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Emerging Trends in Social Care Investing

Social Care Investing Report

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Foreword

Social care in the UK faces unprecedented challenges. Significant underfunding, staff shortages, cost inflation and fragmented provision of services means the UK's social infrastructure cannot adequately provide for the growing needs of its population.

Recent data points highlight the scale of the challenge. For example, it is forecasted that the number of people with dementia – a complex condition for which treatment is not always funded by the NHS – will **increase from about 900,000 to 1.6 million by 2040[1].**

The UK's demographic profile is changing and has created a perfect storm for social care systems, where more people will live with multiple health conditions and require support from a range of services. The UK government acknowledged the strain on systems when it announced ambitious reforms around adult social care with a series of white papers, including the Build Back Better plan for health and social care, and the People at the Heart of Social Care plan.

Combined, these papers set out a vision for the future of UK social care and address major issues. For example, the funding proposed included **£1.7bn for wide-ranging initiatives ranging from home adaptions to digitalisation to workforce training[2].**

The reforms are primarily about improving care and providing greater certainty around consumer costs. The government estimates that the proportion of **older people in care receiving support from the state will increase from around half to around two-thirds due to the reforms[3].**

While the government has gone further than previous administrations, the reforms have received criticism for failing to address wider unmet needs, which range from basic mobility to social contact.

1. Alzheimer's Society | 2. www.gov.uk | 3. Commons Library

A central criticism of the reforms has been that they don't take into account the impact of the pandemic's lasting legacy, rising inflation, and shifting demographics. Pessimism over the lack of a holistic government response will likely be exacerbated by the **abolition of the 1.25% levy on health and social care from November 2022.**

However, the new Prime Minister may well consider bringing the levy back, which he formerly described as a 'dedicated funding source', solely for the 'country's top priority – the NHS and social care'. Meanwhile, there are also reports that the new government may **roll back on its flagship pledge to introduce a cap on care costs in 2023[4].**

Mark Gross

Partner and Head of Development Capital

Mark Gross

Torsten Mack

Investment Director

4. Carehome.co.uk

Introduction

Profits with principles

Against stiff economic headwinds, institutions are increasingly recognising the role of private capital in delivering positive social impact through high-quality care in underserved communities, while producing sustainable returns.

The next few decades could see a profound acceleration of institutional investors adopting social care as an asset class. This is among the principal findings of Downing's new report, Emerging Trends in Social Care.

The report, based on interviews with UK pension funds that collectively have over £102 billion in assets under management, underlines that institutional investors are poised to increase allocations to social care - which could accelerate growth in the needs-based market.

This increased interest is being driven by the attraction of resilient, long-term returns, but also the opportunity to meet key environmental, social and governance (ESG) objectives. The report underlines how institutional investors are using social care investing to increase their focus on the social 'S', in addition to a continued focus on environmental 'E' and governance 'G'.

Social care investing can capture this emerging trend. For example, impact investing in social care involves making investments that deliver positive outcomes for society as well as yield financial returns.

For example, at a local level, social care delivers the infrastructure communities rely on. Investors can work with local stakeholders to align interests and create a shared impact for the benefit of the local area and people.

The report also shows how the vast majority of institutional investors expect the regulatory environment around the social care market to improve over the next few years.

This potential tailwind could help public and private participants to fund, deliver and scale social care solutions in the sector. This will have the potential to support the wide range of needs our society requires and play a key role in the government's broader levelling-up agenda.

Chapter 1

Why schemes are unlocking the value of social care

The survey reveals UK pension schemes are increasingly recognising the multiple benefits of investing in social care. From the pool of UK pension scheme respondents, 84% expect institutional investors to increase their exposure to social care.

Torsten Mack, Investment Director at Downing LLP, explains that there are multiple drivers behind the elevated level of institutional interest:

> *"Our data has found that institutions are poised to increase their exposure to the sector and reflects a growing understanding of social care as an asset class. The commitment to a greater allocation is also a recognition of the unmet need for new investment into the sector."*

Furthermore, Mack notes the sector has been continually evolving and aligning with institutional demand. He argues that while the sector continues to improve standards, institutions are also deepening their understanding of the dynamic and sustainable investment case behind social care.

