

**Deloitte.**



**Healthcare Real Estate**

Our real estate investment perspective

Frankfurt

# Contents

Our point of view

Healthcare real estate – understand the investment

Healthcare real estate market – current situation and future outlook

Our consulting approach



# Our point of view

## Our view of the current situation

While COVID-19 has created near-term economic uncertainty, Healthcare Real Estate still represents an alternative investment class with great potential

### Demographic change

- Despite the current global crisis and its consequences, the shift in population age structure due to increased life expectancy and predicted annual decline in the number of births will increase the number of care recipients by approx. 30% until 2030 and about 70% until 2060
- Need for long-term care amongst the younger population groups (<60 years) increased in the past and will continue to rise

### Investment demand

- There was a strong demand for Health Care Real Estate before the Corona crisis and will probably remain so after it (it is likely that the market segment will become even more requested)
- According to a recent dcpc survey, the investment market for senior/ nursing care properties will survive the Corona crisis well. More than 50% of the respondents think that demand will even increase. In addition, more than 30% assume that prices will rise in the long term

### Potential return

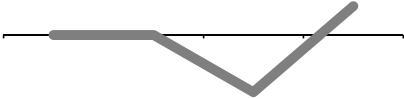
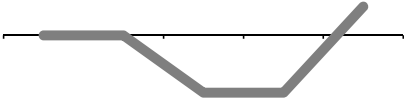
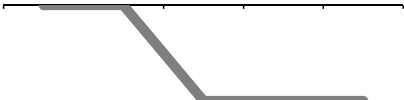
- The current supply of care places still does not meet growing demand caused by an overall increased health awareness. The lack of attractive alternative investments further pushes yield compression especially for high-profile core properties (e.g. prime yields for senior homes between 4.0 and 4.5% at the end of 2019)
- Healthcare maintains a yield advantage over established real estate asset classes such as office or hotel with stronger commitment of institutional investors in this segment

### Occupancy

- According to a recent survey (dcpc) of 150 experts and investors 57% do not expect the crisis to affect occupancy rates, while 29% expect occupancy even to rise
- In the short-term however, many senior homes won't be able to safely show their properties to prospective new residents as they went into lockdown mode during the crisis to better control the infection rate which implies a particularly high risk for the elderly

## Our view of the current situation

The unprecedented nature of the crisis makes forecasting difficult. Three scenarios are possible - history suggests a sharp drop and sharp recovery

Scenario	Shape	Probability	Description / impact
1	 <p><b>"V-Shape"</b> - deep, but short lived recession</p>	Likely	<ul style="list-style-type: none"><li>• Virus can quickly be contained until May/June</li><li>• Securing of the operative hospital tasks and material supply is of existential importance</li><li>• Identify critical resources in personnel/ infrastructure to maintain emergency operation mode</li><li>• Detect vulnerabilities in the supply chain (particularly in medical supplies) and introduce appropriate countermeasures, e.g., source alternative suppliers and jumpstart supply</li></ul>
2	 <p><b>"U-Shape"</b> - prolonged lockdown containment of virus takes longer than anticipated</p>	Plausible	<ul style="list-style-type: none"><li>• Coordination with financing banks regarding measures that may affect liquidity in the short term (e.g. deferral or reduction of redemption payments, extension of maturities, payment deferrals, extension of current account lines, etc.)</li></ul>
3	 <p><b>"L-Shape"</b> - prolonged measures to mitigate the pace of the spread &amp; waves of new infections</p>	Unlikely	<ul style="list-style-type: none"><li>• Partial lockdown (no access for external persons) of senior homes and decline in occupancy, revenue, etc.</li><li>• Usage of aid funds, e.g. through the KfW programmes set up by the Federal Government and the federal states, as well as the use of subsidies and guarantees</li></ul>

