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Care home development stays active in the pandemic

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Will the pandemic accelerate the rate of home closures?

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The outlook for development – we ask the experts

Knight Frank

Healthcare Development Opportunities

Research 2021

SPOTLIGHT ON THE UK CARE HOME SUPPLY

The challenges of the last year have limited the growth of the UK elderly care home market. A quick recovery is vital to ensure we build enough homes to meet future demand.

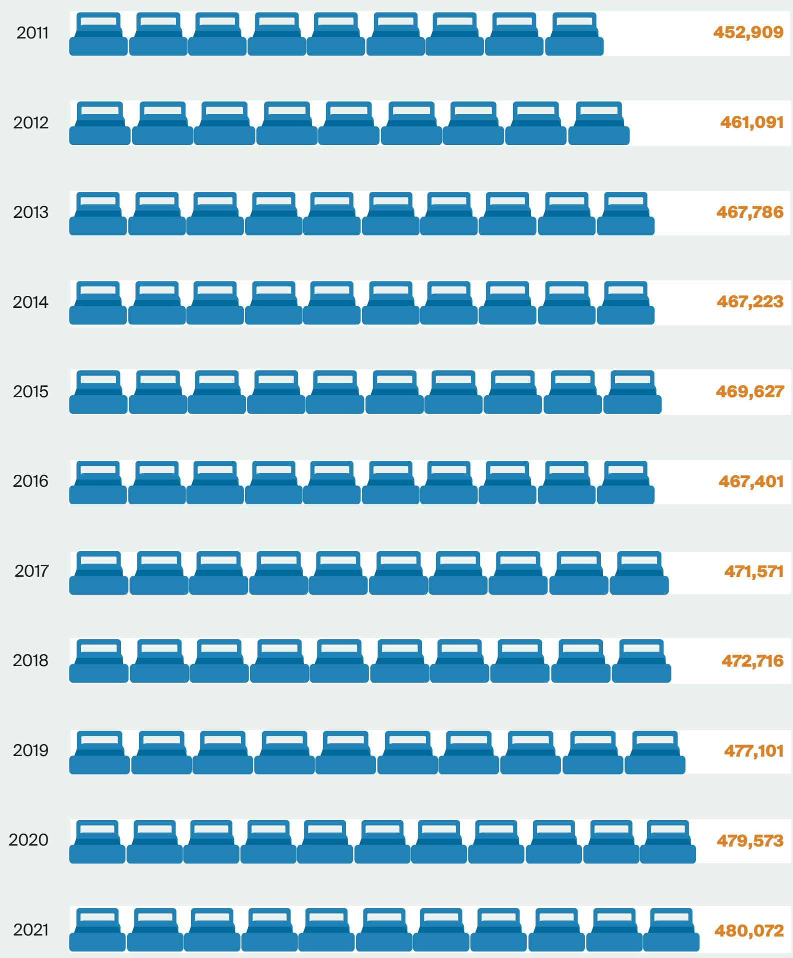
Market size

In our latest assessment of the UK care home inventory, the market measured 480,072 beds spread across 12,034 care homes (as of April 2021). This was only a moderate increase of 0.1% on the previous year, but not surprising in a year when developers and care businesses paused to deal with the pandemic.

The pandemic has forced greater acknowledgment of the hugely important role that residential elderly care plays in supporting any healthcare system

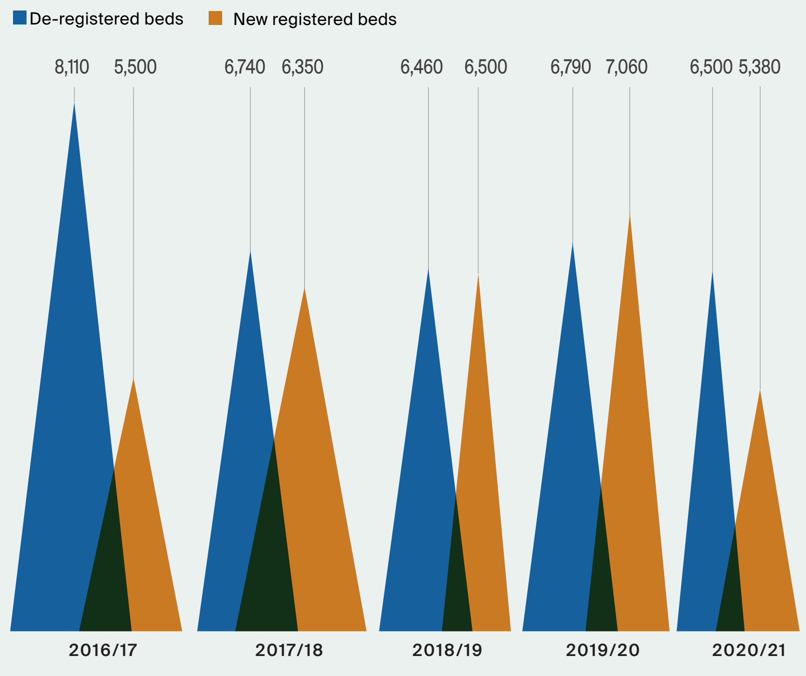
Limited supply growth has been an ongoing trend, as shown in Figure 1, with UK care home supply growing by only 6% over the last decade. When we consider that the UK's over 65 population has grown by 22% over the same period and is forecast to grow by a further 21% in the next decade, it's easy to understand why many people are concerned by the current level of care beds.

