Retirement Living & Care Homes: The opportunities and challenges
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In this report, we set out the trends and the legal and commercial issues impacting investors, operators, developers, lenders and funders active in the retirement living and care homes sectors. We have combined both sectors in this report due to the evolving patterns of care we have seen, as the retirement living sector is increasingly providing care services and facilities.

Growth for the sector is being driven by key demographic changes including a growing and an aging population such as the Baby Boomer generation; increasing care needs of that population; an increase in wealth and expectations in the older generation; and a shifting focus towards the importance of wellbeing. These demographic changes have resulted in the demand for physical housing suitable for older persons outstripping supply and an increased emphasis by the government on assessing and meeting that demand.

Key recent operational challenges faced by care providers such as employment issues (notably the lack of qualified nurses and introduction and anticipated increase of the National Living Wage); social care funding issues and increased regulation have resulted in home closures and deregistrations of care homes, exacerbating the problem. Local authority cuts and increased care standards imposed by the Care Quality Commission (CQC) (the independent regulator of health and social care in England) have led the sector to seek alternative investment from the private market and overseas in order to help maintain compliance and meet demand, although further investment is still needed. It is also anticipated that the demand will continue to increase. This is highlighted in Deloitte’s recent report, Deloitte 2019 Global Health Care Outlook: Shaping the future, which notes that ‘the adage, “What goes up, must come down,” isn’t likely to apply to the global health care sector in 2019’ as they expect that the demand will continue to grow.
Sector Definition

The market

Supply and Demand

JLL's research emphasises that the supply in the sector has been insufficient to satisfy the demand driven by an aging Baby Boomer generation who have benefitted from improved medical developments and lifestyle conditions. There is currently a chronic under-supply of new housing for older persons, in particular in the mid to high-end residential markets seeking to meet the demand of the increasingly prosperous older generation.

Care Homes

According to Knight Frank's analysis:

By 2021, the ONS estimate that there will be around 13 million people over 65 in the UK. This will increase the demand to 471,129 market standard beds (rooms with ensuite facilities) which creates a shortfall of 148,777 against the current supply of 322,352 beds.

Demand and supply

12,914,584
65+ Population by 2021

471,129
Demand by 2021

322,352
Current Supply of Market Standard Beds *

148,777
Shortfall of Market Standard Beds by 2021 *

(Source: JLL: Retirement Living: Where is the Opportunity?)

(Source: Knight Frank: UK Healthcare Property 2018)
Retirement Living

According to JLL’s research:

- The current number of over 65s is 11.7 million. By 2025, 20% of the UK population or 14.3m people, will be over 65 (a 22% rise).
- In 10 years’ time, one in five of the total population will be over 65; becoming one in four by 2050.
- The over 65s own a combined £800 billion of housing equity.
- JLL has estimated that the UK requires an additional 725,000 Housing with Care units by 2025, which amounts to nearly 50% of all new housing currently being built.

JLL’s research highlights that the UK retirement living sector has been slow to satisfy the demand in comparison to the mature retirement living markets in America and Australia.

RICS has evaluated that there could be approximately 2.6 million available houses being released into the mainstream housing market if sufficient, viable housing for older persons is delivered in the UK.

Charles Russell Speechlys has seen a rise in new entrants into the UK market who have established operations in such countries including Australia, America and New Zealand. Most notably, there is interest in the ‘retirement living with care’ market, which is a growing asset class. Looking forward, Charles Russell Speechlys predicts that this trend will continue, with new entrants who are already experienced in successfully delivering care overseas challenging UK operators for market share.

[Source: JLL: Retirement Living: Where is the Opportunity?]
Supply: Development

The rising demand for older persons’ accommodation has created opportunities for developers. With a high housing equity and growing affluence, the older population can now consider buying or renting higher quality housing after downsizing. Charles Russell Speechlys has seen evolving patterns of care in the sector, as the retirement living sector is increasingly providing care services and facilities. This has led to an increasingly range of senior living models becoming available, from age restricted housing with limited facilities, to luxury retirement villages providing residents with access to numerous lifestyle and wellbeing services as well as onsite care facilities. Senior living accommodation for rent also is increasingly being considered in the sector.

