# THE INVESTMENT CASE FOR SENIOR LIVING

February 2022

**IN A NUTSHELL**

_ Senior living is set to benefit from rising tenant demand and increased investor interest given the aging population in Europe.

_ The emerging and undersupplied assisted living subsector is expected to expand over the next ten years as new supply is developed to meet future demand.

_ Germany and France are attractive and the most mature senior living markets in Europe, albeit still relatively nascent compared to other property sectors.

_ Senior living assets are typically valued at a yield premium compared to traditional multi-family residential, reflecting operational and alternative use risk. This yield premium is likely to compress given increased institutional investor interest as the sector matures.

## Senior living as a diversification and expansion of the residential investment strategy

The residential sector has gained prominence among investors in the last few years and continues to be a preferred investment strategy for many. In addition to traditional multi-family residential, operational residential assets – such as senior living, student housing and co-living – sit high on our list of key investment themes. Especially senior living is set to benefit from rising tenant demand and increased investor interest given the aging population in Europe, with the emerging and undersupplied assisted living subsector expected to expand over the next ten years.

The broader senior housing sector – consisting of independent living, assisted living and care homes – is a mix between residential and pure-play healthcare real estate. Independent and assisted living are more akin to the private rented sector (PRS) compared to care homes and hospitals given the similar characteristics, including autonomous tenants, average stay, and rental regulation.

Independent living typically excludes any form of medical care, targets the younger-end of the elderly population (65-75yrs), and offers both for-sale and rental properties. Assisted living commonly provides rental accommodation for >75yrs independent seniors. Additional services – such as meals, activities, and basic care services – can be included, but residents do not require medical assistance with 24-hour skilled nursing.

**SPECTRUM OF RESIDENTIAL AND HEALTHCARE REAL ESTATE**

| Senior Living | | | | | |
|---|---|---|---|---|---|
| | Private Rented Sector | Independent Living | Assisted Living | Care & Nursing Homes | Hospitals & Clinics |
| **Age Cohort** | >18yrs | 65-75yrs | 75-85yrs | >85yrs | All ages |
| **Tenant Profile** | Autonomous | Autonomous, but age-restricted | Autonomous, but age-restricted | Dependent | Dependent |
| **Average Stay** | 3-5 years | 5-10 years | 4-7 years | 6-24 months | 1-4 weeks |
| **Typical Location** | Urban & suburban | Urban & suburban | Urban & suburban | Suburban & rural | Suburban & rural |
| **Regulation** | Private residential | Private residential | Private residential | Medical | Medical |
| **Type of Services** | - | Optional hospitality services | Optional hospitality and basic care services | Dementia care and skilled nursing<br>*(24-hour care)* | Specialised care and doctors<br>*(24-hour care)* |
| **Examples / Also known as** | Multi-family residential<br>Single-family residential | Retirement community<br>Retirement villages<br>Active adult<br>Later living | Housing with care (UK)<br>Service residences (France)<br>Betreutes Wohnen (Germany) | Skilled nursing<br>EHPAD (France)<br>Pflegeheim (Germany) | Private hospital<br>Clinic<br>Post-acute care<br>Rehabilitation |

Source: DWS, February 2022

## Demand for senior living boosted by aging population in Europe

The number of people aged over 65 is expected to grow by ~30% over the next 15 years in the European Union[1], compared to a modest sub-1% growth for the overall population. Currently this group represents ~20% of the total population, but is expected to rise to ~25% in 2035[2]. Germany and Italy have the largest elderly population in Europe and expected to remain the largest in 10 years' time. The elderly population in countries such as France, Netherlands, Nordics, Spain, and the United Kingdom are expected to increase rapidly as the age demographics change.

In addition to demand from an ageing population, the current generation of young elderly – the baby boomers – have often benefitted from defined benefits pension schemes and strong historical house price appreciation. The Nordics and Western European countries have the highest average net wealth at retirement (~€450k[3]) and average disposable income (~€25k[4]) in Europe. The ageing demographics coupled with the wealth of those young elderly bodes well for senior living demand.