FIG 1 | **UK elderly care home beds**



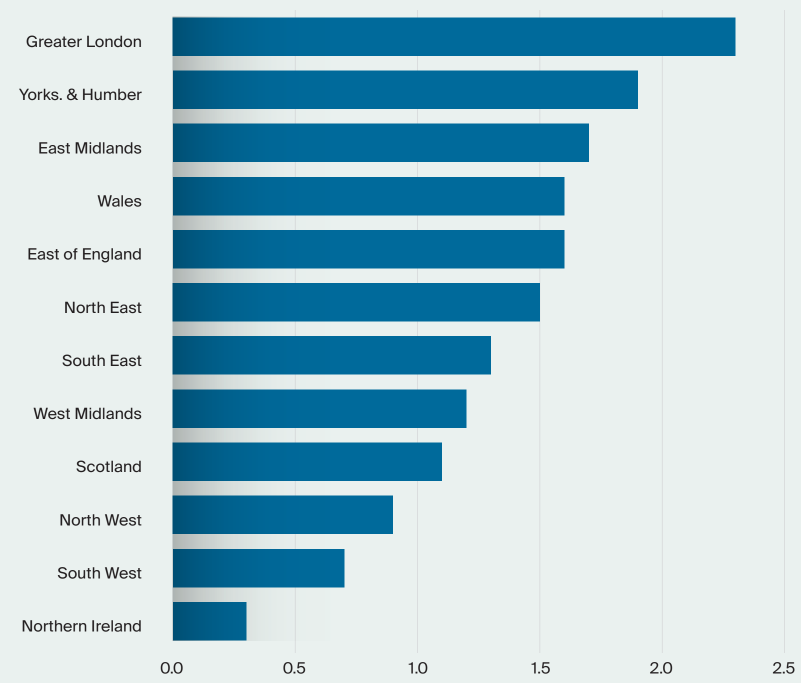
Source: Knight Frank, Tomorrow's Guides

FIG 2 | **De-registered beds vs new-registered beds**
12 months to April 2021



Source: Knight Frank, Tomorrow's Guides

FIG 3 | **De-registrations (12 months to April 2021)**
as % of total stock



Source: Knight Frank, Tomorrow's Guides

The impact of the pandemic

Care home occupancy, measured as the percentage of registered beds occupied by residents, has inevitably fallen over the last year. Knight Frank analysis shows that UK-wide occupancy declined from 89% to 79% (as of April 2021) since the outbreak. Encouragingly, occupancy rates are now recovering with existing residents vaccinated against the virus, and a backlog of new elderly residents beginning to refill care homes. As for supply levels, Figure 2 shows that 5,380 new care beds were registered in the 12 months to April 2021 – a notable decline from the previous year. Although new-registrations also includes properties that may have changed use to elderly care, the vast majority are new build facilities. The pandemic forced many such developments to delay construction (and registration) in the middle part of 2020, but many have since proceeded and we have seen a bounce-back in activity in 2021.

Care home occupancy, measured as the percentage of registered beds occupied by residents, has inevitably fallen over the last year

The number of de-registrations (home closures) fell only moderately in the 12 months to April 2021. As shown in Figure 3, Yorkshire & Humberside and the Greater London area saw the largest level of de-registrations, with the latter losing 2.3% of stock to closure. Inadequate care standards, financial issues, or a combination of both are typically the main reasons for closure. Some homes also temporarily de-register to carry out significant refurbishment or extensions to the property. We suspect that the full financial impact of the pandemic is yet to fully play out in the market. With the government now concluding its year-long financial support package, we could see an uptick in de-registrations. While large-scale operators have adapted and performed very well in the pandemic, poorly managed care homes could yet be casualties of the pandemic.

