

Nursing real estate market in Germany

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Chances and
challenges of a rising
asset class



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PREFACE

The German nursing care market is enjoying unprecedented national and international public attention as a result of:

- Political controversy and election campaign issues
- Shortage of nursing staff and shortfalls in the supply of nursing care
- Politically-driven pushes towards outpatient and visiting treatment rather than inpatient nursing care
- Sixteen different federal-state-specific sets of laws and regulations; as well as
- The short and medium-term need for the construction of new buildings, yields and public welfare

Until not long ago, people talked about demographic shift as if it was just a theoretical phenomenon. However, theory has now become reality – Germany's population is ageing because of significant advances in medicine, with the proportion of the population who are very elderly constantly increasing. This shift brings with it an additional demand for care services due to the increased likelihood of becoming dependent on care with increasing age. According to projections by the Federal Institute for Population Research, the number of people requiring care will rise by a further 27% to 3.62 million by 2030 and by as much as 70% to 4.82 million by 2060, compared with 2015. This is a growth market with many challenges, but also many opportunities, as currently there is quite simply a lack of suitable care facilities.

Regardless of whether we are addressing (partially-) inpatient or outpatient nursing care services, without short, medium and long-term investments, a shortfall is inevitable. In order to guarantee a demand-oriented care landscape in Germany, massive investments in both real estate and eliminating the shortage of personnel is necessary. The public-sector institutions and the social security system are subject to financial constraints due to the

decreasing number of contributors and the increasing number of recipients. The urgently required investments in sustainable, adequate and affordable care infrastructure can only tap into private capital if the potential investors have the reassurance of operating within a long-term, binding and reliable legal framework and the risk premium on the equity capital employed is in line with market rates.

There is movement in Germany's number one growth market, as shown by both the current politically (over-) motivated discussion and also by the consolidation of the still highly-fragmented operator market and the increasing interest of institutional and long-term (real estate) investors in this asset class. To ensure that the nursing care market remains a competitive sector that can develop new creative and alternative care and living concepts and thus contribute to the dovetailing of outpatient and inpatient services, a much lower level of planned-economy regulatory intervention is required.

With this in mind, we hope our new nursing market report provides a thought-provoking read and that we provide you with some interesting insights.

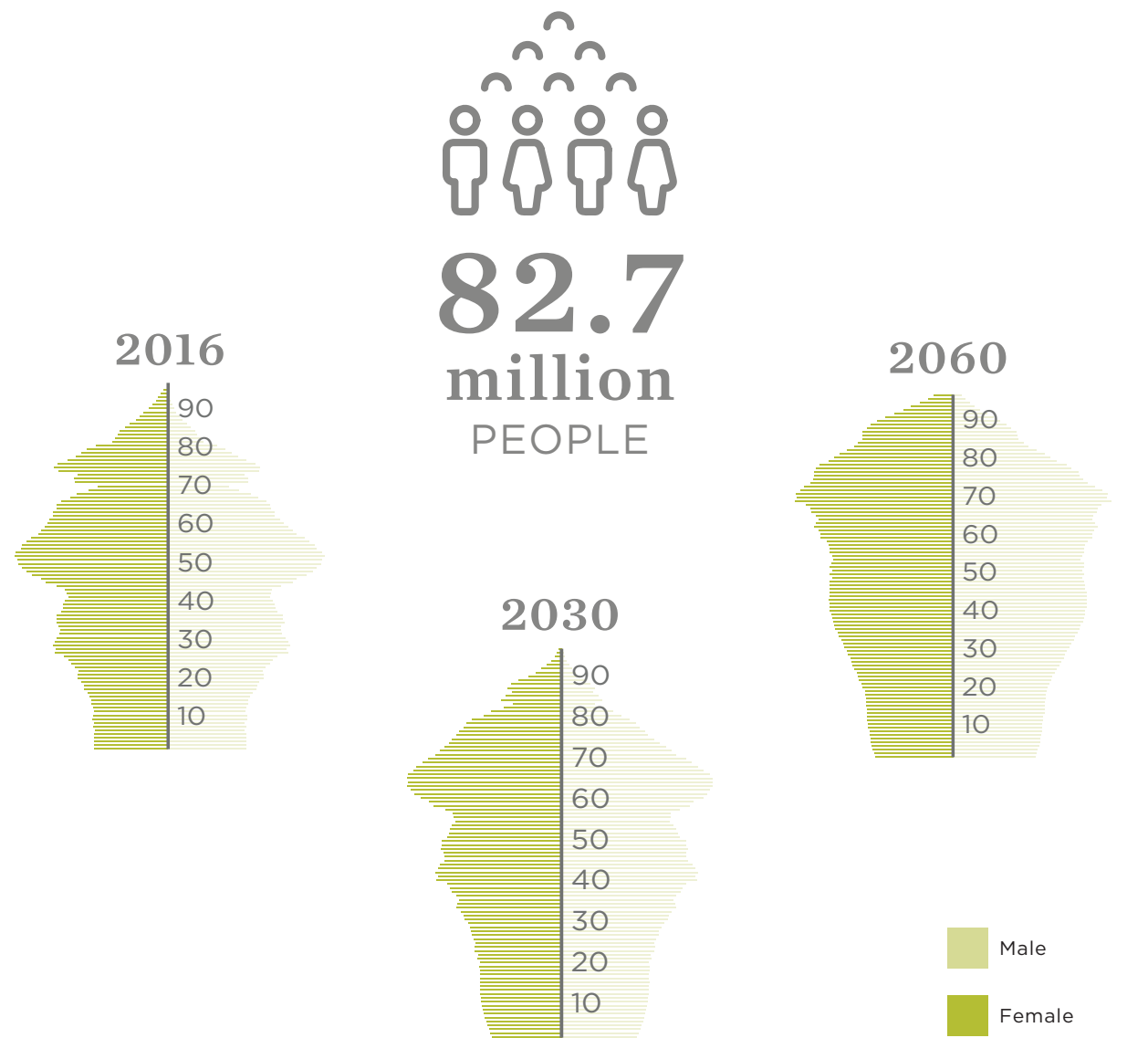


*There is movement in
Germany's number one
growth market!*



01

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**GERMANY'S
DEMOGRAPHY IN
TRANSITION**

