

Senior Living

PROPERTY MARKET

THE ZIMMERS



My GENERATION

Executive summary

- The UK has an ageing population demographic that is increasing demand for all types of senior living and healthcare property
- Land prices are catching up with residential land prices particularly where affordable housing thresholds are very onerous
- The nursing home market has seen significant growth over the past few years
- Increasing investment potential within healthcare property
- Changes in capital allowances following the Budget
- OpCo PropCo models on the increase
- European investment opportunities in senior living property

King Sturge expertise

King Sturge provides agency, professional, valuation, development, building consultancy and capital allowances advice on a range of property types within the senior living sector. Recent appointments have included:

- £2.25bn worth of nursing homes valued
- Nursing home investment portfolio sales
- Retained principal valuer for Pegasus Retirement Homes
- Capital allowance adviser for major nursing home provider
- Building consultancy and design for Craegmoor Healthcare
- Property due diligence provided on the recent McCarthy and Stone and Pegasus company sales
- Rent review advice on South Coast care home portfolio
- Acquisition and agency disposal on a number of senior living sites

Terminology

Confusion reigns in the senior living / healthcare sector over terminology for the different types of care and accommodation available. Definitions of the various accommodation types available are set out below although these are not definitive.

Retirement Home / Sheltered Housing – Occupiers have their own self contained flats, which is usually clustered with other sheltered dwellings. The schemes are generally located within close proximity of a town centre. Occupiers do not receive personal care but each scheme will have a warden. The flats have a C3 residential use class under the Town and Country Planning (Use Classes) Order 1987. These are usually purchased on a long leasehold basis but also available to rent.

Assisted Living / Extra Care – Occupiers have their own self contained flat. Generally occupiers are not able to live by themselves but do not require constant care either. They purchase domiciliary care as and when required. These developments differ from sheltered housing as they provide a catered dining area and 24 hour staff on site. They can have either a C3 or C2 (Residential Institution) use.

Care Home – a home which provides long or short term care where accommodation, meals and personal care (help with washing, dressing and eating) is provided usually for a weekly fee. Each resident will have a bedroom (single or double en-suite), but not a kitchen or separate living room. They have a C2 planning use. Occupation is by licence.

Nursing Home – similar to care homes except they provide care from registered nurses (24 hour availability) to meet more complex care needs.

Close Care – sheltered housing linked to a care or nursing home.

Retirement Villages – villages provide a mix of retirement housing with sometimes extra care and nursing homes on site. Schemes usually have a suburban or peripheral location. They are often large developments providing in excess of 60 dwellings with a central core of communal facilities.

Nursing home market and consolidation growth

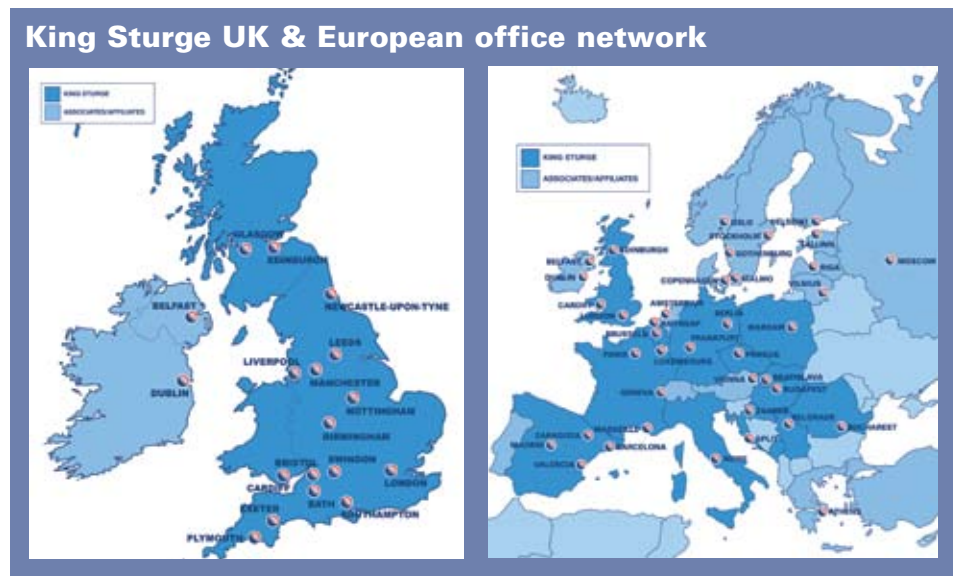
After a period of rapid consolidation the rate has slowed. Although as a whole the sector is still very fragmented with the top 10 operators in terms of bed numbers operating only 22% of the market. This is in contrast to other property sectors traditionally valued as operational entities including the public house market where the top 10 operators have a 47% market share and the budget hotel market where the top 5 operators control 89% of total room numbers. With this in mind it would appear that the market still has significant consolidation potential and we anticipate a number of further takeovers and mergers happening in the foreseeable future.