Much of the market is in need of an upgrade

As shown in Figure 4, much of the UK care home market is made up of older converted stock that lacks essential en-suite facilities. This is not to say that older converted homes can't provide the very highest standard of residential care, but many homes in this category are increasingly unfit for purpose and most likely to experience regulatory and financial pressure.

En-suite or full wet room provision should be a given for any elderly resident, but especially so with the benefit of facilitating resident isolation during the pandemic. 29% of UK care home beds still lack en suite provision. Nobody wants to see care homes struggle, but the Covid-19 pandemic may act to accelerate the closure of outdated homes and replace them with high quality future-proofed assets.

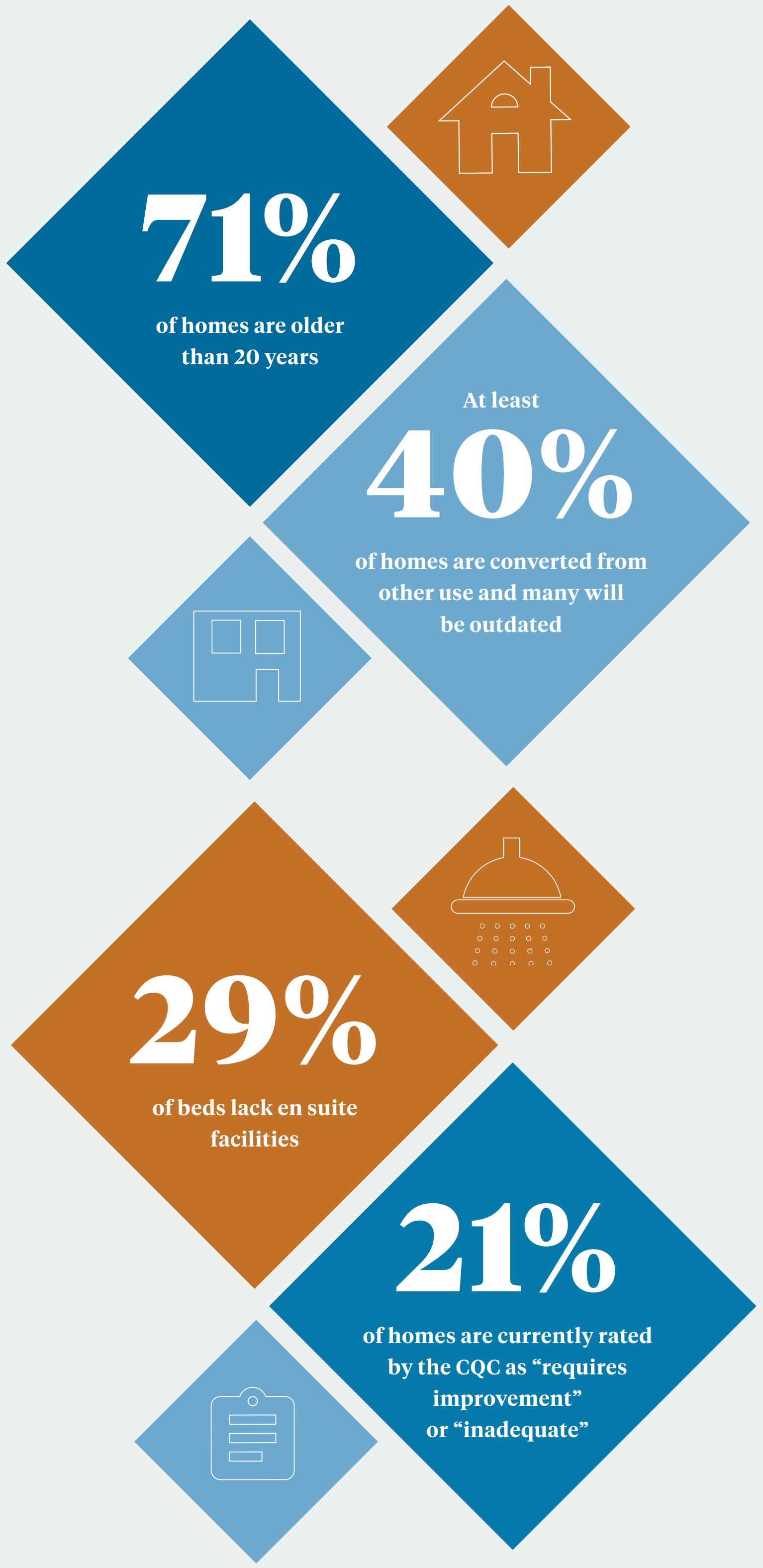
How COVID has impacted care home design

The pandemic will no doubt prompt a change in the way care homes are designed and configured moving forward, with particular emphasis placed on internal circulation, air quality and ventilation.