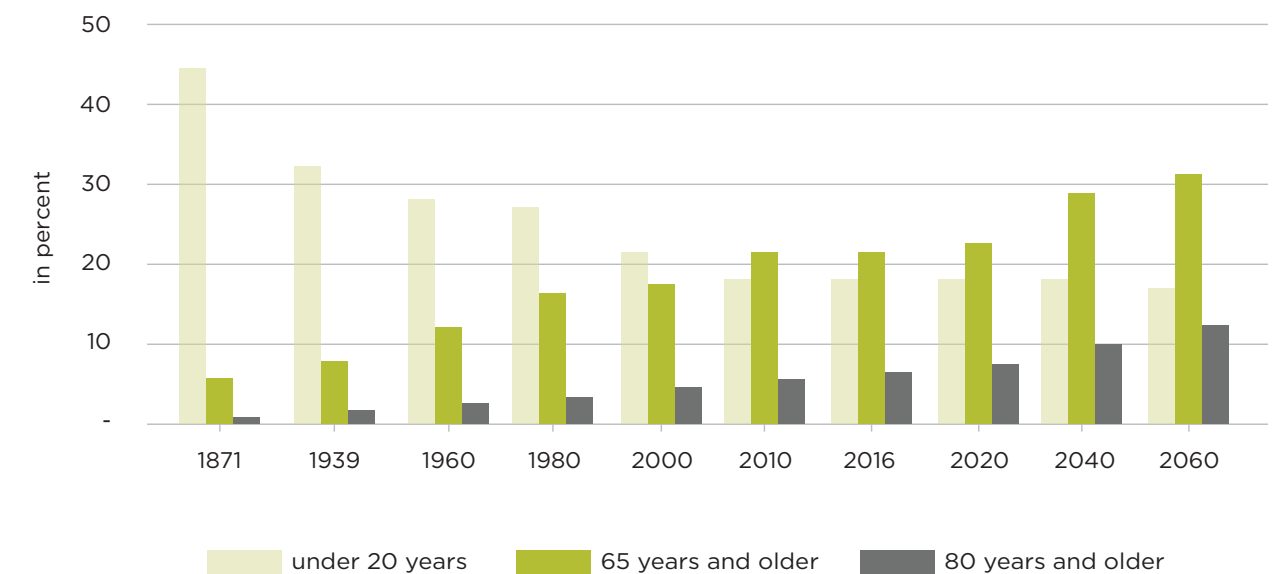


*Federal Statistical Office (Destatis),
Cushman & Wakefield*

Germany's population is ageing. This trend appears irreversible and poses great challenges for society, especially as the probability of an individual requiring care and inpatient admission increases with age. Life expectancy has been increasing for decades: for newborn boys, average life expectancy is now 78.3 years, while for girls it is 83.2 years. In 2060, an average life expectancy of 84.8 years is forecast for men and 88.8 years for women. This steady rise in life expectancy, coupled with low birth rates in recent decades, has contributed to a demographic shift where-

by every fourth German citizen, out of some 20 million people, now belongs to the 60-plus generation. The trend is forecast to continue, accompanied by a corresponding increase in the demand for care facilities as the baby boomers of 1946-1967 first reach retirement age, and then ten-to-fifteen years later possibly require nursing care.

