RESEARCH

THE HUMAN FACTOR

SPECIALIST PROPERTY

2018

OVERVIEW | OPPORTUNITIES | OUTLOOK

KEY STATISTICS

FROM OUR 2018 SPECIALIST REPORT

Please refer to the important notice at the end of this report

FOREWORD

SHAUN ROY
HEAD OF SPECIALIST PROPERTY INVESTMENT

After a record year in 2017, appetite for specialist property investment is stronger than ever.

Last year we made the bold prediction that specialist property investment would rise by 18% in 2017. In fact, activity proved even stronger than this, with volumes growing by 30% to reach more than £16bn. Part of this surge reflects renewed appetite for UK commercial property, as investors largely cast aside the uncertainty that followed the 2016 EU referendum. Yet we believe the rapid growth in demand for specialist property also represents a desire to harness the sector's unique performance characteristics, as well as a growing acceptance of the need to understand the operational demands of these property types.

As we explore in this research, the stability of specialist property's performance makes it a compelling choice for those with an eye to a period of potentially slower returns in the wider commercial market. Investors are attracted by the granular nature of income streams typically associated with specialist property, as well as for some, the ability to extend and de-risk

Yet all of this would be moot were it not for the undeniable structural support for specialist property. The human factor – the end user demand that ultimately drives the sector's performance – is not in question. Demographic trends can be reliably predicted, and combined with expert market knowledge, provide a solid footing for demand projections.

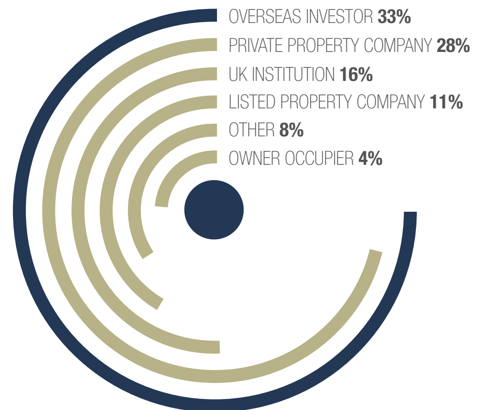
> "We continue to see strong and sustained demand for specialist property, driven by the desire for durable long income investments to good covenants".

In contrast, the supply of sufficient specialist property is not keeping pace with demand. Indeed, we predict a number of subsectors will face an ongoing shortage of modern stock, which will only enhance the rental performance of those assets that make the grade.

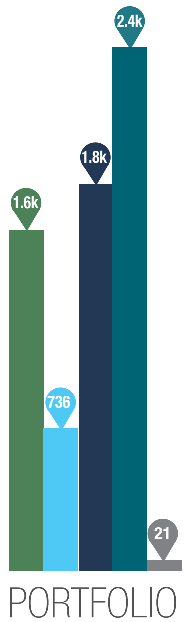
Our predictions for wider commercial property investment this year point to a modest slowdown – a function of stock shortages, rather than any significant change in investor demand. Our view on this sector specifically is more positive: our core scenario sees a 15% increase to £19bn, although we recognise that anything above 10% will depend on sufficient stock coming to the market. Even so, if last year's experience is anything to go by, we cannot rule out passing the £20bn milestone.

SPECIALIST INVESTMENT ACTIVITY 2017

ALL SECTORS
£16.1BN

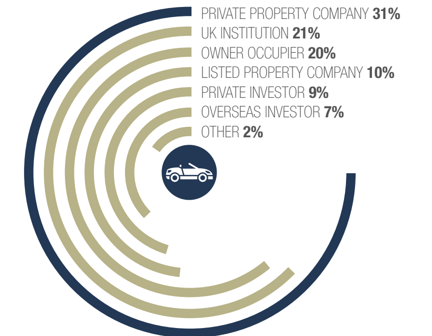


SCOTLAND 192 16 107 15
NORTH EAST 79 46 5 96 5
NORTH WEST 259 39 428 80 64
YORKSHIRE & THE HUMBER 67 31 20 263 62
WALES 30 5 14 26
WEST MIDLANDS 306 50 186 282 22
EAST MIDLANDS 70 41 160 60 32
SOUTH WEST 167 55 19 97 60
SOUTH EAST 220 183 223 224 104
LONDON 2.4k 77 2k 370 148
EASTERN 121 41 123 60 9



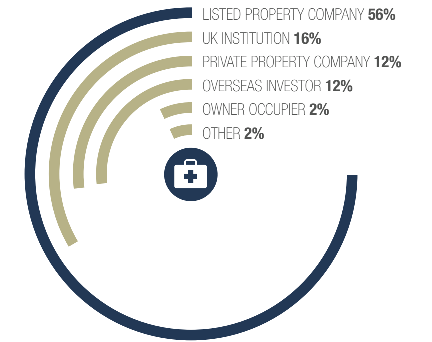
HOTELS
HEALTHCARE
PRS
STUDENT HOUSING
AUTOMOTIVE

AUTOMOTIVE
£0.5BN

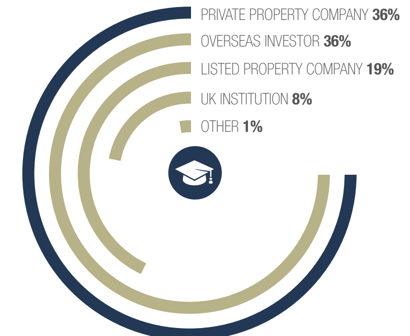


PRS
£5.0BN

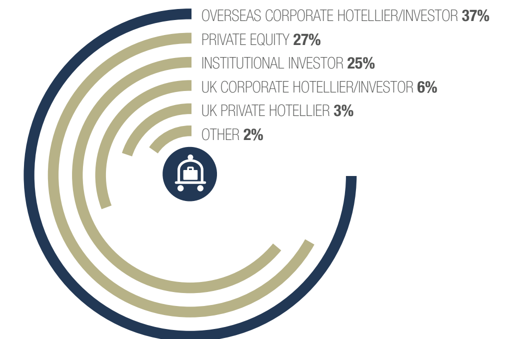
HEALTHCARE
£1.3BN



STUDENT HOUSING
£4.1BN



HOTELS
£5.5BN



THE EVOLVING MARKET

INVESTMENT ACTIVITY REBOUNDS

2017 saw a strong rise in commercial property investment generally, but activity in the specialist property sectors grew even faster: purchases of these property types were up 30% on 2016 levels. With over £16bn transacted last year, specialist property accounted for a greater proportion of market activity than ever before, eclipsing investment in the retail and industrial sectors. Indeed, in accounting for over 25% of the commercial investment volumes in 2017, specialist property has doubled its share of the market in the space of just three years.