Further focus is likely to be directed towards transitional and communal space with a view to maintaining an element of social distancing. This also presents a strengthened argument for en-suite resident rooms suggesting the benefits of this extend far beyond that of resident experience to future virus control too.

Finally, similarly to the shift in preferences that we have seen in the residential markets we are likely to see greater attention paid to the already important outdoor and breakout spaces. It is useful to note that whilst the mentioned is a result of prioritising infection control, developers will need to be careful that it doesn't lead to a compromise in the quality and standard of resident life.

FIG 4 | Why the UK care home market needs upgrading



NEW BUILD CARE HOMES

New build activity has remained buoyant as developers and investors press ahead with development sites.

Developers have remained active

As shown in Figure 5, 71 new care homes (4,610 beds) were added to the market in 2020, compared to 79 homes (5,530 beds) in 2019. This is an impressive figure when you consider the freeze on construction sites from April to June of 2020 and the financial uncertainty that may have delayed or reversed many decisions on development. Activity in 2021 has so far been active with 35 new care homes (2,430 beds) already delivered or due for completion by mid-year.

There is a healthy balance of development across UK regions, the only exception being Wales where developers have been reluctant to break ground

Some of this stock was rolled over from 2020 but developers and investors have remained keen to press ahead with new sites despite the economic issues. There is a healthy balance of development across UK regions, the only exception being Wales where developers have been reluctant to break ground. The long-term drivers of this market have definitely been a feature of developer confidence.

PDR

The overhaul of the planning, commercial use classes & permitted development rights will play a significant role in the freeing up sites and the ability to deliver new care assets.

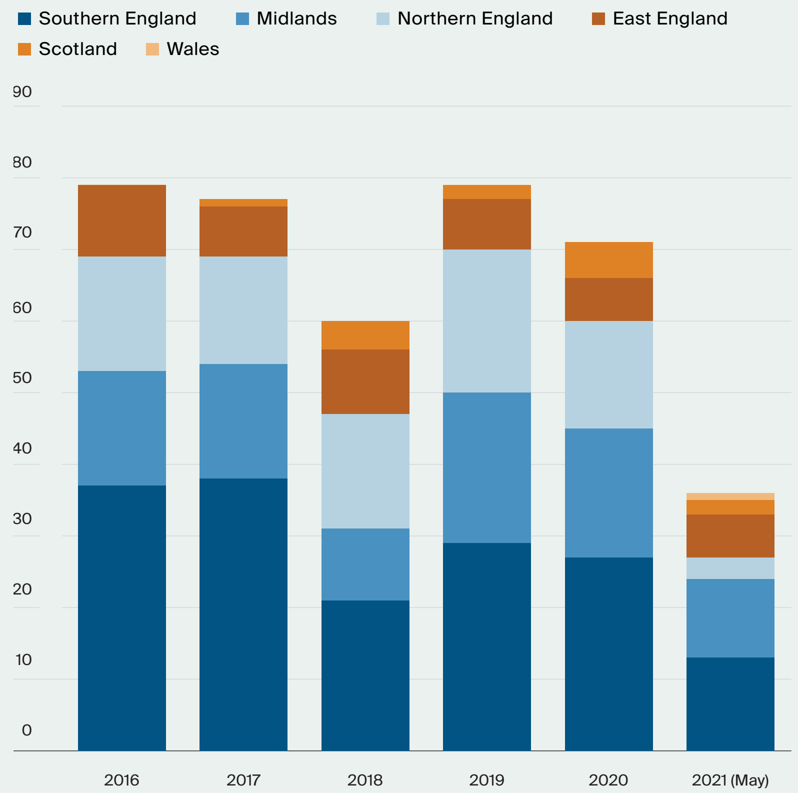
Firstly, the new PDR to allow change of use from the new use class E (commercial, business and service) to C3 residential may serve to promote the emergence of smaller supported living facilities. Additionally, the simplification of existing use classes and PDRs as well as amendments in line with a promise of faster turnround times on applications suggests that we could see a growth in development activity.

The UK is on the brink of a significant demographic shift that will see the over 85 population grow from 1.6 million in 2020 to 3.7 million by 2050. As such, many developers and investors have been undeterred by the shorter-term impact of the pandemic. 2021 will be a challenging year with regards to development financing across the whole commercial real estate sector.

Finance / Funding

Whilst appetite towards the sector is more favourable in comparison to conventional real estate classes, conventional bank debt terms have become less desirable. Therefore, forward funding as well as sale and leaseback deals are likely to remain the fundamental key to unlocking further site development moving forward.