Age Group Proportions 1871 to 2060

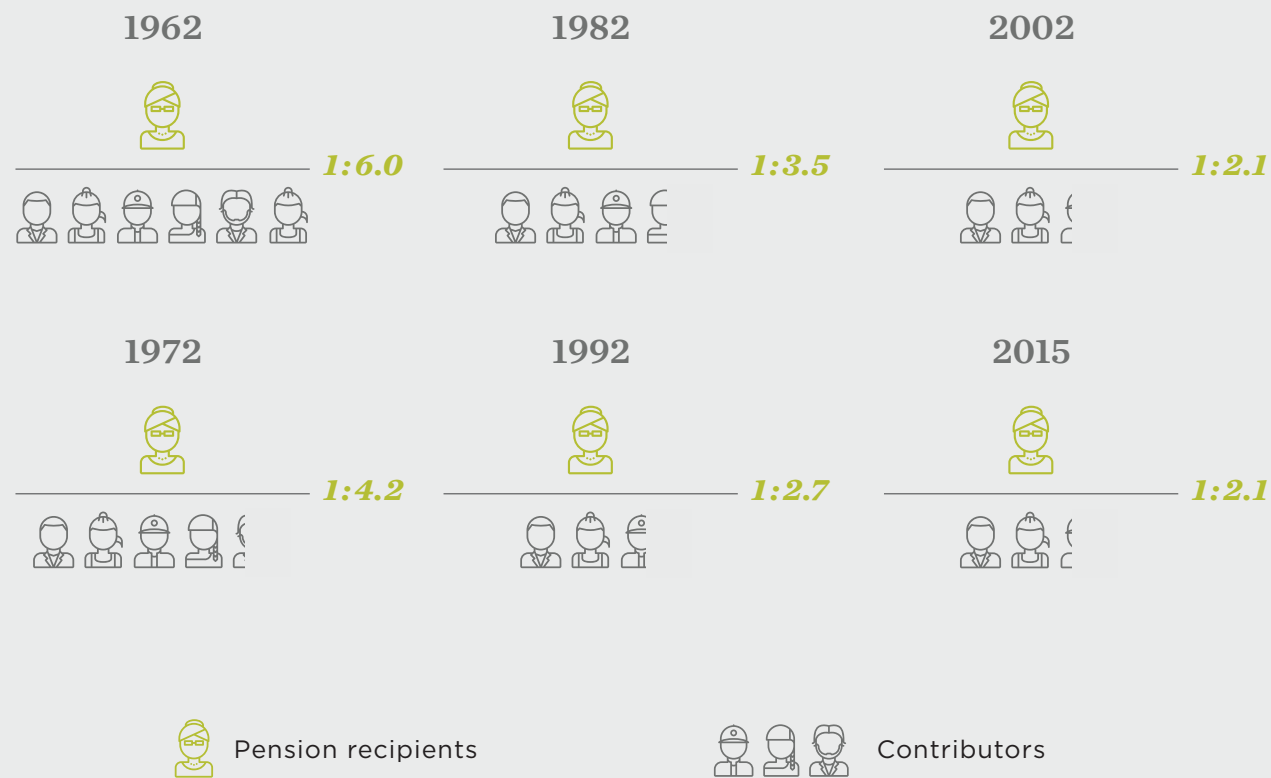


*Federal Institute for Population Research (BiB),
Cushman & Wakefield*

This development is accompanied by a further challenge: with the change in the proportion of the elderly in the population, the ratio of pension contributors to those drawing a pension has also changed drastically in recent years. In the 1960s there was a ratio of six to one, which means that for every pensioner there were six people contributing. By 2015, there were already only 2.1 contributors per pensioner. Due to the demographic shift it is assumed that this trend will continue and that pay-as-you-go contributions as a means of financing our pension system

will encounter ever greater difficulties. Since 1st August 2018 state pension contributions have been at 18.6 % in Germany. The pension authority, Deutsche Rentenversicherung, recently forecast that this rate will have to increase significantly, to as much as 19.3 % by 2023 in order to ensure medium-term security for the state pension system.

Ratio of State Pension Contributors to Pensioners (1962 to 2015)

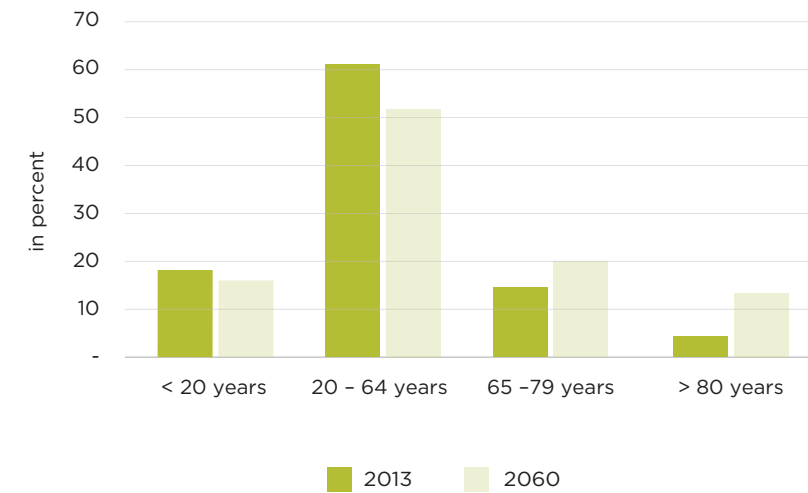


Federal Institute for Population Research (BiB),
Cushman & Wakefield

The shift in the age structure of the population is leading to the increasing importance of professional care services and care facilities. The rise in life expectancy is not the only contributor to the demographic shift, as previously mentioned a further factor is the relatively low birth rate. Despite a recent rise, Germany's birth rate is midfield among the EU member states. In addition, there is a change in the compo-

sition of households in Germany and a growing lack of familial care. The trend towards one- or two-person households is resulting in an increasing dependence on third parties. Furthermore, there is an enormous demand for age-appropriate, barrier-free housing. According to Terragon, at least 1.6 million barrier-free dwellings were lacking across Germany in 2017 - and the trend is rising.

Population by Age Group



Federal Statistical Office (Destatis),
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Although the ageing of the German population is a national phenomenon, some regional differentiation must also be made in this respect. The demographic shift is more advanced in the "new" federal states of the former German Democratic Republic (informally "East Germany") than in the "old" federal states of western and southern Germany. A sociodemographic analysis of the regions yields clear differences. The old-age dependency ratio, comparing the population aged over 65 to the population aged between 20 and 65, provides a suitable means of making the age structure regionally comparable.

