Healthcare Capital Markets

Knight Frank

2023

Despite economic uncertainty, the UK healthcare sector remains buoyant and the overall outlook is positive

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Introduction

This year's report focuses on the healthcare investment market in 2022, looking at emerging trends from both an operational and real estate perspective, as well as our insights for the year ahead.

RYAN RICHARDS, SENIOR ANALYST

UK healthcare markets have remained robust and continue to draw the attention of both domestic and global capital. As with previous years, the fundamental drivers – demographics, long-term income and ESG credentials – have played a key role in pushing the case for healthcare.

With 2022 a year of headwinds in the form of inflation, rising interest rates and political uncertainty, we saw significant transaction volumes closing at circa £2.4bn. This, in line with improved operator trading, as highlighted in our *Care Homes Trading Performance Review 2022*, suggests a maintained confidence in the sector.

Despite the absence of major outlier deals, the trend of increased transactions slightly up on the year is testament to the healthcare sector's pulling power. Overseas capital was once again a key factor, accounting for 31% of transaction volume. This stems from a mix of both European and North American capital continuing to find value in the sector. It is worth noting that, while it remains the largest contributor to transaction volumes, overseas capital was not as prominent in 2022, with occupiers and domestic REITs/listed investors taking back some share volume. With 2022 volumes more organic than previous years, domestic capital is also showing interest.

Average annualised returns sat at 3.50% at the end of Q4 22. When considered with the wider shocks felt by other commercial real estate classes over the past year, the sector's stability and return potential is even more apparent.

The overall outlook for the healthcare sector can be considered positive, and we predict an active market for care assets in 2023. That being said, due to the operational nature of the sector, it is becoming increasingly important that operators, investors, developers and lenders pay close attention to the impact the current economic environment has, or will have, on their capital.

2022 SUMMARY

£2.4bn
Total transaction volume

31%
Percentage of demand from overseas capital

3.50%
Average annualised returns

72%
Portfolio transactions

£200m
Largest single asset transaction

£2.17bn
Five-year average transaction volume

Source: Property Data, MSCI. *As at end of Q4 22

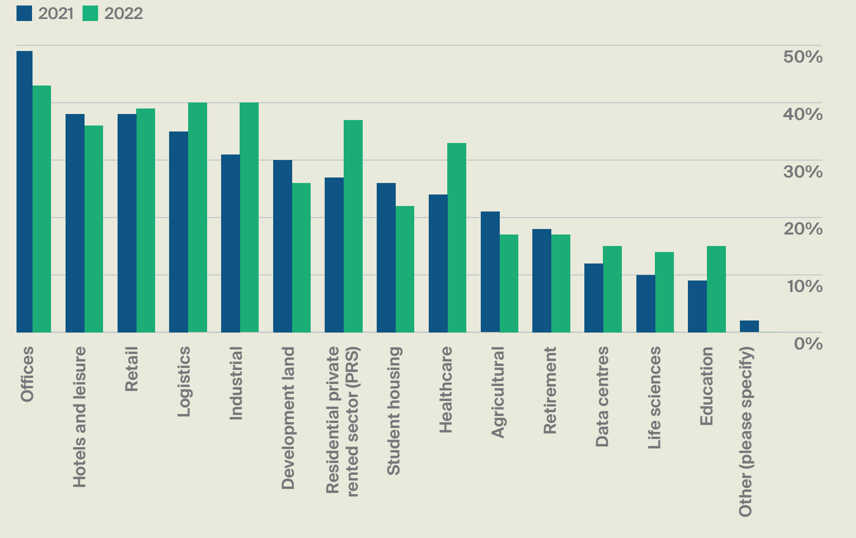
Continued private investor sector focus

For the second year in a row, the healthcare sector has experienced a fundamental shift in the attitudes of private investors. In the 2023 edition of *The Wealth Report*, healthcare topped investors' wish lists for a second year in a row. Our Attitudes Survey highlighted that just over a third of respondents globally were looking to invest in healthcare-related assets in 2023.

Figure 1 presents a compelling view of the growing recognition of healthcare as a leading sector within real estate. As illustrated, there has been a substantial rise in private capital allocated to the sector, and the 24% share in 2021 grew to approximately 33% in 2022. This comes at a time when we have seen the percentage of capital allocated to more conventional classes, such as offices, dip. While this may simply be an indicator of diversification, we are ultimately experiencing a shifting of sentiment towards defensive sectors as investors seek certainty and consistency.

Fig 1: Which sectors do your clients currently invest in?

% respondents



Source: Knight Frank

The case for healthcare as an investment

Long-term income

Weighted average unexpired lease terms (WAULT) average 25 to 30 years in the residential care and hospital sectors.

Leases are commonly index linked to inflation.

Demographic shift

The UK's over-85 population is set to increase from 1.7 million to 3.7 million in 2050.

This ageing population will result in increasing demand for residential care, primary care and acute hospital services.

Secure income

Operator revenue is reinforced by a healthy mix of self- and publicly-funded care.

Income is supported by high occupancy and patient demand across the healthcare arena.

Investment performance

Total returns measured 3.5% in 2022, higher than many core property sectors.

Returns are historically stable, offering investors protection and diversification.

Structural change in real estate

Real estate investors are already de-risking from traditional sectors such as retail into alternatives including healthcare.

Demand for safe havens

Broader UK real estate offers security and liquidity in a global downturn.

The UK healthcare sector's long-term and often government-supported income offers further defence.

Social impact

The influence of ESG investing in real estate is growing at a faster pace than ever.

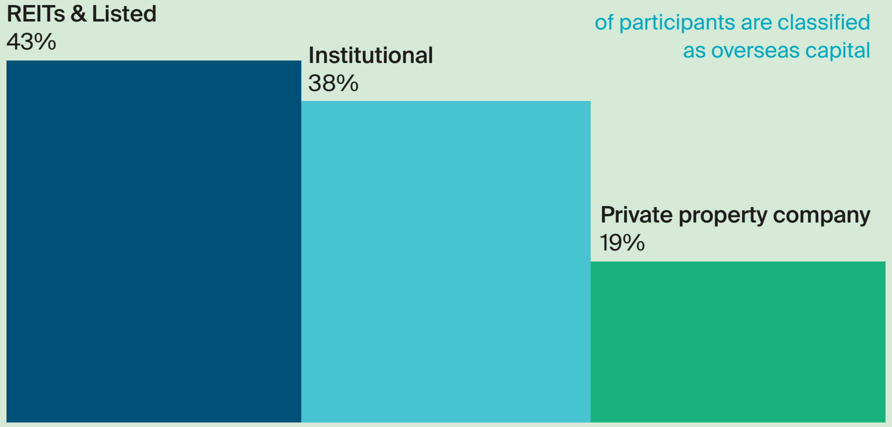
A range of investors are now focusing on social infrastructure investments, with healthcare part of this.

The Attitudes Survey: The 2023 instalment is based on responses provided during November 2022 by more than 500 private bankers, wealth advisors, intermediaries and family offices, who between them manage over US$2.5 trillion of wealth for UHNWI clients.

Market view

As with last year's report, given the various factors impacting the sector, it is extremely important to drill down into investor sentiment to truly understand the state of the market. While extensive resources and in-house data provide a strong overall view of the market, the first-hand investment experience and strategies utilised by those involved provide invaluable insights. We have therefore surveyed most of the key UK market players including major REITs, institutional and overseas investors.

Composition of survey participants



38%
of participants are classified as overseas capital

Source: Knight Frank Research

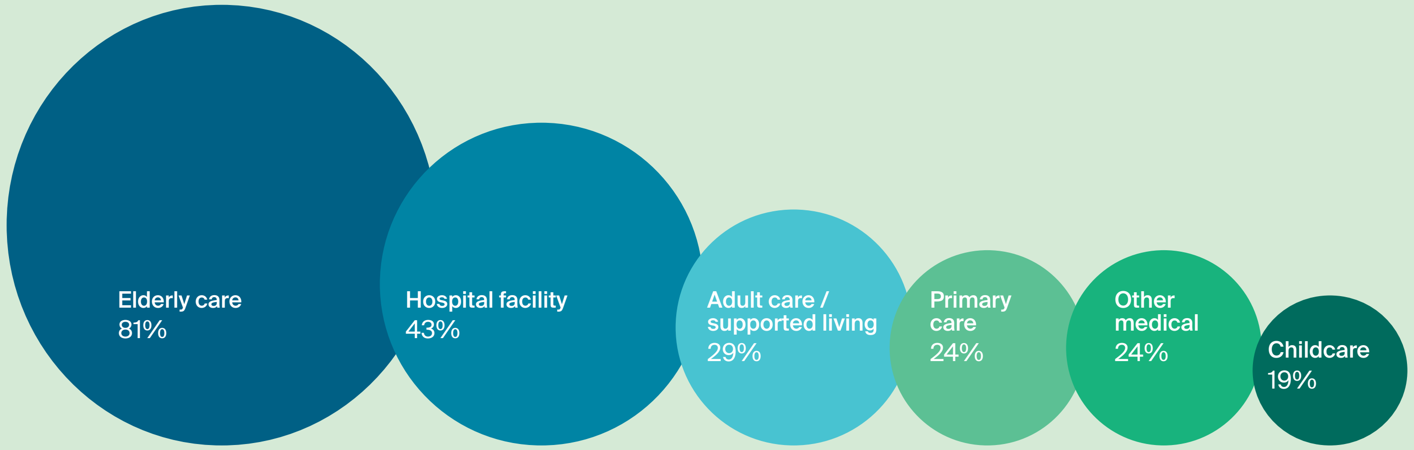
4,113
Total care assets

£74bn
Approximate value of care assets under the management of survey participants globally

£14bn
The amount of capital currently available and committed for surveyed investors to deploy on care assets

Source: Knight Frank Research

Which areas of healthcare do you currently have exposure to? (% of respondents)



Source: Knight Frank Research

99% Average rent collection percentage for participants' portfolios

4.2% Average cost of debt among survey participants

37% Average loan to value among survey participants

4.63 Average years remaining on term of survey participants' debt facilities

1.81x Average rent cover across survey participants' portfolios

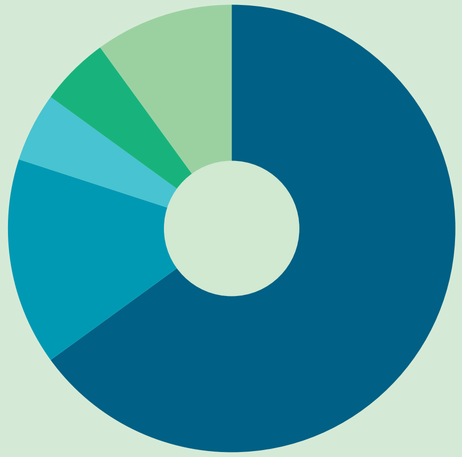
91.1% Average percentage of survey participants' debt that is hedged

24% Percentage of survey respondents that report no use of debt

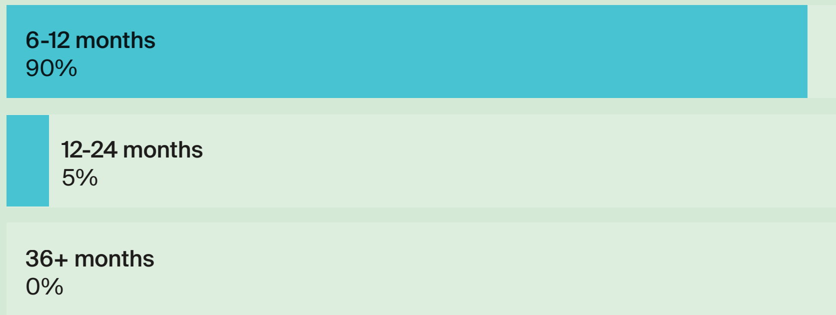
Source: Knight Frank Research

Most important driver of demand for UK healthcare

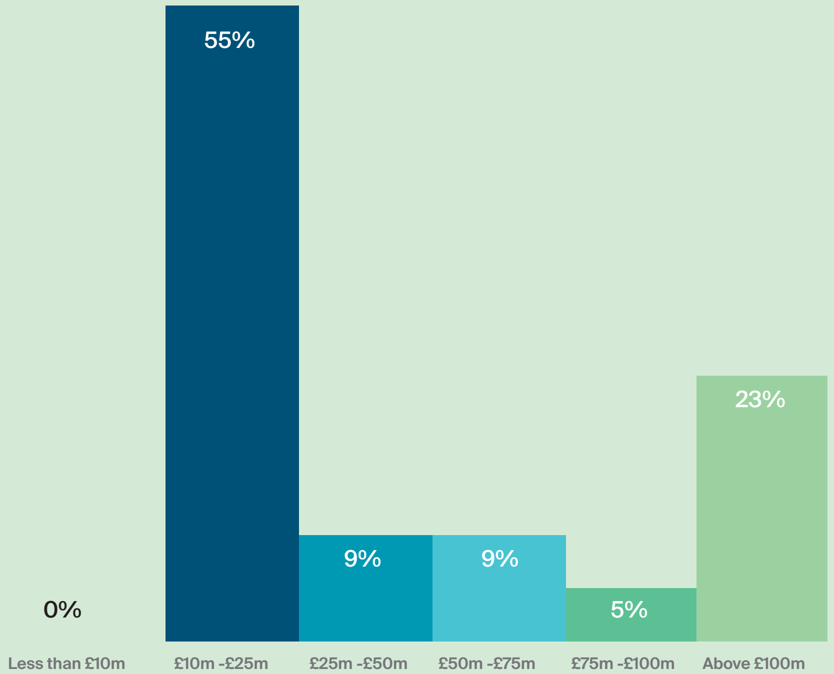
Demographic shift	65%
Secure income	15%
Long-term income	5%
Investment performance	5%
Structural change in real estate	10%
Demand for safe-havens	0%
Social impact	0%



How far is the healthcare sector from normality, following Covid-19?