# Healthcare real estate – understand the investment

# Understand the investment – healthcare real estate market segments

## How we evaluate the market segments from an investor perspective

Care type	Facility	Market size/ liquidity	Market development	Operator risk/ default risk	Regulatory risks/ legal framework	Market entry barriers	Possibility for alternative usage (3 <sup>rd</sup> use)	Return on investment perspective	Recommendation*	Comment
<b>Acute care</b>	Acute hospital	→	→	↘	↘	↘	↓	↗	→	Continued market consolidation, strong dependence on regulation, restricted alternative use capacity
<b>Rehabilitation</b>	Rehabilitation facility/ clinic	→	→	↘	↘	↘	→	↗	→	Regulatory and operator risks, limited investment market
<b>Inpatient care</b>	Senior nursing home	↑	↑	↗	↘	→	→	↗	↑	Regulatory and operator risks, limited investment market
	Senior residence/ retirement home (Partial care during day/ night, short term care)	↗	↑	↗	→	→	→	↗	↗	Development potential, diversification possibilities in the "care" area (complementary to inpatient "permanent care")
<b>Outpatient care</b>	Senior residence/ retirement home (residence with additional services/ assisted living)	↗	↑	↗	↗	→	↑	→	↑	Growth market due to demographic trend
	Shared flat/ community with care services or multiple generation house (care at home)	↘	↑	↗	↗	↑	↑	→	↑	Residential character with high self-determination, limited investment product availability
<b>Medical care &amp; outpatient health centers</b>	Individual and community medical practices; medical care centers	→	↗	↗	↗	→	↗	↗	↗	Growing market segment, low regulatory risks, high third-party usability (depending on location)

# Healthcare real estate market – current situation and future outlook



## Healthcare real estate market overview – market drivers (1/2)

An increasing and aging population together with growing expenditure are main drivers of the healthcare and nursing market

### Aging Population

- Germany has the oldest population in Europe. Share of the population aged 65 or older expected to rise from 21% (2018) to 23% (2023)
- Increasing life expectancy - 75 years for males and 80 years for females, along with an increase in immigration
- An increase in aging population is leading to a significantly increased demand for the senior care market

### Consolidation and privatization

- Trend to privatize publically owned businesses as a result of increasing investment capital needs
- A relatively high growth rate is visible in private operator capacities over the last years



### Increasing expenditure on healthcare

- In 2017, the total spending on healthcare as a percentage of GDP stood at 11.3% and is expected to rise to 11.9% by the end of 2023

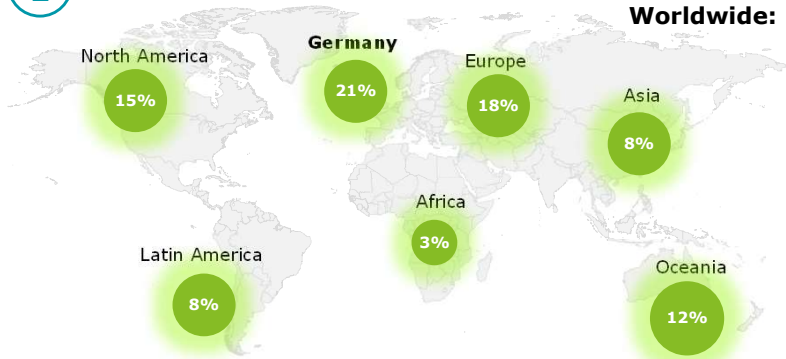
### Increasing number of care recipients

- The number of care recipients continues to grow and is expected to reach more than 4mn by 2030
- Germany has recently set up an association to support people who look after their dependent relatives

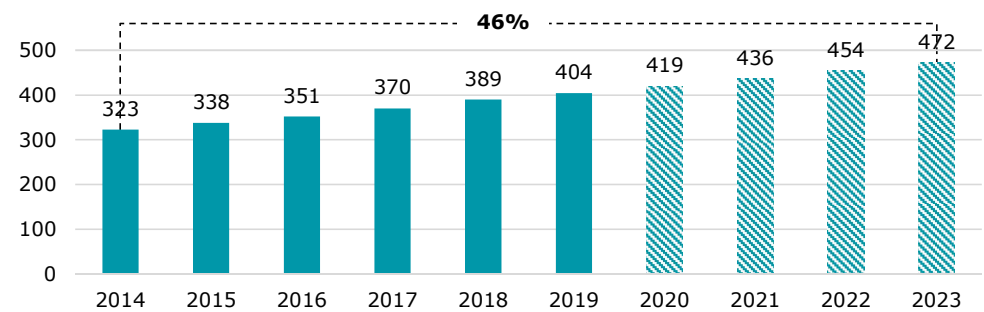
# Healthcare real estate market overview – market drivers (2/2)