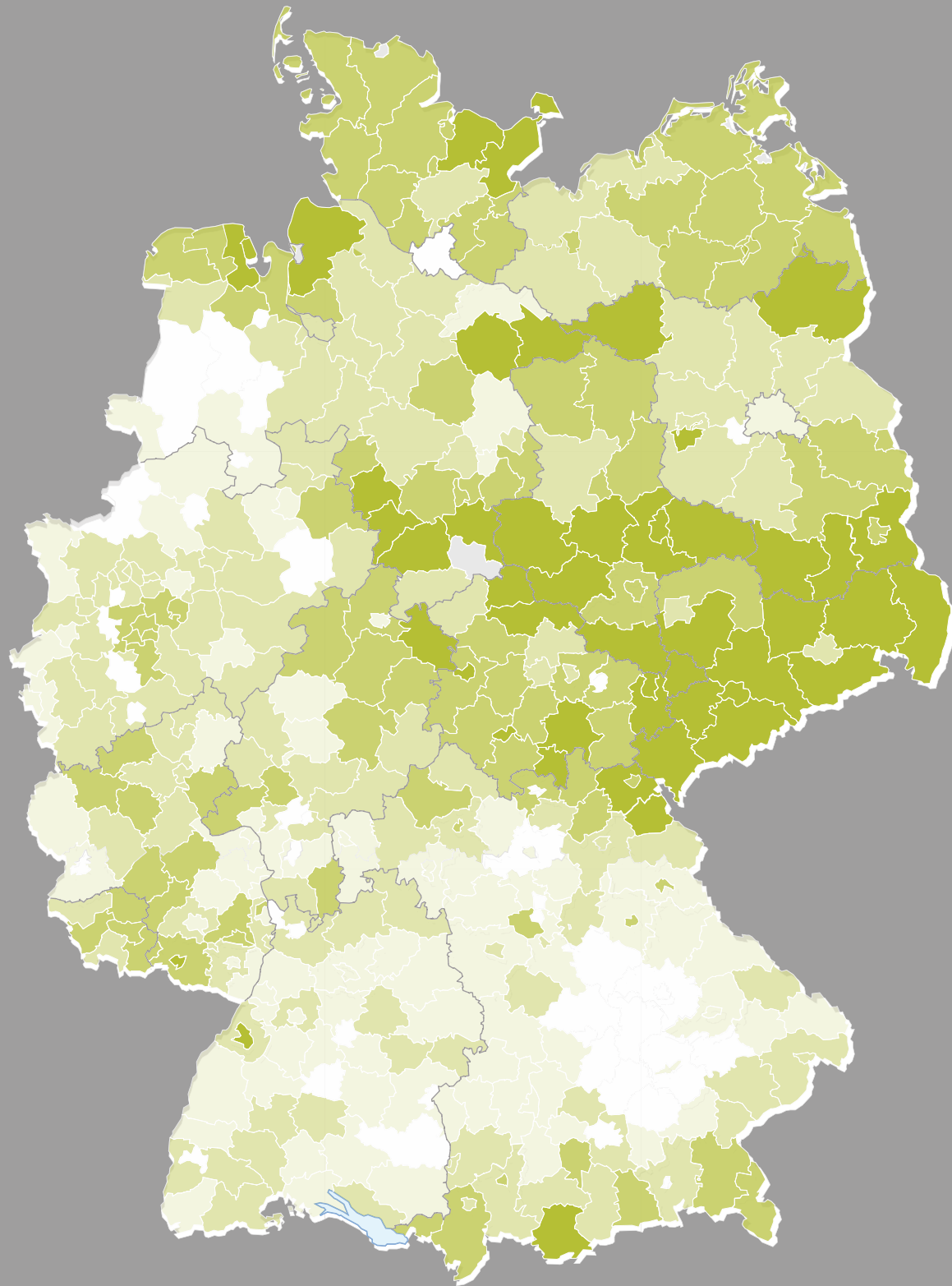
Household Size Trend to 2030



Federal Statistical Office (Destatis),
Cushman & Wakefield

Over the next few years, the ageing of the population will continue and also become increasingly apparent in the "old" federal states. In addition, the populations of urban regions such as Munich and Hamburg are on average younger than those of rural regions. This results from the generally higher quality of life in structurally-strong urban regions than in rural and peripheral areas, and from the significantly higher availability of jobs and training places in the growing cities and inward-migration regions.

The Old-Age Ratio

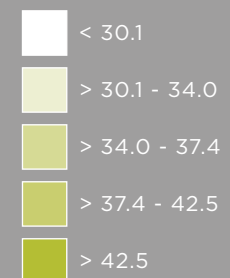


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Percentage of persons over 65 years of age compared to those aged between 20 and 65 (2015 in percent)





02

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**RISING DEMAND FOR
CARE SERVICES**

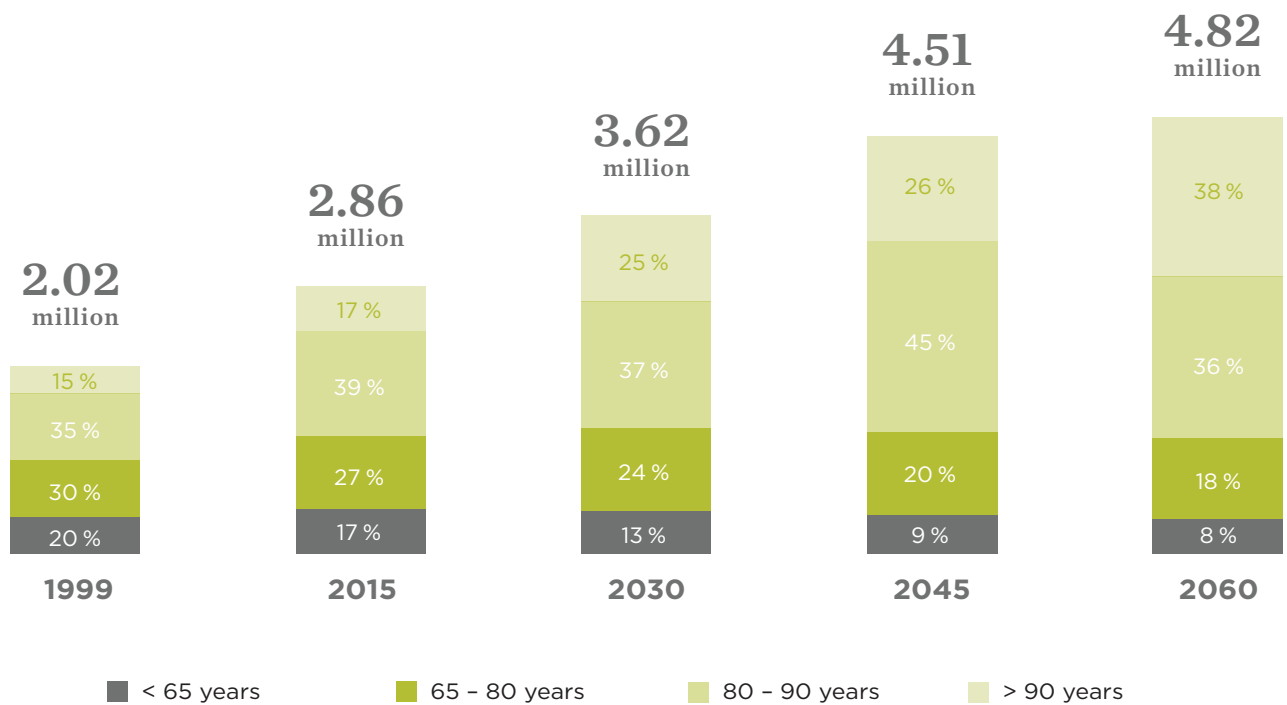
The reasons for the further increase in the need for care are complex:

- The shift in the age structure of the population – due to increased life expectancy and the forecast ongoing annual decline in the number of births – means that the proportion of the population over 65 will continue to rise;
- In addition, however, the need for long-term care amongst the younger population groups is also increasing – the number of people under the age of 60 requiring long-term care increased by more than 28%, to just under 385,000 between 2001 and 2015;
- In addition, familial care is steadily decreasing as a consequence of children and grandchildren tending to move away, increased mobility at international level and the increase in the employment rate.