FIG 5 | UK new purpose-build care homes completed



Source: Knight Frank

Cost of raw materials & labour slowing new build

The BCIS Materials Cost Index states a 5.6% year on year increase in the price of raw materials such as aggregates, timber, and steel as at Q1 2021. This is a result of the global pandemic's effect on factory supply, port timings in addition to rising shipping costs causing a continued shortage of such goods, with demand therefore outstripping supply. The knock-on effect of this, in addition to a lack of quality labour available is a slowing effect on the speed of new build delivery.

Although there are clear issues with finance and build costs, the fact that the market is driven by an unrelenting need for care beds could provide shelter from wider economic headwinds.

Therefore, we expect new care home development to remain active in 2021 and beyond, however it is vital that we support this process.

Supporting site selection: Knight Frank Development Hotspots Index

Careful and well-informed research is a vital part of the development process and Knight Frank's *Development Hotspots index* gives a simplified insight into which locations present the best future prospects for care home development. The index analyses 50 counties in England and Wales and 12 in Scotland, based on eight variables comprising demographic and economic projections, levels of wealth, existing bed supply, the future supply pipeline, land values and operational performance. The table shows a county's ranking on each of these variables and the total index score indicates a county's total score relative to the national average with indices above one implying above average scores.

In this index, 5 out of the top 6 counties are located in South East and Eastern England. This includes Greater London which has the highest index score in 2021. These counties score highly because of the expected demand for care beds, indicated by high elderly population growth, economic growth and wealth. Levels of wealth and income are a driver of bed demand because residents are increasingly self-funded. The main barrier to development in these counties are typically land values and staffing, with the cost of both much higher for respective developers and operators.

Other counties scored highly in England and Scotland for different reasons. For example, Cornwall and the Highlands in Scotland score well not because of exceptional demand prospects but because of very low levels of current and future supply. Ergo, the core purpose of this index is not to determine where developers should build, but to provide a guide to the different opportunities across the UK and introduce the key variables that should be examined in the site section process.

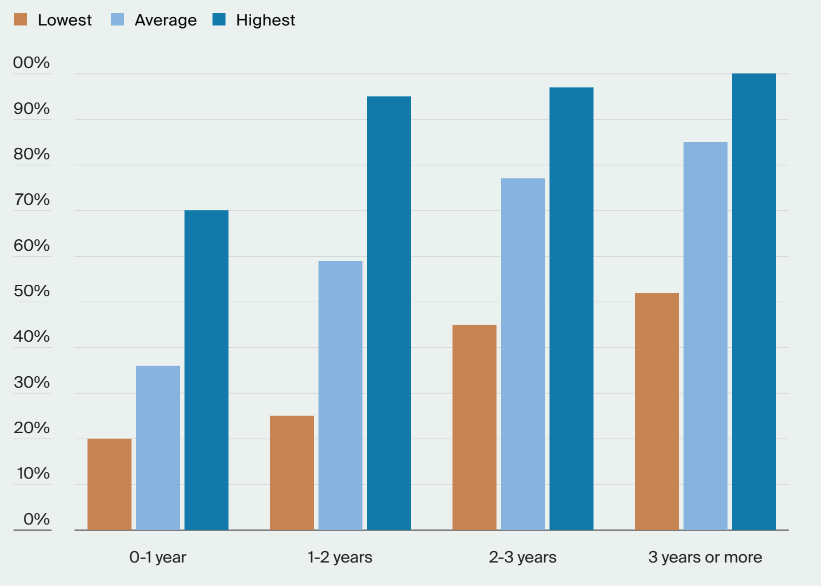
Figure 6 demonstrates the importance of understanding local supply and demand characteristics before embarking on new developments. According to research conducted before the pandemic, the average new build care home takes at least two years to reach full occupancy. However, fill rates vary, with high quality sites reaching 70% occupancy within one year, while others can take longer to reach maturity. Such differences can translate into gains or losses of income into the millions over a 3-year period, highlighting the importance of investing time and money into the site selection process.

