UK Elderly Accommodation Market

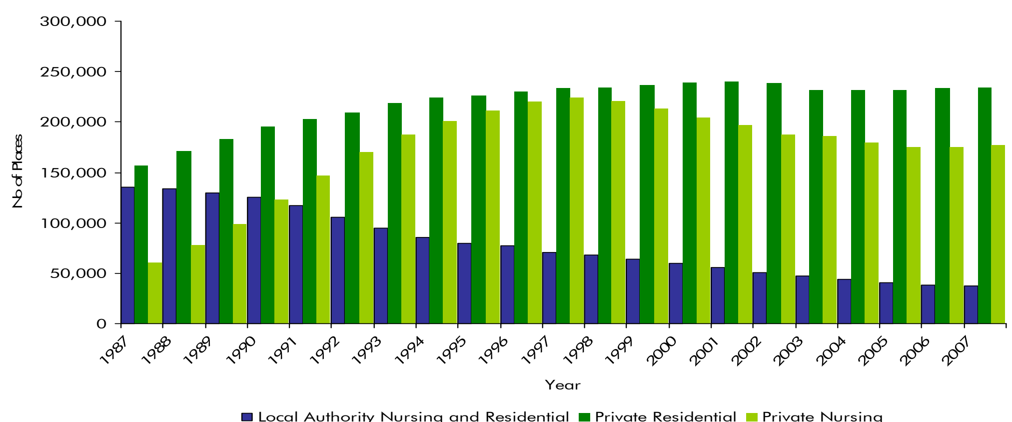
September 2008

MARKET OVERVIEW

Over the past decade, the elderly care home market has substantially restructured. There has been an overall decline in care home places, due mostly to a decline in public-funded provision. In contrast, the private sector has been growing.

The closure of so many local authority homes was largely driven by the introduction of the Care Standards Act 2000, which bought about more stringent standards of care. Many homes became financially unviable. Larger private operators have been better equipped to deal with changing regulations and the additional cost pressures that these have incurred. The profitability of providing elderly care homes is highly contingent on scale. Although provision has traditionally been fractured market, with the top-10 providers representing only 25% of all bed spaces, there has been recent consolidation within the industry.

Care Homes Places for Elderly, Chronically ill and Physically Disabled People



Source: Laing and Buisson

Types of Elderly Accommodation

The types of elderly accommodation are defined according to the level of care they provide, but there is often some overlap. They generally fall into four categories:

Nursing Homes - Nursing Homes offer the greatest level of care and are registered to offer medical and nursing care. They are classified as planning use class C2 (Residential Institution). They usually take the form of blocks of single en-suite rooms with additional communal facilities. Residents typically pay an all-inclusive rent for their room, food and up to 24-hour care.

Care Homes - They provide accommodation with residential and personal care, but do not offer medical nursing care. The resident can usually choose the level of care they receive and the cost of such ancillary services will vary accordingly. They are also classed as C2.

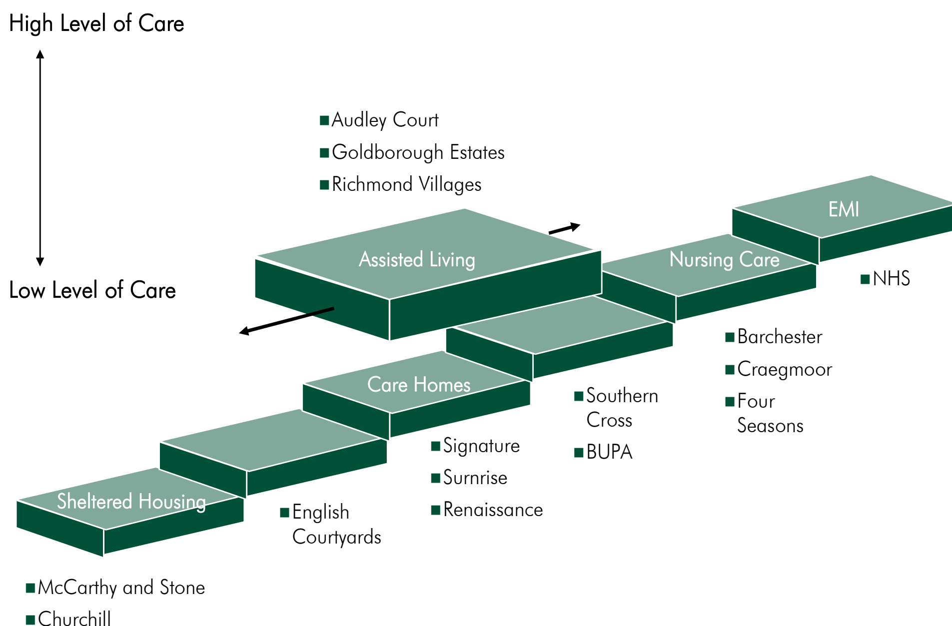
Assisted Living - These are often also referred to as Extra Care Housing, Retirement Housing and Close Care Housing. They typically comprise a block of apartments, series of bungalows or small self-contained community. They offer a flexible, independent living environment with on-site care options, from an 'a la carte' menu. They can be registered to offer either nursing / medical care, domestic care, or both. They can be classified as C2 use, thus relieving s106 obligations.