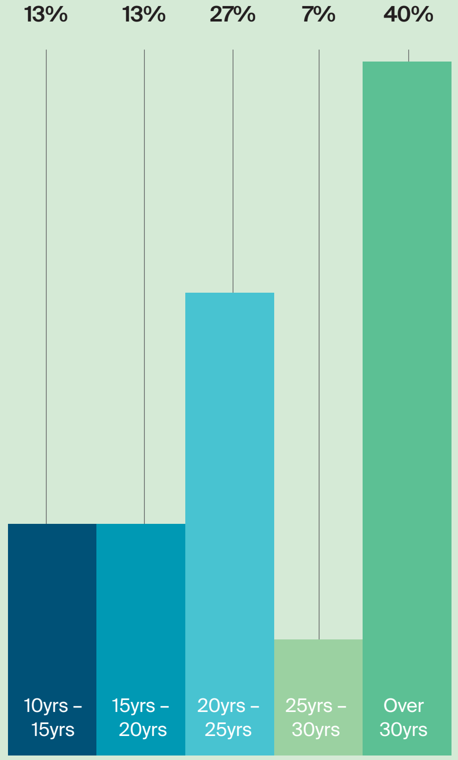


Primary lot size sought by respondents for acquisitions



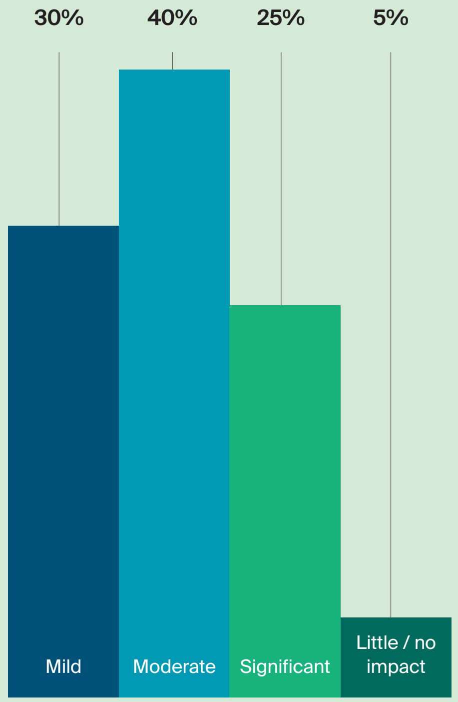
Source: Knight Frank Research

Current WAULT of survey participants' healthcare portfolios



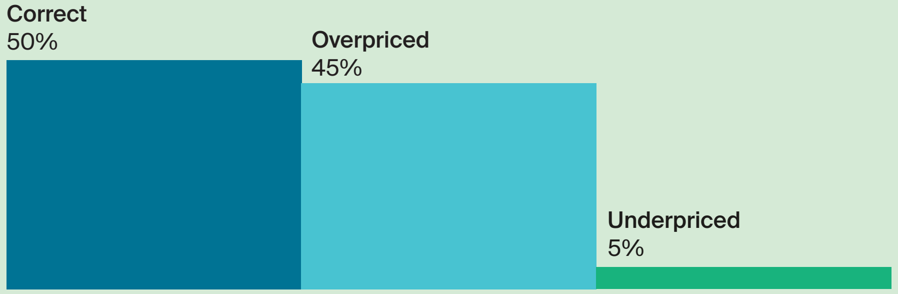
Source: Knight Frank Research

How would you describe the impact of current economic conditions on the performance of your portfolio of care assets?



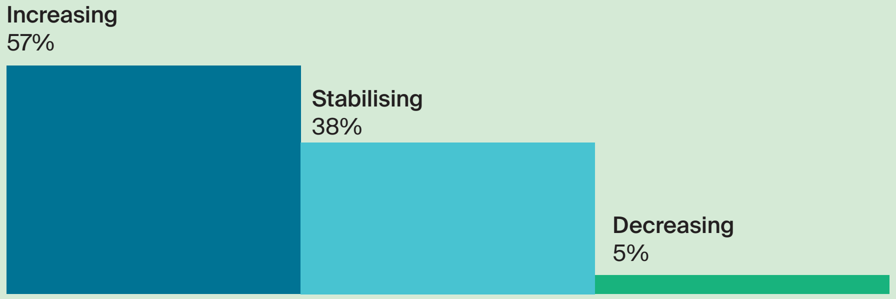
Source: Knight Frank Research

What are your thoughts on the general pricing tone of the market?



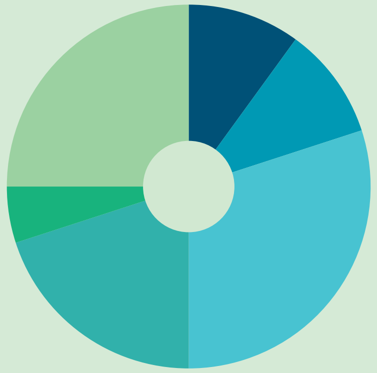
Source: Knight Frank Research

Do you see demand from overseas capital for UK care assets increasing, decreasing or stabilising?



Source: Knight Frank Research

What would you suggest is a major issue with the current quality of stock?



Size	10%
Lack of en-suite	10%
Lack of full wet room	30%
ESG credentials	20%
Scope for repurposing	5%
Other	25%
Location	0%

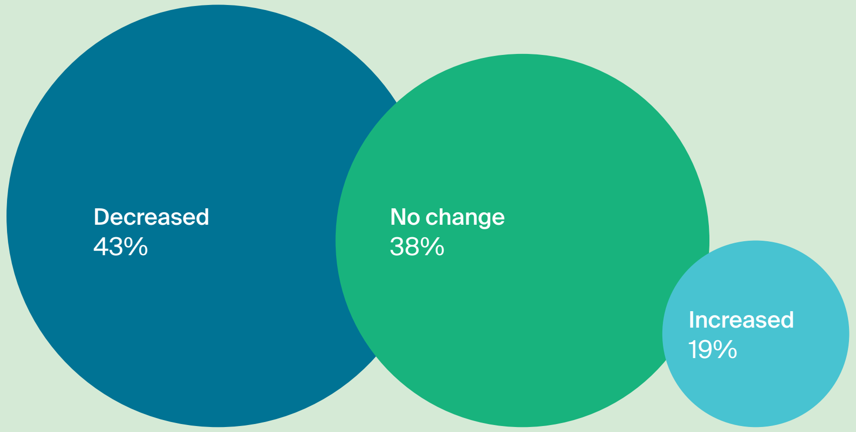
Source: Knight Frank Research

Area of healthcare that presents the greatest investment opportunity

Childcare 0% | Primary care 0% | Other medical 0%

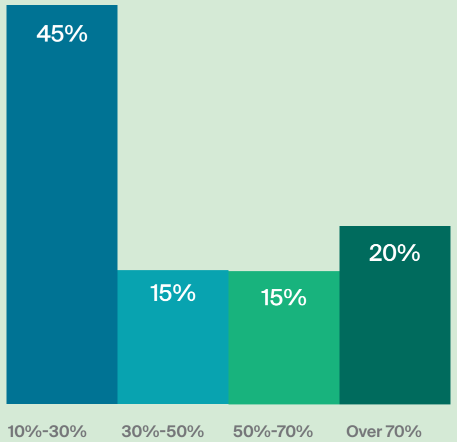
Source: Knight Frank Research

How has the current climate impacted your current appetite for risk?



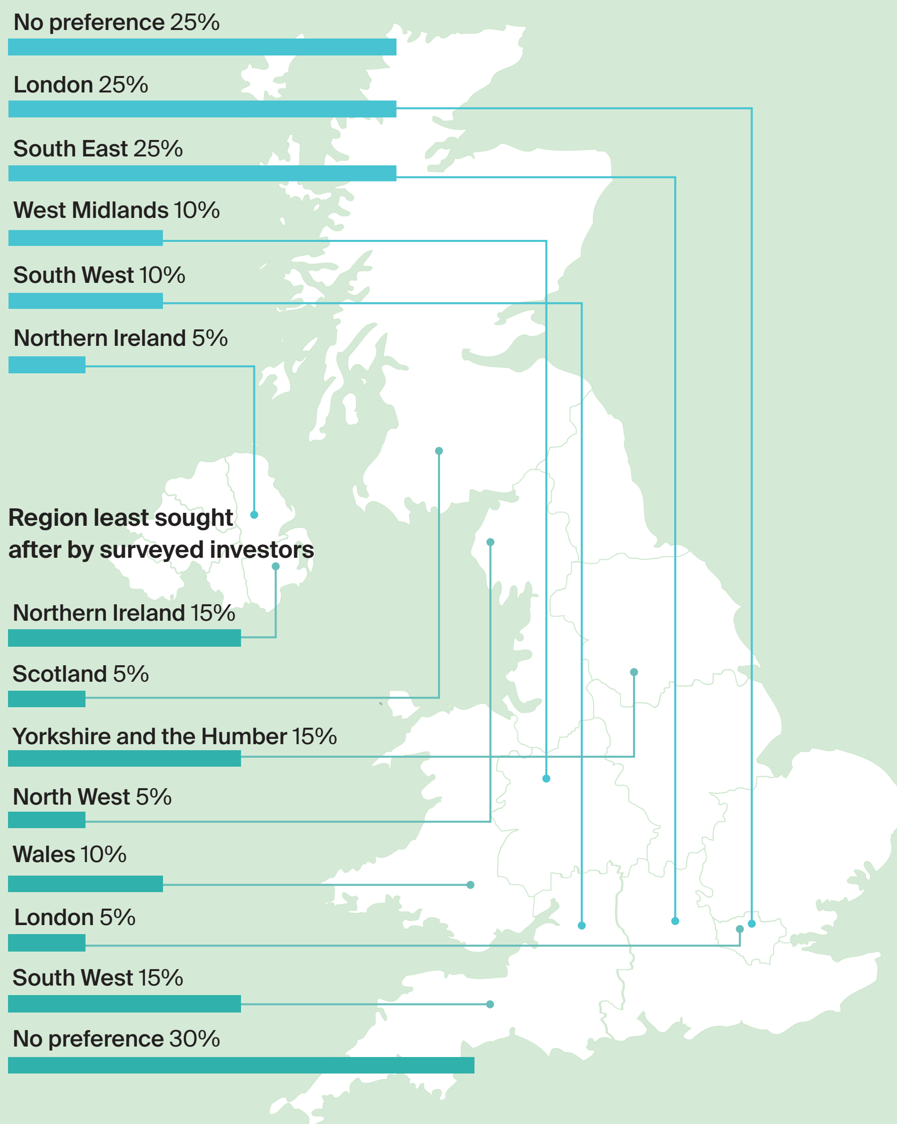
Source: Knight Frank Research

Percentage of survey participants' current strategy attributed to development



Source: Knight Frank Research

Region most sought after by surveyed investors

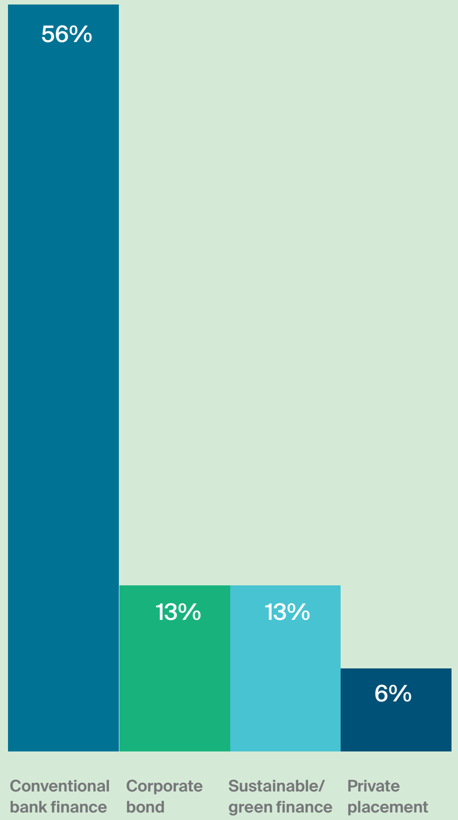


Source: Knight Frank Research

95%

of survey participants have begun to implement ESG into their current strategy

Type of debt



Source: Knight Frank Research

What has been the greatest obstacle in the ability of investors to implement ESG into their strategy?

Lack of ESG opportunities	20%
Lack of ESG understanding	15%
Lack of set standards/ guidelines	25%
Difficulty in enforcing among operators	25%
Other	15%

Source: Knight Frank Research

What would you suggest is the greatest cost pressure on operators at present?

