Health

Elderly Care Home Investment

Market Review

October 2015

"...a recent boom, sparked partly by our friends from across the Atlantic, has breathed new life into the sector ..."

A market uplift heralds recovery in the healthcare investment sector but with newer more severe struggles to come, is history about to repeat itself?

Introduction

Late this summer, London & Regional put on the market their Southern Cross investments.

Once the UK's largest provider with 750 care homes Southern Cross, squeezed by tight local authority funding and inflexible rents, almost brought its landlords to their knees. In truth, no amount of re-structuring could save a company drowning in safe-guardings, placement embargos and a severe lack of past investment. Senior managers were constantly fire fighting, and there was no investor saviour. When the company finally collapsed in 2011 the repercussions for the investment market were huge.

But recovery came and a recent boom, sparked partly by our friends from across the Atlantic, has breathed new life into the sector. U.S. real estate investment trusts (REITs) found an untapped market of portfolios, groups that had battened down the hatches waiting for the storm to pass. Development of new stock has accelerated, and investment funds have followed.

Recovery has in no small part been fired by private equity firms with strong appetites and advantages over traditional institutional investors of flexibility and short term thinking. That recovery has included active investment in private hospitals and specialist care facilities too as "Healthcare" has become established as a popular alternative investment sector.

Can these investments be successful?

Ability to pay rent is so heavily dependent on the tenant's trading position. What can investment holding landlords do to protect their interests? The elderly care home sector is grappling with public under-funding and binding regulation. It now faces a Living Wage and restrictions on the employment of non-EU staff. Major care providers are warning of catastrophe. Four Seasons' results are putting the market on alert that there is no fat in certain parts of the sector. We cannot pretend that tenants operating largely in the state-funded sector will not find it very tough. Many of the same issues afflict the specialist care sectors and the independent hospital world, together with other issues beyond the scope of this piece.

Flexibility will be key

In a portfolio, there may well be homes that are destined to struggle, fail even. We all too frequently witness the decline of homes where tired interiors, high staff turnover, rock bottom wages, and deteriorating morale combine to harm reputation, blight occupancy and erode profits. Southern Cross has not been the only group to demonstrate this. Of course the ability to pay the rent suffers.

But those operators with a real, on the ground understanding of these people orientated businesses, will seek to ensure that their care homes offer the best possible service, accommodation and value for money. This may require expenditure on facilities training of staff, or a change of client group, perhaps requiring property alterations, all of which could result in a temporary dip in profits.

> *"Operators are going to need support from their investors and landlords..."*

Operators are going to need support from their investors and landlords (and their banks). Flexibility and speed is essential in giving consent to well-planned alterations and extensions, or to investment in staff.. Fixed annual 2 or 3% rent uplifts may need to be waived temporarily, or lower collars accepted. Consideration might have to be given to short-term rent reductions to back up a business plan that secures long term success.

This agility is not something that institutional property funds are noted for, and partly explains why private equity concerns are increasingly outbidding them for both rescue/recovery opportunities and for the prized private market assets.

Is the sector doomed?

Absolutely not.

There are some massive challenges ahead, but investors should take comfort from the core strengths that will underpin the sector for decades to come – the demographics and the capital wealth of the older generations. The sheer scale of the need for residential care and nursing provision is not going to go away.

There will undoubtedly be casualties among operators during the term of this Government, and margins may be seriously eroded, particularly for those heavily reliant on the public purse. But the self-pay market continues to expand, bolstered by rising house prices. With each year that goes by there are more and more customers, either by choice or through necessity and absence of alternatives.

One such alternative, domiciliary care, is itself facing massive trading challenges. Another, housing with care, needs domiciliary care services as part of its offer. The other alternative, of course, is the NHS. Bed-blocking. Enough said.

It all adds up to an imperative that good care homes survive long into the future. Those holding elderly care home investments can take some reassurance if those homes are of high quality and attract self-payers. Most important though is that the rents offer a sensible margin of comfort for the operator, because companies better than Southern Cross will face difficulties if they do not.

Investors are learning the hard way that malleable rents are necessary. Fixed yearly uplifts may well have to be waived and new rents certainly have to be agreed at levels that still work for an operator when the business is stress tested. Operators and investors need to work together and the traditional sale and leaseback hasn't fostered this relationship. That doesn't necessarily mean leases can't work or that the sector has to move to a management contract model but it will be ever more essential for the parties to co-operate with each other and to be flexible in the face of operational challenges.

> *"...With each year that goes by, there are more and more „customers", either by choice or through necessity and absence of alternatives ..."*

So, it needs the terms of leases to be reasonable and possibly flexible, and both the investor-landlord and the operator-tenant to appreciate the position of the other. Then investments will continue to be created, existing investments will continue to be traded, and we all look forward to 2016 as another year of exciting activity.

Contact Us

For further information please contact :

Iain Lock
Senior Director
020 7911 2603
iain.lock@gva.co.uk

Andrew Sidwell
Senior Director
0121 609 8410
andrew.sidwell@gva.co.uk

Charlotte Brierley
Principal Surveyor
020 7911 2778
charlotte.brierley@gva.co.uk

Published by Bilfinger GVA.
65 Gresham Street, London EC2V 7NQ.

Bilfinger GVA is the trading name of GVA Grimley Limited and is a principal shareholder of GVA Worldwide Limited, an independent partnership of property advisers operating globally. Bilfinger GVA is a Bilfinger Real Estate company

@GVAHealth

08449 02 03 04

gva.co.uk