Care home development hotspots index 2021

COUNTY	REGION	ELDERLY POPULATION*	ECONOMIC GROWTH*	WEALTH	CURRENT SUPPLY	FUTURE SUPPLY	LAND VALUES	AVERAGE WEEKLY FEES	STAFF COSTS	TOTAL SCORE INDEX
England and Wales - top 12 counties out of 50 in analysis										
1. Greater London	Greater London	1	1	1	3	20	50	13	42	**1.55**
2. South Glamorgan	Wales	19	8	15	10	32	10	1	41	**1.50**
3. Cambridgeshire	East of England	9	6	9	11	36	44	18	21	**1.32**
4. Berkshire	South East	6	2	2	8	41	46	5	48	**1.29**
5. Essex	East of England	15	11	28	14	14	38	27	18	**1.23**
6. Buckinghamshire	South East	5	3	4	12	47	46	2	47	**1.23**
7. Cornwall	South West	34	15	43	7	5	14	7	50	**1.16**
8. West Midlands	West Midlands	33	33	24	1	10	25	31	23	**1.13**
9. West Yorkshire	North West	24	22	23	29	27	9	39	9	**1.12**
10. Lincolnshire	South West	22	24	22	21	16	21	42	14	**0.80**
11. Gloucestershire	South West	12	23	13	49	2	29	9	46	**1.11**
12. Wiltshire	South West	3	16	14	23	44	34	12	38	**1.11**
Scotland - top 6 counties out of 12 in analysis										
1. Highlands & Islands	Scotland	9	10	4	3	2	1	8	1	**1.36**
2. Lanarkshire	Scotland	2	6	8	5	1	4	11	4	**1.26**
3. Grampian	Scotland	5	2	1	8	6	10	2	9	**1.20**
4. Lothian	Scotland	1	1	3	6	7	12	3	12	**1.15**
5. Central	Scotland	3	5	6	4	12	4	4	8	**1.12**
6. Borders	Scotland	8	7	10	1	8	2	7	6	**1.05**

Source: Knight Frank *Based on 15 year projection, 2021 to 2036

FIG 6 | **New care home fill rates**



Source: Knight Frank

Supporting site selection – its all about granular data

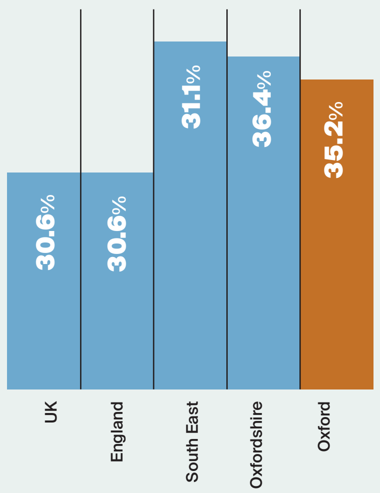
Data has a huge role to play in site selection and having easy access to market data is essential for any prospective care home development. Benchmarking chosen locations against broader regional metrics allows investors and developers to address demand-supply imbalances and provides vital intelligence into local fee levels, staff costs and much more. Our Development consultancy team can take your research even further, providing market-leading feasibility studies that take due diligence and research to greater levels of detail.

Looking forward

The development activity we have seen in the last year is a very encouraging sign and this looks set to continue judging by the current pipeline. As shown in Figure 10, there are over 7,000 beds currently under construction and a further 10,000 in the planning or tender stage. Many of these homes are situated in Southern England, The Midlands and East of England where the demand characteristics are typically stronger and investors have remained confident in forward funding new developments. While 2021 may not be an exceptional year for development activity, there will not be a shortage of appetite for new care homes.

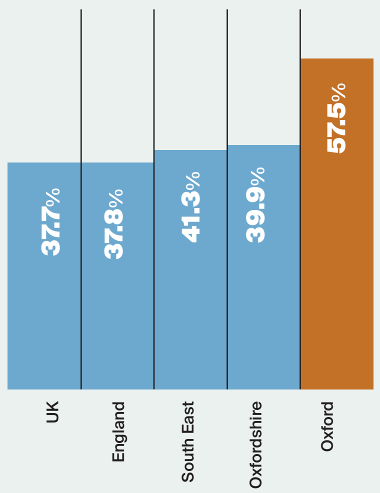
Looking further into the future, projections suggest that we must build more care homes to service future demand (Figure 11). The growth in our elderly population is such that by 2050 an additional 350,000 people will potentially need an elderly care bed – the level of bed demand will almost double within 30 years. Despite the new beds being developed, the level of home closures means that supply is not keeping pace with demand. The UK elderly care market is now at risk of reaching capacity by the end of the decade and this is a worrying projection. We must build more care homes and actions must be taken to support existing homes and operators to make sure the residential elderly care system is ready for the future.