Investment transaction volumes in the senior housing sector have roughly doubled since 2016 compared to the 2012-2015 average, albeit remain a small percentage of overall transaction volumes. Transaction volumes are expected to further increase as non-specialized institutional investors and residential property funds are entering the sector.

[1] Source: Eurostat
[2] Source: Eurostat
[3] Source: Eurostat, Credit Suisse and DWS
[4] Source: OECD

## Investment yields and returns

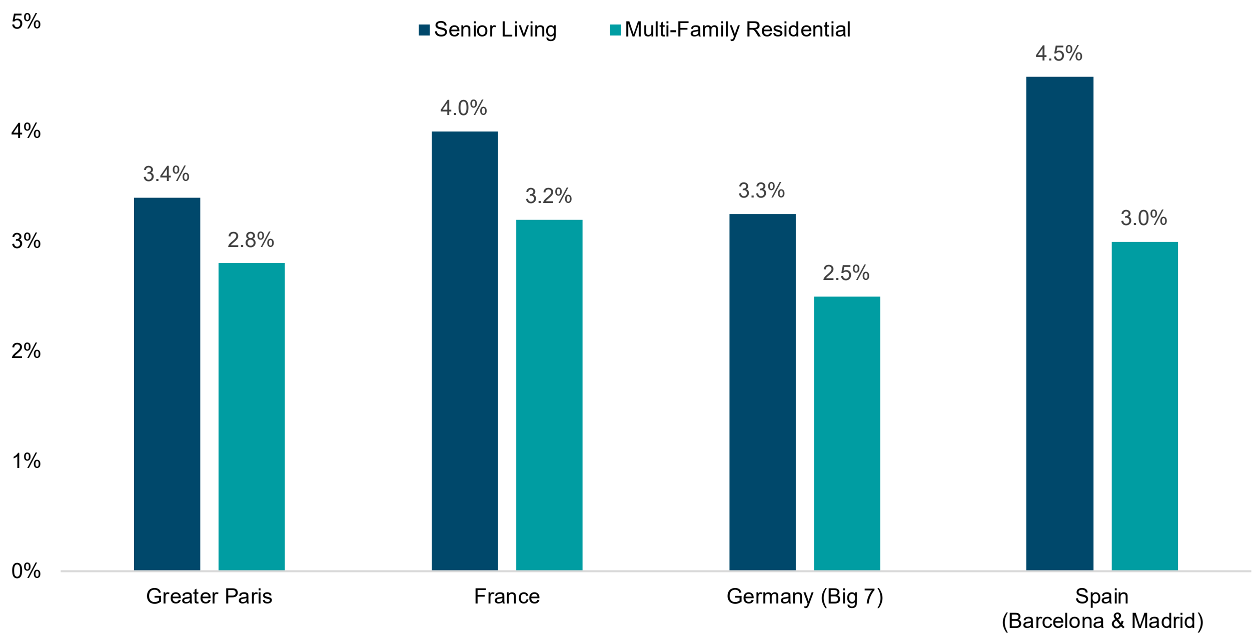
European senior living assets are typically valued at a 50-150bps premium compared to multi-family residential, depending on asset type, micro location, market maturity, and level of healthcare regulation. The yield premium reflects operational and alternative use risk. Alternative use values are often lower compared to investment values: Capital values for senior living assets are typically 5-20% in excess of comparable residential products in similar locations.

In France we observed the narrowest yield premium given the similarity to residential and limited healthcare regulation. For example, senior living assets can be constructed on a residential permit. In more healthcare regulated markets, such as Germany, the yield premium vs. residential would typically be higher compared to countries such as France. The higher yield premium in Spain reflects higher country risk and the infancy of the senior living market.