In terms of care homes, the table below illustrates Knight Frank’s Care Home Development Index analysis which identifies the top locations in England & Wales which they consider to have the best future prospects for care home investment and development. Amongst the 50 counties featured in the study, Greater London presents the greatest opportunity and has overtaken the previous front-runner, South Glamorgan. In the next 15 years, it is estimated that the region will have a projected elderly population growth of 46% and projected GDP growth of 38%. Despite the challenges to development in Greater London (including competition and high land values), Knight Frank consider that the strong average weekly fees should underpin positive development appraisals.

West Yorkshire is the only Northern county to be ranked in the top 12 out of the 50 counties across England & Wales included in the analysis.

### 2018 Rank

<table>
<thead>
<tr>
<th>2018 Rank</th>
<th>Forecast Growth</th>
<th>Economic Growth</th>
<th>Wealth Growth</th>
<th>Current Supply</th>
<th>Future Supply</th>
<th>Land Values</th>
<th>Average Weekly Fees</th>
<th>Environmental Costs</th>
<th>Change Rank</th>
<th>Total Score</th>
<th>Index</th>
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</thead>
<tbody>
<tr>
<td>1. Greater London</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>11</td>
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<td>12</td>
<td>38</td>
<td>1</td>
<td>1.72</td>
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<tr>
<td>2. South Glamorgan</td>
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<td>12</td>
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<td>4</td>
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<td>1</td>
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<td>9</td>
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<td>46</td>
<td>2</td>
<td>43</td>
<td>2</td>
<td>1.35</td>
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<tr>
<td>5. Cambridgeshire</td>
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<td>7</td>
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<td>7. Cornwall</td>
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<td>49</td>
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<td>8. Worcestershire</td>
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<td>1.17</td>
<td></td>
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<td>10. West Yorkshire</td>
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<td>10</td>
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<tr>
<td>11. Essex</td>
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[Source: Knight Frank’s Care Home Development Index 2018]

West Yorkshire is the only Northern county to be ranked in the top 12 out of the 50 counties across England & Wales included in the analysis.
There has been a growing investor appetite in the buoyant healthcare sector. In Knight Frank’s Healthcare Capital Markets 2019 report on the elderly care, adult and supported living and primary care sectors, it notes a 13% rise in documented real estate healthcare transactions to £1.49 billion in 2018, with REITs, specialist funds, UK institutions and overseas investors accounting for the primary investors.

Reduced funding by local authorities has seen a shift in funding towards the private sector and overseas investment. Rising private sector funding is creating opportunities for developers of high-end schemes, innovative care facilities and high quality services. According to Knight Frank, over the past 5 years, domestic investors have been the dominant buyers, with UK REITs and quoted property companies being the largest net buyers accounting for 55% of the overall investment and £800 million of deals. The high number of REITs being active in the sector has led to a large number of sale-leaseback deals as REITs grow their portfolios and operators dispose of their assets. Overseas direct property investment has been subdued compared to its peak in 2013, however 2018 is a notable increase since 2016 and 2017. In particular, we would highlight the pan-European Healthcare REIT, AEDIFICA acquisition of Lone Star’s 93 care home portfolio, which was the largest transaction in 2018. [Source: Knight Frank: Healthcare Capital Markets 2019]

Continued growth in investment:

2018 Top 10 investors by investment volumes:

<table>
<thead>
<tr>
<th>Investor</th>
<th>% of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aedicia</td>
<td>19.9%</td>
</tr>
<tr>
<td>Cindat</td>
<td>17.7%</td>
</tr>
<tr>
<td>Octopus Healthcare</td>
<td>11.5%</td>
</tr>
<tr>
<td>Other</td>
<td>11.4%</td>
</tr>
<tr>
<td>Civitas Social Housing</td>
<td>9.9%</td>
</tr>
<tr>
<td>Impact Healthcare REIT</td>
<td>7.7%</td>
</tr>
<tr>
<td>Alpha Real Capital</td>
<td>6.4%</td>
</tr>
<tr>
<td>Target Healthcare REIT</td>
<td>5.6%</td>
</tr>
<tr>
<td>Assura Group Ltd</td>
<td>4.3%</td>
</tr>
<tr>
<td>Triple Point Housing REIT</td>
<td>3.2%</td>
</tr>
<tr>
<td>LaSafeIM</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

[Source: CBRE: UK healthcare 2019: Polarisation of Investment Strategy]

Key legal points for REITs to consider on a sale and leaseback transaction

1. **Hell or High Water Lease**
   - Typically, in our experience acting for REIT’s, they require a “Hell or High Water” lease. This type of lease is drafted so that it will continue to operate and secure income regardless of any difficulties faced by the tenant operator.

2. **EBITDARM and Financial Reporting**
   - Consider what EBITDARM levels are to be maintained by the operator.
   - What cash lockup arrangements should be in place should the operator fail to comply with its EBITDARM obligations.
   - How frequently should the operator make financial disclosures to the investor and what information should that comprise.

3. **CAPEX**
   - What spending obligations will be placed on the operator e.g. typically an amount per registered bed.
   - We are increasingly seeing the CAPEX spending obligations being tested on the basis of a fixed 3 yearly look back.

4. **Strategic Capital Improvement**
   - Should there be an ability for the operator to call on the investor to provide additional capital for the purposes of investing in the care homes. Typically the provision of any additional funds would trigger a review of the lease rents.

5. **Assignment and Change of Control**
   - Will assignment of leases be permitted and if so on a portfolio or site specific basis.
   - Assignment tests and conditions will need to be considered, in our experience a test that any proposed assignment should not adversely affect the home and/or portfolio’s residual investment value is controversial and heavily negotiated.
   - Are change of control restrictions required and if so how far up the operator group should they reach.

6. **Addition, Substitution and Removal of Care Homes**
   - Should the operator be allowed to add, replace or remove care homes from the portfolio e.g. substituting underperforming care homes.

Figure 1: Investment volumes 2016 - 2018

[Source: CBRE: UK healthcare 2019: Polarisation of Investment Strategy]

6 out of the top 10 investors ranked by investment volume were specialist UK funds investing in; care homes; supported housing; mental health and primary care.

The top 2 investors were overseas investors; a Belgium listed REIT and a Chinese owned private equity vehicle.
Operational Challenges

Over the past few years, operators have been forced to respond to difficult operational challenges such as employment issues, the social care funding crisis and increased regulation.

This has led to an increased number of home closures and deregistrations of care homes, as seen in Knight Frank’s research below. Note that the analysis also includes some closures for redevelopment of care facilities.

The key operational challenges are:

**Employment issues:**
- Introduction and anticipated increase in the National Living Wage (NLW) and the impact of that on the profit of the business. The Care Quality Commission (CQC) has estimated that usually the largest overhead for businesses in the supported housing and care homes markets is staff costs, being on average 60% of all total costs;
- Introduction of the workplace pension scheme; and
- Lack of available qualified nurses and staff in the sector. There is a high turnover due to the low wages combined with the challenging nature of the work. More work needs to be done to encourage workers to stay in the sector and to create longstanding career opportunities instead of short-term employment options.

**Social care funding crisis:**
- A gap has emerged between the affluent Baby Boomer generation and the local authorities who cannot afford to pay for the growing and aging population. Additional cuts to funding by local authorities due to funding pressures have also exacerbated the problem.

**Increased regulation:**
- The Care Quality Commission (CQC) determines the rating and standards required for care homes, which has impacted on the number of care homes being deregistered due to being rated ‘inadequate’ or ‘requires improvement’; and
- Buildings considered not being fit for purpose.

[Source Knight Frank: UK Healthcare Development Opportunities 2018]