The hotel sector made the greatest contribution to the rise in specialist property volumes in 2017, with transactions up by more than £2bn, while student housing saw an increase of around £1bn. The healthcare sector recorded the greatest rise in activity relative to 2016, with volumes up almost threefold. There was little change in Automotive and PRS volumes.

A DIVERSE INVESTOR BASE...

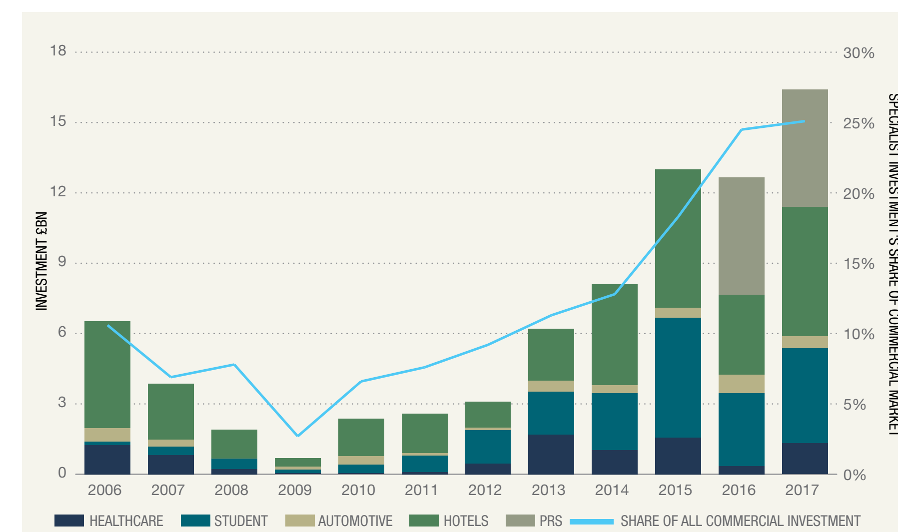
The specialist property market continues to attract a diverse range of investors: owner-operators compete alongside private equity, institutional funds, and many others. Each specialist sector has its own unique investor mix, but in general, overseas investors play an important, albeit somewhat smaller role than in the wider market. However, there is every reason to expect this share to grow over the coming years. One barrier to overseas investment is the relatively small lot sizes that typify some of the specialist sectors, as many cross-border investors require scale to justify transactions. However, as ongoing consolidation creates portfolios and platforms of greater volume, we expect that the attraction to cross-border investors will rise.

We also note that investment from listed real estate businesses accounts for a significant share of activity in many of the specialist sectors. This is in sharp contrast to the wider market, where major REITs and public property companies were net sellers of assets in 2017. The demand from listed real estate companies reflects the fact that a number have successfully raised capital from stock market listings or further share issuance in recent years, which is now being deployed. The ability of these businesses to raise capital in this way demonstrates the appeal of specialist property beyond that of those investing directly in physical assets.

...WITH CLEAR REGIONAL DEMAND FOR REGIONAL ASSETS

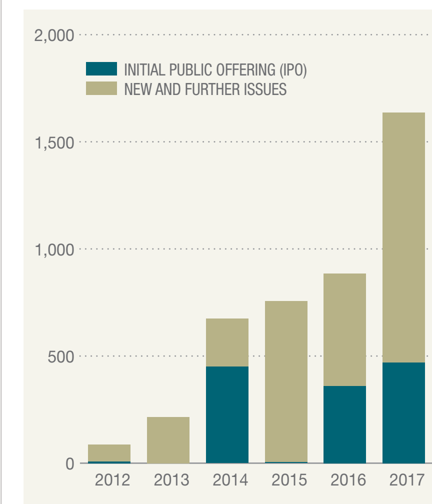
The resurgence in regional commercial property investment is being reflected in specialist sectors too. A significant share of hotel and PRS investment is London-bound, meaning that the capital accounts for 30% of all specialist property investment. Purchases of student housing, healthcare and automotive property, however, have been much more evenly spread across the UK's major regions.

FIGURE 1
Specialist sector investment



Source: RCA/Property Data/Knight Frank Research

FIGURE 2
Specialist sector share capital raising 2012-2017



Source: LSE

WHAT DRIVES SPECIALIST PROPERTY INVESTMENT?

Over the longer term, we expect investment in specialist sectors to continue to rise in future, both as a share of the wider commercial property market, and in absolute volumes. There are three main drivers:

1. THE HUMAN FACTOR

Superior returns from commercial property have traditionally come from two sources: identifying occupier demand, and timing purchases to avoid paying excessive prices. The same is true for specialist property investment. However, for many of the specialist sectors, occupier demand is far less cyclical than in the wider market. Because much of the occupational demand for specialist property comes directly from individuals, who do not – or often, cannot – change their need for certain types of property, the ebb and flow of the economic cycle plays a less important role.

