AUTUMN 2009
UK HEALTHCARE
Development opportunities
Knight Frank

Overview

Healthcare valuations have held up better than those of other property sectors due to the greater end value derived from owning a trading property in a sector which is, to some extent, occupationally recession proof and often offers indexed rents on very long leases.

This has resulted in more sites being made available for healthcare development, as the sector is able to attract higher land values at a time when there is little competition from other uses. However, buyer attention is predominantly focused on prime locations which now appear extremely good value while more marginal locations, which previously would have attracted interest, are less sought after.

Nonetheless, the sector has not been immune to the wider downturn. Although primary stock has been resilient, values on secondary and tertiary care homes have softened while the availability of debt is an issue for healthcare as it is for all commercial property, placing constraints on development.

A number of high street clearing banks are still financing healthcare development, but there are fewer active in the market. Available terms are also far more stringent, with loan to value ratios now c. 65-75%, down from c. 85% at the peak of the market.

This 80 bed care home in Salisbury was developed by Cannon Capital on a site acquired for them by Knight Frank and pre-let to Caring Homes Group.

Recent development trends

Although the Care Homes Regulations set out national minimum standards for new development – for example, bedrooms must have at least 12 sq m of usable floorspace, have en suite facilities and all rooms must be for single occupancy – many are now being future-proofed and built well beyond these standards. It has been the mid cap (i.e. 1,000 to 6,000 beds) operators who have been leading the market in this area.

However, even this type of development can struggle to secure financing in the current lending climate and therefore an emerging trend is that of the pre-let.

Developers, ranging from property companies to construction companies to private individuals, have been able to finance loans on the back of pre-lets to care home operators, and in the process have established a new leasing market which is growing in size.

Operators in this sector have historically favoured freehold tenure, but are themselves struggling to find sufficient equity to purchase or develop their own properties.

Pre-lets have enabled developers and operators to create joint ventures and ensure the objectives of both sides are met.

Developers or landlords are securing tenants on 25 to 30 year leases, with annual rental uplifts based on RPI (though with a collar and cap set).

Operators have the opportunity to expand, to their own design standards, without any immediate cost to their business and are often able to secure rent free or stepped rent periods. Some will ask for a buyback clause within 3 to 5 years of occupation, once their business has matured, although developers are resistant to relinquishing the freehold.

Thus tenants who can't finance freehold purchases can continue to grow their businesses while landowners/developers are able to derive value from sites which might otherwise have been left redundant.

Whatever the circumstances underpinning new development, however, the criteria for C2 use development remain extremely tight. If an operator is to be secured, a feasibility study will likely be required, inclusive of local demographics, access to arterial routes and competitor analysis.

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Healthcare hotspots

In addition to these major trends influencing the development market, key to identifying opportunities is an understanding of the comparative prospects for successful development across the country. The Knight Frank Healthcare Hotspots model was developed three years ago with the objective of identifying where in England the best opportunities and prospects in the healthcare sector may be located.

The hotspots model is a county-based assessment using a matrix of eight carefully selected criteria incorporating economic, demographic and healthcare specific commercial factors. A key focus is the anticipated growth in healthcare demand relative to current and pipeline supply and, therefore, the prospects for both development and investment. The model also encompasses economic strength, bed values and the cost of land for development. In all, 45 English counties were assessed, highlighting the range and diversity of opportunity currently and potentially available.

This year Buckinghamshire has been identified as the top development hotspot for healthcare provision within England. With a final score which is 83% above the all-county average, Buckinghamshire tops the league by a significant margin. The county performs strongly across most of the criteria, particularly in its current relative under-provision of beds and its outlook for long-term economic growth. The only area where Buckinghamshire underperforms significantly is for its land value which, as one of the home counties, is of course very high relative to many English locations.

Of the 45 counties assessed, a top tier of five hotspots is evident. In addition to Buckinghamshire, this out-performing group includes Warwickshire, Cambridgeshire, Berkshire and Northamptonshire.

Although having shifted position, each of these was also a top 10 location in 2008. As the total score index reveals, these five counties surpassed the all-county average by at least 40%. The structure of what makes each of these counties offer better opportunities varies significantly, however. For example, while first-placed Buckinghamshire scored well for factors such as its economic strength and higher bed values, fifth-placed Northamptonshire is expecting the fastest growth in its older (65+) population and has comparatively low land prices.

Table 1 sets out the top 12 hotspots and is dominated by counties in the South and the Midlands. Greater Manchester, ranked 12th, is the only hotspot outside this area. It was also the biggest mover in England, rising up 25 places from its 2008 rank due to a strong improvement in its economic outlook. The other new entrant to the top 12 is Nottinghamshire, which climbed 17 places due to its land values becoming comparatively more attractive.

Interestingly, Warwickshire is second-placed in the rankings despite the fact it scored notably well in only two of the eight criteria employed, having limited pipeline supply and a strong economic outlook. Instead, its final position is due to Warwickshire being the only location which performs above the all-county average for every input variable.

Cambridgeshire and Berkshire retain their status in the top tier of healthcare hotspots, achieving third and fourth place respectively. In Berkshire's case, this is explained by its healthy long-term economic and employment prospects, together with high current bed values. These factors are also strong in Cambridgeshire, but in addition this county is forecast to see significant growth in its population aged 65 and over.

Table 1
2009 Healthcare hotspot rankings

2009 rank	County	Forecast growth in 65+ population	Forecast economic growth	Current supply	Future supply	Change in rank from 2008	Total score index
1	Buckinghamshire	8	2	4	28	Up 9	1.83
2	Warwickshire	14	5	25	3	Up 2	1.73
3	Cambridgeshire	3	7	17	19	Down 2	1.58
4	Berkshire	30	1	18	20	Up 3	1.41
5	Northamptonshire	1	10	40	12	Down 2	1.40
6	Oxfordshire	29	15	15	17	Down 1	1.29
7	Nottinghamshire	32	6	20	33	Up 17	1.17
8=	Leicestershire	17	18	2	27	Down 6	1.15
8=	Cornwall & Isles of Scilly	11	23	30	1	Down 2	1.15
10	Shropshire	4	26	13	16	Up 3	1.14
11	Devon	22	19	8	10	Down 2	1.13
12	Greater Manchester	41	12	27	24	Up 25	1.12

Source: Knight Frank Research
Note: The above represents only a sample of the variables which contributed to the final rankings