 89.9%
- Nursing: 89.1%

STAFF COSTS (% OF INCOME)
- All Care: 57.9%
- Personal: 55.8%
- Nursing: 58.4%

AVERAGE WEEKLY FEES
- All Care: £838
- Personal: £671
- Nursing: £773

EBITD & R (%) OF INCOME
- All Care: 28.3%
- Personal: 28.5%
- Nursing: 28.2%

YIELDS (AUTUMN 2018) - HEALTHCARE VS. OTHER SECTORS

CARE ACUITY
- Care Homes (Prime): 3.50%
- Surgeries & Clinics: 4.00%
- Private Acute Hospitals (Prime): 4.75%
- Specialist Care Homes (Prime): 5.50%
- Specialist Schools (Prime): 6.00%

OTHER SPECIALIST SECTORS
- Student Accommodation (Prime): 3.75%
- Budget Hotels: 4.00%
- Automotive: 4.50%
- Leisure Parks: 5.00%

Market Characteristics

TYPES OF HOUSING FOR THE ELDERLY

RETIREMENT HOUSING
- Houses designed with older people in mind
- Over 55 developments
- Retirement village
- Sheltered retirement community
- Extra care / assisted living
- Residential & Nursing Care Homes

HIGH DEPENDENCY

CARE HOME CHARACTERISTICS BY CLASS

CLASS | CONSTRUCTION | BEDS (+/- 10) | EN SUITES | LAND VAL. (PER BED) | BUILD COST (PER BED) | AWF* | EP YIELD
---|---|---|---|---|---|---|---
Super Prime | Luxury and future proof | 70+ | Wet room as standard | £60-£75k | £125k-£150k | £2,000+ | < 12 | < 4%
Prime | Purpose built (pb) | 50 | En suite as standard | £30k-50k | £90k-£120k | £750-£1,000 | < 8.5-10 | < 6-8%
Secondary | 1st generation and 1990’s pb | 40 | Part en suite | £15k-25k | £50k-£75k | £500-£750 | < 7.5 | < 6-7%
Tertiary | Period conversion | 25 | No en suite | £5k-15k | £40k-£65k | £400-£650 | < 5.7 | < 7%

YIELD SOURCES: Knight Frank Research, Knight Frank Care Home Trading Performance Index

UK FUNDING MIX

- Local Authority (Private Pay): 44%
- Self-funded (Private Pay): 44%
- NHS: 11%

INDICATIVE RENT COVERS

- Residential
- Nursing
- Acute
- Mental Health
- Other 1%
**Market Performance**

**2017/18 Operator Results**

**Demand Supply**

**OCCUPANCY RATES REACH RECORD HIGH**

**ELDERLY CARE BEDS UK 2018**

**PROJECTED DEMAND FOR BEDS***

<table>
<thead>
<tr>
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<th>36-59 BEDS</th>
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**Potential Shortfall in Market Standard Beds**

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Sources: ONS, Tomorrow's Guides, Laing Buisson, Knight Frank Research

*Based on Laing Buisson data

**Long-term Population Growth Future-proofs Demand**

**Supply Response Requirements**

**OVER 85'S POPULATION**

**SUPPLY RESPONSE REQUIREMENTS**

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**Future Proofs Demand Supply Requirements**

**Long-term Population Growth Future-proofs Demand**

**Over 85's Population**

**Supply Response Requirements**

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**Market standard beds are rooms with en-suite facilities**
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CARE HOMES TRADING PERFORMANCE REVIEW 2018

HEALTHCARE CAPITAL MARKETS 2018

UK HEALTHCARE DEVELOPMENT OPPORTUNITIES 2018

RETIREMENT LIVING

HEALTHCARE PROPERTY DINNER

LUXURY CARE HOME GUIDE

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