To illustrate the consolidation rate, a comparison of the top 10 operators in 2003 and 2007 is set out below.

Nursing home market consolidation changes within the top 10 operators by bed numbers					
Jun-03			Jun-07		
Operator	Homes	Beds	Operator	Homes	Beds
BUPA	246	17,688	Southern Cross Healthcare	640	32,420
Four Seasons	297	14,930	Four Seasons	446	21,154
Highfield Holdings	188	8,748	BUPA	299	20,389
Southern Cross Healthcare	140	7,741	Barchester Healthcare Ltd	164	10,172
Ashbourne	130	7,438	Craegmoor Group Ltd	318	5,878
Westminster Health Care Ltd	87	5,695	Anchor Trust	100	4,276
Craegmoor Group Ltd	289	5,654	Care UK plc	90	2,895
ANS Homes Ltd	45	3,177	MHA	60	2,494
Barchester Healthcare Ltd	37	2,364	Bondcare	46	2,324
Leonard Cheshire	81	2,276	The Order of St John Trust	55	2,260

During this period the market share of the top 10 operators has increased from 15% to 22%.

The two largest operators have both changed hands in 2006 with Four Seasons being acquired by Three Delta for circa £1.4bn and Southern Cross successfully floating on the London Stock Exchange.





Runnymede Campus - Brunel University

Land is king

Potential development land is scarce and highly sought after in the UK healthcare sector. Uses which have a C3 planning consent (sheltered housing and some retirement villages) have to compete with 'main stream' residential property for suitable sites. However uses with a C2 planning

consent (residential institution) can avoid this direct bidding war but such sites / buildings are relatively scarce.

A number of care home sites have recently sold for in excess of £30,000 per bed space equating to more than £2 million per acre (for fairly intensively developed sites) resulting in care home site bids becoming far more

competitive. In sought after areas land values, particularly in the South East, have achieved in excess of £40,000 per bed space, with one operator reportedly having offered £60,000 a bed for a very high quality site. Prices though vary considerably according to local demographics, existing competition and local authority fee rates.

Retirement village operators also have difficulty in acquiring sites. Developers often seek out large sites with a principal building which can be converted to provide communal facilities with further new build accommodation constructed in the grounds. Competition for these types of sites comes from residential house builders, very wealthy private individuals and hotel operators. For example, the Runnymede campus (sold by King Sturge) previously owned by Brunel University attracted considerable interest as a retirement village but retirement village operators were out bid by a residential developer who paid in excess of £45m on an unconditional basis.

UK market commentary

Care home

The care home market has evolved considerably over the last ten years and has emerged as an important sector in the wider property market attracting considerable interest from owner occupiers, corporate operators and property investors.

The UK's ageing population is well documented with the trend towards a greater proportion of older people set to continue for the next 50 years. Supply of new beds has been falling for the last 10 years due to increased regulation, high residential land prices and historic low local authority fee levels. The decline has lessened in recent years as the rate of new build homes has rapidly increased.

The market is very active with occupancy levels on the rise and unprecedented price increases having been achieved for homes and operators which have changed hands. For the past 5 years average occupancy levels have been in excess of 90% and for the past 7 years the average increase in fee rates has risen at a faster rate than RPI. These factors have undoubtedly contributed to a sustained period of growth within the care home property market.