> *"As standards improve and the obvious benefits that come from investing in this market are recognised, more professional investors are seeking to increase their exposure to it."*
>
> – Torsten Mack

Digging deeper

The report identifies a hierarchy of reasons behind institutional allocations to the asset class. One major motivation for investing was due to a shortfall in public funding towards social care, prompted by strains on the wider healthcare system. This has led to a funding gap that is being increasingly occupied by private capital.

Much of the pressure on the provision of services is related to our populations changing health needs. When the NHS was first established in 1948, one-in-two people died before age 65. This figure is now about one-in-eight. By the time they reach 65, women can now expect to live on average for another 20 years; men 18[5].

This is, of course, a success story, but it presents a profound challenge to the NHS and highlights the necessity for private capital to alleviate the mismatch between supply and demand for the wide spectrum of social care services.

Spending is also a factor, as increases in social care budgets have not kept pace with growing demand.

Fundamental drivers

The trends discussed above tie in to the survey's findings. The highest-ranking motivation for institutions investing in social care is an older generation which holds significant wealth and is willing to pay privately for good quality healthcare, given the lack of adequate available service.

While this highlights a heightened demand within the elderly care sector, further key reasons include the UK's profound demographic challenges and the necessity for improved diagnosis of needs - which could in turn improve the provision for other sub sectors such as specialist dementia care and special educational needs.

Mack explains these factors are fundamental for driving the demand for quality social care services which are suffering from a highly constricted supply of high-quality management teams and dedicated properties for social care.

Other important reasons for investing in the sector cited by UK pension schemes were regulatory improvements and the development of more effective systems for monitoring the service and care quality provided.

Mack said the findings raise important points and there is an increasing recognition that social care has a complex set of dynamics and faces significant challenges:

> *"As a sector and asset class, social care is a broad church. It spans everything from elderly care to dementia and supported living to special educational needs – we don't look at it as one homogeneous group.*
>
> *"All of the areas we focus on have different drivers and are sub-sectors in their own right. Investors need to understand the complexity of each sub-sector. Successful specialist investors understand the nuances of how each aspect of social care is commissioned and provided, and then, crucially, understand how value flows through these assets."*
>
> – Torsten Mack

5. NHS England | 6. British Medial Association

Recipe for success

Within those areas, **Mark Gross, Partner and Head of Development Capital at Downing LLP** says there is one constant: high-quality management teams.

> *"Due diligence is crucial and selecting high-quality management teams with strong track records will enhance the quality of care and give the best chance of sustainable returns. A consistent process, incorporating these principles, also supports the mitigation of reputational risk.*
>
> *At the highest level, when investing into these sectors, it is about the right management team with the right operating experience - combined with the right asset and the right local market."*
>
> – Mark Gross

Gross also agrees that specialist investors are far better suited to navigating this space than generalists, given their deeper understanding around social care sub-sectors.

> *"Taking a top-down, macro-driven approach is not enough. You need to cultivate an understanding around the micro-level trends and the local variances – investors need to look beyond the homogenous approach,"*
>
> – Mark Gross

Chapter 2

Exploring additional drivers of social care investing

The report also reveals that institutional investors are not only looking for social impact and returns; they also identify the defensive nature of the social care sector as a key reason to invest.

88%

It was found that nearly nine-out-of-ten (88%) UK pension schemes interviewed believed the commitment from local authorities and governments to social care provision demonstrates strong defensive attributes.

Indeed, the UK government has set out ambitious plans to reform elderly social care aimed at improving care and providing greater certainty about costs.

The government says the proposed reforms will mean 'people will no longer face unpredictable or unlimited care costs'[7]. It estimates that the proportion of older people in care receiving support from the state would increase from around half to around two-thirds as a result of the reforms[8].