Moreover, the likelihood that an individual will require care increases with age. At present, about 83% of those receiving assistance under the German Long-Term Care Insurance Act (SGB XI) are 65 or older. Among people of 75 to 85 years old more than one in ten require care, but for those between 85 and 90 it is already one in four. For the over-90 group, this proportion rises to about two thirds, of whom about half require round-the-clock care.

The number of people requiring care will increase by a further 27% to 3.62 million by 2030 from the level of 2015. In the short term, there will be a significant increase in the demand for nursing services and age-appropriate housing by 2030. The almost 13,600 nursing homes which currently exist, providing around 930,000 places, will no longer be sufficient in the future. The occupancy rate of inpatient care places in all nursing homes was already more than 91% in 2015. More recent official care statistics are expected to become available in January 2019. However, it can already be assumed that the average occupancy rate of all nursing homes in Germany will continue to rise significantly.

Development of the Number of People Requiring Care (1999 to 2060)



Federal Statistical Office (Destatis),
Federal Institute for Population Research (BiB),
Cushman & Wakefield

Regionally, some waiting lists are years-long because the number of available (fully inpatient) nursing care places is limited. The changed legal situation in North Rhine-Westphalia and Baden-Wuerttemberg requiring an increased proportion of single-room accommodation has brought with it an additional need for inpatient care places. Since 1 August of this year, nursing homes in North Rhine-Westphalia have only been allowed to offer

a maximum of 20% of accommodation in double rooms. In Baden-Wuerttemberg the single-room quote has even been set at 100% - double rooms may only be offered at the express request of the residents.



03

ADVANCE OF MARKET
CONSOLIDATION



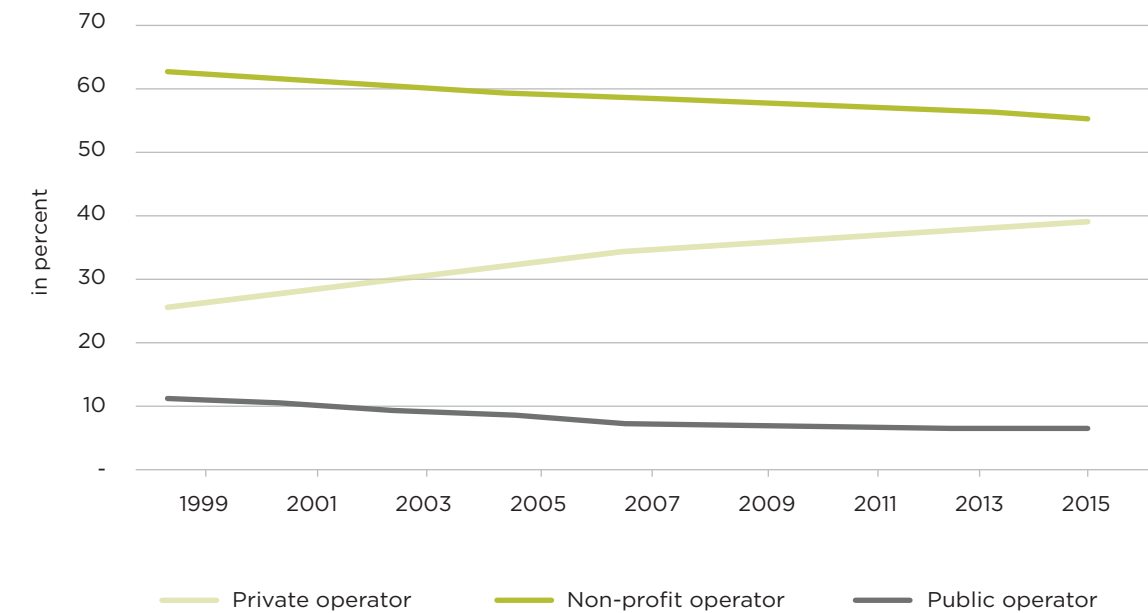
The operator market in Germany is characterised by its pronounced fragmentation on the one hand but, especially in the recent past, an increasing rate of consolidation on the other. This dynamic is largely driven by private capital from Germany and abroad, as well as by the expansion of large operator chains. In total, private operators account for almost 42% of the market in terms of inpatient care beds. This share has increased continuously since 1999. The privatization of the operator market in Germany is in full swing.

The consolidation of the market has recently been boosted by a large number of takeovers by investors and private operating companies from abroad, who have recognised the potential of the German care market for themselves. The year 2017 was one which saw significant company takeovers by foreign players, mostly from the private equity sector. Chequers Capital (France) took over EMVIA Living (formerly MK-Kliniken AG) with approx. 5,400 beds, Nordic Capital (USA) took

over Alloheim with over 16,000 beds and Oaktree Capital (USA) took over Pflege & Wohnen with approx. 2,690 beds. Two French operators Korian and Orpea have also grown in Germany via company takeovers. In 2018, the Schönes Leben Group, a subsidiary of the Dutch private equity company Waterland, attracted attention with the takeover of Compassio with almost 3,000 beds and Pflege & Wohnen, with its approx. 2,690 beds changed hands again, as Deutsche Wohnen took it over from Oaktree.