FIG 7 | Elderly population growth 2021-2036 (persons over 65)



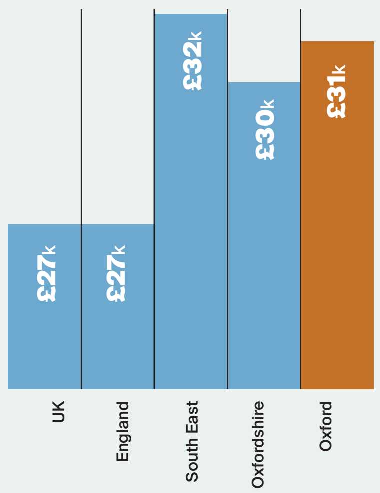
Source: ONS

FIG 8 | Elderly care beds (per 1,000 person over 65)



Source: Tomorrow's Guides

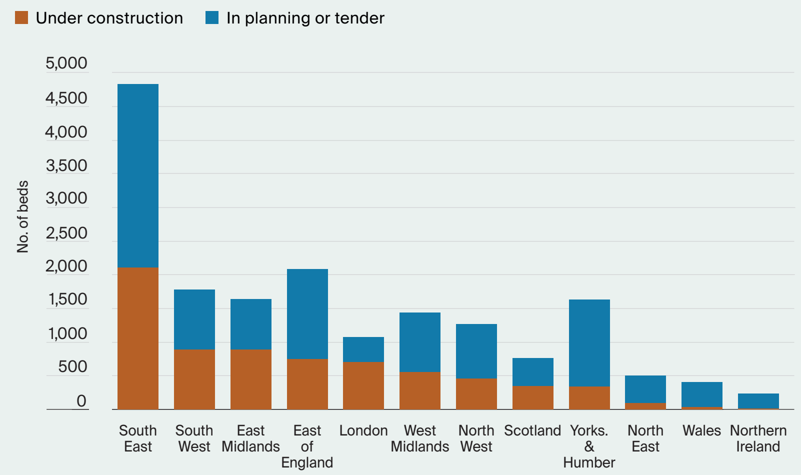
FIG 9 | Staff costs (per bed per annum)



Source: Knight Frank

HEALTHCARE DEVELOPMENT OPPORTUNITIES 2021

Figure 10: Under construction and planned care home developments



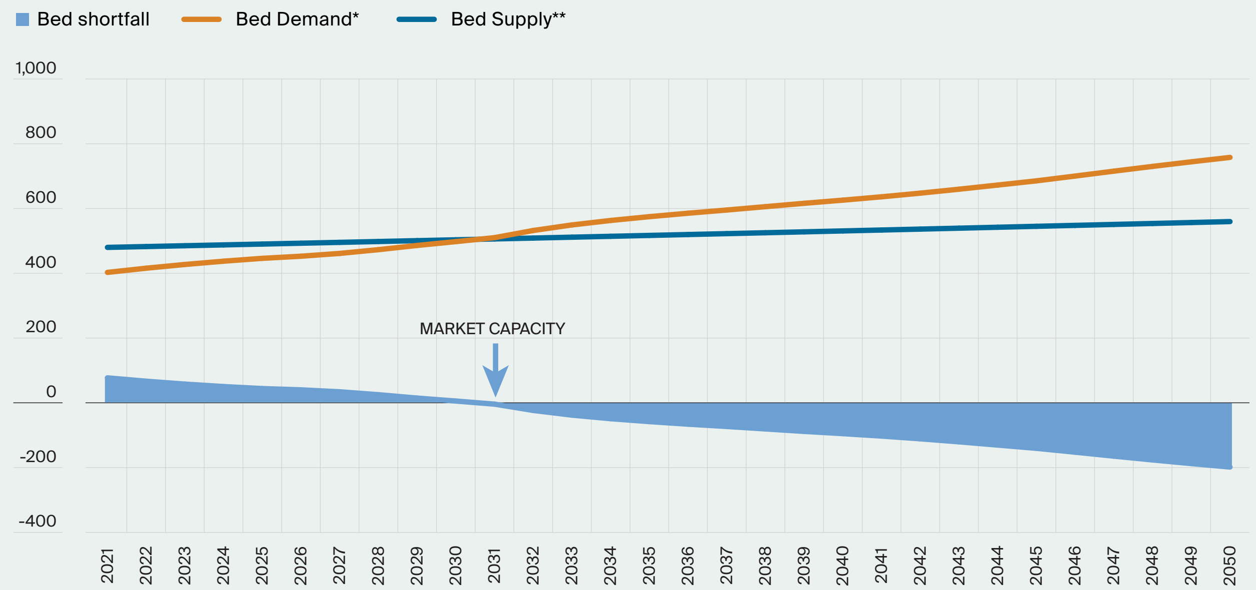
Source: Glenigan

ESG

With global investor and occupier demand for sustainable buildings on the rise, the emergence of sustainable finance from lenders as well as a growing desire to place money into ESG strategies (According to Calastone, Inflows into ESG strategies grew sevenfold between 2019 & 2020 with $84 of every net $100 into equity funds placed with ESG funds over same period) the importance of ESG in development of care assets remains very apparent.