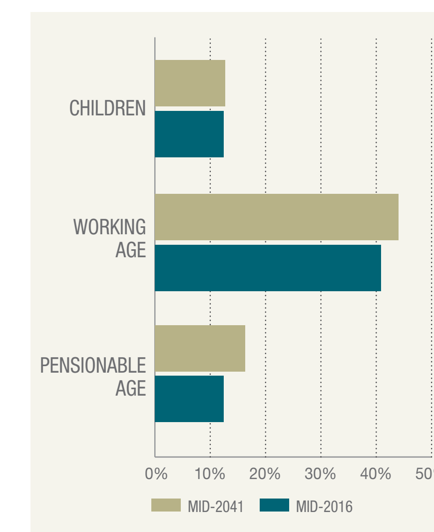
This is an important contrast to other commercial property sectors, where occupational demand is much more finely balanced, and economic conditions can force businesses to make binary choices over the number of properties they occupy.

The UK's population is widely recognised to be aging as it grows, with official statistics suggesting the pensionable age population will increase by more than 30% by 2041, supporting in particular the end user demand for property such as care homes and healthcare facilities. But it is also important to recognise the growth in the working age population, which is directly supportive of residential demand, and indirectly supportive of demand for hotel and automotive property.

The reliance on demographic shifts as sources of demand growth also has the advantage that they are relatively easy to forecast, at least in comparison to the economic cycle, which is the focus of many commercial property forecasts. For investors, an understanding of broad demographic trends does not negate the need for a detailed understanding of local market characteristics, but it does give some comfort that underlying demand is present.

The structural undersupply of many specialist property types is another important attraction to investors in the sector. Unlike many commercial property sectors, in which developers are able to keep supply relatively well balanced with demand, a number of specialist sectors face significant stock shortages that cannot be quickly reversed. For example, we estimate there will be a shortfall of 160,000 market standard care home beds by 2021, while there are three times as many students in the UK as the number of purpose built student beds. Even with ambitious delivery pipelines, this level of aggregate undersupply of specialist property would take many years to reverse.

FIGURE 3
UK population projections 2012-2017



Source: ONS

FIGURE 4
The Human Factors

SECTOR	THEME	EVIDENCE
AUTOMOTIVE	Growth in personal mobility	The department for transport forecasts car ownership will rise by 4% from 2015 to 2025, while motor traffic will rise by 17%.[1]
HEALTHCARE	Elderly population growth	The number of elderly people is estimated to reach 13 million by 2021, equal to 19% of the population.[2]
HOTELS	UK tourism on the rise	UK visitor numbers forecast to rise by 4% in 2018.[3]
PRS	Growing demand for rental housing across all age groups	We predict there will be over 1m additional households in rented accommodation by 2022.[4]
STUDENT HOUSING	Growing demand for further education	At 36%, the 2018 university application rate from UK 18 year olds is the highest on record.[5]

Source: 1. DFT, 2. Knight Frank Research, 3. Visit Britain, 4. Knight Frank Research, 5. HESA

2. THE PERFORMANCE APPEAL

The human factor is a compelling rationale for specialist property's outperformance in theory, but does it translate into better returns in practice? In short, the answer is yes. Specialist property's less cyclical nature can be easily seen from the available market data, which shows a more stable return profile than for the market as a whole. This does not mean that specialist property always outperforms. Indeed, the trade-off for greater stability has been modest underperformance during market-wide boom years. However, MSCI data shows that hotels, healthcare and residential property all offer a better risk-adjusted return than the all-property benchmark over the long term.

The 18 month period following the UK's referendum on EU membership demonstrated how specialist property performance has remained less volatile than that of the wider market. While all property capital values grew by 4% from June 2016 to December 2017, specialist values rose by 10% or more. This was due in no small part to the increasing demand for the sector, which saw yields compress in most specialists sectors. This, combined with comparatively strong and reliable income returns, meant specialist property sectors outperformed the wider market quite significantly over this time.

In addition to the support of robust demand from end users, specialist property sectors can have particularly strong covenants, as properties are typically fundamental to the operation of the business that occupies them. This, in turn, encourages tenants to enhance assets via capex either to boost or maintain trade, or may be required to conform to brand identity standards, in the case of car showrooms for example. These 'sunk costs' create a significant incentive for tenants to remain in occupation.

3. PLAYING THE LONG GAME

For some investors, one of the most compelling aspects of specialist property is prevalence of long leases: operators of healthcare, student housing and hotel properties frequently sign 25-30 year terms at a time when average new lease lengths on 'traditional' commercial property have fallen to around seven years. These agreements, which normally feature inflation linked rental increases, are particularly attractive to institutional investors, such as pension or insurance funds, which need to match investment income to their long-term liabilities.

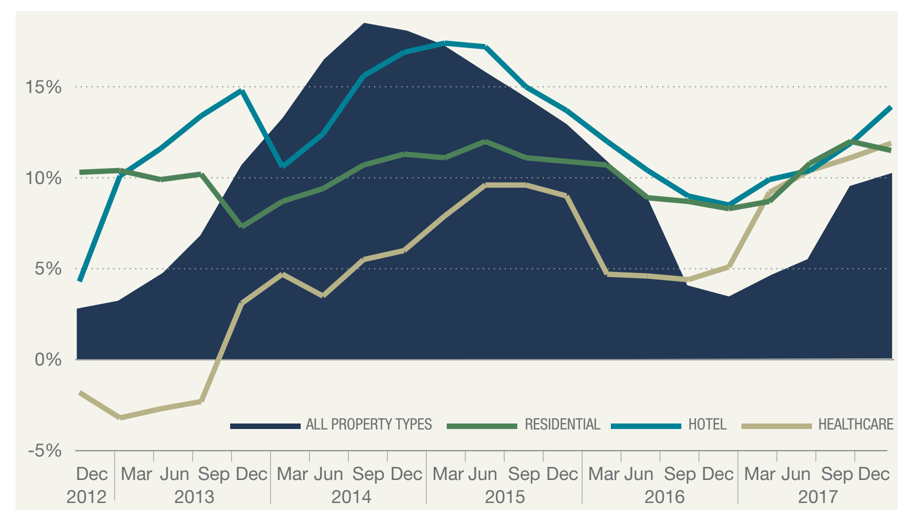
This institutional demand for long-term income, combined with the potentially significant cost of maintaining facilities, has seen investors and owner-operators collaborate on agreements that unlock capital in exchange for secure long-term income. Sale and leasebacks are an established method: an owner-operator sells their freehold to an investor, thereby releasing capital, while the investor receives rental income from the property they then own.