The German healthcare industry is expected to grow along with an aging population and an increasing number of people in need of care

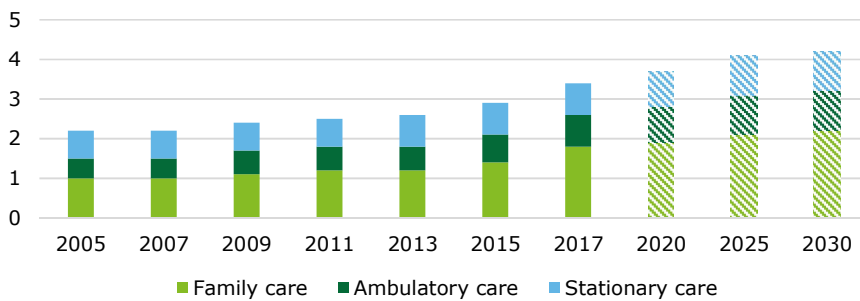
## 1 Aging Population - Share of Generation 65+ Worldwide: 9%



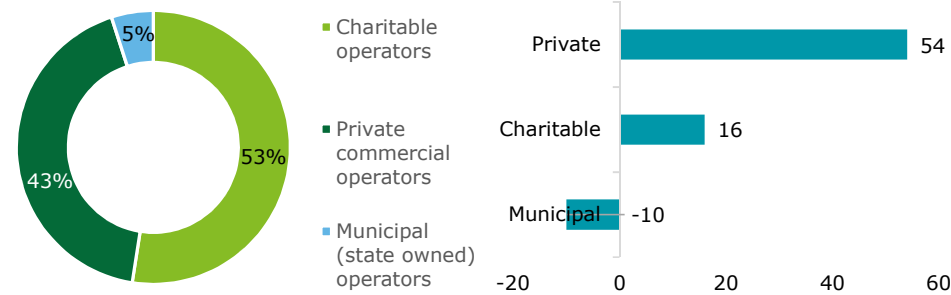
## 2 Increasing expenditure on healthcare German Healthcare Expenditure (€bn)



## 3 Increasing number of care recipients Number of Care Recipients in Germany ('000s)



## 4 Consolidation and privatization German residential homes by operator in 2017 and growth rate



Source: Obtained from publically available data including Statistisches Bundesamt - 14. Bevölkerungsvorausberechnung Deloitte 2020

## Healthcare real estate market overview – current trends

Investors have identified the potential of Healthcare and further increase their engagement in this asset class

- Investments in healthcare real estate bear substantially higher risks than investments in traditional and more established asset classes
- Transaction advisory in this challenging sector requires a high level of industry experience
- Asset specific expertise and a strong network of strategic partners is getting more important

### M&A/ Real estate markets



- The real estate healthcare sector offers chances for diversification, high yields as well as growth potential in alternative investments
- Strong price increase and correlated yield compression on the investment market and in traditional asset classes
- Challenge to identify suitable investment opportunities

### Capital markets



- Enduring positive financing conditions for alternative investments
- Yield expectations of investors are barely achievable with traditional investment products

### Strategy



- Set-up of asset management platforms and strategic partnerships
- Targeting of companies/groups facing financial difficulties (especially by PE)
- Not all healthcare real estate categories offer identical risk-return ratios
- Concentration risk for large facility operators

### Regulations



- New and continuously changing regulations in the healthcare sector are forcing investors and their asset managers to built up specific knowhow in order to evaluate and handle correlated risks

## Healthcare real estate market overview – senior care (1/2)

Third largest healthcare segment in Germany with 5% annual growth, offers a variety of services including assisted living, ambulant care, day care and others