71% Staffing costs

19% Utility costs

10% Agency costs

Source: Knight Frank Research

Market volume

2022 was a year of promising volumes, and healthcare remained stable, despite a volume dip in other property classes.

As we can see in figure 2, recorded volumes for 2022 sat at £2.36bn, compared with £2.34bn in 2021. Although only a slight upwards movement on the previous year, it is useful to note this volume lacks the outlier style of major deals that skewed transaction volumes in the past.

Figure 3 compares the annual movement in healthcare volume to that of all property classes. Healthcare, which accounted for around 4% of all commercial property transactions, was up 1% on the year, despite a slight dip in volume experienced by all property classes. While only a minor upward trend, this can be considered positive due to 2021 volumes being down 15% on 2020 volumes, and signals a move in the right direction. This further illustrates the resilience of the healthcare sector and its lack of sensitivity to wider economic shocks, when compared with more conventional real estate classes.

Figure 4 presents transaction volume on a quarterly basis, as well as rolling four quarters. One trend highlighted by this year's data is the lack of spikes due to standout transactions and a resulting smoothness in volumes between quarters.

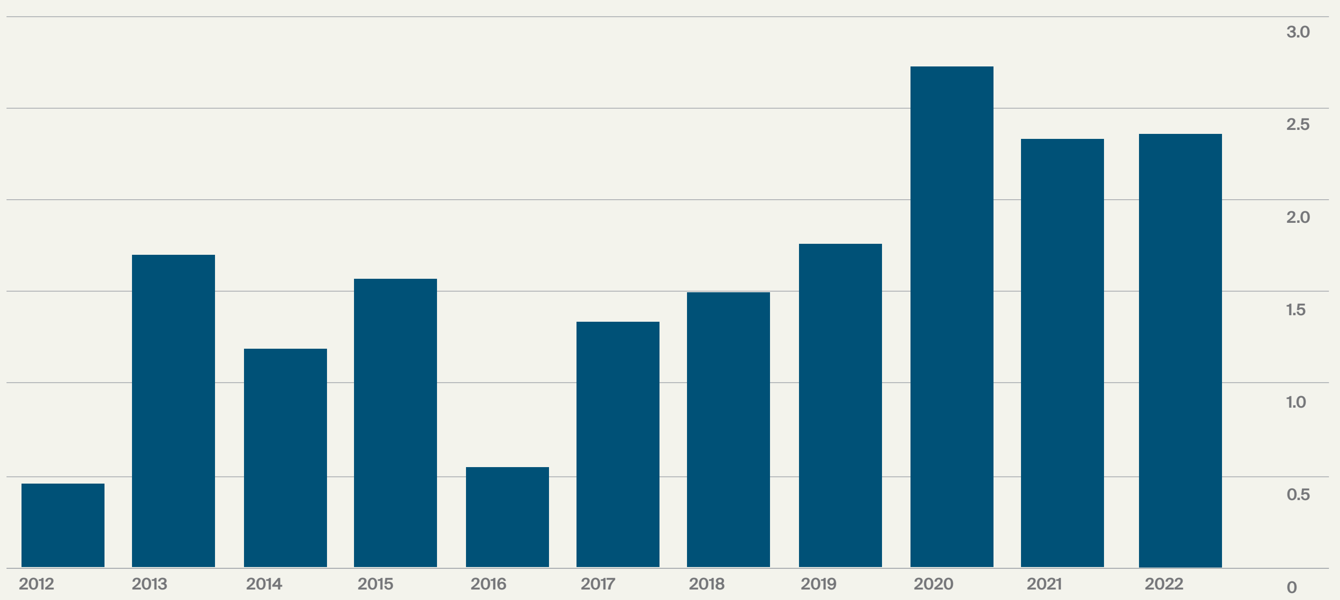
> "Healthcare, which accounted for around 4% of all commercial property transactions, was up 1% on the year, despite a slight dip in volume experienced by all property classes."

Investment by sub-sector is another area to consider when discussing market volume. It is useful to understand where capital is being placed and how this differs from historic investing trends. Figure 5 presents the share of transaction volume attributed to each care sector in 2022, as well as the past five years.

The standout factor from the chart is the continued interest in elderly care, which accounted for 61% of volume. In addition to this, adult care and private hospital spaces regained some share of volume, accounting for 35% collectively, due to notable portfolio deals.

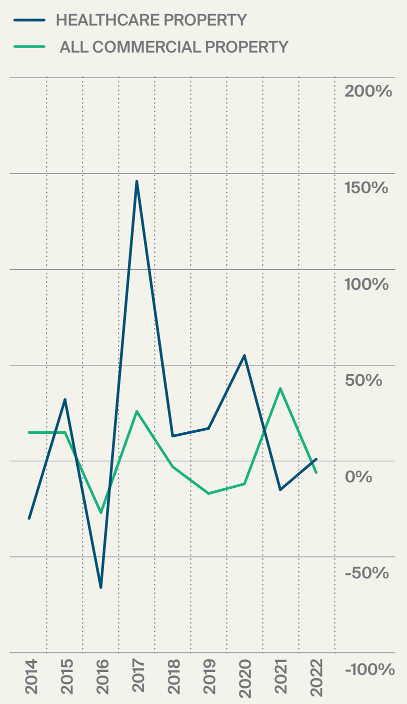
> "One trend highlighted by this year's data is the lack of spikes due to standout transactions."

Fig 2: Recorded healthcare investment volumes (£bn)



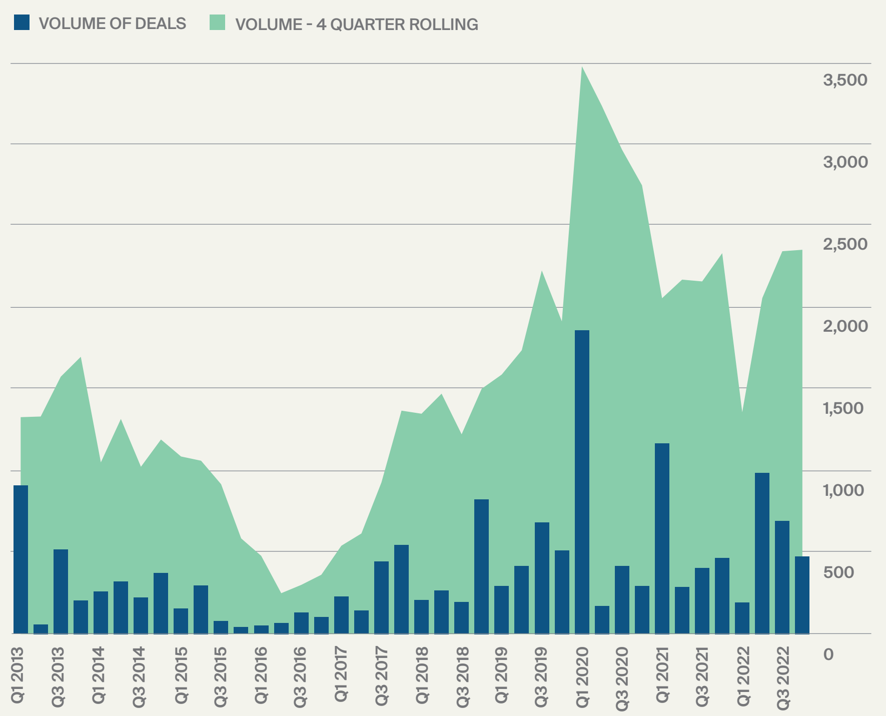
Source: Knight Frank, Property Data

Fig 3: Percentage change in property investment volumes



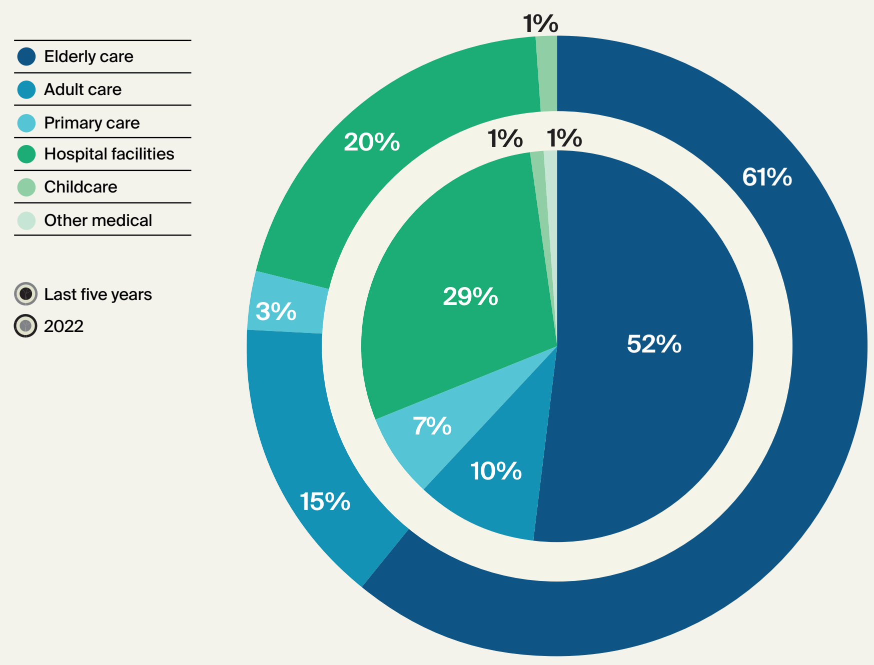
Source: Property Data

Fig 4: Recorded healthcare property transactions (£m)



Source: Knight Frank, Property Data. Includes recorded transactions for elderly care, adult care and supported living, primary care, hospital facilities and childcare

Fig 5: Healthcare property investment by asset type



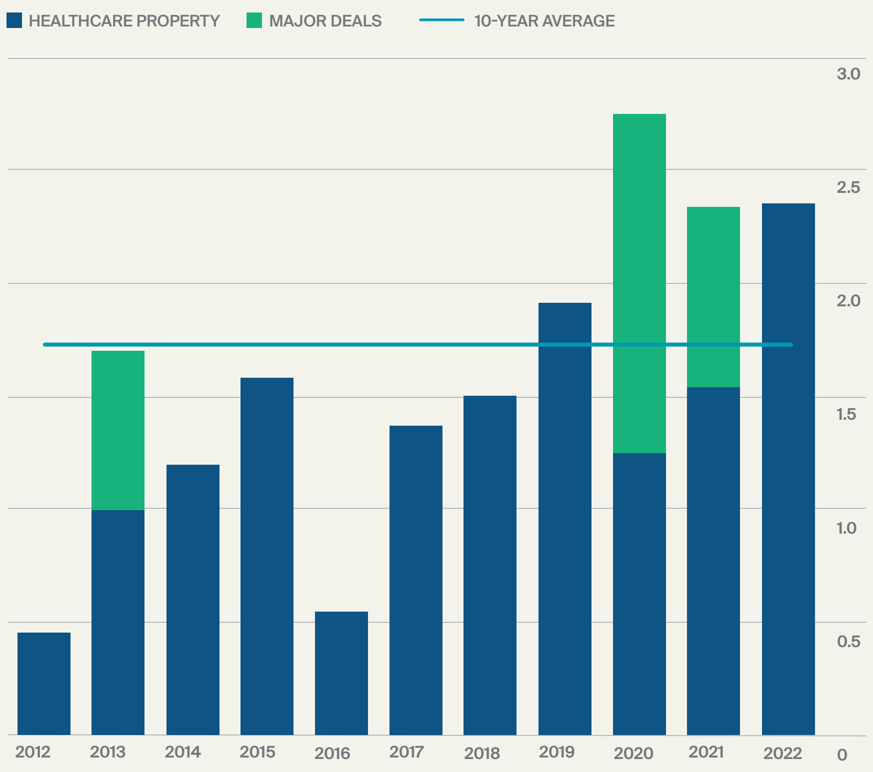
Source: Knight Frank Research

£2.4bn

in healthcare property transactions took place in 2022

Following last year's analysis, figure 6 illustrates a strip out of major deals (classified as any large transactions over £500 million). Although there are few such transactions (three within the last 10 years), the inclusion or exclusion of such deals can present a different picture or sentiment. The lack of major deals within 2022's volumes should be considered positive where volumes are not skewed. This has seen volumes moving towards a more organic state, built on a number of varied transactions, as opposed to a few high-value ones.

Fig 6: Recorded healthcare property transactions (£bn)



Source: Property Data

Table 1: Notable deals in 2022

Deal type	Price £m	Date	Details	Properties	Purchaser	Purchaser Type	Sector
Portfolio	200	Dec-22	S&L	45	Civitas Social Housing	REITS & Listed	Adult care / Supported living
Portfolio	78.5	Jun-22	Care homes across Somerset and Devon	3	Impact Healthcare REIT	Reits & Listed	Elderly care
Portfolio	70.2	Feb-22	Five care homes in East Anglia with a sixth asset located in Dorset	6	PGIM Real Estate	Institutional	Elderly care
Single asset	58	Apr-22	Undisclosed	1	Assura PCP UK Ltd	REITS & Listed	Primary care
Portfolio	51.25	Sep-22	Yorkshire care homes	2	Anchor Housing Group	Occupier	Elderly care
Portfolio	45.5	Sep-22	Three care homes: 198 beds in total	3	Aedifica NV/SA (Belgium)	Overseas	Elderly care
Single asset	31	Apr-22	Undisclosed	1	Primary Health Properties	REITS & Listed	Primary care
Single asset	8.5	Jul-22	Undisclosed	1	Middle Eastern investor	Overseas	Elderly care

Source: Knight Frank Research, Property Data

For the year ahead, we anticipate the sector will maintain its momentum in relation to recorded transactions, particularly as the sector's volume emerges as more sustainable. Figure 7 shows forecast volumes based on an average five-year growth, excluding any major deals (above £500 million). Essentially, we anticipate this further growth in volumes will be a result of a combination of the sector normalising, more organic demand and high-capital investors seeking to opportunistically deploy funds.