Income strips are an increasingly popular variation on this principle. Investors acquire the right to rental income as with a sale and leaseback, but the tenant retains the right to repurchase the property for a nominal sum at the end of the term. This can be highly attractive for institutional investors, as it removes the question of how to deal with the property once the lease ends. These 'bond-like' characteristics mean income strips attract demand from both traditional real estate investors as well as those active in fixed-income markets.

Ground rents offer the longest terms, sometimes stretching over hundreds of years. They typically involve tenants paying an income stream that represents only a small share of the operational rental level, and are therefore sit in an over-collateralised position. However, because of the low level of contracted income, ground rents tend to be valued at low levels relative to the market value of the property. Ground rents represent a relatively small share of specialist sector investment, but are gaining traction.

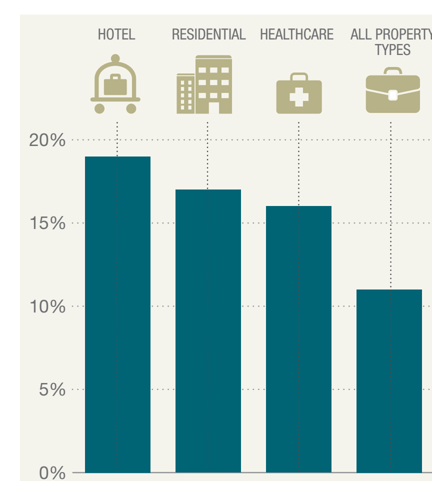
The variety of ways to derive long-term inflation-linked income from specialist property gives the sectors particular relevance in the current market. Fewer long-term commercial property lease are being signed, while fixed income investors are grappling with the negative real yields offered by index-linked bonds. The popularity of this type of specialist property investment is therefore not in question, although the pace of growth in transacted volumes will ultimately depend on the ability of investors to source or create such deals.

FIGURE 5
Total returns by sector



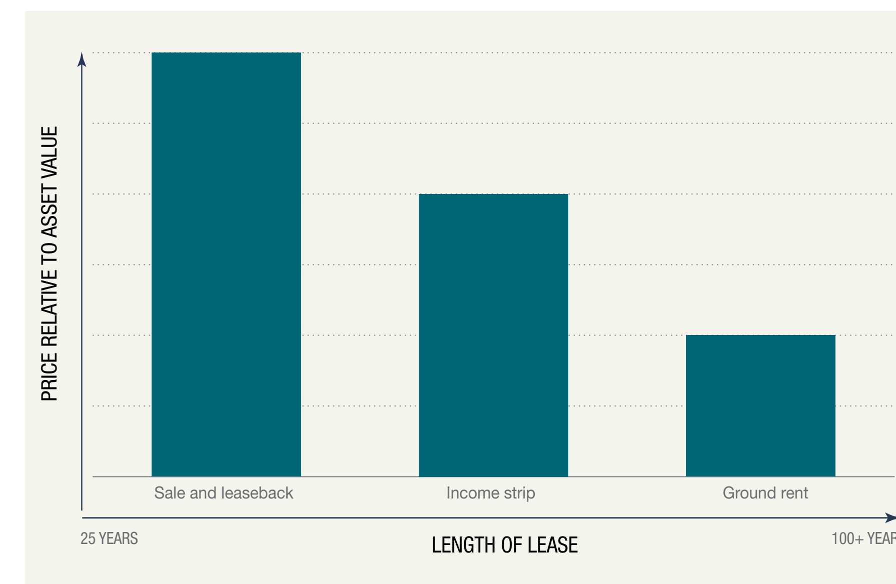
Source: MSCI

FIGURE 6
Total returns
June-16 to Dec-17



Source: MSCI

FIGURE 7
Long income strategies



Source: Knight Frank Research

THE OUTLOOK FOR THE YEAR AHEAD

We expect specialist property's share of the commercial market to continue to grow over the year ahead, and forecast £19bn of transactions in 2018. Overall, we expect less downward pressure on prime yields than in 2017, although do not rule out some compression for the best assets. However, solid rental prospects will drive further interest from tactical investors seeking an alternative to the more modest performance expected in the wider market. Others will be seeking the safety of property typically less exposed to economic and political risks.

The sector is not without challenges, however. Average lot sizes remain small, and significant amounts of stock remains in the hands of owneroperators, or otherwise outside the investible market. One issue for larger investors will therefore remain the ability to source deals and invest at scale. This is driving ongoing demand for portfolio and platform deals – indeed, 2018 has already seen a number of such transactions. The latter will be particularly attractive to those investors without the in-house expertise required to operate what can be relatively management-intensive assets.

The bigger picture, however, is the ongoing structural shift towards increased volumes of specialist property investment. A number of the specialist subsectors are now every bit as liquid as 'traditional' property types in terms of aggregate volumes traded. Meanwhile, MSCI data shows that domestic funds allocations to specialist property have increased from less than 14% to almost 18% over the past three years.

"The appetite for long-term investments with good covenants has intensified amid the current uncertainty. This is fuelling strong and sustained demand for specialist property assets."

THE REAL ESTATE DEBT OPPORTUNITY

There is an abundance of debt targeting existing core real estate, but far fewer lenders willing to finance specialist property, especially development – where it is arguably most needed. The situation is most pressing in the healthcare sector, where there is a clear lack of built stock, but few lenders willing to finance development. Sector-specific regulations and an increased reputational risk both work to subdue lender appetite, but supported by a cast-iron case for demographic demand, we believe that competent developers who opt for conservative leverage and build-in sufficient contingency to their appraisals should not be perceived as excessively risky. Longer term, as the debt market becomes saturated with supply, we expect that lending to specialist sectors will become more widespread.