As care assets are often more difficult to evaluate in terms of ESG than assets which fall into the more conventional real estate classes, unlocking sustainable building processes has become more important which opens the door for innovative methodologies such as modular construction for example. As the social aspect of ESG becomes more of a topic of conversion, more and more institutions have sought to align their operational activity to several of the UN Sustainable Development Goals, e.g. goal 11 of Sustainable Cities and Communities, we can expect to see investors and developers place further emphasis on the long-term social impact of each asset.

Figure 11: 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.

DEVELOPMENT OUTLOOK: ASKING THE EXPERTS

To get a better steer on the outlook for care home development we have collected the views of Mandip Bhogal, Development Consultant at Knight Frank and Nick Broadbent, Development Director at LNT Group. LNT is one of the UK's leading purpose build residential care home developers. The group currently have a construction pipeline of 80 plus sites and 5,000 beds spread across the UK, putting them at the very centre of the market.

Mandip Bhogal
Head of Development Consultancy
Knight Frank

Nick Broadbent
Development Director
LNT Group

Q1. The data shows that new build activity has declined only moderately in the last year, despite the pandemic – Why do you think this was?

Mandip: Care home development activity has remained buoyant during the pandemic, underpinned by an ageing population and shortfall of future-proof assets. Despite the disruptions caused to the construction sites in Q2 2020, development activity continued, once appropriate measures were put in place. Operators and developers have taken the medium to long-term view with regards to developments when compared to the short-term impact of Covid-19. New build activity will remain robust for the next 12-18 months, with an even larger focus on design, post Covid-19.

There needs to be investment and commitment from all levels of government that will ensure timely and consistent decision making through the planning process

Nick: The events of the last 12-18 months has further reinforced the overwhelming need to improve care home stock in the UK. LNT have built 14 state of the art care homes throughout the last year, notwithstanding the wider challenges in the economy. We will commence over 20 new developments in the current financial year, while future demand pressures give us significant confidence to continue our growth ambitions in the next few years. The general confidence of developers has in our experience been matched by that of the global investment community in the sector which ought to continue to underpin developer confidence.

Q2. At the current rate of building, we are at risk of a bed shortage by 2030. How do we build more care homes?

Mandip: In the next 18 months, we expect to see the repositioning of existing care homes as they look to adapt to a post-Covid-19 environment. As part of a broader high street revitalisation, we also expect to see the re-purposing of well-located alternative use property classes into healthcare or retirement living residences. We may also see further opportunities within secondary tier markets for mid-market products where reasonable fees can be achieved coupled with lower land values.

Nick: As operators become released from the operational intensities faced during the pandemic, bandwidth will become available to focus on business growth which will undoubtedly lead to more investment in new care homes. If this could be supported by a social care sector that was more appropriately funded, there would be an ability to fund widespread investment and development in non-premium demographic areas that have historically been largely passed over.

Q3. What will be the number one challenge to new development in the aftermath of the pandemic?

Mandip: The planning process remains a key challenge. We continue to see operators and developers invest in challenging sites within desirable markets due to the scarcity of suitable land i.e. greenbelt sites. For such opportunities, we continue to support their planning processes via our needs assessments and alternative site assessments.

Nick: The number one challenge, pre or post-pandemic is in my view the delays, obstacles and lack of consistency in the planning process. Over recent months this has been exacerbated in some areas of the country with the inertia caused in dealing with Nitrate/Phosphate offsets. As we continue to ensure we deliver our programme of sites on time, forward planning and visibility is key. Whilst we will look to mitigate risk around this through growing our land bank there needs to be investment and commitment from all levels of government that will ensure timely and consistent decision making through the planning process.

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Page 7:
Lambwood Heights, Chigwell, Essex, Oakland Care

Page 11:
Emmerson Grange, Hextable, Kent, Cinnamon Care

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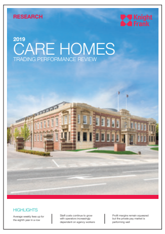

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Please get in touch with us

Healthcare

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

Patrick Evans MRICS
Head of Corporate Valuations
+44 20 7861 1757
patrick.evans@knightfrank.com

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

Mandip Bhogal, BSc (Hons)
Head of Development Consultancy
+44 203 869 4702
mandip.bhogal@knightfrank.com

Commercial Research

William Matthews
Head of Commercial Research
+44 20 3909 6842
william.matthews@knightfrank.com

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

Senior Living

Tom Scaife MRICS
Head of Senior Living
+44 20 7861 5429
tom.scaife@knightfrank.com

Lauren Harwood
Head of Senior Housing Consultancy
+44 20 7268 2599
lauren.harwood@knightfrank.com

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