In the United States, where senior is more established than in Europe, the cap rate spread between senior housing and multi-family residential has narrowed overtime as the sector matured. We could see a similar trend in Europe, as the yield spread vs. multi-family residential could be 25-50bps for best-in-class standing assets in selected submarkets.

The combination of a higher in-going net yield vs. multi-family and inflation-linked leases could result in an attractive cash-on-cash return for institutional investors. Additionally, IRR returns could be boosted by a modest yield compression – relative to multi-family residential – as the sector matures in Europe.

**PRIME NET YIELDS**




Source: DWS, February 2022

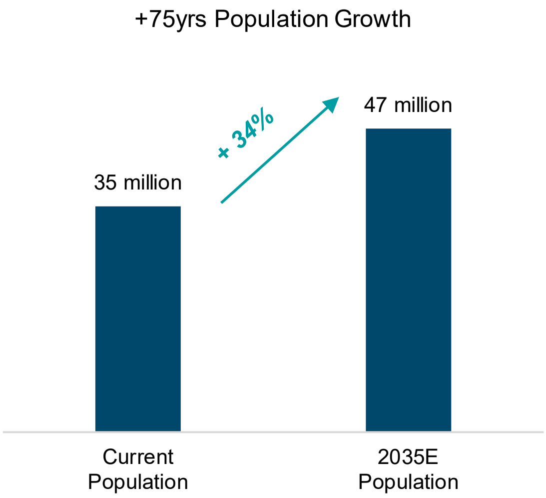
## Focus on Assisted Living

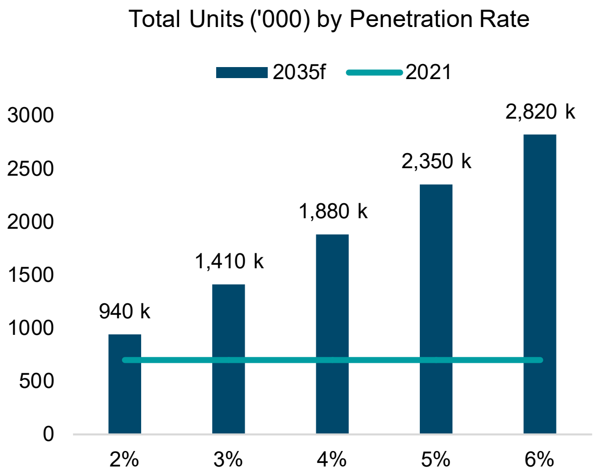
Assisted living could be a natural expansion of the residential asset class for institutional investors with PRS exposure and knowledge, given the many similarities. Assisted living units often attract rental tenants based on the average age and length of stay of residents, whilst independent living accommodation often competes with for-sale properties in retirement villages given the younger age of the residents. Care and nursing homes are often considered healthcare investments given the skilled care requirements and government regulations. Assisted living does not require skilled nursing, has fewer regulatory rules compared to care homes and benefits from longer tenant tenures. We see the biggest opportunity in the assisted living market but won't exclude investing in other senior housing property types in the future.

The investable universe (excluding PRS) is currently dominated by care and nursing homes, but the assisted living market in Europe is expected to expand over the next 10 years. The largest European markets – France, Germany, Italy, the Netherlands, Spain, and the United Kingdom – have more than three million care and nursing home units[5], compared to roughly 700,000 assisted living units[6].

We have seen substantial growth in assisted living establishments in France and Germany over the last few years. However current stock of assisted living units relative to the elderly population – also known as the penetration rate – remains well below mature markets such as the United States and Australia. The penetration rate is defined as the percentage of the +75yrs population vs. the number of assisted living units. Penetration rates in France and Germany are in the 3-4% range, compared to 6-7% currently in the United States and Australia. The sector remains nascent in the rest of Europe, with sub-1% penetration rates in most countries.