Sheltered Housing – Sheltered housing schemes offer the most independence, as residents effectively live in their own home but with an on-site warden and alarm system. The flats typically sell at a premium over other residential space. They are usually C3 (residential) use but can vary according to each local council.

The Major Players

Notwithstanding recent consolidation across the private sector, growth within the industry has also occurred in a fragmented fashion; a number of developers have splintered off to form new models of accommodation and care, adapting to changing demand and desires of the market and its subsequent profitability. Established providers have diversified along the care spectrum, providing nursing and specialist care such as EMI nursing (for Elderly Mentally Infirm). For example, Signature Senior Living have followed the successful US-founded Sunrise model in their care homes that incorporate elements of assisted living and nursing care. Richmond Villages also offer a range of care in their assisted living schemes, including some provision for EMI, in the form of a block of specialist dementia apartments.

SCALE OF CARE AND MAJOR PLAYERS



Occupancy of Living in a Care Home or Long Terms Hospital by Age, UK April 2007

	<65	65-74	75-84	85+
% Living in Homes of Hospitals	0.04%	0.84%	4.10%	16.90%

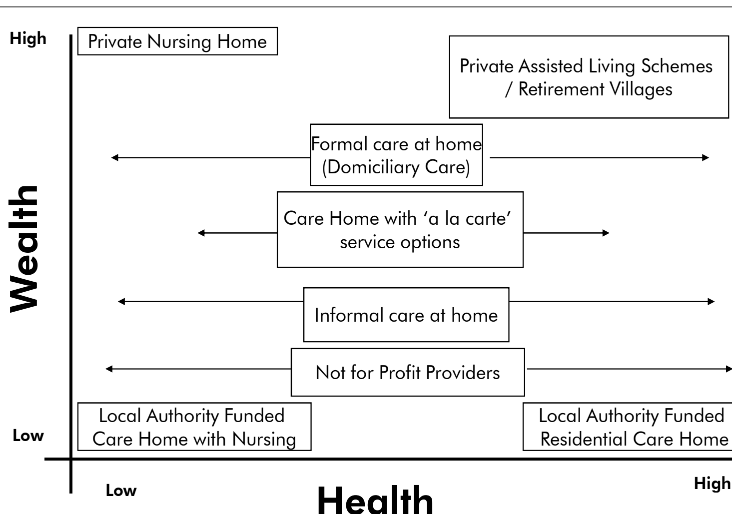
Source: Laing and Buisson

Demand

There are two main features of the elderly population that will affect demand for different types of accommodation: these are health and wealth. Health and dependency will dictate the type of accommodation an individual needs. Dependency usually increases with age; for example, those over the age of 85 are likely to be in poorer health with a higher level of dependency and are more likely to seek nursing home facilities. Those aged between 65 and 85 are typically healthier with a lower level of dependency, thus preferring more independent living solutions. There is an immediate preference to stay in one's own home; this includes sheltered housing or assisted living complexes. The latter are proving particularly popular as they can accommodate an individual even as their condition worsens and their needs increase, preventing them from having to move house at a later stage.

While health dictates the level of care they require and more suitable accommodation, their wealth will ultimately determine their choice of accommodation. All accommodation costs; at one end of the spectrum, sheltered housing units are sold at a premium over other residential space; at the other end, full nursing care homes can be very expensive and are usually considered to be the last resort. Although wealth has generally increased across the elderly population, some still have low levels of income through other sources. They are typically asset-rich / cash-poor. This highlights the importance and massive potential of equity release schemes