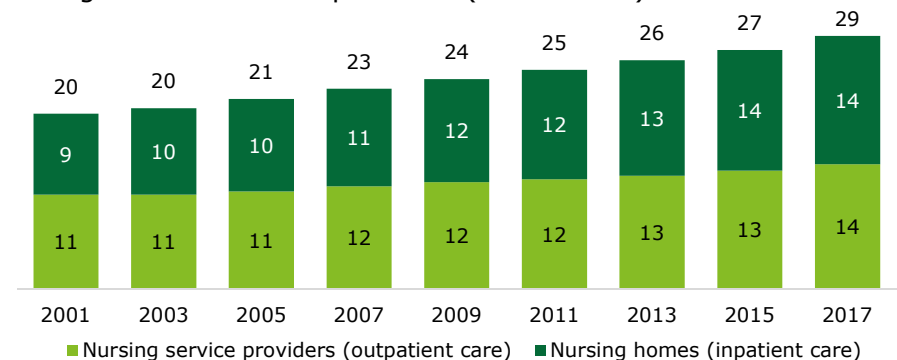
### Key observations

- Senior care market is a crucial driver of the German social economy with a strong growth of the number of care recipients
- The senior care market is the third largest segment within the healthcare sector after hospitals and outpatient medical care
- The senior care market is divided into three segments:
  - Long-term care received at home by relatives
  - Long-term care received as full inpatient care in a nursing home
  - Long-term care outpatient care received through a ambulatory nursing services provider
- Additionally, nursing homes often focus on further care services like assisted living, day care, short time care as well as special services for dementia patients

### Demand drivers

- **Demographic changes:** With Germany's aging population, the requirement for nursing services is expected to increase
- **Changes in nursing home:** A change in the legal requirements for nursing home may cause the homes to undergo renovation or may lead to a maintenance backlog due to which nursing services are more appealing
- **Reducing inpatient care:** Despite the mergers and takeovers recently, the market still has smaller operators that will not be able to work economically in the long term resulting in higher demand for outpatient care services

Nursing homes & service providers (in thousand)



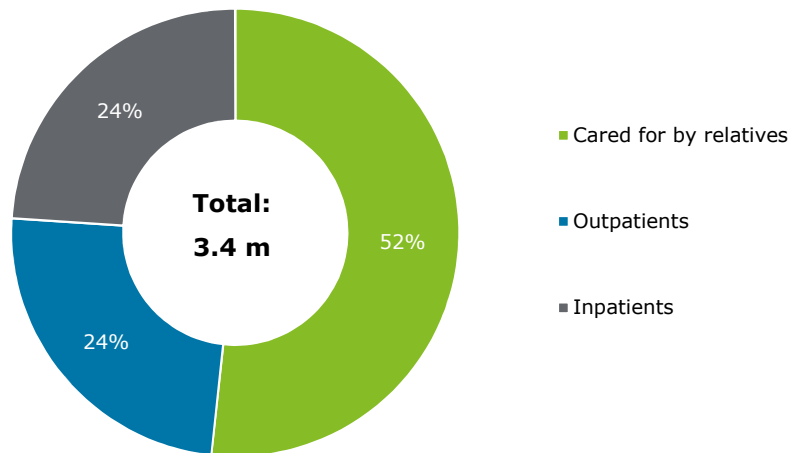
Source: Obtained from publically available data including German Federal Statistical Office

## Healthcare real estate market overview – senior housing (2/2)

Approx. 50% of care patients use services from care service providers (inpatient and outpatient market segment). PSG II & III reformed the care level structure

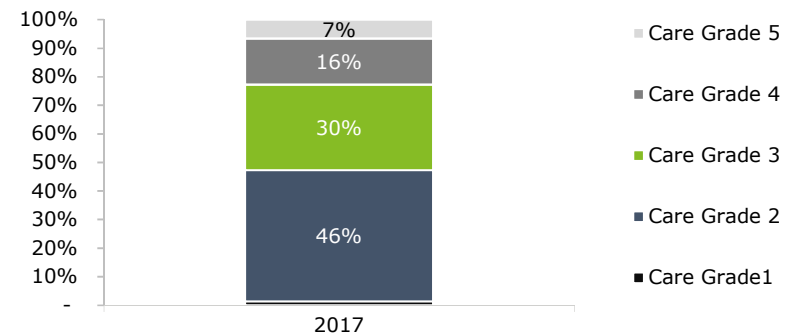
### Categories of care patients

- Approx. 50% of care patients in Germany use service from care service providers either as ambulatory services (outpatient market) or in stationary care locations (inpatient market)