**ASSITED LIVING: DEMAND AND SUPPLY**




Source: OECD, BONARD, DWS, February 2022

The over 75-year population is expected to grow by 34%, from 35 million to 47 million in 2035 in the six largest European markets. The current stock of roughly 700,000 assisted living units translates to a penetration rate of ~2%. In a scenario whereby the penetration rate remains stable at 2%, an additional ~240,000 units (or ~17,000 per annually) are required by 2035 to meet future demand. As the European market matures, an expansion of the penetration rate – ranging from 3-6% – could require 1.4 million to 2.1 million additional units by 2035. Higher divorce rates and increased mobilization, such as children living in other parts of the country or abroad, could lead to further growth in demand for assisted living.

[5] Source: Knight Frank, 2021

[6] Source: BONARD, JLL, Knight Frank, DWS, 2021

## Defining Investment Strategy

The assisted living market can be accessed through acquisition of standing assets or forward funding built-to-suit developments. An initial strategy of purchasing individual assets with different developers and operators could be executed to gain experience and knowledge, and ultimately become an established player. In the medium term, a partnership with a developer and operator could accelerate capital deployment. Additionally, in a partnership model the investor has the ability to select partners, negotiate the lease with the operator, and provide input on the development strategy, including location and asset specifications.

In Continental Europe, the OpCo/PropCo lease model is very common in the assisted living sector. The asset is typically leased to a specialized operator for 9-25 years, with inflation-linked rent increases. The OpCo/PropCo lease model offers operational simplicity, predictable income, and inflationary rental growth. An operating model via a management contract is possible in some markets (including Germany), whereby the investor directly lets residential units to tenants and hospitality and medical space to an operator. The residents have the option to purchase hospitality and medical services from the operator. In contrast to Continental Europe, the for-sale model is widely adopted in the United Kingdom. However, the rental model is increasing on the margin.

In the OpCo/PropCo model, the operational risk is shifted to the operator via a long lease. Quality of the operator, track record and financial performance – including EBITDA[7] margin and EBITDAR[8] coverage ratio – are key criteria for underwriting. 15-25% EBITDA margin and 1.3-1.5x EBITDAR coverage are considered healthy ratios.

We have developed a market scoring methodology based on demographics, wealth and economic indicators, current and future supply, and operator landscape to identify attractive markets. France, Germany, the Netherlands, and Spain screen attractive for senior living investments based on our scoring methodology. The United Kingdom is also an interesting market from a demand and supply perspective, but senior and assisted living units are often obtained in a for-sale model.

- **France and Germany**: Our top pick based on strong demand fundamentals, size of the market, proof of concept given modest existing supply and active large operators.

- **Spain:** In addition to strong growth in the elderly population, Spain benefits from a relatively wealthy foreign retirement population as a well-known retirement destination.

- **The Netherlands:** A market with one of the strongest growth rates in elderly population in Europe, coupled with good purchasing power among pensioners.

On balance our strategy is to focus on partnering with established developers and operators in core European countries, targeting locations with a supply-demand imbalance and sufficient purchasing power. The current share and growth of the +75yr population is the key demand driver. On the supply side, we favor emerging and affluent areas with some proof of concept and active best-in-class operators, but low supply relative to elderly population (i.e. the penetration rate).

Existing private commercial stock is mainly located in suburban areas of large cities or in the edge of town of regional cities. Scarcity and high value of land have pushed developers and investors away from the city centre. Easy access to shops and pharmacies, good transport connections and local purchasing power will be key location criteria.

ESG is of course an important part of our investment strategy. We would aim for energy-efficient buildings and implement innovation projects to yield a sustainable impact. Improving elderly well-being and integrating seniors into a community are part of the social proposition. Good working conditions and ethnic diversity in the workforce of the operator are potential examples of governance policies.

[7] Earnings before interest, taxes, depreciation, and amortization (EBITDA)

[8] Earnings before interest, taxes, depreciation, amortization, and rent (EBITDAR)

# Research & Strategy—Alternatives

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