> "We anticipate the sector will maintain its momentum in relation to recorded transactions."

Table 3: Major healthcare deals by investor type and sector

	Elderly care	Hospital facility	Total
Banks	962		**962**
Overseas		3,000	**3,000**
Private property company		691	**691**
Total	**1,762**	**2,891**	**4,653**

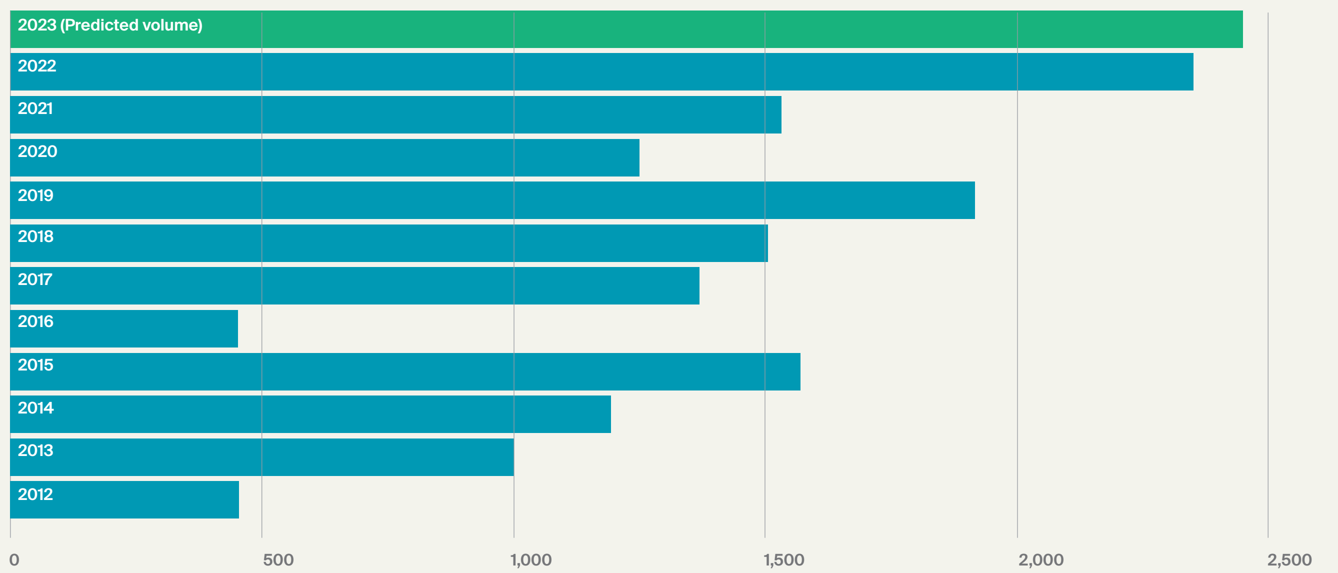
Source: Knight Frank Research, Property Data

Table 2: Major healthcare deals (£500m+) 2012–2022

Description	Deal type	Price (£m)	Date	Purchaser	Type	Category
BMI healthcare portfolio	Portfolio	1,500	Jan 1 2020	Medical Properties Trust	Overseas	Hospital facility
Spire Healthcare	Portfolio	700	Jan 1 2013	Malaysia Employees Provident Fund	Overseas	Hospital facility
Priory sale & leaseback	Portfolio	800	Jan 1 2021	Medical Properties Trust	Overseas	Hospital/ mental health facility

Source: Knight Frank Research, Property Data

Fig 7: Anticipated transaction volumes



Source: Knight Frank Research, Property Data

Transaction composition

With significant volume recorded, we now look to transaction composition. This is vital to understanding the sector's direction in terms of capital flows, investor type, target areas and much more.

Figure 8 illustrates that in 2022, portfolio deals accounted for 72% of transactions, in comparison to single assets at 28%. This is an increase of 500 bps on last year's figure, owing to transacting REITs and overseas capital, in their continued pursuit to grow assets under management. Single asset transactions will no doubt remain prevalent, especially in the private hospital sector, where we have seen notable large acquisitions.

From figure 9, we can see how transactions by overseas investors in 2022 compares with the five-year total, whereby over time, overseas capital has become more prominent. However, 2022 also experienced a dip in the share of transaction volume attributed to overseas capital. This is not owing to a lack of overseas demand, but more increased domestic demand eating into the overseas share, as REITs and private capital demonstrate more interest in the sector.

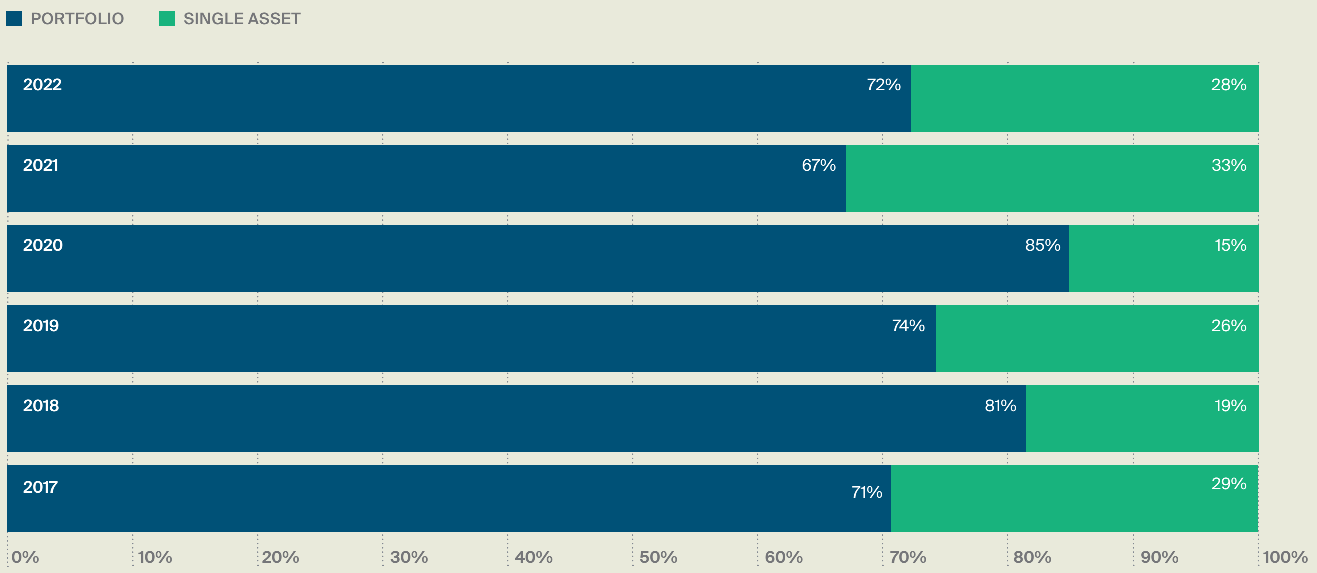
Figure 10 provides an insight into the target market areas from overseas capital over the last two decades. This analysis focuses on the location of capital and the sub-sector of healthcare that it flows into. We can see that US-based capital has historically been split between elderly care and private hospital assets, whereas European-based capital has been more elderly care-focused. We are also witnessing an interest in specialist and childcare facilities. However, these are less prominent within the analysis due to less maturity in the space, in comparison to elderly care and hospital facilities.

> "In 2022, portfolio deals accounted for 72% of transactions in comparison to single assets at 28%."

Figure 11 provides an insight into the source of overseas capital in 2022. As in previous years, capital from the US is a large component of transaction volume; a trend not only seen in care but also within all broader property capital flows.

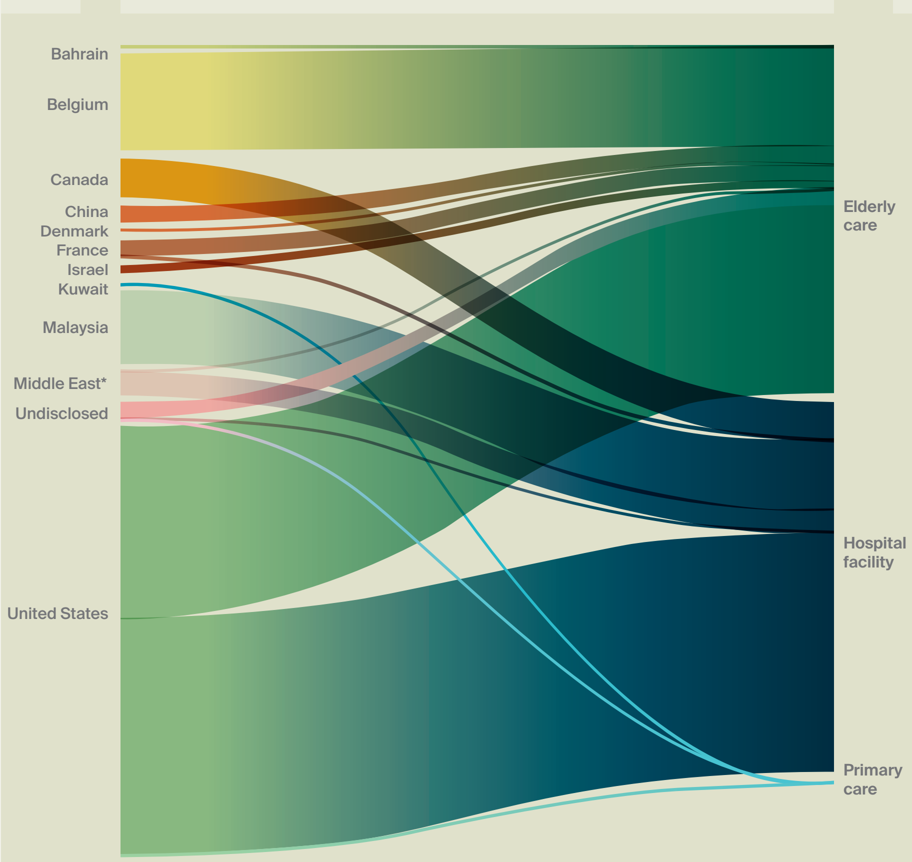
However, healthcare seems to have a more even split between European and US capital, which is responsible for 39% and 32% of overseas flows respectively.