DRIVERS OF ACCOMMODATION CHOICE



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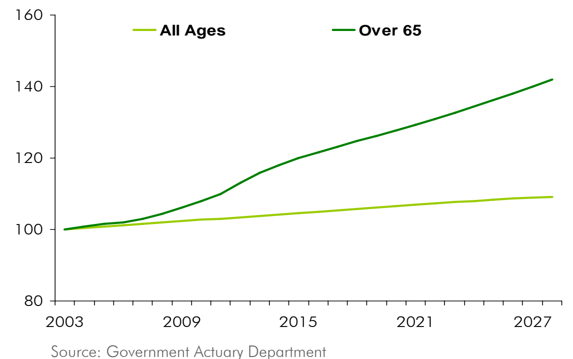
Future Demand for Accommodation

Demographic trends are the main driver for elderly accommodation, with a massive growth expected in the elderly population. Growth is exacerbated by the demographic 'blip' known as the post-war baby-boom generation. This group, born in abnormally large numbers in the years immediately following the Second World War, is now nearing retirement age. By 2031, the population of the UK is projected to grow by 7 million. Crucially, the older population is also living longer. For example, the population aged 80 and over is expected to grow from 2.6 million in 2004, to 5 million in 2031; nearly doubling in size. This suggests an increase in demand for elderly accommodation. This population cohort will also have specific demands and desires from its accommodation, particularly as the rates of disability and dependence will increase with age.

UK POPULATION TRENDS



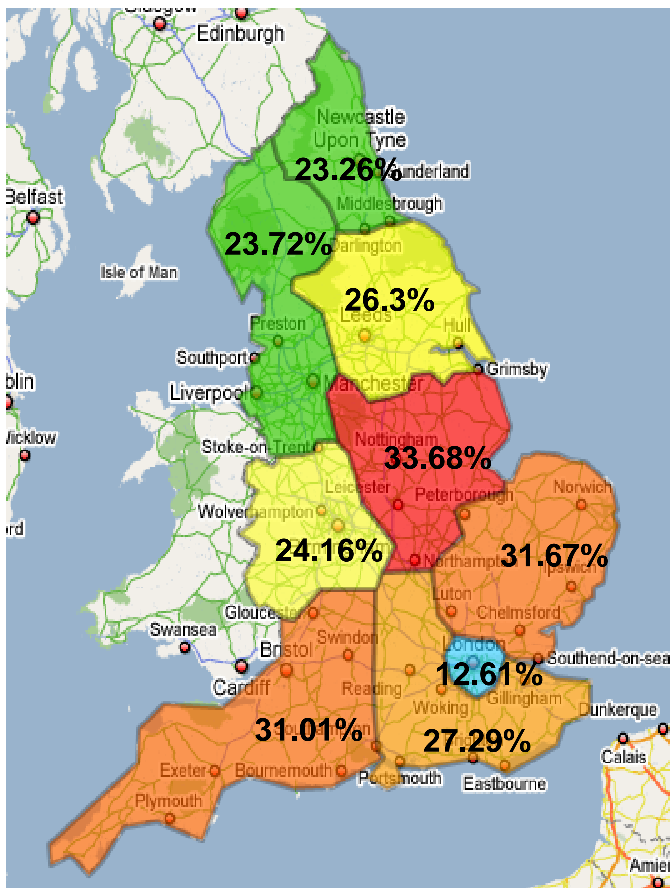
Source: Government Actuary Department

Regional Demand

Demand for elderly accommodation will vary geographically as the elderly population disperses across the country. For example, the number elderly people in London is projected grow at a much slower rate compared with the rest of the country; outward migration from large cities is common. This is illustrated by the more pronounced growth in the elderly population in the areas surrounding London; the East, South East and even the East Midlands. The South West and West of England will also see the number of people over 65 increase as they incorporate popular retirement zones, particularly along the coast. This will drive demand for intermediate elderly accommodation, such as sheltered housing or assisted living schemes.

Demand for more specialist housing, such as nursing homes, is more evenly spread across the country. With exception of London, the number of people over the age of 85 is growing at a similar rate across the country. This is partly fuelled by the tendency for older people to move close to family members as they become increasingly dependent. The distribution of people over the age of 85 is fairly even across the country, with the exception of London.