"Investor appetite for prime dealership stock remains unabated and as such yields will likely see further compression."

Adam Chapman
Head of Automotive

AUTOMOTIVE

KEY STATISTICS

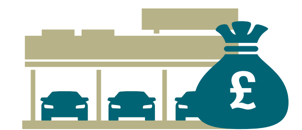
Investment volume 2017	£0.5bn
Share of UK investment market	0.8%
Investment volume 2008-17	£3.28bn
Prime yield as at end of 2017	TBC%

Source: Knight Frank, PropertyData

THE BENZ PORTFOLIO

A PORTFOLIO OF MODERN DEALERSHIPS LOCATED IN THE NORTH WEST AND LET TO THE UK'S SECOND LARGEST DEALER GROUP, PENDRAGON PLC.

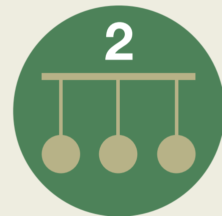
TOTAL ACCOMMODATION OF 95,366 SQ FT, WITH A PASSING RENT OF C £1,250,000 PER ANNUM, RISING ANNUALLY IN LINE WITH RPI (CAPPED AT 2.77% PER ANNUM).



SOLD BY KNIGHT FRANK AUTOMOTIVE ON BEHALF OF AN OVERSEAS CLIENT. THE PRICE ACHIEVED WAS IN EXCESS OF £20,000,000 / NIY 5.7%.

DEMAND DRIVERS

- The market will see strong investor demand for long-income, with demand comfortably outstripping supply. There is a significant weight of money available for allocation to automotive stock.
- The rise of premium brands, combined with increasing interest from overseas dealer groups, will provide good opportunities for covenant windfall.
- After somewhat 'artificial' record sales numbers in 2016, new car registrations are returning to a more sustainable position, providing opportunity for dealers to make stronger profit margins.



LIMITING FACTORS

- Wavering consumer confidence due to a lack of clarity from Government on diesel vehicles and tax bands could limit sales volumes.
- Pressure on personal disposal income alongside a weak sterling is resulting in potential purchasers delaying their purchase or upgrade to a new car. In addition, there is the potential for an increase in the cost of the end-product due to border-crossing levies on materials and components, depending on the outcome of Brexit negotiations.
- There is a lack of investment-grade product being created and released to the market.

OPPORTUNITIES & VALUE

- Investing in the right franchises in terms of future model line-up and likely market share will be key, as will ensuring current sites are future-proofed.
- There will be an increasing variety of forward funding/commitment opportunities as new and highly impressive bespoke 'destination' facilities are developed.
- Given the appeal of the sector and scarcity of stock, those investors acquiring or able to create an automotive portfolio will witness an appreciation in value as scale increases.

KEY ATTRACTIONS

- Opportunities are often priced on a cost-recovery basis, proving low rental levels and leading to investments that are almost entirely underpinned by vacant possession value.
- There can often be strong underlying land values and alternative use opportunities given the size of plots and prominence to main arterial routes and motorways.
- Corporate identity standards, as enforced by manufacturers upon their dealer partners, create a product in which the tenant will continually invest and upgrade, serving to preserve or enhance reversionary value.

WHAT TO BE AWARE OF

- Considering rental levels on a traditional 'rate per sq ft' basis alone is likely to prove misleading, with occupiers having increasing regard to a 'sustainable rental overhead' based on brand and market catchment.
- Modern bespoke automotive facilities let to major covenants on long leases are an attractive asset and pricing reflects this: the sector no longer attracts a pricing discount to the 'core' property sectors.
- The influence and importance of the manufacturer should not be overlooked. Whilst rarely on the lease, they play a key role in value as a 'silent partner'. An understanding of corporate identity standards and the brand's market position is critical.

BOLD PREDICTIONS

- We will see a new overseas brand enter the UK car market.
- One of the UKs largest dealer groups will be sold.
- Sales of hybrid vehicles will increase two-fold over the next 12 months.
- Prime yields for long income will tighten to inside NIY 4.5%.

HOTELS

"The UK hotel sector is far from maturation and requires inward investment in what is still a fragmented arena. High quality asset backed businesses such as hotels and hostels continue to attract domestic and international buyers."

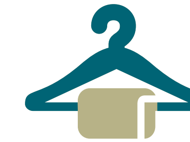
Julian Evans
Head of Healthcare & Hotels

KEY STATISTICS

Investment volume 2017	£5.5bn
Share of UK investment market	8.4%
Investment volume 2008-17	£27.28bn
Prime yield as at end of 2017	TBC%

Source: Knight Frank, PropertyData

THE CROWN HOTEL, HARROGATE, YORKSHIRE



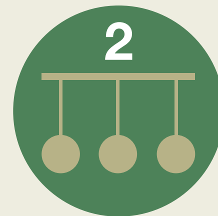
SINGAPORE'S FRAGRANCE GROUP BOUGHT THE 115-ENSUITE BEDROOM, GRADE II LISTED PROPERTY, WHICH DATING BACK TO THE 19TH CENTURY.

LOCATED 0.5 MILES FROM HARROGATE RAILWAY STATION AND 12 MILES FROM LEEDS BRADFORD INTERNATIONAL AIRPORT.
the hotel offers extensive conference facilities with capacity for over 400 guests.

THE PRICE ACHIEVED WAS £7.25 MILLION, REFLECTING A NET INITIAL YIELD OF 6.2%.

DEMAND DRIVERS

- 2017 was a record year for inbound tourism to the UK, with the fall in sterling contributing to demand. Visit Britain is forecasting another strong year of tourism growth, with visitor numbers up 4% to 41.7 million and spending up 7% to £26.9 billion.
- Stronger global growth and rising business confidence will have a positive impact on UK hotel trading performance. With strong growth from major source markets, in particular the Eurozone and the USA, enhanced hotel RevPAR performance is expected.
- The weight of foreign capital invested in hotels reached new heights in 2017, with a growing acceptance by overseas investors to deploy their funds into assets located in prime regional UK cities. There will be no let-up in 2018 as new international investors enter the sector and existing investors expand their holdings.