Fig 8: Portfolio vs single asset transactions



Source: Knight Frank Research, Property Data

Fig 10: Placement of overseas capital into UK healthcare



Source: Knight Frank Research, Property Data
*undisclosed

Fig 9: Overseas share of healthcare property investment

2022

Domestic	49%
Overseas	51%

2018-2022

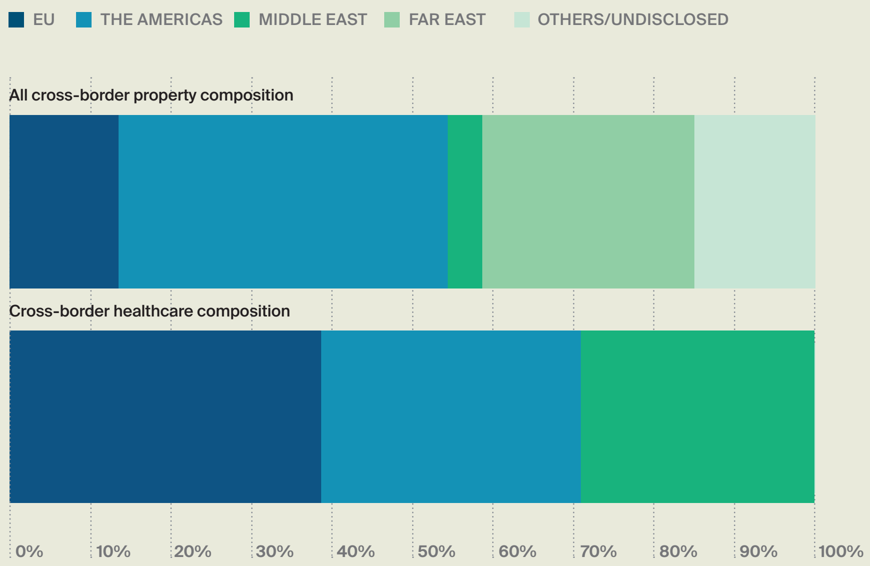
Domestic	56%
Overseas	44%

2022 Healthcare vs all property

2022 All property	
Domestic	49%
Overseas	51%
2022 Healthcare	
Domestic	69%
Overseas	31%

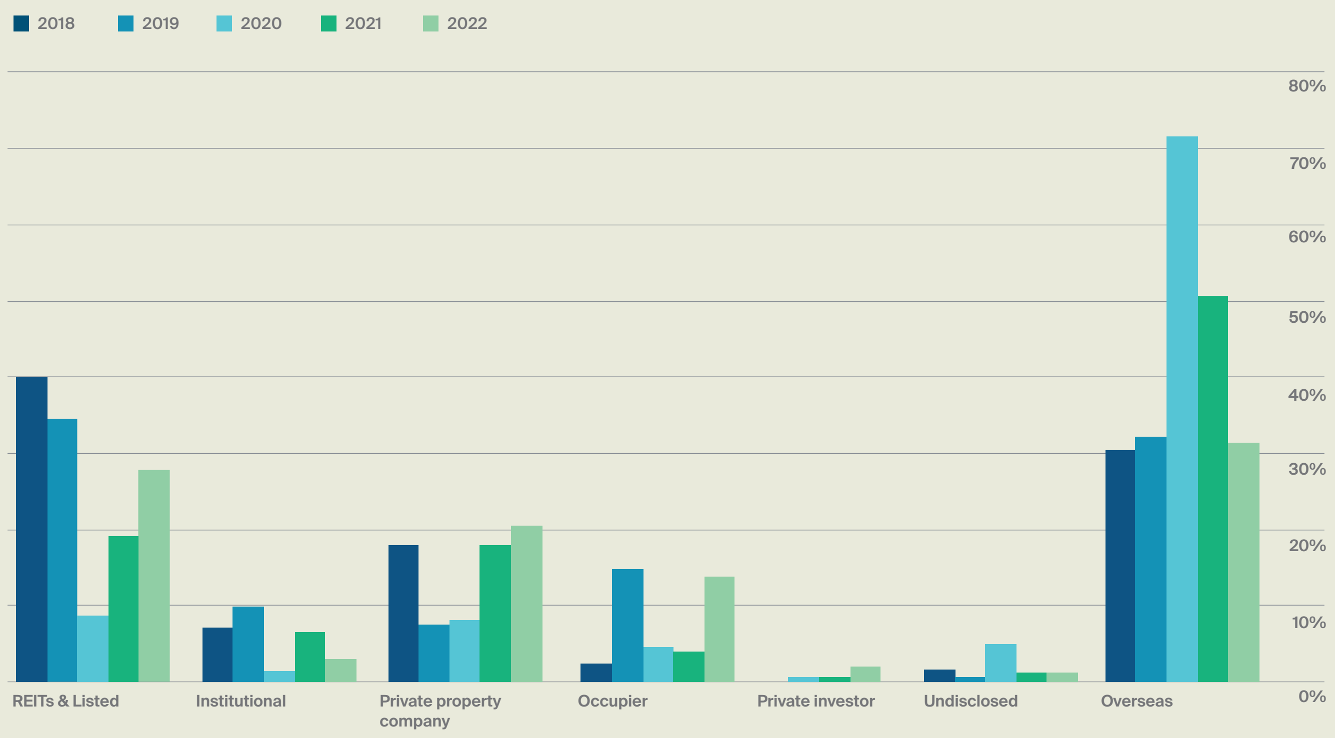
Source: Property Data

Fig 11: Cross-border composition



Source: Knight Frank Research, Real Capital Analytics

Fig 12: Healthcare property investment by buyer type



Source: Knight Frank Research

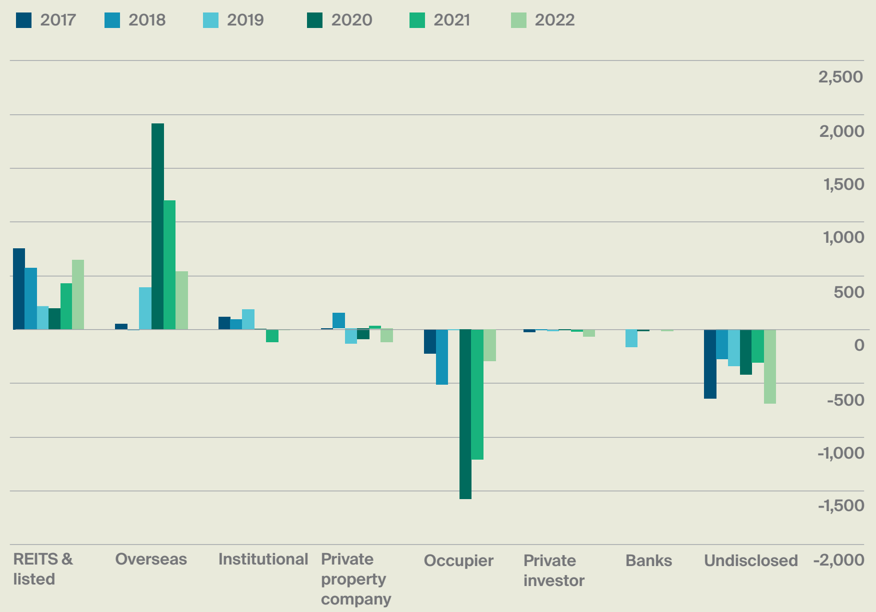
The trend that instantly emerges from figure 12 is the extent to which REIT and general domestic demand has eaten into the share of transactions attributed to overseas capital, showing 9% growth in comparison with the previous year.

Healthcare as a sector remains diverse in its own right. From elderly care to private hospitals, investor capital has the benefit of options. Figure 14 shows which target areas have changed and which remained consistent for each investor type over the past few years.

While elderly care has emerged as a target area for domestic demand, there has always been a substantial interest in private hospitals from overseas capital. This year, however, has also seen the adult and specialist care space gain more, due to interest from REIT investors.

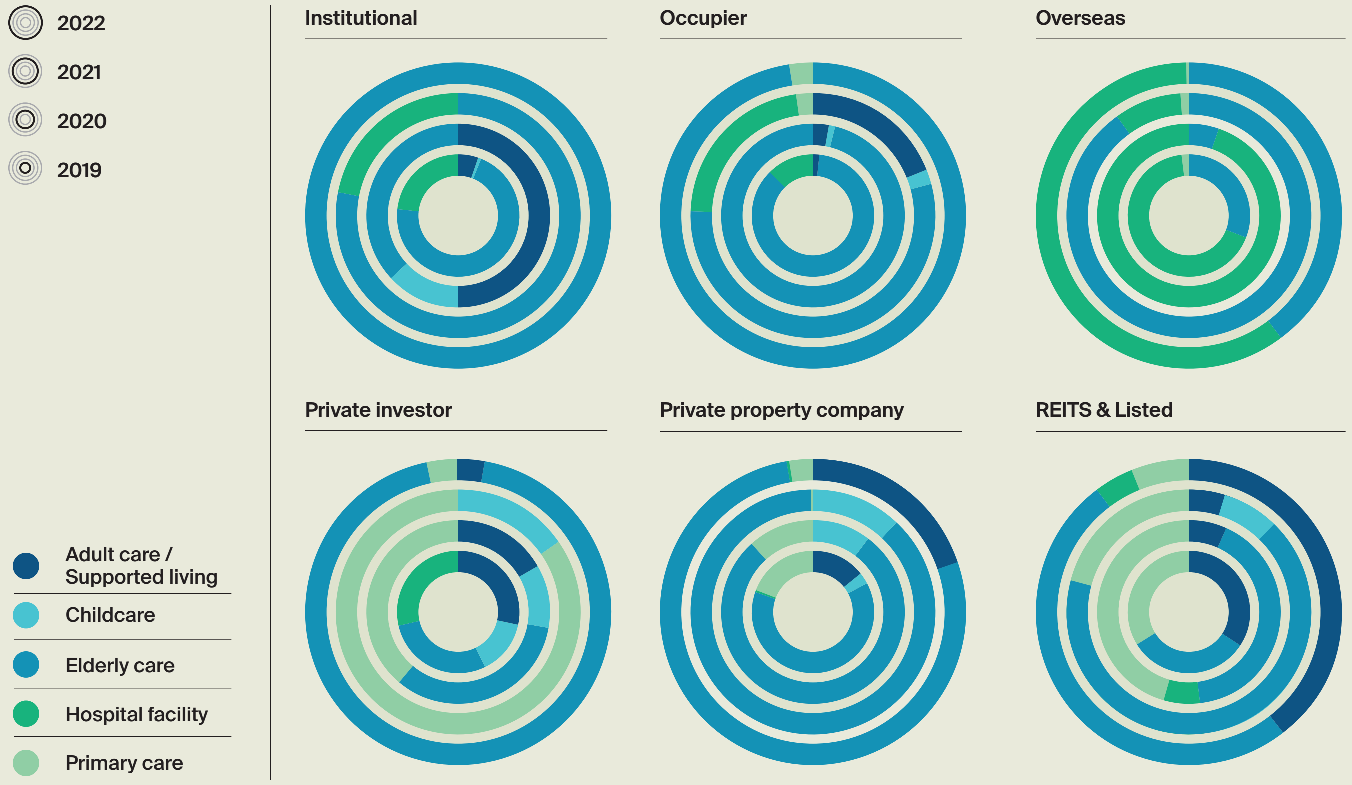
Figure 13 presents net acquisitions and disposals over the past few years by investor type. Despite occupiers being more active, there is still a trend for occupiers to present themselves as net sellers, once again supporting the narrative of exiting longer-standing, family-owned operators. This also highlights a growing trend for sale and leaseback transactions between operators and investors as a capital release strategy, as debt terms become less favourable.

Fig 13: Net acquisitions or disposals by investor type



Source: Knight Frank Research, Property Data

Fig 14: Sector investment by investor type 2019-2022



Source: Knight Frank Research

Operational deals and the changing face of capital

Another active force in healthcare is the merger and acquisition space, with the sale of many operational businesses. Interestingly, it is not only operators that have been actively transacting on this side. Over the years, we have seen interest from the likes of infrastructure funds, as well as sovereign wealth-backed capital. An example of such a deal is Mubadala Capital's investment in Witherslack Group. Where we have also previously seen equity-led capital, with a presence across operations (such as private equity house Waterland with the Priory Group), we are now seeing a diverse interest base. Such interest is in the form of institutions and even REITs who have, and continue to formulate, strategic relationships and joint ventures with operators. This not only presents a strong value-add opportunity, it also highlights the fundamental importance of the landlord and tenant partnership in driving healthcare's performance.

On assessment of such deals from 2020 to 2023, this blend of investor types aids the notion that there is appetite for the sector from numerous angles; be it Reuben Brothers' interest in Avery Healthcare, or the joint venture between Aedifica and Emera on the LV Care Group.

From a sample set of deals over this period of time, disclosed multiples suggest an average revenue multiple and an average EBITDA multiple of 4.6x and 10.8x, respectively.

4.6X

*Average revenue multiple

10.8X

*Average EBITDA multiple

*Source: Merger market - averages taken from reported deals within sample that disclosed multiples.

Commentary

HENRY ELPHICK, DEPUTY CHAIR, EUROPEAN HEALTH CARE PRIVATE EQUITY ASSOCIATION

Healthcare remains a core sector for investors and returns have remained strong through cycles. The sector is not immune to the higher cost of debt, or to the impact of higher inflation and staffing cost pressures, but the underlying demand for healthcare, diagnostics and therapy remains. Perhaps the biggest changes have been the entry of strategic buyers interested in social infrastructure and sovereign wealth funds and family offices looking for exposure to healthcare more broadly. Often with a lower cost of capital, this has led private equity investors to look for value in sectors that are less asset- or people-intensive, such as capex-light clinic models, tech-enabled business models, diagnostics and pharma services and manufacturing, often partnering with real estate investors.

Jorge Manrique Charro

Vice President, Investments: Welltower

Jorge Manrique Charro is Vice President, Investments at Welltower Inc. and leads the firm's London office. He previously worked at Sidewalk Labs, the Abu Dhabi Investment Authority and Tishman Speyer.

Welltower (NYSE: WELL US$45bn enterprise value) is the largest owner of healthcare real estate globally, with a portfolio of nearly 2,000 properties focused primarily on the private pay seniors housing space.

Q: The Welltower portfolio is spread across several geographic regions. How would you describe the UK healthcare sector in comparison to alternative global markets?

We benefit from having large portfolios in three major markets (US, Canada and UK). Two key differences between these markets are first a new net supply of senior housing (as a percentage of existing stock) that is consistently lower in the UK than in the US. Second, the percentage of beds managed by the top 20 operators is much lower in the UK than in the US and Canada.

Q: What is your current strategic focus, and has this changed significantly from this time last year? Or even pre-pandemic?

We believe the biggest opportunities are in addressing the need for purpose-built accommodation and improving the performance of existing assets through active asset management. For that reason, our focus is the backing of a small number of high-performing operators to grow their businesses through developments and acquisitions.

Q: How would you say your capital structure, e.g. equity vs debt, aids the ability to support your strategy during the current climate?

Welltower has a prudent capital structure strategy, as illustrated by the lower-leverage level compared to our peers. Our capital markets team does a great job in publishing regular business updates, and that transparency is key to inspiring trust with our investors. As a result of this strategy of prudence, transparency and disciplined capital allocation, we currently have $5bn of available liquidity.

We would like to increase our presence in the UK, and we are very well capitalised to fund the growth of our existing platforms and to seize new opportunities.