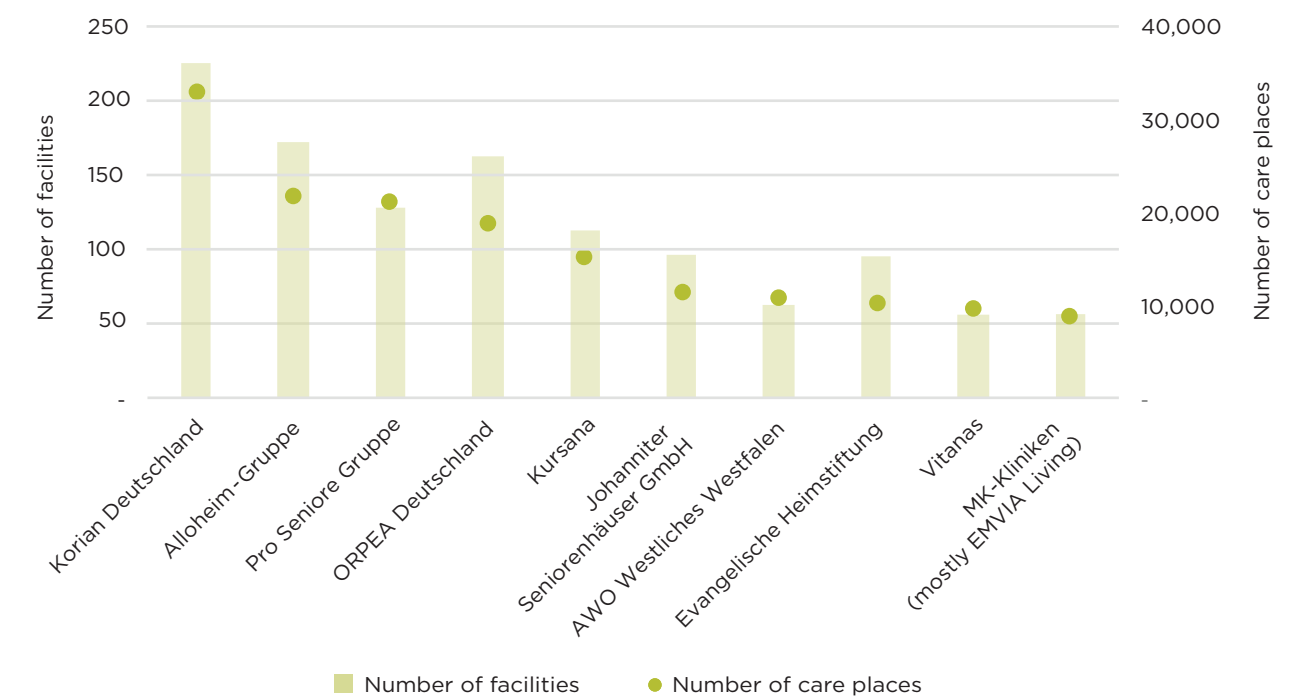
Private-sector oriented companies see opportunities in the small-scale character of the operator market, as regionally operating medium-sized companies in particular can make promising investment targets. The establishment of a profitable platform or operator chain is therefore still possible in Germany.

Proportion of Care Beds by Operator Type



Federal Statistical Office (Destatis),
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Top 10 Operators Germany



Care Invest, Cushman & Wakefield



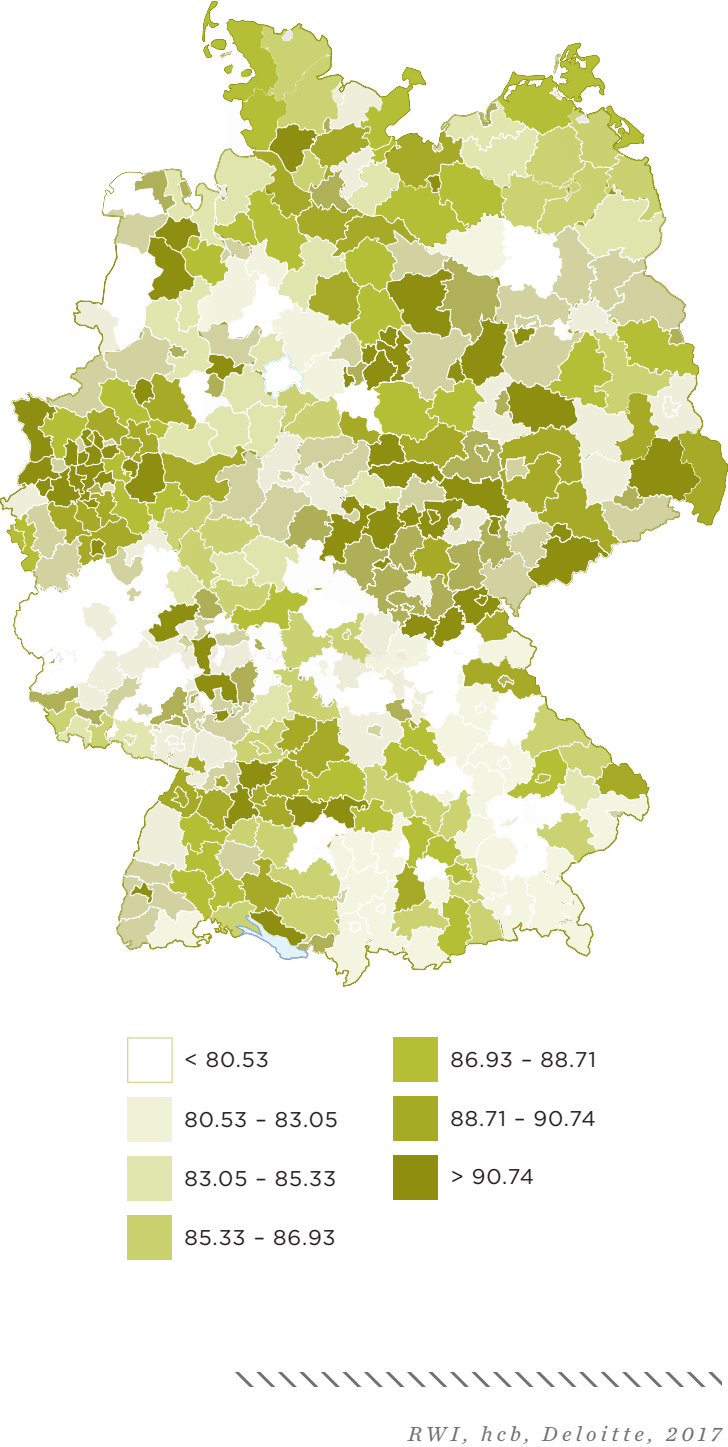
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PERFORMANCE
OF NURSING HOMES