### Care level mix

- PSG ("Pflegestärkungsgesetz") II & III introduced a new "in need of care" definition, resulting in a new reclassification into five care grades (formerly only three care levels)
- The new law comprises the strengthening of local municipalities conducting care related activities and the introduction of precautionary measures to reduce fraud (supervisions of health insurance)
- Until 2015 more than 50% of the patients belonged to the lower care level (former care level I). With the new care grade cluster c. 46% of patients are related to care grade 2 and c. 30% to care grade 2



Source: Obtained from publically available data including German Federal Statistical Office; data references to most recent and available figures 2020

# Healthcare real estate market overview – ambulatory health centers (1/2)

## Further establishment of medical care clinics as pillar of the health economy and interesting investment target

### Market characteristics:

- Since 2004 the number of medical care centers in Germany has steadily increased to more than 2,800 in 2017. The number of MVZ (medical care clinics) carried by contracted doctors is again well above the MVZ carried by hospitals
- The number of “traditional” outpatient health centers has declined over the past ten years. Doctors more and more decide to collaborate with colleagues in larger practice structures. Although individual practices are still the most used form of medical practice, their number has declined disproportionately in this period

### Property/operator characteristics:

- **Medical care clinics (MVZ):** The cooperation form was introduced with the health modernization law in 2004. Doctors work predominantly in an employee relationship (>80%), the economic risk is taken by a carrier company
- **Outpatient health centers:** Doctors work mostly self-employed and carry the economic risk. Every medical practice has its own equipment and personnel. The medical practices work autonomously, without bond and obligation to higher level parent carriers or providers
- Flexible, structural design that enables for third-party utilization
- Area for further expansions

### Location characteristics:

- Good connection to the city centers, public transport in the outpatient area
- Good competitive structure with a long-term need for health services in the sector medical treatments
- Sufficient skilled labour potential in the respective region