Q: With regards to strategic partnerships such as Welltower's joint venture with the Reuben Brothers (and their recent acquisition of Avery Healthcare), what are the key elements of such partnerships that prove fundamental in scaling quality care provision?

Reuben Brothers have an outstanding track record of building fantastic businesses (such as Global Switch). In addition to their deep understanding of real estate, they have a commitment to creating best-in-class platforms and recruit the best people to build the business. Lorna Rose recently joined Avery Healthcare as CEO and this is just the start of an exciting journey that will lead to growth in the number of homes, but more importantly to further improvements in processes, people and quality outcomes.

Q: How would you describe current market pricing?

Currently, the pricing expectations for many sellers are anchored on the future stabilised performance of homes that are in lease up or recovery phase. Based on those projections, underwritten returns look historically attractive. Some of those business plans will be achieved and some won't – there are big opportunities for those who can find the right combination of portfolio and operator to deliver improvements in trading performance.

Q: What are your thoughts and predictions for the future of the sector?

Over the next 10 years, I believe the industry will create the right processes to safely collect and analyse data about buildings and how they are experienced by their residents. Excellent operators will create solutions to improve building designs, enhance sustainability and achieve improved health outcomes. The ability to have a positive impact on society is what makes it such an exciting opportunity.

> "Over the next 10 years, I believe the industry will create the right processes to safely collect and analyse data about the buildings and how they are experienced by the residents."

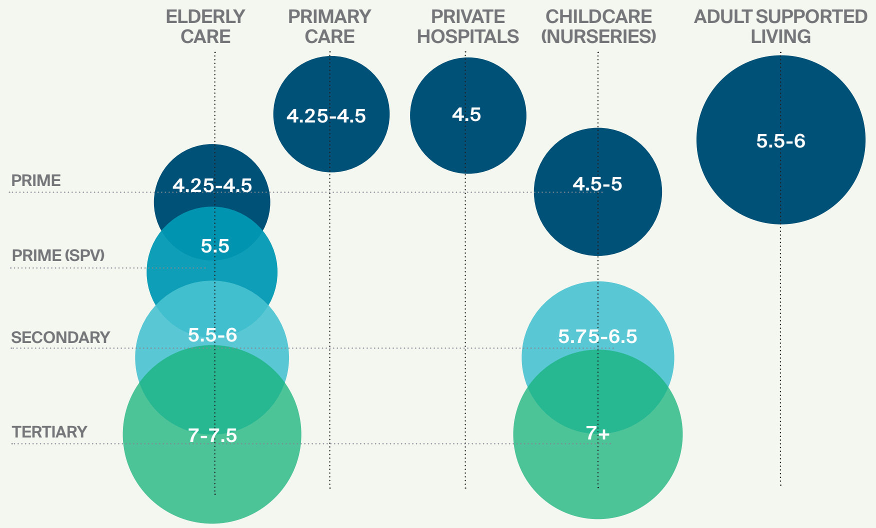
Investment performance

As well as strong transaction volume in 2022, healthcare assets have also shown a robustness in holding returns and performance for the year.

Overall, returns and the general performance of the sector continue to justify the fundamental drivers associated with healthcare. Whether long-term income capabilities or demographic-led demand, the sector certainly remains attractive to investors.

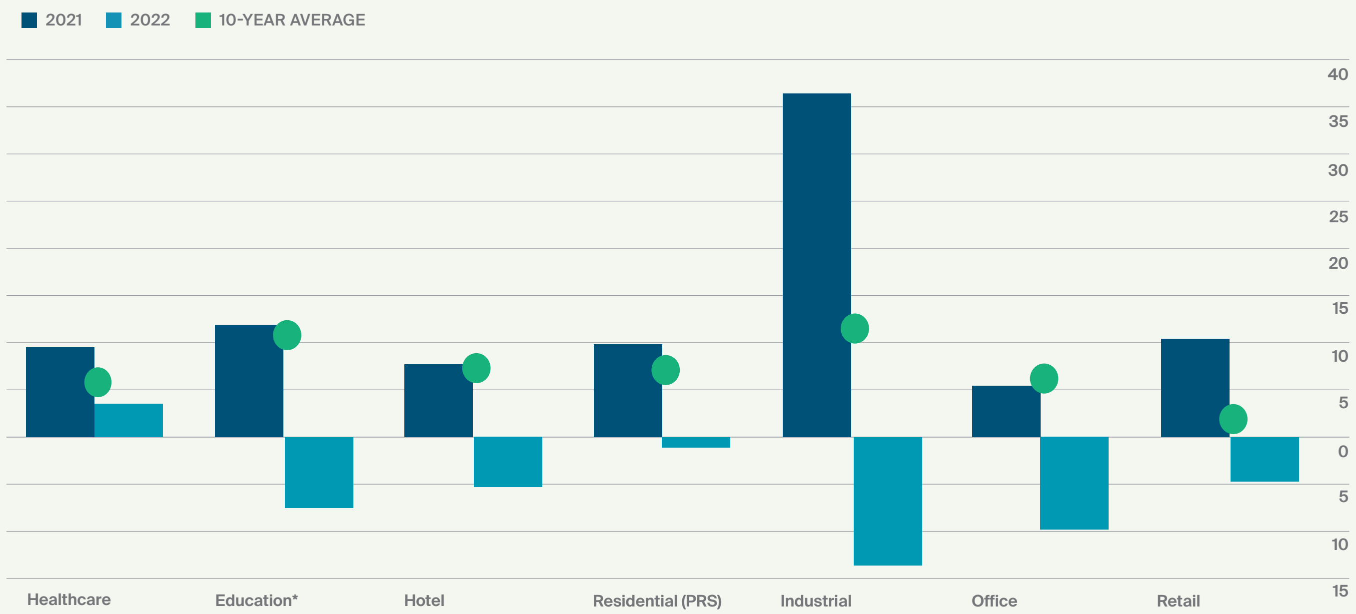
Figure 15 presents a view of yields for the various sub-sectors within healthcare. Figure 16 highlights total returns across several sectors at the end of 2021. Although there are several other sectors demonstrating higher returns than healthcare's 3.5% annualised average return, it is important to note that while healthcare sits below its long-term average, there have been some more significant variances among other sectors.

Fig 15: Healthcare yields by sub sector



Source: Knight Frank Research, MSCI

Fig 16: Total returns (%)

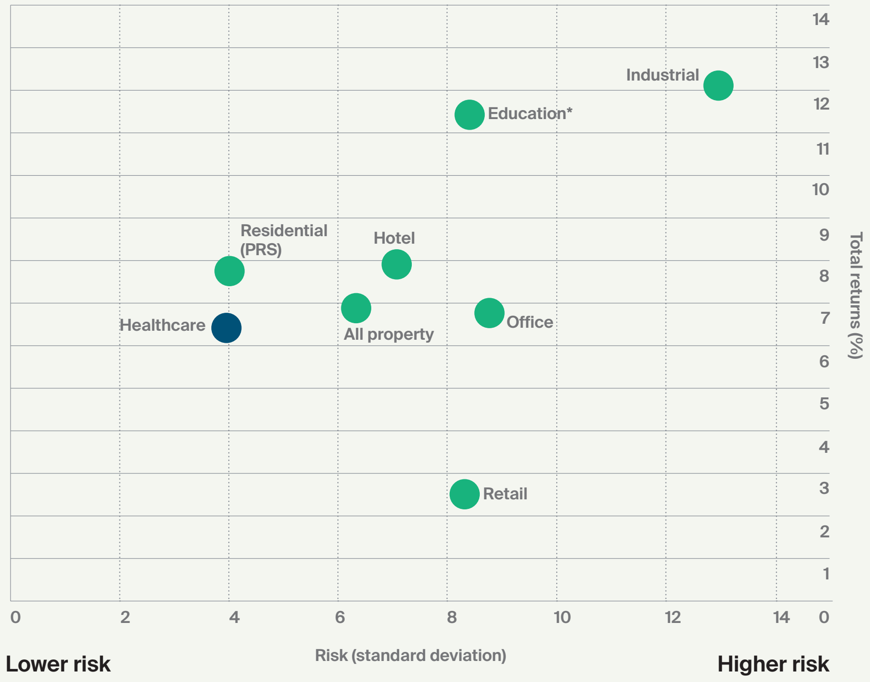


Source: Knight Frank Research, MSCI

"Due to conventional healthcare leases benefiting from longer terms, the sector presents itself as a long-term income option for many investors."

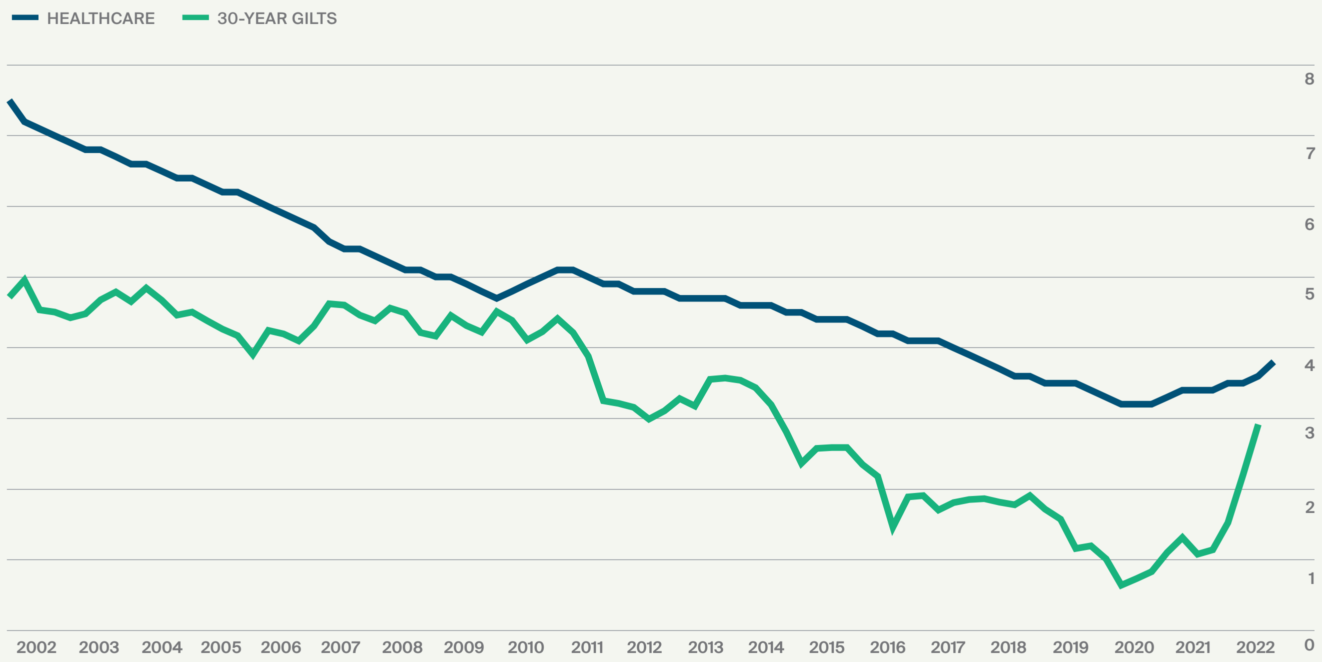
Off the back of consistency of returns presented in figure 16, figure 17 takes this a step further by providing an insight into the risk/return relationship of these sectors. Healthcare emerges as presenting a lower risk level, due to its lack of variance. Because conventional healthcare leases benefit from longer terms, the sector presents itself as a long-term income option for many investors. Figure 18 compares average healthcare capital rates to that of 30-year gilts, with an average spread of 1.65% between the two.