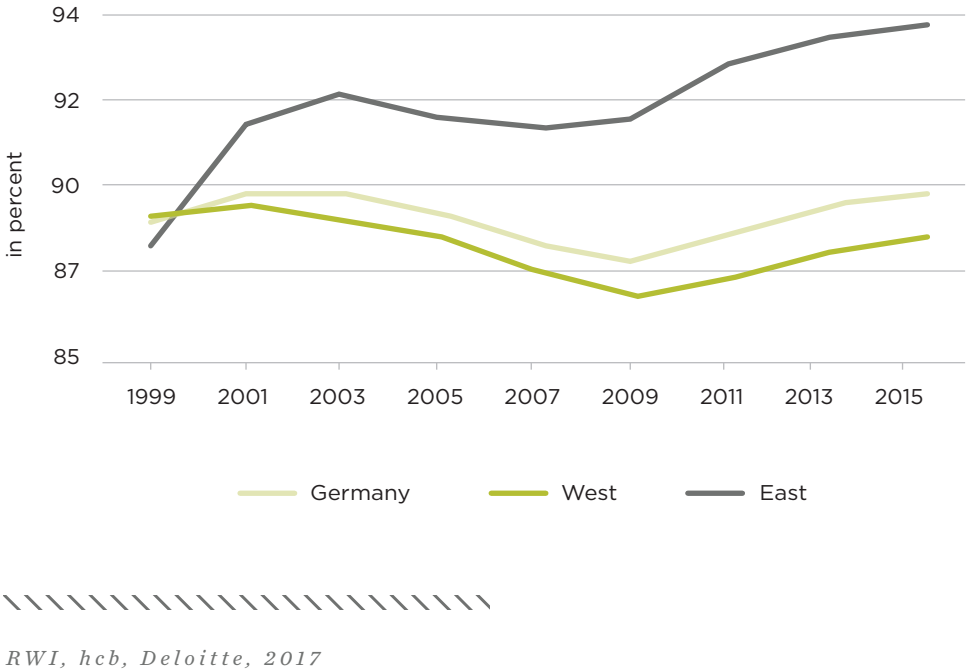
Occupancy of Residential Nursing Homes (in %)

The occupancy rates of nursing homes vary not only by region, but also between operators. From a geographical perspective, nursing homes in eastern Germany in particular, as well as in parts of North Rhine-Westphalia and Baden-Wuerttemberg, for example, have above-average occupancy rates. The varying occupancy rates of private, public or non-profit operators, on the other hand, are mainly due to factors connected with reputation, but also to an extent, to the sometimes-lack of market penetration of predominantly-regional private operators. In addition, large non-profit or public-sector operators exploit synergy and coupling effects, as they are often also active in other health sectors, such as the hospital segment or outpatient medical care. This enables an early commitment to potential patients requiring inpatient care in the future.

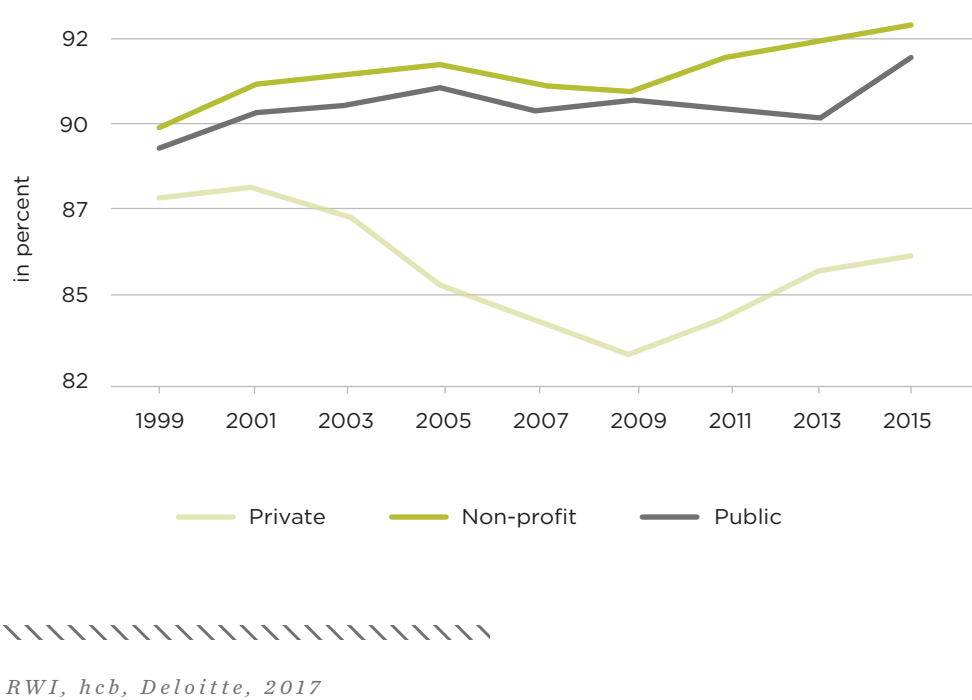
The occupancy rates are almost certainly even higher than the figures indicate, as the data collection of the various states is not only carried out on a date-related basis, and only those persons requiring inpatient care are included who receive benefits under the long-term care insurance in accordance with SGB XI. Self-payers who do not receive SGB XI benefits and persons requiring care but without a care-level classification are not included. Care insurance forms only one of three revenue-relevant pillars for an operator. Further income is generated in the form of investment costs resulting from the construction and repair of buildings and from accommodation and meals. These cover all operating and catering costs and are borne by the residents themselves, unless social assistance is provided.