LIMITING FACTORS

- Higher interest rates, combined with higher inflation and falling real wages, may dampen domestic consumer spend as disposable incomes are squeezed. As a result, the UK hotel domestic market may experience a slowdown, resulting in fewer leisure overnight stays as well as a reduction in incremental revenue spend.
- With ongoing concerns over the risk of terrorism, visitors particularly from Asia and the USA may choose to alter their travel plans to the UK, thereby affecting hotel performance, with trading in London likely to be more severely impacted.

OPPORTUNITIES & VALUE

- Institutional investors spent approximately £1.4 billion on hotels in 2017, attracted by the potential for high returns and the ability to match long-term liabilities with long-term investments.
- The hotel sector is well-placed to create ground rent structures, which are considered very secure, long-term income streams. Hotel cash flows typically grow in line with inflation and hotel assets considered less likely to become functionally obsolete, due to the ongoing level of capex invested by the tenant.
- The creation of specialist dedicated credit funds and the increased availability of debt from non-traditional banking sources is attractive to investors and offers customised solutions to those seeking financing for hotel development, product repositioning, acquisitions or refinancing.
- Private equity investors are likely to continue to divest from their investments during 2018, offering opportunities to new entrants.

KEY ATTRACTIONS

- As a property sector, hotels are set to remain a strong performer in 2018, benefitting from an attractive risk-return, diversification opportunities, and the ability to capture the demand of a different demographic profile to that associated with other commercial property types.
- There is an opportunity for developers to become more creative in their design and planning applications, incorporating other specialist property sectors into mixed-use development. The emergence of hybrid schemes, such as vibrant hubs for student communal living, combined with serviced apartments, is an emerging trend that is set to become far more prominent in the future.

WHAT TO BE AWARE OF

- The lack of clarity over post-Brexit UK immigration policy is causing some uncertainty for the hotel sector and its employees, with the British Hospitality Association estimating that around 15 percent of the sector's workforce are EU migrants. Margins may come under pressure from rising labour costs as well as increased food, utility costs and business rate rises.
- Good asset management remains key to delivering the superior returns required by private equity and institutions. Investors must identify the true level of on-going capital investment required, as under-invested hotels will struggle to compete new or refurbished stock.
- General Data Protection Regulation comes into force in May 2018. This can mean amendments to management and franchise agreements and new procedures for owner operators, while investors may require new systems in order to comply with the legislation.

BOLD PREDICTIONS

- Overseas capital, emanating largely from Asia, in particular Singapore, will continue to seek out prime assets in London and the UK's regional cities.
- Assets benefitting from the proximity to strong demand generators, with a proven income stream and significant upside potential will naturally attract the greatest interest.
- The attractive risk-return profile of the hotel sector, combined with favourable and alternative demographics, will continue to fuel strong demand from private equity and institutional investors who seek to diversify their portfolios across multiple asset classes.
- The availability of alternative debt sources, through the creation of private equity debt funds is expected to continue to grow in prominence in 2018, allowing private equity capital exposure to the hotel asset class, but with reduced risk.

PRIVATE RENTED SECTOR

"Investment into PRS continues to exceed forecasts".

James Mannix
Head of Private Rented Sector

KEY STATISTICS

Key statistics	
Investment volume 2017	£5.7bn
Share of UK investment market	8.7%
Investment volume 2008-17	£26.7bn
Prime yield as at end of 2017	4.00-4.25%

Source: Knight Frank, PropertyData

UXBRIDGE

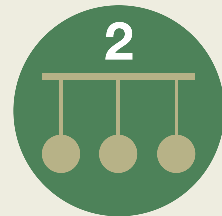
A PRS BLOCK WITHIN PHASE 7 OF THE VINCI ST MODWEN ST ANDREW'S PARK MIXED USE REGENERATION SCHEME, LOCATED IN UXBRIDGE, GREATER LONDON.

CONSISTING OF 207 UNITS SPREAD OVER THREE 6 STOREY BLOCKS, WITH A NIA OF 149,800 SQFT AND ASSUMED TOTAL RENT PASSING (IF BUILT TODAY) OF C. £3,770,000 PA.

A FORWARD FUNDING DEAL ON BEHALF OF ANNINGTON HOMES LTD FOR C. £75 MILLION WITH AN INITIAL YIELD OF C. 3.9%.

DEMAND DRIVERS

- A growing share of the population is finding home ownership unaffordable, despite historically low levels of mortgage interest rates. In addition, those opting to rent instead of buy are increasingly attracted to the flexibility associated with the PRS.
- Meanwhile, as the removal of tax reliefs starts to affect profitability, small-scale buy-to-let investors may begin to sell properties, reducing the pool of stock available to let.
- More generally, a structural under-provision of homes regardless of tenure, combined with ongoing population growth, means that demand continues to outstrip supply.



LIMITING FACTORS

- While there is a large number of investment funds ready deploy means into the PRS market the number of sites or existing developments is small, with the number of operating BTR blocks even smaller. This creates a bottleneck in the market and it is important to realise that now is the time to increase the capacity of this market and create more product.
- At the same time land supply is limited – there are not many sites available in locations attractive to renters such as transportation hubs and urban areas. Competition for land is significant between traditional house builders and BTR developers. One of the solutions could be partnering and developing a product that will deliver the best return for the location.