Nevertheless local authority fee levels are still considered by some to be too low and consequently a number of operators are seeking out areas of the country which can support private fees or where top ups can be charged over and above the local authority fee. These top up fees are often paid by

the family of the resident. This enables the operators to substantially increase turnover and consequently profit levels.

The sector is currently preparing for the introduction of a star rating system which is scheduled to be in place in 2008. Current proposals are for the following: 3 star *** = excellent, 2 star ** = good, 1 star * = adequate and 0 star = poor. The ratings will undoubtedly have an impact on the sector and highly rated homes are likely to experience higher demand from residents with the obvious knock on effect for profitability for the operator and consequently the underlying property value.

The future performance of the care home sector will continue to be strong particularly with an increasingly ageing

population, the general upturn in local authority fee rates and the shortage of bed spaces available.

Investor interest in the sector has developed in the past few years and there are now a significant number of homes which are subject to operational leases. Over the past 24 months King Sturge has valued in excess of 550 care homes held in investment portfolios. These homes are spread throughout the UK.

Average rents within the portfolios range from £3,598 to £5,321 per bed per annum.

Retirement property / villages

Projected growth in demand from older people, who are wealthier and choosier than they have ever been, is substantial with an ageing population demographic and rising house prices. This has inevitable benefits for retirement developers as purchasers often sell their home to finance a move into a retirement scheme.

The success of the retirement property / village model can be seen when studying the following examples:

Meadow Park (first retirement village in Braintree, Essex) developed by Hallmark developments has received over 1,000 enquiries from potential

purchasers for the 51 cottages and bungalows and 4 apartments and St Elphin's Park, Matlock a development by Raven Audley Court where 80% of the first release was reserved off plan.

McCarthy and Stone plc the largest retirement property operator has recently been purchased and taken back as a private company when HBOS acquired the shares for £1.2bn. McCarthy and Stone complete over 2000 units per annum. King Sturge provided full property due diligence as part of the bid team advising Bank of Scotland, Private Investors, the Rueben Brothers and Sir Tom Hunter (through his West Coast Capital Investment vehicle).

In March 2007 Pegasus Retirement Homes was subject to a management buyout through the Royal Bank of Scotland. The retirement home company now has a new facility of £137 million to buy and develop sheltered housing sites across the UK. They also have an expansive land bank which was valued by King Sturge as part of the transaction.

Capital allowances – don't miss out

Considerable tax savings are available from expenditure on nursing homes but are often overlooked.

Nursing homes, have high levels of furniture, fittings and equipment, as well as a substantial element of plant and machinery within the fabric of the building i.e. heating and sanitary ware. Very often nursing home owners and operators do not claim capital allowances relating to this latter element especially when the expenditure is as a result of the second hand purchase of a building.

This loss of tax saving will be exasperated by the changes to the capital allowances system announced at the recent budget. From April 2008, plant and machinery allowances will be reduced to either 20% or even 10%, in comparison to the existing 25%. Corporation tax rate is also due to reduce from 30% to 28%. The following 12 months therefore is an ideal time to address any unclaimed capital allowances in order to save as much tax as possible.

As well as preparing one off claims King Sturge are the sole advisor to a major nursing home provider, having produced capital allowances claims across their portfolio of homes. Following total expenditure of over £19 million, King Sturge has produced capital allowances claims amounting to over £4.5 million, which has amounted to a total tax saving of over £1.35 million for the client.

OpCo / PropCo

The hottest topic for the care home sector

In recent years, the idea of using an OpCo/PropCo model as a means of funding future growth has been raised with a number of clients of King Sturge. Used by private equity houses in connection with such high profile companies as Travelodge, Debenhams and NCP, this is a strategy that releases the value locked-up in property. This split functions by the operational company (OpCo) taking a lease of the premises from a newly formed property company (PropCo). Lending can then be secured



Pegasus Scheme – Weston-super-Mare

against a property-owning SPV PropCo on a loan to value basis, backed by the flow of lease rentals.

This type of approach is not without precedent in the care home sector, albeit in a different format. The sector's largest player, Southern Cross Healthcare plc, grew to its present size, initially through acquisition of homes by 'sale and leaseback' and subsequently through its preferred operator status with NHP and acquisition by Blackstone Capital. Blackstone then disposed of portfolios of leases, to promote the separation of home operation from the property ownership.