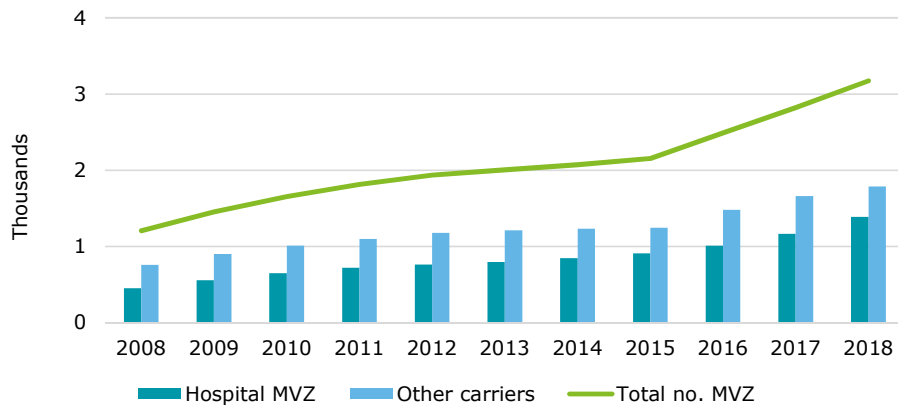


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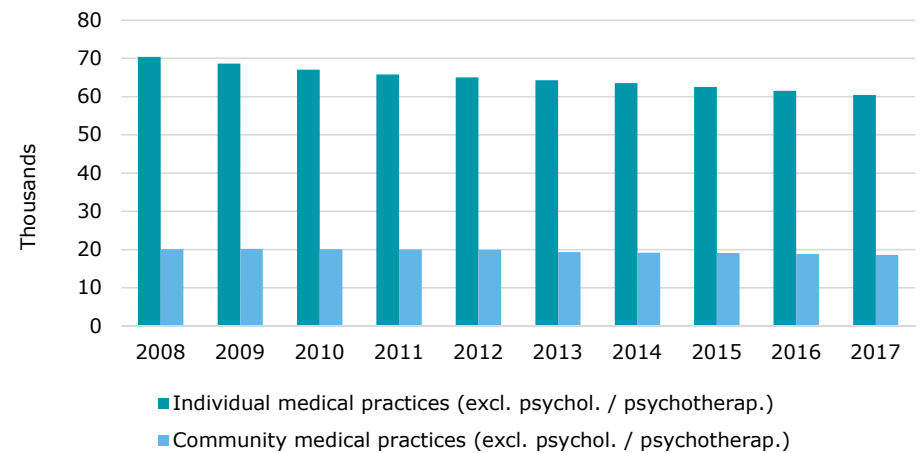
## Healthcare real estate market overview – ambulatory health centers (2/2)

Further establishment of medical care clinics as pillar of the health economy and interesting investment target

**Total no. of medical care centers by carrier**



**Total no. of outpatient health centers**



# Healthcare real estate market overview – clinics and rehab facilities (1/2)

## Special segment with additional potential for operating efficiency and quality improvements

### Market characteristics:

- Past consolidation in the clinic sector was mainly driven by privatization. For rehab facilities the M&A market is characterized by the ongoing expansion of German market leader Median Kliniken
- On the buyer side also foreign financial investors have acquired clinics. These acquisitions were made to dispose of service providers, the prerequisite for the acquisition of medical care centers (MVZs) in the outpatient sector
- In general the market segment for clinics and rehab facilities shows a growing demand (increasing utilization) together with limited competition in the existing operations (only few new constructions)

### Property/operator characteristics:

- Supply contracts with several cost carriers
- Modern medical equipment
- No or less investment and redevelopment backlogs
- Developed concept for private patients / self-payers
- Strategic cooperation with regional partners to realize synergies
- Differentiated offer of outpatient and stationary services (AHB, early rehabilitation, medical treatment)

### Location characteristics:

- Good competitive structure with a long-term need for health services in the hospital and rehabilitation sector
- Good connection to the public transport in the outpatient area and sufficient distance to noise sources (transport, production, etc.)
- Focus on locations close to residential areas and/or tourist-established regions



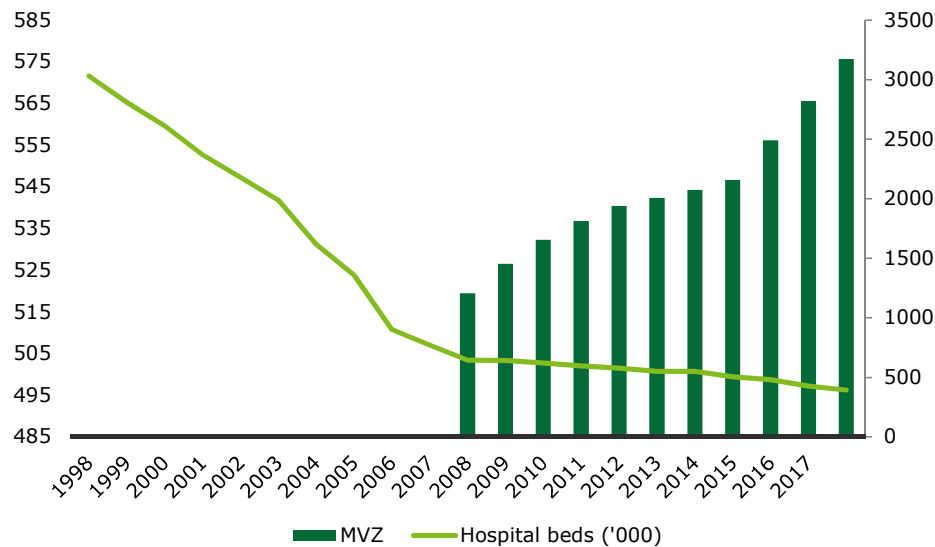
Deloitte research



# Healthcare real estate market overview – clinics and rehab facilities (2/2)

## Special segment with additional potential for operating efficiency and quality improvements

Development of available beds / care places in clinics / medical care centers in Germany (in thousand)