It is also predicted by the government that the annual cost of the social care charging reforms, including the 'fair cost of care', starts relatively low (£1.42 billion in 2023/24) but increases to an estimated £4.74 billion by 2031/32 (in 2021/22 prices)[9].

7. Commons Library | 8. Commons Library | 9. Commons Library

Stickier spending

Gross explains that while the government is putting weight behind reform, the reality is that the sheer gravity of the shortfall means there is likely to be a gap in provision for the foreseeable future. This deepens social care's defensive attributes. He believes the demand dynamics are pushing the government to prioritise and focus on higher needs and acuity care – which presents an opportunity for specialist investors.

This is reflected in the fact that local authority and government funding budgets for high acuity social care are more resilient than other areas of social care. And 90% of UK pension schemes interviewed believe this will have a positive impact on institutional investors wanting to invest in this part of the sector.

Gross continues:

> *"Our research shows that over the next five years, dementia care, care homes for adults with physical, mental, and learning difficulties and care homes for residents with other complex needs are the three areas within the social care sector where pension funds expect institutional investors to increase their allocation the most.*
>
> *One of the reasons for this could be the level and stickiness of state and local government funding in these areas. However, we are also seeing a general increase in private investment going into these subsectors."*
>
> – Mark Gross

Relative preferences

The research also highlights the specific areas of social care where institutions are seeking to deploy capital.

Pension schemes are expected to increase their level of investment in dementia care the most over the next five years. This was followed by residential care homes for adults with physical, mental and learning difficulties, and then residential care homes for adults with other complex needs.

Type of social care	Percentage of UK pension schemes interviewed who expect institutional investors to 'dramatically' increase their level of investment here over the next five years	Percentage of UK pension schemes interviewed who expect institutional investors to 'slightly' increase their level of investment here over the next five years
Dementia care	48%	46%
Residential care homes for adults with physical, mental and learning disabilities	44%	42%
Residential care homes for adults with other complex needs	42%	52%
Supported living accommodation for adults with physical, mental and learning disabilities	42%	50%
Residential care homes for the elderly (personal care & nursing, excluding Dementia)	36%	20%
SEND (specialist education needs and disability) schools for children	34%	54%

Chapter 3

Shift in ESG focus will benefit sector

One of the biggest emerging themes the report reveals was around the evolution of ESG investing.

54%

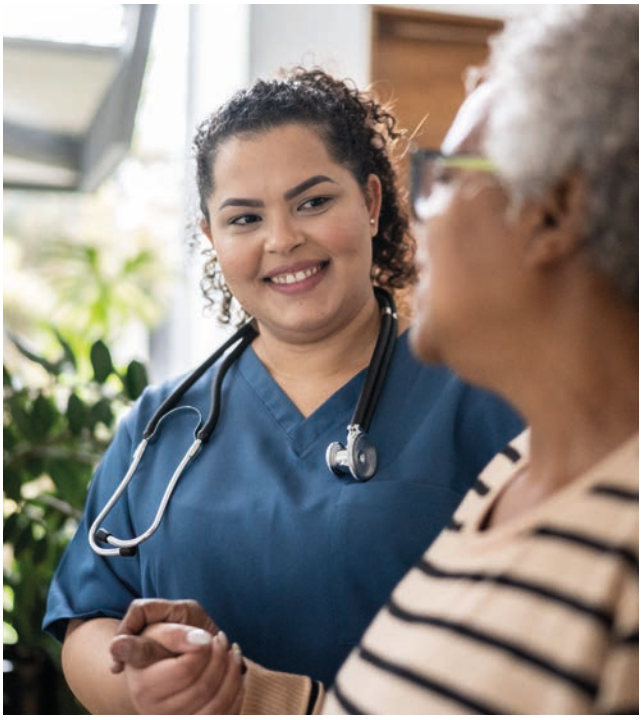
believe the social care sector is poised to benefit from the fact that to date institutional investors have primarily focused on the 'E' (environmental) of ESG, but they are now placing a much bigger focus on the 'S' (social).