Occupancy Rate by Location (in %)



Occupancy Rate by Ownership (in %)





05

SHORTFALLS
IN SUPPLY

Today, demand already exceeds supply of (partly-) inpatient care places. Waiting lists for accommodating parents or other very elderly relatives in need of care are no longer a rarity in view of the high level of occupancy of care facilities.

Assuming constant proportions of care dependency and inpatient care rates for the near future, the construction of a good 320,000 new care places by 2030 is imperative. In addition, a large number of existing nursing homes are themselves ageing and have correspondingly high maintenance backlogs. According to the ZIA position paper published last autumn, the level of new investments and reinvestments necessary amounts to around €70 billion. In addition, there is a lack of sufficient alternative forms of housing appropriate for those requiring care, primarily barrier-free apartments in accordance with DIN 18040-2, which is required to foster the planned and necessary closer integration of outpatient and inpatient services for the benefit of those requiring care.

Unfortunately, this aspect is ignored in the current public debate surrounding the drafting of legislation with the unwieldy name "Pflegepersonal-Stärkungsgesetz" (Nursing Staff Strengthening Act), analogous to the "Concerted Nursing Action" in the government coalition agreement. More staff, better training and better pay, as well as raising the status of care professionals in society, are just as essential as a reliable and sustainable economic and legislative background for investment in nursing homes.



**Inpatient
care**



**Outpatient
care**



**Care
personnel**





06

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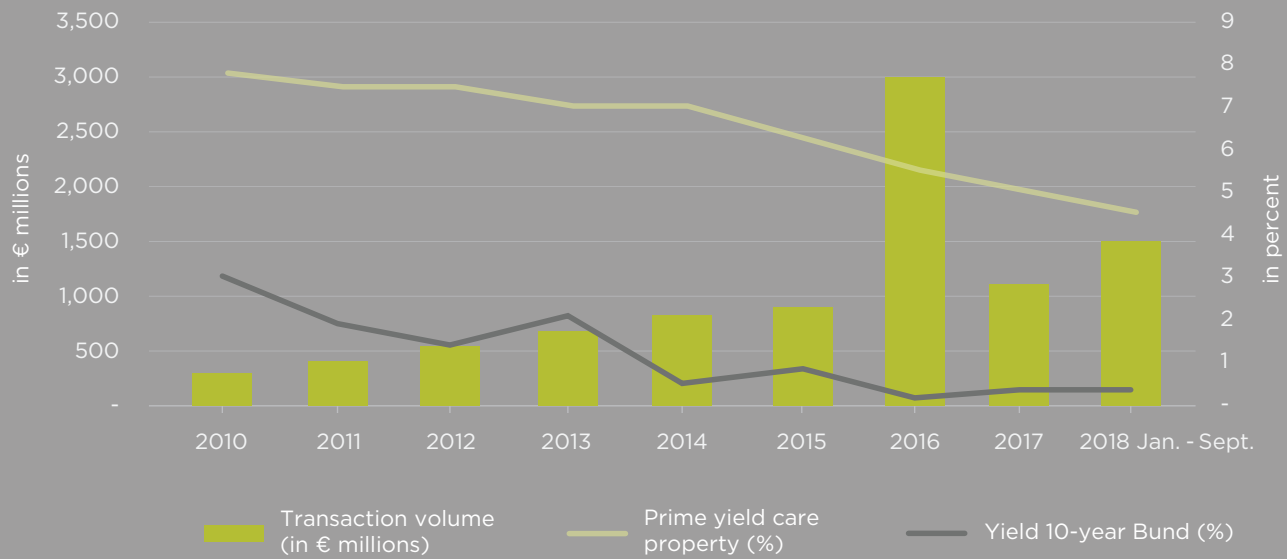
**INVESTMENT MARKET
NURSING CARE
PROPERTIES**



Preventing the impending under-supply of appropriate (residential) care facilities and averting an ongoing intensifying crisis in care is a macroeconomically important challenge, which is not achievable without private investments at adequate returns. Already, 42% of the approx. 13,600 inpatient nursing homes are operated by private providers - and the trend is still gaining strength despite the highly-fragmented market. In addition, investment in nursing homes is also dominated by listed real estate companies and institutional investors pursuing long-term investment strategies. Between 2013 and 2017, more than €6.3 billion was invested in nursing homes and senior residence facilities throughout Germany. In 2018, we expect transaction volume in this sector of at least €1.8 billion, with over €1.4 billion having been invested in this asset class so far (to August 2018). It should also be noted that there are increasing numbers of health care REITs and investment funds specializing in this asset class.

In order for the urgently required investment to be made available, and to remain available in future for the creation of new and innovative forms of facilities and residences appropriate to the needs of the growing numbers of people requiring care, a dismantling of regulatory barriers to invest is required. Statutory stipulations regarding the ratio of single rooms and the minimum size of care units, while strict, are not uniform across the sixteen German federal states, and are not helpful in the effort to rise to the massive challenge. In addition, in view of the continuing increases in construction costs and land prices, a market-appropriate indexation of the investment costs should also be taken into account over and above this. Long-term investors need planning security, not the restrictions of a planned economy.

Transaction Volume for Care and Senior Residence Property in Germany



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Due to the lack of market transparency, the legal challenges, regional variations, variations in operating lease terms and the importance of the specific operator, investment in nursing homes is extremely advice-intensive. Numerous value-enhancing or value-reducing factors may

be hidden behind apparently lucrative investments. Specific know-how in this segment is indispensable in order to make sustainably profitable investments.

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