Fig 17: Risk vs returns (10-year history)



Source: Knight Frank Research, MSCI

Fig 18: Healthcare vs 30-year gilts

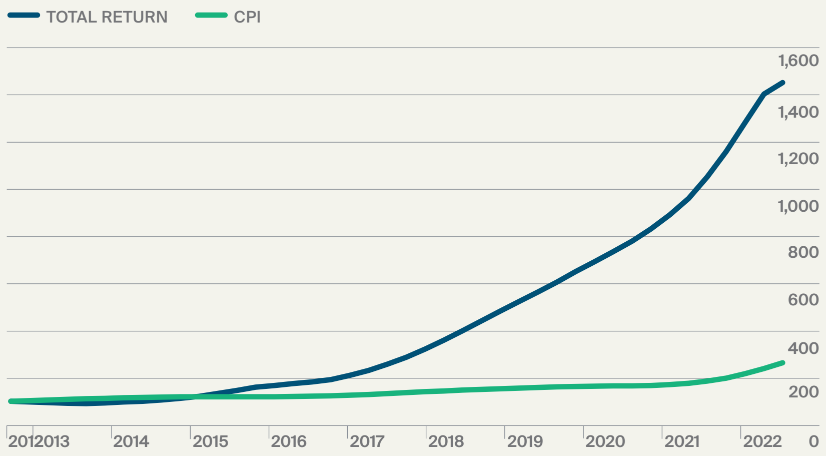


Source: Knight Frank Research

Seeing the bigger picture

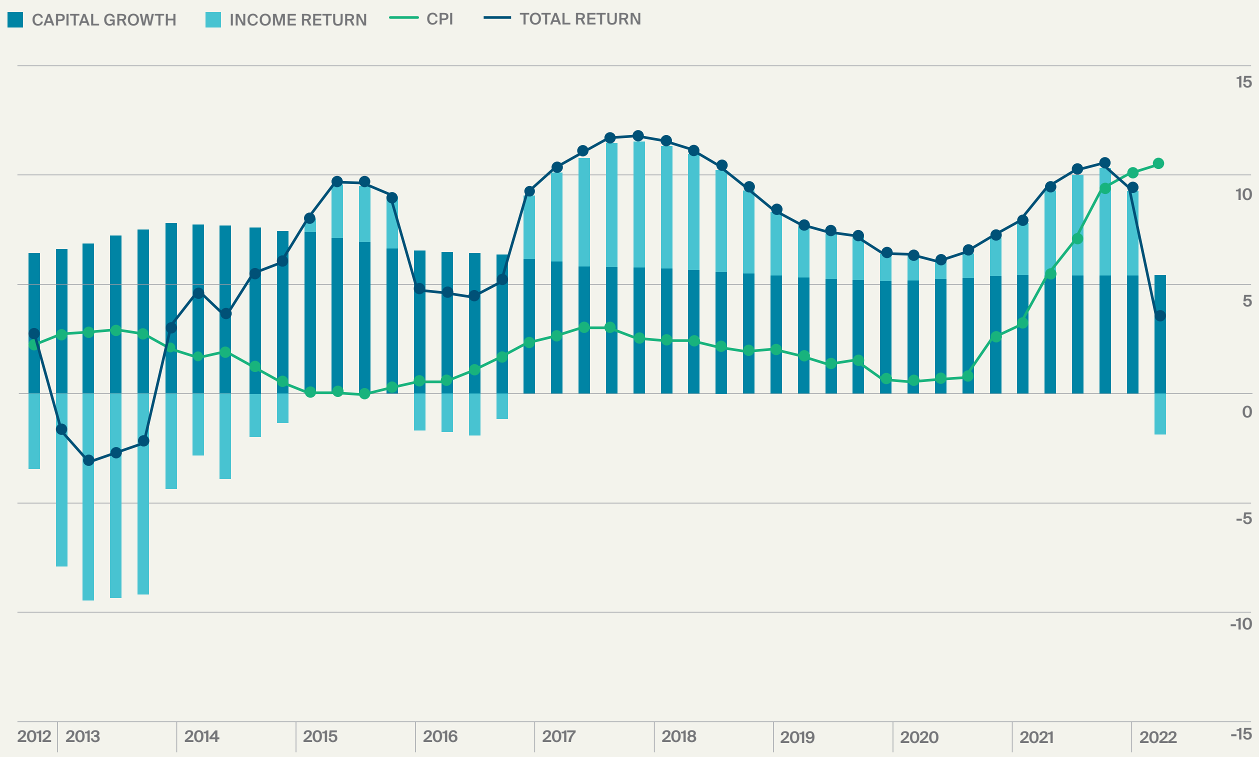
Figure 19 showcases the trend in healthcare's total returns from 2012, and the contribution of both income and capital returns towards this. Owing to consistency, income return has been a fundamental factor in total returns able to trend above CPI, with the exception of two periods, to support the long-term income credentials of the sector. Taking a step back from the now, and indexing total return along with CPI over the period in question, total return substantially outpaces CPI. This again points to the view that investment in the sector is a long play to deliver a comforting positive sentiment from market participants, despite the various headwinds.

Fig 20: Healthcare total returns vs CPI (indexed)



Source: Knight Frank Research

Fig 19: Healthcare returns vs CPI (2012–2022)



Source: Knight Frank Research

REITs in the spotlight

Similar to the increase in demand for healthcare assets, the presence of healthcare REITs among investors has grown. With domestic REITs accounting for £655 million, or approximately 28% of 2022's transaction volume, this has seen the gap significantly close on interest from overseas capital.

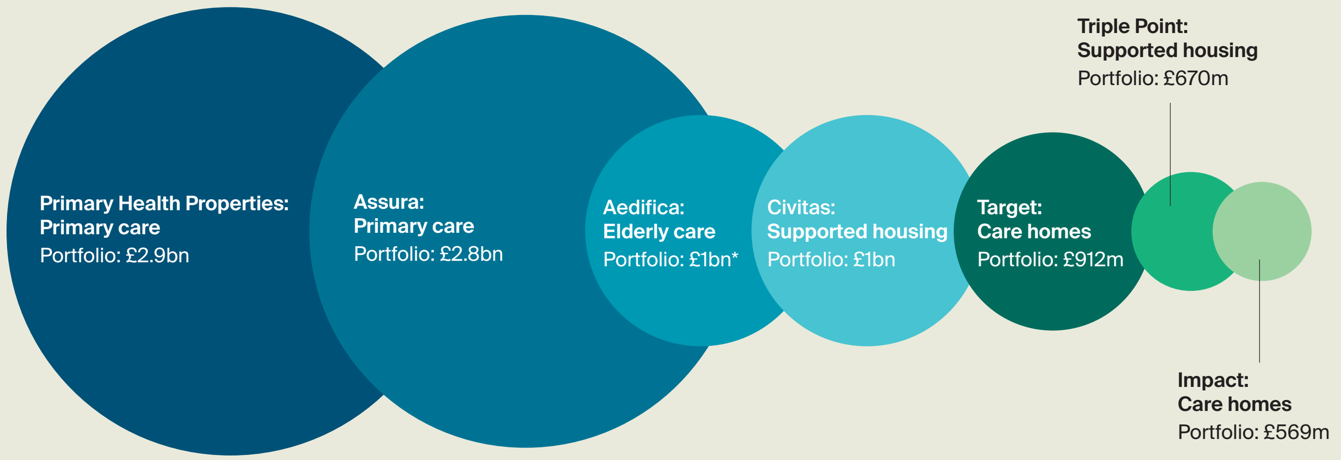
This section of the report looks into the seven key healthcare REITs, which, at the date of their 2022 interim reports, had a combined portfolio value of £9.86bn across 2,669 care assets, producing a total rent roll of circa £526 million per annum.

Over the years, these REITs have continued to grow in terms of portfolio values. Figure 21 presents these REITs by AUM, with Primary Health Properties being the largest, reporting a valuation of £2.9bn as at June 2022. In terms of combined value, due to a mixture of acquisition and organic growth, this has increased from £6.99bn to £9.86bn between 2019 and 2022; an approximate 41.2% growth over the period or 12.2% on a compounded annual growth rate (CAGR) basis.

As seen by the overall healthcare returns relative to other sectors, figure 22 represents the performance of healthcare REITs in comparison to all property REITs and the FTSE 250. Following 2022's use of this chart, we can see healthcare REITs' continued consistency and divergence away from the "all REIT" line. While the FTSE 250 line continues to trend above healthcare REITS overall, we should note this will most likely be down to the early strong performance of financial services and energy equities that have indirectly capitalised on rising base rates and inflationary pressures. Nonetheless, the performance of healthcare REITs, when compared to all property and the FTSE, is a supporting argument for the case of healthcare and its long-term credentials.

> "Primary Health Properties presents as being the largest REIT, reporting a valuation of £2.9bn as at June 2022."

Fig 21: Healthcare REITs by AUM



Source: Company websites, data based on 2022 mid-year or interim reports
*European REIT with significant UK based portfolio

UK HEALTHCARE REITS IN NUMBERS

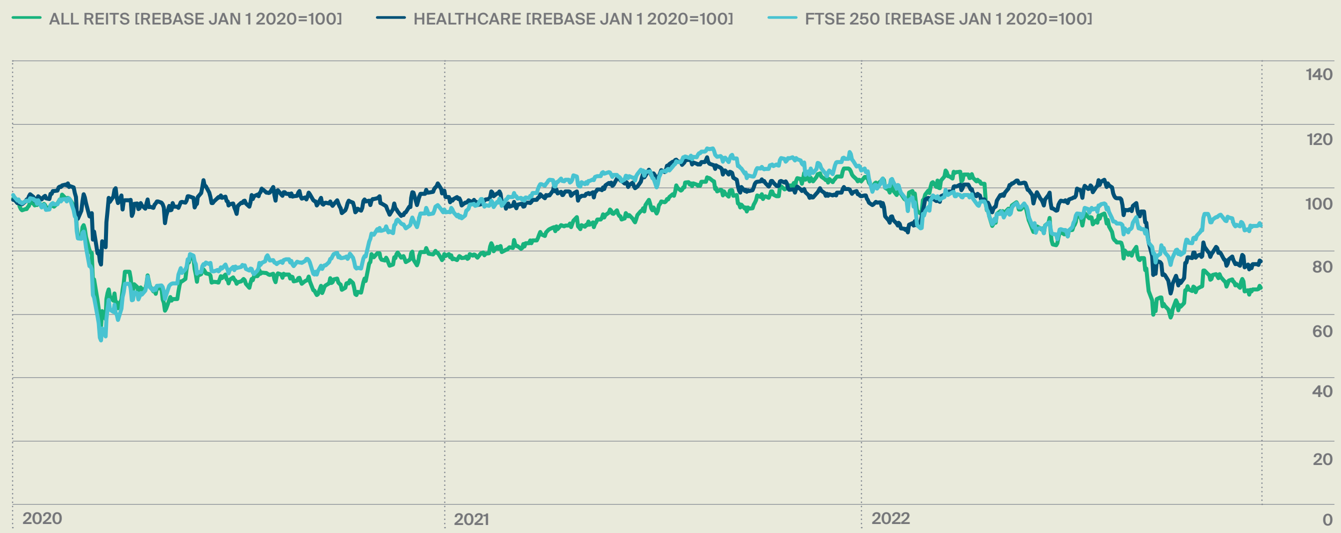
7	**2,669**	**£9.86bn**	**£526m**	**18.3yrs**
Key UK healthcare REITs	Combined number of assets	Combined asset value	Combined annual rent roll	Average WAULT

Table 4: Notable transactions completed by REITs 2022

Deal type	Price £m	Date	Properties	Purchaser	Sector
Portfolio	200	Dec 22	1	Civitas Social Housing	Adult care/Supported living
Portfolio	45.5	Sept 22	3	Aedifica NV/SA (Belgium)	Elderly care
Portfolio	78.5	Jun 22	3	Impact Healthcare REIT	Elderly care
Portfolio	58	Apr 22	1	Assura PCP UK Ltd	Primary care
Single asset	31	Apr 22	1	Primary Health Properties	Primary care

Source: Knight Frank, Property Data

Fig 22: Healthcare REITs vs all REITs vs FTSE 250



Source: Macrobond, Knight Frank

Debt market update

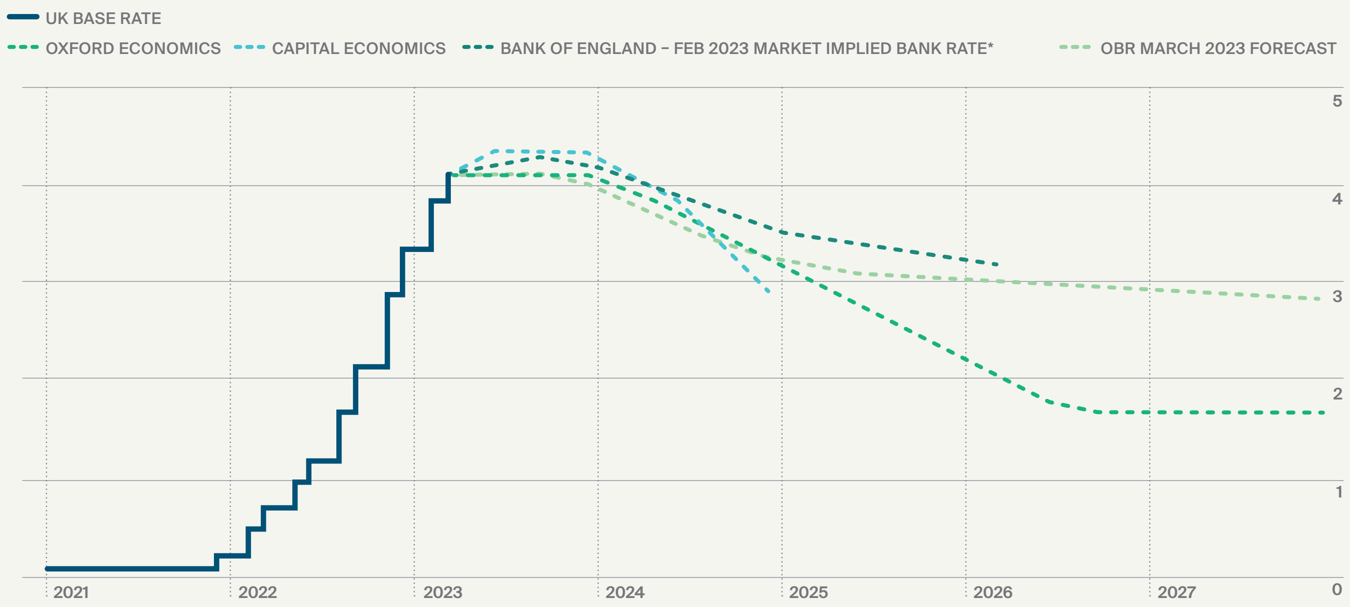
Over the past year, the debt market has been dominated by news of monetary tightening, driven primarily by attempts to control and reduce inflation. Interest rates in the UK have risen 11 consecutive times and currently sit at 4.25% compared with 0.50% only 12 months ago. The increased cost of debt has impacted borrowing costs and investor returns, in addition to putting pressure on interest cover ratios. The question is, have interest rates hit their peak?