Heat Map of Projected Growth Across England, Ages 65+



Source: Googlemaps.com / ONS

Regional Population Increases; Growth and Actual Numbers (in thousands)

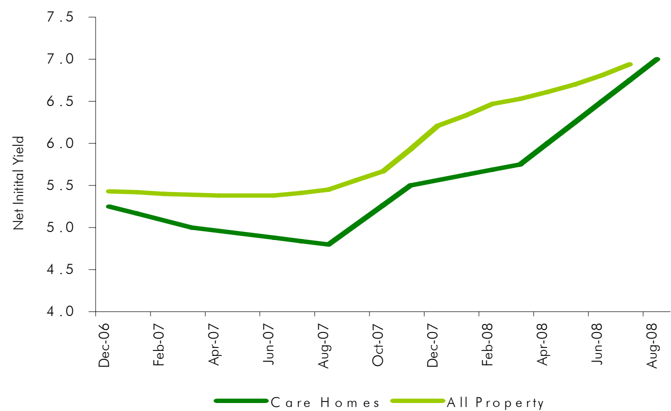
	Region	% Growth 2008-2020	% Growth Annual
65+	London	12.61%	1.05%
	North East	23.26%	1.94%
	North West	23.72%	1.98%
	West Midlands	24.16%	2.01%
	Yorkshire	26.30%	2.19%
	South East	27.29%	2.27%
	South West	31.01%	2.58%
	East	31.67%	2.64%
	East Midlands	33.68%	2.81%

	Region	% Growth 2008-2020	% Growth Annual
85+	London	18.55%	1.55%
	North East	38.85%	3.24%
	North West	30.85%	2.57%
	West Midlands	34.98%	2.91%
	Yorkshire	32.51%	2.71%
	South East	31.68%	2.64%
	South West	33.01%	2.75%
	East	39.61%	3.30%
	East Midlands	38.78%	3.23%

Investment Market Overview

Following the credit crunch and in line with wider trends, investor sentiment in the healthcare market has been affected in-line with the wider property market. Prior to this, large-scare transactional activity, driven by the availability of finance, was strong. However, larger deals are now much more difficult and require more effort; deals that completed in the first quarter of 2008 were generally those that were negotiated prior to the liquidity issues in the global credit markets and the subsequent re-pricing in the commercial property market. We are aware of a number of care home portfolios currently available on the market that have failed to sell, even though the covenants secured have been the prime healthcare covenants on long (25years plus) leases with guaranteed fixed annual uplifts.

Care Home Yields Vs All Commercial Property Yields



Indications seem to be that single asset 'prime quality covenants' with fixed income streams are being considered at yields in the region of 6.0% - 6.5%, although we are aware of yields in the region 7% - 8% being discussed. There is limited evidence in relation to larger portfolios although there are numerous opportunities currently being marketed at asking yields between 5.75% and 7%. Sentiment amongst lenders seems to be that lot sizes up to about £75m – 100m are still fundable, although terms have obviously changed to reflect the issues in the current credit market. Recent market activity suggests that lenders and investors are considering such transactions, albeit at initial yields which vary depending on the quality of the covenant and the assets offered. This reflects a movement on prime care homes of 125 to 250 basis points above yields experienced 12 months ago.

Lease Terms and Market Rent Considerations

The majority of leasehold transactions and sale and leaseback deals are being concluded on the basis of standard institutional lease terms. Indicative lease terms are for the following:

- Minimum 25 years with no tenant breaks or option to purchase
- RPI or compounded uplift paid every five years
- Open market review (upward only) every ten years. The third party should be an expert and not an arbitrator
- Full repairing and insuring by the tenant
- Clear restrictions on user clause, assignment, sub letting and alterations

Rental values of care homes are a function of their sustainable trading and profit margins. They are therefore determined by key performance indicators (KPIs) such as the average fee, occupancy rate and ultimately the EBITDA margin. Operators are typically prepared to pay a rent which equates to between 50-60% of adjusted EBITDA (after Head Office and Capex provisions). The exact amount will depend upon the terms of the lease, the quality of the building / location, as well as their negotiating position with the acquiring landlord.

Private Equity

In recent years it has been common for healthcare groups to be targeted by private equity. This reflects the underlying attractiveness of the healthcare businesses, that provides stable cash generative businesses with strong property assets. Additionally, from an operational point of view, the private equity companies believe that there exists the potential to increase efficiency, cut costs going forward and benefit from the effects of consolidation.

Private Equity Providers that have bought into the Sector

Target	Private Equity Interest	Date	Value
Craegmoor	Advent International	July 2008	£290m
Healthcare Homes	Bowmark Capital	April 2008	£75m
Castleback (part of Grove Ltd which also owns Barchester)	Lydian Capital	July 2006	£255m
Four Seasons	Three Delta	May 2006	£1.4bn

Over the past six months, with significantly less debt available, it has become harder to implement a highly leveraged PropCo at low yields. Rent bids yields have moved back to more sustainable levels. At the same time multiples on profit paid for operating freeholds have generally been more resilient, dependent upon the development potential of the portfolio, consolidation opportunities within the sector and the quality and stability of the assets and management. The result is beginning to reverse the trend experienced where the aggregate of the split PropCo and OpCo were attaining significant premium to the assets valued as operating freeholds.