OPPORTUNITIES & VALUE

- Despite seeing strong growth in recent years, PRS housing remains a tiny proportion of the UK's overall rental market. We see significant scope for investors able to create or back PRS 'brands' which prioritise flexibility towards tenant needs and offer superior levels of service and professionalism.
- Much activity in the PRS sector to date has been focused on apartment blocks. Whilst we expect this to continue, we also see significant unmet demand for single family housing in commuter-belt locations around major cities. For investors, the advantage is the potential for lower operating costs compared to apartment blocks.
- At the other end of the scale, micro-apartments and co-living concepts will enhance affordability, and if well executed, will therefore prove attractive for those seeking city-centre locations.

KEY ATTRACTIONS

- In addition to the highly attractive supply and demand imbalance, the PRS offers investors a number of other benefits. Income streams are long-term, secure, and typically diversified across a high number of tenancies, making the sector particularly appealing to institutions seeking to match long-term liabilities.
- As this is a highly emerging market in the UK now is the right time to start investing and identifying the best opportunities. The demand is high and there is a large supply gap hence the timing is of high importance.

WHAT TO BE AWARE OF

- Whether purchasing an existing PRS asset or playing a role in development, investors need to consider how building design can affect operational efficiency and investment performance. This involves identifying a specification and mix of amenities that is appropriate to the location, as well as targeting sufficient number of units to be able to benefit from economies of scale.
- While investors can often access larger lot sizes in London, regional markets tend to offer stronger income returns. Successful PRS schemes share good proximity to work locations, local amenities, extensive transport links and high quality of service.

BOLD PREDICTIONS

- PRS investment activity will grow rapidly over the next five years, with the total invested in the sector reaching £70bn by 2022. Investment inflows from overseas will continue to become a more important part of the market.
- The fastest pace of growth will be seen in the market for single family housing, which caters to the rapid growth in the 35-55 demographic.

"Quote to come."

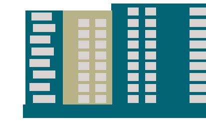
James Pullan
Head of Student Property

STUDENT PROPERTY

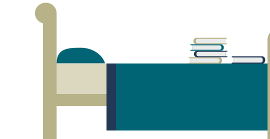
KEY STATISTICS	
Investment volume 2017	£4.1bn
Share of UK investment market	6.2%
Investment volume 2008-17	£19.6bn
Prime yield as at end of 2017	TBC%

Source: Knight Frank, PropertyData

PURE STUDENT LIVING PORTFOLIO



GOLDMAN SACHS AND WELLCOME TRUST'S IQ STUDENT ACCOMMODATION HAS BOUGHT PURE STUDENT LIVING FROM LETTERONE. KF ADVISED IQ.



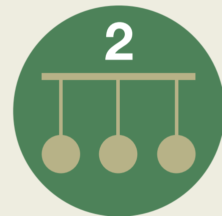
THE PORTFOLIO COMPRISES 3,644 ROOMS ACROSS 11 SITES IN LONDON, EDINBURGH, YORK, BATH AND BRIGHTON.

The bulk of the portfolio was bought from Carlyle Group by LetterOne in 2015. The sites will be fully integrated and rebranded as iQ in spring 2018.

THE PRICE ACHIEVED WAS £870M, REFLECTING A YIELD JUST ABOVE 4%.

DEMAND DRIVERS

- Student numbers have rebounded since tuition fees were increased in 2012, despite demographics meaning lower student numbers in university age cohorts. There are 1.74m full time students at UK institutions, 3.5% higher than in 2012 and 19,100 higher than the number prior to the tuition fee hike in 2011/12.
- At 36%, the 2018 application rate from UK 18 year olds is the highest on record. Applications from international students have increased, bucking the downward trend seen in 2017 when applications from within the EU declined amid uncertainty surrounding the UK's future relationship with Europe.
- Over £4bn of student property was purchased in 2017, up 25% on 2016 levels. We expect this strong pace of activity to continue in 2018, with demand supported by an influx of overseas equity, which has been especially notable from Singapore and North America.



LIMITING FACTORS

- A key challenge for investors in 2017 has been stock availability and this will remain in 2018. Portfolio acquisitions accounted for around 60% of the total investment as investors seek to access stock at scale.
- Forward funding of new developments is an established, albeit small, share of the market. Such deals trade at a discount to existing investment stock, allowing new developments to take place. We expect a key challenge for 2018 will be the viability of forward funding opportunities in secondary locations.
- Non-UK domiciled students are currently included within official immigration statistics, but there is considerable pressure on the UK government to amend this. However, any potential reduction in demand from EU students is unlikely to have a significant on demand: EU students represent 6.3% of full time students in the UK, while 16.5% are from outside the EU, providing investors with some comfort during the Brexit negotiation period.

OPPORTUNITIES & VALUE

- The fundamentals Purpose Built Student Accommodation (PBSA) remain in place: the market is structurally undersupplied at the UK level, and servicing a thriving Higher Education sector.
- UK universities recognise that they are independent businesses operating within a highly regulated environment. As such, there is now more focus on the role of PBSA within the Higher Education sector as the importance of the 'consumer experience' is more widely appreciated.
- It is increasingly recognised that whilst Universities focus on education and research, the undersupply of accommodation will be met by the private sector. Furthermore, tax changes within the 'Buy-to-let' sector may also see private rented sector landlords leave the student market, further bolstering demand for PBSA at local levels.

KEY ATTRACTIONS

- Student accommodation demonstrated solid occupational demand in 2017. Rental growth averaged 2.55% as student numbers remained stable and supply struggled to meet demand. Over the last decade, PBSA has been one of only a few asset classes to deliver rental growth every year.
- Across the UK as a whole, full-time student numbers outweigh current PBSA bed spaces by 3:1. Despite the volume of student accommodation, either planned or underway, this supply/demand imbalance will remain evident in a number of key cities.
- The market for PBSA is broadening: the number of first year postgraduates in 2016/17 was up 9.5% on 2015/16 levels and is at its highest point in ten years. This coincides with the introduction of postgraduate loans for those students from England studying a master's course. Overall, UK domiciled postgraduates from the UK are up by 8.3% on 2015/16 (26,260) levels.