General Trends in the clinics and rehab sector

Competitive intensity	The intensity of competition will continue to increase, as a result the bargaining power will shift progressively towards the cost carriers
Quality requirements	The demand for high-quality services will further increase. Regulatory interventions, already recognizable in the acute inpatient area (obligation for quality reporting, initial initiatives for quality-oriented payment), are expected to occur in the post-acute care in the near future as well
Increasing need for efficiency	The need for economic service provision will become increasingly important. Restrictive fiscal policies are increasingly limiting health spending
Ambulantization	Through technical innovations and new medical treatment models, an increasing number of patients are treated on an outpatient basis. This also has direct implications for rehabilitation, with outpatient services continuing to increase

# Our consulting approach

## Our consulting approach

We focus on the parameters critical for success in industrial real estate and help you to assess every single one of them in order to make solid investment decisions



### Tenure & Tenancy

- Indexation clauses
- Lease term duration and extension options
- WALT
- Stabilized Occupancy / vacancy rate



### Competition

- Competitor analysis for relevant health care real estate types and operators



### Cash flows

- Care fees
- Fees for medical treatment
- Board and lodging
- Invest costs



### Technical infrastructure & building situation

- Building condition assessment



### OPEX/ CAPEX

- Modernization backlog
- Renovation works



### Room structure

- Single vs. double rooms
- Floor structure



### Patient structure

- Self paying vs. social welfare



### Non-recoverable costs

- Evaluation of non-recoverable costs taking into consideration relevant contract types (triple-net vs. double net)



### Operator

- Management company
- Credit rating



### Micro/Macro Location

- Assessment of Micro and Macro location
- SWOT analysis



### Demographic change

- Lackage of qualified staff
- Fast aging society
- Shortage of care places



### Gouvernement Regulation

- Assessment of regulatory environment affecting investment decisions

\* Digital expenditures

## Our consulting approach

With our service portfolio we provide a 360° consulting approach from due diligence to strategic investment decisions

### **Typical components of our industrial real estate M&A transaction & due diligence services include:**

- Analysis of healthcare market conditions and trends including demographics, forecast of future demand, etc.
- Regional competitive analysis of the relevant healthcare/ elderly care markets
- Operator analyses regarding economic key figures of the relevant operating companies and groups
- Review of concepts (strategic and operational review)
- Financial modelling & real estate valuation
- Preparation, review and 2nd opinion regarding operators' asset business plans from a market and real estate perspective
- Benchmarking of key figures including care rates, investment costs, etc.
- Location, site and property analyses, SWOTs, lease reviews, market rental assessment, operating costs benchmarking
- Analysis of potential savings and revenue enhancement in personnel and material costs, in connection with outsourcing concepts