Creating the OpCo/PropCo structure requires a fine balancing act and whilst tax advice will be a corporate operator's primary concern, the underlying lease structure needs to be given careful consideration. When negotiating the terms of the leases, the OpCo and PropCo should aim to achieve a fair balance between the interests of landlord and tenant. There will inevitably be a tension between the need of the OpCo for flexibility and the demands placed on the PropCo by potential third party involvement in the form of the banks and potential future purchasers. The lease from the PropCo to the OpCo will normally be long term (25-30 years), with no breaks or rent free periods. Rents will be subject to annual indexation. The PropCo should also be looking for rent cover of around 1.5 – 1.6 times the operating profit.

This form of structure can provide added value particularly if the tenant (OpCo) has a strong covenant strength as this enables the PropCo to command a lower investment yield (higher value) and this coupled with the OpCo value can provide a value higher than the enterprise value of the business.



European update

Interest in investment property within Europe has increased substantially in the past 2-3 years particularly driven by foreign investors who have seen substantial yield compression in their home markets leaving Germany, France, Scandinavia and Holland as well as Central European purchases looking comparatively more attractive.

The trend towards an ageing population in Europe is as established as it is in the UK. Currently 19.3% of the German population is over the age of 65 and this is due to increase to nearly 30% by 2030. In France the population over the age of 65 is forecast to rise from 16.5% to 25.7% by 2030 whilst in Holland it is forecast to rise from 14.2% to 24.4% in the same time period. National policy changes and the view that demand for care services will increase as the demographic profile of European countries changes have led to changes in the financing and delivery of social care services and increasingly the transfer of services from the public sector to the private sector. Generally markets in Europe are still fragmented although consolidation is taking place. As the privatisation of social services and the consolidation of national and multinational companies continue interest from private equity

and venture capital investors has been prevalent with particular emphasis in the German market.

Potential investors should be aware of the differences between investing in European care home markets when compared to the UK. As with the UK market, European care home markets are generally unaffected by economic cycles and do not correlate with other real estate sectors. However the investor must have understanding of the structure of social service facilities and legal parameters affecting security of income in the relevant country together with an awareness of differing lease terms and rent review prospects. This understanding will reward the investor with gross yields of 7-8.5% in a market that is attracting an increasing amount of interest from UK and foreign investors.

The performance of the care home sector will continue to be strong for the foreseeable future particularly as the European demographic profile shifts towards an ageing population, leading to a continued demand for care beds and a shift from the non-profit sector to profit-orientated structures. We believe the market will therefore experience a sustained period of growth over the next few years with continued demand for similar investments in the future.

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Contacts

Outlook

Senior living / healthcare property is an emerging specialist property sector which is increasingly attracting significant investor interest. Property funds will look towards the retirement home sector in greater measure due to the increasing elderly demographic, tight yields in other sectors, guaranteed rental uplifts and the rise in capital values together with improving tenant covenants.

In the coming years we anticipate the introduction of the first Real Estate Investment Trust in the sector which is likely to contain nursing homes and the further expansion of care villages throughout the UK and Europe.

Our skills

King Sturge has a core specialist team along with a number of regional specialist around the UK with experience in Senior Living / property market. The core team are also undertaking work in mainland Europe in conjunction with it's European offices. Our core skills include:

- Valuation
- Agency / acquisitions & disposals
- Investment advice
- Building consultancy / project management
- Capital allowances
- Planning and development
- Landlord and tenant services

Recent appointments

- Valuation of multiple care home investment portfolios
- Capital allowance advice on newly purchased nursing homes
- Disposal of a nursing home investment portfolio
- Disposal of large site suitable for senior living on behalf of Birmingham University
- Disposal of nursing home sites in Bristol, Stroud, Surrey, Cheltenham, Wells and Gloucester and retirement scheme sites in Cirencester and Newbury
- Valuation for loan security purposes on a number of care homes as going concerns
- Valuation of two care homes and an assisted living complex in Germany

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