Opportunities

Buyers in the sector have increasingly identified the growth potential of the underlying business as the value driver of the real estate. The opportunity to become involved in the operational side of a business is a key function in the pricing of real estate backed alternative investments

Distress in the residential development market is creating opportunities for the healthcare sector, particularly in the areas of elderly / specialist care, assisted living and medical centres. At the same times, values are holding up better in the healthcare sector driven by strong underlying trading performance and specialist lenders staying in the market. Investors are turning away from leveraged propco structures to the fundamentals of trading performance and underlying quality of management and operational revenues.

There is an opportunity to link the strong demand for care homes from operators, the availability of credit for robust trading models and the recent availability of quality sites that were previously out of reach, to deliver a significant pipeline for landowners, investors, developers and operators work collaboratively'.

Value Drivers

REVENUE STREAM -	HIGH	LOW
Private : Publicly funded ratio	Nationally 1/3 : 2/3 split	
Fee Levels -Non Nursing Care (per week)	£700	£300
Non Specialist Nursing Care (per week)	£1000	£450
Occupancy Rates	92%	< 85%
Measured by -	1.	1.
EBITDA Margin	35%	<20%
Capital Value per bed	£125,000	£50,000
Rent as percentage of EBITDA	70%	50%

A Planning Perspective

Local Authorities have an obligation through national planning policies to undertake comprehensive assessments of need in the local area. They are required to ensure that a good mix of housing is provided, including extra care homes, residential care homes, nursing care homes and other appropriate specialist housing for older persons.

Schemes that fall within Planning Use Class C2 such as Extra Care Housing, Close Care Housing are likely to be relieved of s106 obligation, such as provision of affordable housing. Sheltered housing, which falls within Use Class C3, can vary in its treatment by the planners. Schemes that provide over ten units will usually be required to make s106 contributions, although the extent will be negotiated on a case by case basis (dependent upon the level of need) and will depend upon the financial viability of the scheme.

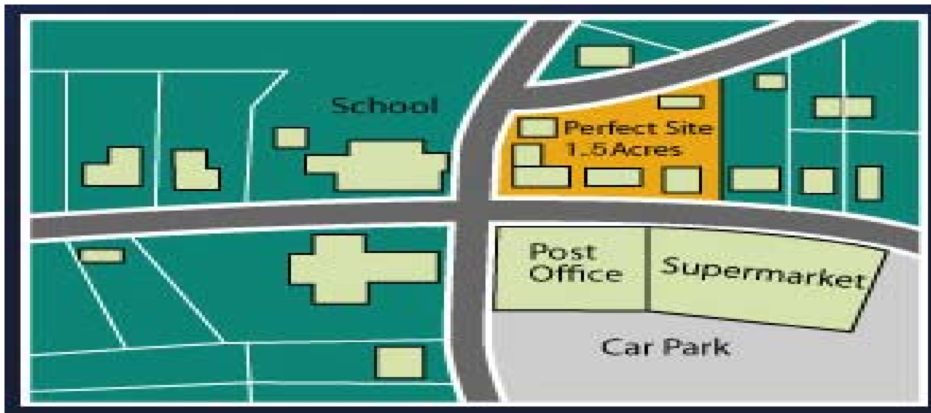
The Perfect Site

Although 'the perfect site' clearly varies according to each developer and their product, our interviews with developers suggest that there are a number common features that most developers are looking for, when acquiring land for residential or nursing care facilities:

- For urban or suburban sites, the preferred size is around 1 acre. For best value, there will need to be a minimum of 60 beds, all single and en-suite.
- Should be situated on a busy road with high visibility.
- In primarily affluent residential areas.
- Close proximity to public transport.
- Close proximity to local amenities, such as a food-store, post office, chemist, doctors, etc.
- Car parking, usually up to 25 spaces though this is dependent on area (rural or urban)
- Would look to sites with a variety of current uses, not just C2 or C3 residential. Popular alternatives include petrol stations, hotels, pubs, gardens centres, etc.
- It is also clearly important to identify local competition, particularly with regards to pricing.

Developers that specialise in providing greater levels of care tend to prefer developing horizontally, i.e. not over two floors. This is not only prompted by development economics, but also the keenness to move away from the 'institutional feel' of traditional nursing homes. Developers of Assisted Living or other retirement flats, such as McCarthy and Stone, are more open to three storey potential or higher. Below is an illustration of a common 'perfect site'.

THE SUNRISE SITE MODEL



Source: Sunrise Senior Living

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