WHAT TO BE AWARE OF

- Each regional market demonstrates different credentials largely depending on the balance of demand and supply, together with the development pipeline and its delivery in any given year.
- New stock will be driven predominantly by private sector investment. 23,000 purpose-built student bedrooms are due to be completed by the start of the 2018/19 academic year, increasing the stock of PBSA by 4.3%.
- The balance of new stock in 2018/19 is likely to be less expensive, in real terms, than in previous years and this may mark the beginning of a shift in development, as the market reacts to perceived affordability pressures in some key cities.
- Rising build and site costs will put pressure on margins, especially at the more affordable end of the market and, subsequently, this will play a key role in shaping the PBSA pipeline in the coming years.

BOLD PREDICTIONS

- Yields will compress in central London to 4.25% NIY as the planning pipeline slows due to the implication of affordable housing provision and developing student accommodation in Zone 1 becomes increasingly difficult and expensive. Regional yields will remain stable.
- Regionally there will be a reduction in all studio schemes being developed, this is due to a drop in rental growth for studios in some markets where it is perceived there has been an over development of all studio schemes in the last 2-3 years.

"The under provision of UK care bed capacity is now at national crisis levels. Demand for healthcare fixed income is at its highest in over 25 years as investors seek to source future proof care facilities."

Julian Evans
Head of Healthcare & Hotels

HEALTHCARE

KEY STATISTICS

Investment volume 2017	£1.3bn
Share of UK investment market	2.0%
Investment volume 2008-17	£6.83bn
Prime yield as at end of 2017	TBC%

Source: Knight Frank, PropertyData

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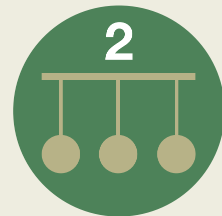
DEMAND DRIVERS

- Population ageing is a key demand driver within this sector, triggered by extending life expectancy and the ageing of the baby boomer generation. The rate of growth in those over 65 is faster than for those below this age, and the number of elderly people is estimated to reach 13 million by 2021, equal to 19% of the population.
- As the elderly population increases, the gap between those that require care, and the existing provision, will widen further. We estimate a shortfall of almost 160,000 (en suite) market standard beds by 2021.
- There is a lack of modern stock. 53% of UK provision comprises homes of 35 or fewer registered beds, either in older purpose built or converted properties. Furthermore, one third of existing provision does not have an en suite facility.



LIMITING FACTORS

- Ultimately, a lack of stock, not demand, will be the greatest impediment to investment activity. However, 2018 will see further funds invested to support the development of new care homes, with a number of potential large funds on the starting blocks.
- Operators face multiple challenges, including rising staff costs due to the introduction of, and subsequent increase in, the National Living Wage, high staff turnover, and a shortfall of qualified nurses, which may be exacerbated by Brexit. These factors, combined with a social care funding crisis, will have an adverse impact on at least 6,600 homes in the UK and could result in further home closures.
- A shortage of skilled construction labour and price inflation on raw materials will continue to restrict the pace of healthcare developments.

OPPORTUNITIES & VALUE

- Pre-lets, both on a forward-fund and commitment to purchase basis for new build care facilities, hospitals and surgeries are at a record high, with Knight Frank currently mandated to lease over 2,500 beds throughout the UK. We envisage continued forward-fund opportunities for investors in the year ahead.
- We also predict an increase in sale and leaseback transactions as operators take advantage of historic low yields, which allows them to recycle the proceeds to enable platform growth.
- Savvy developers and investors are continuing to target areas of good wealth profiles in regions such as the East Midlands and Yorkshire, where land values are lower and profitability margins are strong. Our 2017 Care Homes Trading Performance Index pointed to profit margins of 28% for homes in the East Midlands region, the equivalent to margins achieved in the South East, where land values are higher.

KEY ATTRACTIONS

- Investors, both domestic and international, are attracted to the sector's long-dated income, typically comprising 30-year lease terms, with either Retail Price Index-linking or fixed uplifts. When comparing this with the average lease length of roughly seven years for other UK commercial properties, the care home sector remains a compelling target for investors.
- The sector's institutional appeal is also heightened by comparatively lower yields in both the bond markets and broader commercial property markets.
- Underpinning this, demand for healthcare services is typically driven by domestic factors, and therefore unlikely to suffer directly from any Brexit related uncertainty. The fundamentals of the care home sector remain robust as investors seek defensive sectors in which to invest.

WHAT TO BE AWARE OF

- The care sector is innovating more rapidly than ever, influenced by data, technology and improved knowledge of specialist care such as dementia. For instance, electronic care plans are being used within homes for quality assurance, to meet regulatory requirements and to save valuable staff time. Acoustic monitors are installed within care homes to improve the quality of care and improve staff efficiency during night shifts. Healthcare assets will need to adapt to facilities and technology fit for 21st century care and ensure that they do not become obsolete.

BOLD PREDICTIONS

- We expect a record year for investment, dominated by the fixed-income market.
- We also estimate that there is circa £3.5bn of UK private equity and circa £20bn of overseas private equity looking to enter the UK care home market this year. Furthermore, an estimated £500m of ground rent transactions are in the deal pipeline for the year ahead.
- We can expect to see further investment from infrastructure funds and the emergence of new UK REITs and Asia Pacific funds. Attracted by the UK's ageing population, an under provision of care home beds, the attractiveness of long-dated income and a weakened Sterling, we envisage overseas investors to re-enter the market.

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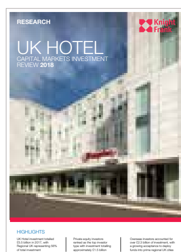

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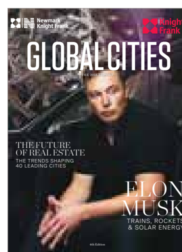

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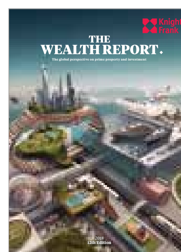

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