MARKET IN MINUTES
Savills Research

Healthcare Properties Germany

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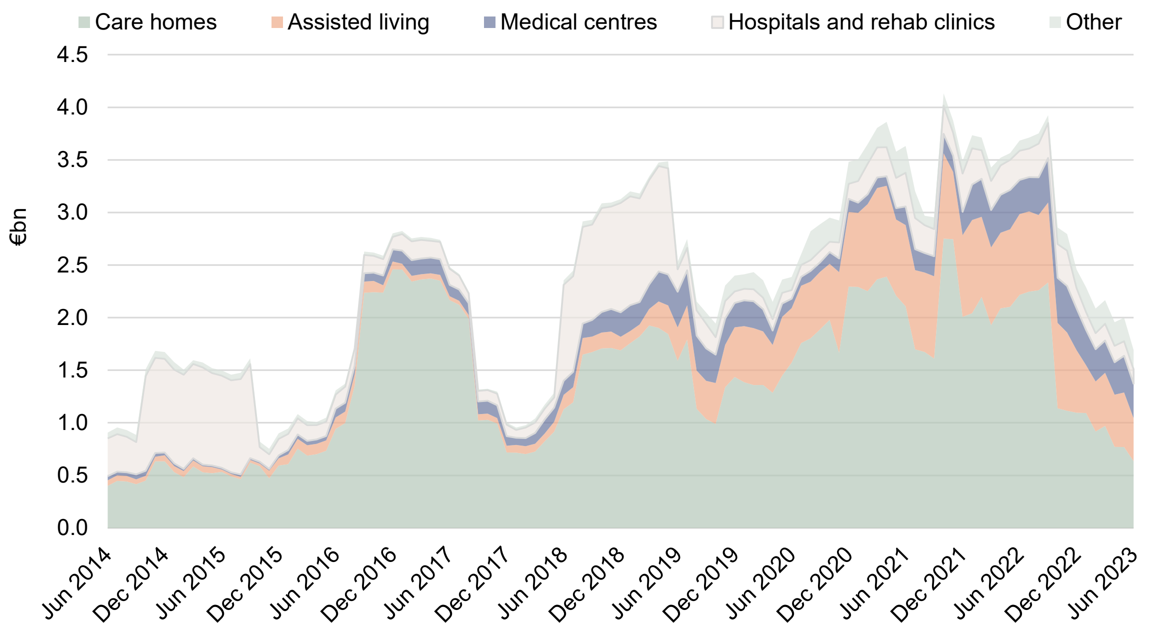
Graph 1: Transaction volume Germany (past 12 months rolling)



Source Savills

Solvent operators sought

In the first half of the current year, healthcare properties in Germany were traded for €723m (Graph 1). This means that the transaction volume was 51 % lower than in the first half of 2022. At the same time, it was the lowest half-year volume since the second half of 2017. Both the volume and the number of transactions (Graph 2) declined in the second quarter compared to the previous quarter. As before, price expectations of owners and bidders that are too far apart make it difficult to conclude many transactions. In addition, the properties for sale often do not match the investors' search profiles. For example, although care homes are increasingly being offered for sale, properties with value-add character dominate, but only a manageable group of investors is currently interested in them. In contrast, there is little supply of medical centres and assisted living facilities, which are in high demand.

Care home operators in crisis

In the traditionally largest and most liquid segment of healthcare real estate, care homes, the challenges that have been looming on the occupier market for some time have recently manifested themselves clearly. Since the beginning of the year, there have been five major insolvencies and insolvency protection proceedings of care home operators. These alone affected about 270 properties with a total of 18,600 care places. In addition, there are various smaller insolvencies or already closed care homes. The care home operators were already confronted with sharply increased costs and lower occupancy rates in the course of the COVID-19 pandemic. Since the beginning of last year, the high inflation rate led to significantly higher energy and consumer goods costs for the operators, but also to higher lease payments due to indexation clauses. The new Tariftreuegesetz led to further challenges, especially because the operators are very much dependent on the framework conditions of the care policy and negotiations with the cost bearers of the nursing care insurance for their income. In the unanimous opinion of the care home operators, for example, the so-called investment cost rates are rising far too low to finance the economic operation of care facilities in the long term. In addition, staff shortages at more and more facilities mean that either not all places may be occupied and the operators lose income, or else they have to resort to very expensive leasing staff. This situation is a structural problem in the German care system. Although the new care reform came into force at the beginning of July, which is supposed to mobilise an additional 6.6 billion euros per year for care, at the same time the federal government is cutting its subsidy to care insurance. At the moment, a

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25%

Larger portfolios in particular are currently meeting with restraint among investors. In H1-2023, portfolio sales accounted for only a quarter of the volume - compared to a five-year average of 51%.