### **Core Services**



Financial DD



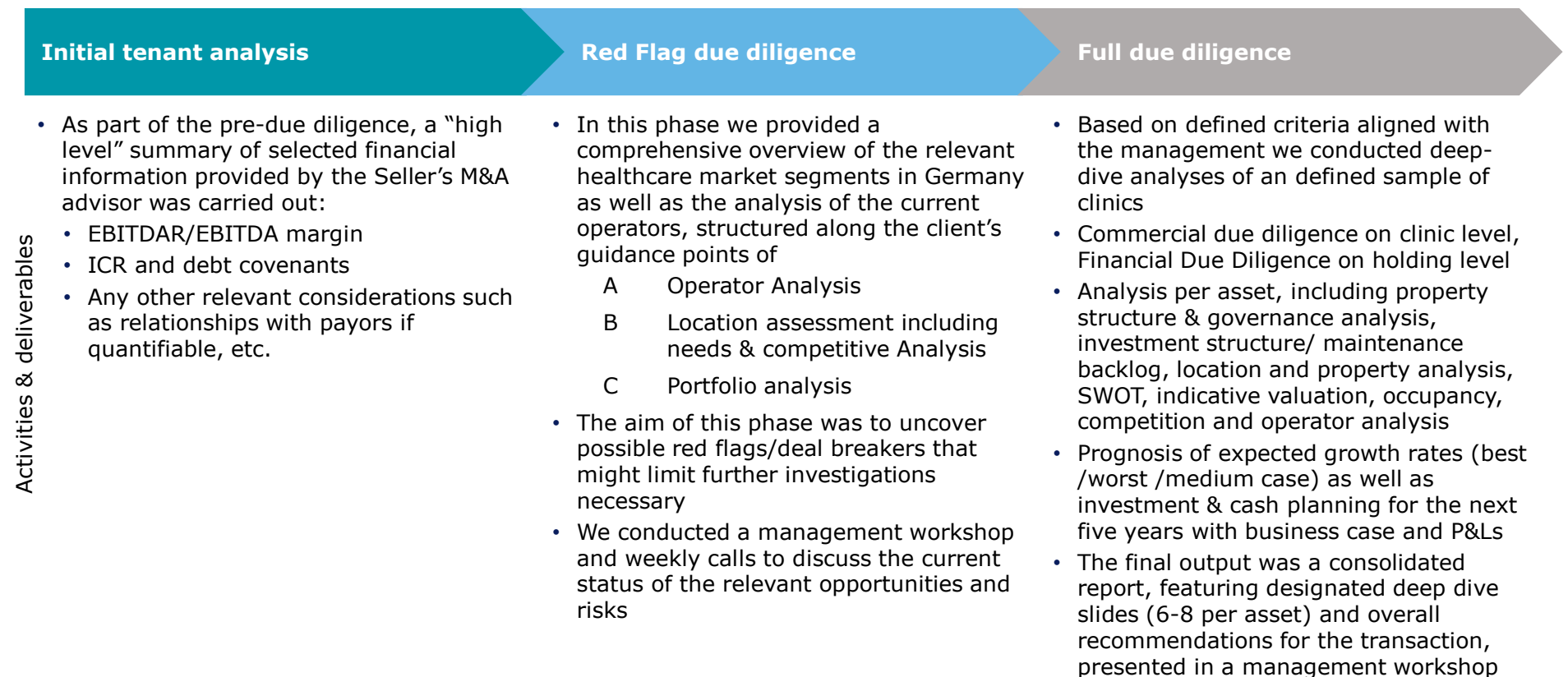
Commercial DD



Real Estate DD & Valuation

## Our consulting approach

### Real life case 1: Multidisciplinary multiphase buy-side DD for a portfolio of special clinics and senior homes



## Our consulting approach

### Real life case 2: Real estate appraisal and valuation of purchase options for a senior home portfolio

- Client was looking into disposal of a portfolio of 12 German care homes via execution of contractual purchase options. All homes were in-use and run by the same operator
- The value of the properties depended on the perspective. Hence a comparison of an occupier-approach vs. a valuation under the assumption of a potential renewed sale-and-lease-back structure was chosen to provide clarity about the potential as well as the risks related to the execution of the purchase options without secured exit
- Deloitte visited all assets and prepared full valuation reports including senior home market report and DCF calculations for all assets; market rents were derived from investment costs and benchmarked against the market



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#### Market Constraints

- Limited investors demand for “used” facilities
- Restricted access to bank funding
- Uncertain future regulatory environment

#### Key considerations under a sale-and-lease-back structure

- Rental agreement in place and sustainable rent (based on investment costs)
- Tenant risks (vacancy, incentives, improvements etc.) and market yield
- Capex requirements and compliance with relevant laws/regulation
- Exit options (under contractual constraints)

## Indicative Value/ Purchase price

#### Key considerations under owner occupation

- Cash flows derived from operator’s strategy and business plan; no risk adjustments for tenant risks (vacancy, incentives, improvements etc.)
- The property value depends on generated cash flows based on operator’s strategy, thus value might suffer in a scenario which would assume a possible shut down/ exit of the operations
- (Potentially higher) individual costs of capital need to be considered

## Our consulting approach

Our team set up combines experienced transaction advisors and experts from the healthcare real estate sector

### Central contacts



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