LISA ATTENBOROUGH, PARTNER, KNIGHT FRANK CAPITAL ADVISORY, DEBT

The market was still pricing in a 0.25% increase in the 12 months leading to March 2023. However, the expectation is that rates will begin to soften towards the back end of 2023 (see figure 23). The extent to which rates come down (or the length of time they will remain at peak levels) will be dependent on inflation data showing some downward movement (see figure 24). Current expectations show inflation reducing to 2.90% by the end of the year, which will be hugely welcomed and should signal the end of monetary tightening.

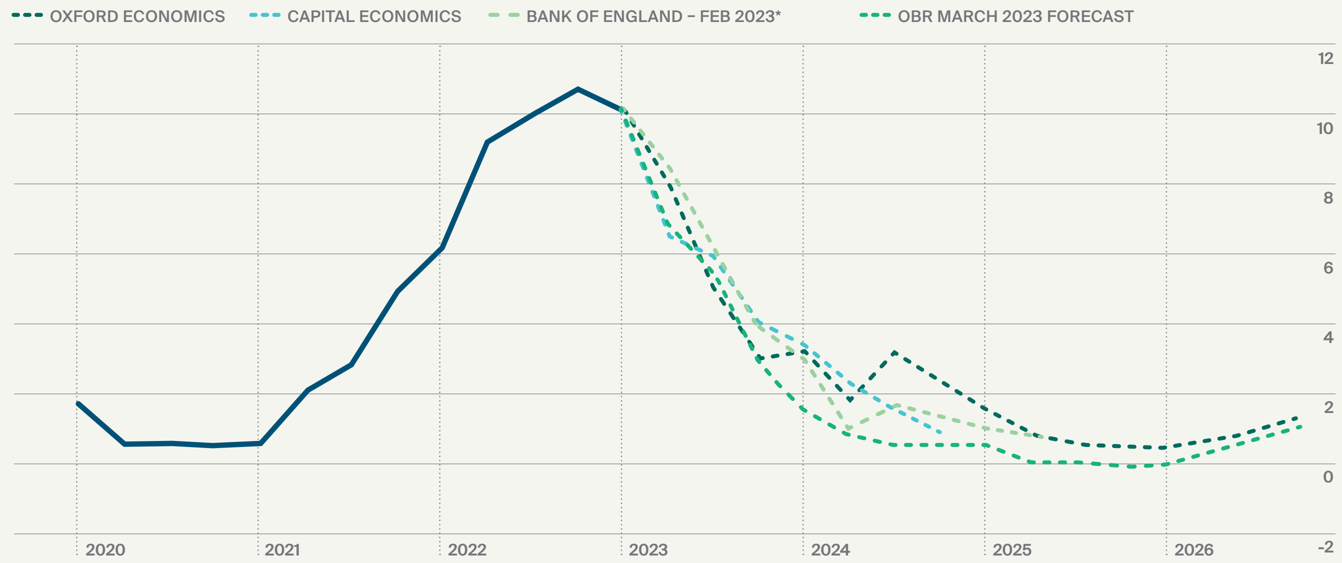
The banking sector more generally is not without its challenges, demonstrated recently by the collapse of Silicon Valley Bank and Credit Suisse. However, UK banks have proven to be resilient and well capitalised post the global financial crisis. Sensible lending decisions over the last decade mean banks will be well placed to weather any storm, alongside the large number of new alternative lenders that continue to provide invaluable sources of liquidity in today's debt market.

Fig 23: Predicted Bank of England peak base rate (BoE base rate forecasts %)



Source: Knight Frank Research, Oxford Economics, Macrobond, Capital Economics, OBR
*Bank of England Feb 2023 forward interest rates, market perception of future rates

Fig 24: Predicted inflation rates (UK CPI forecasts, % change year-on-year)



Source: Knight Frank Research, Oxford Economics, Capital Economics, OBR
*Bank of England Feb 2023 CPI forecast

2.90%

Current expectations show inflation reducing to 2.90% by the end of the year, which will be hugely welcomed and should signal the end of monetary tightening.

HOW HAS THIS IMPACTED THE AVAILABILITY OF DEBT IN THE HEALTHCARE INVESTMENT MARKET?

Lender appetite for the healthcare market has remained resilient, largely because the healthcare sector is dominated by a number of relationship-driven and sector-specialist lenders. These lenders have continued to support operators over the years and are well versed in sector dynamics and performance metrics.

While debt pricing has increased in the past 12 months, this has primarily been driven by underlying interest rate rises. Margins in the sector have remained broadly stable, with senior debt pricing for core assets seen in the 200s. The big banks are now focusing on financing larger-ticket investment transactions, which is leaving challenger banks and debt funds to finance smaller care home deals, both development and investment.

A focal point for all lending decisions in the last 12 months has been ESG requirements. In that regard, financing healthcare sector transactions provides ample opportunity for lenders to demonstrate their support of social care and community-driven developments.

> "Sensible lending decisions over the last decade mean that banks will be well placed to weather any storm, alongside the large number of new alternative lenders that continue to provide invaluable sources of liquidity in today's debt market."

Our expectation is that financing into the healthcare sector will remain stable throughout 2023, due to its specialist financing requirements, coupled with the undeniable and ongoing demand for quality healthcare provision across the UK.

The presence of tech in healthcare

The technological impact on the healthcare sector can be broken down into two areas: the buildings from which the care is conducted, and the provision of care itself. Both of these present their own technological opportunities to the industry and investor alike.

MAX BEARD,
BSC (HONS) MRICS,
PROPTECH ANALYST

> "Since the average human spends around 90% of their time indoors, one emerging opportunity is to improve the air quality within buildings. One business doing just this is Pathogen Reduction Solutions."

Technological advancement and efficiencies within healthcare are nothing new. To take just one example from the 19th century, the modular hospitals designed and built by the illustrious engineer Isambard Kingdom Brunel for Florence Nightingale – the so-called Nightingale Hospitals – had a major impact in reducing disease and death. Comparatively, the confluence of healthcare, property technology and venture capital is in its infancy. However, year-on-year we are seeing more money spent on innovation and efficiencies across the board.

Since the average human spends around 90% of their time indoors, one emerging opportunity is to improve the air quality within buildings. One business doing just this is Pathogen Reduction Solutions (PRS), whose air-handling system was designed initially in response to the Covid-19 pandemic. This patent-pending, proprietary application of UVC technology is retrofitted into existing or new-build air-handling systems, and inactivates 99.9999% of dangerous airborne pathogens within a building.

Effective air sanitisation reduces disease transmission among occupants, enabling landlords and building managers to get health facilities back to full occupancy, as well as building resilience against future pathogen-based health threats.

When discussing the sustainability benefits of the PRS unit, founder Ian Sinclair says, "PRS also delivers significant, sustainable energy efficiencies and environmental benefits over the life of the asset. PRS achieves this by reducing the total power needed to run the adapted heating, ventilation and air conditioning (HVAC) system through safe recirculation of indoor air, rather than relying upon 100% outside air, which needs energy-consuming conditioning (temperature adjustment, dehumidification, etc). The order of magnitude of any improvement is material when considering that HVAC systems account for approximately 40-45% of a typical building's power consumption."

Another opportunity we have discovered is internal building navigation for the blind, disabled and able-bodied. A frustration shared by many is turning up to a hospital or medical facility and not knowing where you are going (of the 122 million appointments booked in 2022, around 6.4% were missed. Of these 7.8 million missed appointments,* it is reported a large majority were missed through people getting lost or not knowing where they were going.

With current GPS-based navigation apps hampered by indoor inaccuracies, WayMap has developed an indoor navigation phone app that requires no external signals and is accurate to one step. Initially developed for people with visual impairments, but with countless uses for the general public, the app can navigate a person to any inputted waypoint. WayMap has a solution that benefits the healthcare sector, from mapping care homes and medical facilities for the visually impaired, to providing route guidance for patients and visitors.

It is an exciting time to be involved in the healthtech space. There are many opportunities and great companies that will help drive both revenues and a higher level of service for all healthtech stakeholders. The implementation of wearable technology, for example, will allow doctors to monitor and measure a patient's health trends to help manage chronic conditions and prevent serious illness. In addition, developments in artificial intelligence can be used to analyse medical data, develop personalised treatment plans and run buildings more efficiently through smart controls.

> "It is an exciting time to be involved in the healthtech space. There are many opportunities and many great companies that will help drive both revenues and a higher level of service for all healthtech stakeholders."

*"NHS drive to reduce no-shows to help tackle long waits for care", NHS England, January 11 2023.
Note: Knight Frank does not endorse any company mentioned in this section and therefore this commentary should not be taken be taken as a recommendation in any form.

Commentary

JOCELYN ORMOND,
PARTNER AND HEAD OF
HEALTHCARE & LIFE SCIENCES,
ASHFORDS LLP

We are continuing to see venture capital and private equity investors, as well as operators we know in the sector, allocate growing amounts of capital to digital health technologies. The tailoring of these solutions to existing ways of working, the need for appropriate data sharing, and the convergence of healthcare with other technologies such as fintech and proptech, are accelerating the digital transformation of care provision. There is an enormous amount of commentary regarding the impact of tech on the provision of care, but its impact on the buildings from which the care is conducted deserves the greater attention it receives here.

Forward view

Despite a clear set of challenges, 2022 was yet another positive year for healthcare, with strong transaction numbers as well as continued improvement in the average occupancies of operators. This, coupled with the ever-ageing UK demographic driving demand for care beds and more capital turning to defensive sectors, suggests we can be confident these trends will continue.

JULIAN EVANS,
HEAD OF HEALTHCARE

In addition to promising transaction volumes, we are also seeing more active domestic capital. This is another sign of positive sentiment as REITs and private capital eat into the share of transaction volume attributed to overseas capital. Additionally, a more consistent and organic trend of transactions lends support to the view that the current level of demand for the sector is sustainable in both the short and long term.

Social impact and ESG will continue to drive interest towards the sector, due to the person-centred nature of healthcare creating a case for social impact investing. Both investors and occupiers will be searching for buildings with viable ESG credentials in line with their net zero and overall sustainability targets.

Inflationary pressures such as energy, staff and food costs will be a point to watch for operators in managing their bottom lines as well as investors when underwriting deals and assessing rent/rent covers. Those with a reliance on debt will be exposed to the possibility of less desirable terms and therefore become more particular in their pricing of deals, creating opportunity for equity-based money to capitalise. It is, however, important to note that the debt situation may not be as negative as the news suggests, due to a number of investors under fixed terms as well as hedged with conservative loan to values. Healthcare as a sector certainly sits in a less exposed position than more conventional commercial real estate sectors.

The upgrading or repurposing of standing assets – for example, older, smaller and less fit-for-purpose buildings – may present a viable value-add strategy for both investors and operators.

> "The upgrading or repurposing of standing assets – for example, older, smaller and less fit-for-purpose buildings – may present a viable value-add strategy for both investors and operators."

Overall, the sector is well positioned with regards to demand, capital awaiting deployment and the underlying drivers that have contributed to the sector's consistent performance over the years.

2023 PREDICTIONS

Strong healthcare demand and transaction volume to come

Despite clear headwinds, the underlying drivers for healthcare will support demand and performance. As in previous times of uncertainty, the sector's resilience will shine through in the coming year.

Further overseas capital penetration

The current climate, while presenting a great amount of uncertainty, will also present opportunity for savvy investors and operators. Those with significant cash piles, or who are less reliant on debt in terms of the origin of their capital, will likely seek opportunity where others are hesitant or priced out of the deal. As healthcare's underlying fundamentals remain intact, we imagine the sector will continue to attract investment from outside the UK.

Standing investments and pre-existing stock may present an opportunity for investors

The upgrading, refurbishment or repurposing of standing assets – for example, older, smaller and less fit-for-purpose buildings – may present a viable value-add strategy for operators and investors across the sector.

Conventional bank debt will likely become less prominent

Debt and financing could become more creative and present in a number of different forms, as we see private equity return with the need to deploy committed capital.

ESG to feature

Social impact/ESG will continue to feature. This is a growing area, and the nature of healthcare as a sector means the social element is well supported.

Cost inflation is a factor to consider for both operators and investors

Inflationary pressures such as food and energy costs will be a point to watch for operators in managing their bottom lines, as the extent to which this can be passed on to consumers approaches its ceiling.

We like questions. If you have one about our research, or would like some property advice, we would love to hear from you.

Recent research

Knight Frank European Healthcare Report 2022

Knight Frank Childcare & SEN Overview 2022 Report

Knight Frank 2022 UK Care Homes Review

Knight Frank UK Healthcare Property Market Overview 2022/23

Healthcare

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

Kieren Cole, MRICS
Partner
+44 20 7861 1563
kieren.cole@knightfrank.com

Nick Kempster, MRICS
Partner
+44 20 7861 5265
nick.kempster@knightfrank.com

Commercial research

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

Knight Frank