€146m

In the first half of the year, €146m or approx. 20% of the volume was realised with the purchase of project developments. Most of these were facilities for assisted living.

>€50m

In the year to date, there have only been three transactions with a volume of at least €50m – care home portfolios were not among them.

substantial reform for the sustainable financing of long-term care does not seem to be in sight. The sword of Damocles of operator insolvencies will therefore continue to hover over the sector.

Care homes continue to lose importance on the investment market

Because the structural problems in the profitable operation of care homes outshine the long-term growth prospects of the sector, we are observing a clear reluctance to make further care home investments, especially among risk-averse investors. This is increasingly reflected in the investment market figures. Care homes accounted for only 39% of the transaction volume and thus significantly less than the average of the past five years (57%). Instead, medical centres and assisted living facilities are becoming increasingly important. Around 26% of the volume in the first half of 2023 was accounted for by assisted living facilities and a further 19% by medical centres.

Many investors are making themselves scarce

Although healthcare properties are still on many investors' lists, many players are currently holding back on purchases and waiting to see how the market develops. In the first half of the year, not a single one of the ten largest investors of the last five years (measured by acquisition volume) appeared as a buyer. Buyers from Germany dominated events in the first half of the year with a volume share of 89%. On average over the last five years, they accounted for only around 52% of the volume (Graph 3). In particular, specialists who have been active for many years and who can also organise a change of operator due to their good networking and market knowledge are finding what they are looking for in the growing number of offered properties. However, a large proportion of investors continue to focus on new constructions and accordingly have relatively few purchase options. In view of the decline in construction activity, also due to persistently high construction costs, supply for core and core-plus investors is likely to remain tight in the near future.

Prime yields scratching the 5% mark

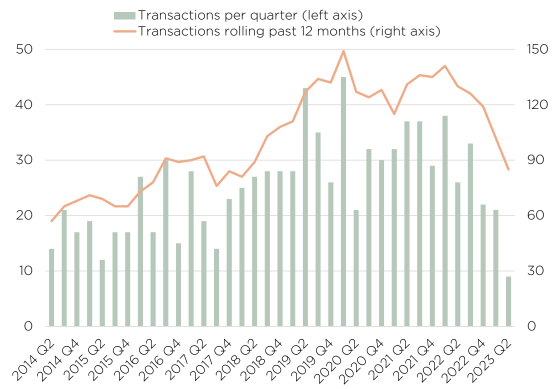
Increased initial yields are also contributing to the declining transaction volume. The prime yield for care homes was 4.9% at the end of the first half of the year. This means that the prime yield rose by 100 basis points over the year and is thus roughly at the same level as in 2018. Yields are likely to rise further, especially for existing properties with poor building standards or a struggling operator.

Outlook

In view of the rise in initial yields, some investors are likely to consider more purchases again. We expect the number of transactions to increase in the second half of the year, but overall assume that transaction activity will remain quite subdued. While more care homes are for sale, investors in this segment will only act very selectively, so volumes are likely to remain below average. The stronger focus on assisted living and medical centres, but also on specialist and rehabilitation clinics, will continue. Although doctors and operators of rehabilitation clinics are also confronted with higher costs and are largely dependent on payments from health insurance companies, the economic situation in the occupier market is much less precarious here from an investor's point of view than in the care market. There is likely to be strong demand for properties with tenants who rely primarily on solvent private patients.

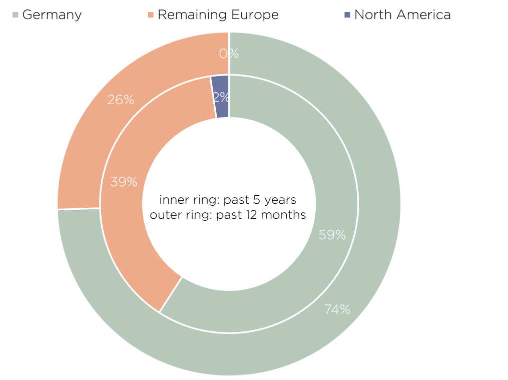
Download the charts and raw data here

Graph 2: Number of transactions



Source Savills

Graph 3: Transaction volume by origin of investor



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