Gross explains that the social care sector is under pressure from the weight of growing demand, funding shortfalls, and a lack of supply of modern, fit-for-purpose accommodation delivering high quality care - and this is an opportunity for ESG and impact investors.

One hundred percent of the respondents surveyed agree that investing in social care can help ESG credentials. This universal consensus is hugely encouraging for the sector, says Gross.

"We are witnessing an evolution in how institutional investors are thinking about ESG investing. The increased focus on 'S' is hugely encouraging, and, as part of a virtuous circle, should increasingly influence on the way social care businesses are run in the future."

– Mark Gross



Regulatory reform

In an overwhelming consensus view, **94% of UK pension schemes interviewed expect the level of regulation focusing on the social care market, and the checks and systems in place for ensuring the sector provides quality care, to improve over the next five years.** One in three (32%) expect a 'dramatic' improvement.

Gross says this was encouraging but explains that regulation within the sector is not yet uniformly applied across localities and you have to factor in a range of different inputs such as the history of resident feedback and inspection history.

Gross also feels that institutional investors can access a number of specific ESG-related aspects across the subsectors of social care, including the provision of fit-for-purpose buildings to bridge the gap between supply and unmet demands. There is also another wider community dynamic associated with the labour force. Good quality employment has a multiplier impact on local communities from financial resilience to greater well-being.

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Final word

Social care: investing in all our futures

Often social care is equated with a narrow set of personal care services for elderly care. But the reality is social care supports adults and children with a range of disabilities or conditions – from dementia and frailty to physical and learning disability, mental health and acquired brain injury.

And while on the surface the market might seem homogenous, the reality is very different. Broad macro trends might drive demand, but social care is about micro market provision that is delivered at local levels and influenced by the local market.

Gross stresses the route to a successful and sustainable approach is through a combination of operating capability, quality of property, and management factors.

He mentions it is about understanding nuanced emerging trends. For example, one of the pandemic's legacies has been a shift in the type of demand for elderly care. Care home businesses are now seeing more later-in-life patients with higher acuity needs. In turn, occupancy rates have shorter stay profiles.

Reallocation of capital

The survey reveals institutional investors are overwhelmingly positive about the sector in the post-pandemic landscape.

Inflation, economic headwinds and structural changes with traditional property markets have moved investors broadly into alternatives. But while some asset-based alternatives such as hospitality and leisure have suffered, social care has remained resilient. The sector's lower cyclicality and defensive characteristics are driving higher allocations.

The characteristics of the social care landscape are also driving more providers to the sector. Competition for assets is increasing and more will come to the market, however the quality is not consistent. This could emerge as a major opportunity for specialist investors with a deep understanding of local markets.

The report reveals a surge of interest in social care. However, institutions entering the market need to be wary of a homogenous and generalist approach. Investors need to develop an understanding of factors influencing different types of care. The sector demands a fundamental understanding of local supply and demand factors.

When investing in social care, working with specialist investment teams that have a deep knowledge of the social care sector and are able to access experienced management teams that have a strong understanding of local market dynamics and the requisite expertise to operate high-quality assets, continues to be the best way of generating long-term sustainable returns, avoiding reputational risk and creating a positive social impact.

About the research

Downing commissioned independent research company PureProfile to interview 50 UK pension funds, who collectively manage around £102 billion in assets under management using an online methodology during August 2022.

About Downing

Social care represents one of the key areas in which Downing has deep sector knowledge and forms a crucial part of our investment strategy.

Downing has been a long-term investor in the healthcare sector since 1997. Our award-winning team focuses on asset-backed investment opportunities, and partners with highly experienced management teams who want to grow their businesses and provide exceptional care to vulnerable people in our society.

Click here for more information on Downing Development Capital.

About Downing LLP

Downing is a sustainable investment manager established in London in 1986. We currently manage £1.8 billion of assets under a broad range of investment mandates across our funds, investment trusts and tax-efficient products. As a certified B Corporation we are focused on creating a sustainable future and our key investment areas are renewable energy, infrastructure, property and healthcare.

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