

# MAPPING A HEALTHCARE STRATEGY

Healthcare is among the most sought-after sectors for real estate investors thanks to its solid fundamentals. Its defense against downturns with the prevalence of long leases, the need-based nature of the services and the lack of correlation of healthcare rental growth with the business cycle are pulling investors towards this sector. However, the lack of visibility and available public data may hold back investment. To improve transparency and investor guidance on where to invest in healthcare, we have developed a scoring methodology based on economic and real estate criteria at the lowest geographical granularity to identify the most attractive markets, which we will present in this paper.

## THE STRUCTURAL DRIVERS OF HEALTHCARE REAL ESTATE

The underlying economic and demographic trends driving demand for healthcare assets from both users and investors are compelling. The accelerated population ageing in Europe is amplifying the overall

need for medical care. Moreover, the older population is now generally better educated and wealthier than previously and therefore likely to access medical services more frequently.

### SPECIFIC HEALTHCARE FACTORS THAT ARE DRIVING INVESTMENT



#### ECONOMICS

Economic growth, defensive nature against downturn



#### DEMOGRAPHICS

Ageing population, rise in chronic diseases



#### FINANCIAL

Lease length, high occupancy rate, ongoing consolidation, portfolio's diversification.



#### SOCIAL IMPACT

Public financing, positive impact, need for private investment.

The increasing need for care is reflected in the adjustment of capacities and the building of customised facilities to ensure proper care and meet the growing demand.

The Covid-19 outbreak highlighted the limited capacity of the healthcare system in Europe and the need for high quality and specialised healthcare solutions. However, given public budgetary constraints and growing demographic pressure, public facilities are struggling to meet demand for healthcare, and private-sector involvement is increasingly necessary.

In addition to these structural trends, the long-term leases, rental growth expectations unrelated to business cycles and portfolio diversification possibilities are also attracting investors. Moreover, combined with the expected yield compression, the increase in rents suggests that the healthcare sector will have one of the highest total returns in Europe for the next 5 years.

### INVESTMENT MANAGEMENT



# LIVING THOUGHTS

A BNP Paribas REIM Research Paper

MAY 2022

## DEVELOPMENT OF AN INVESTMENT STRATEGY

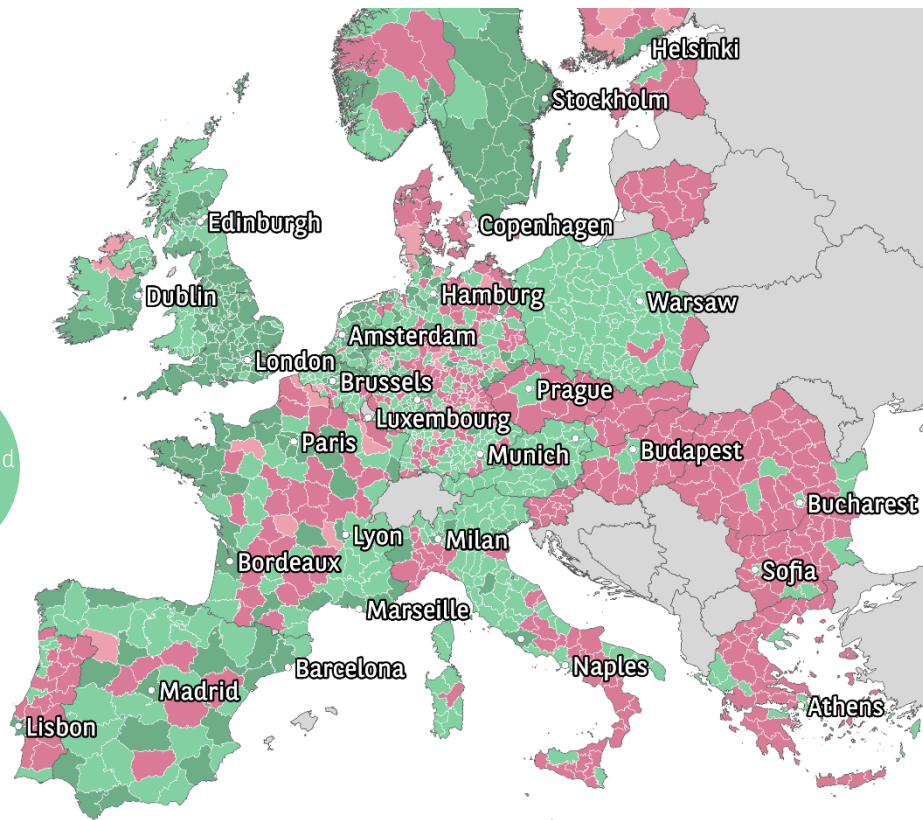
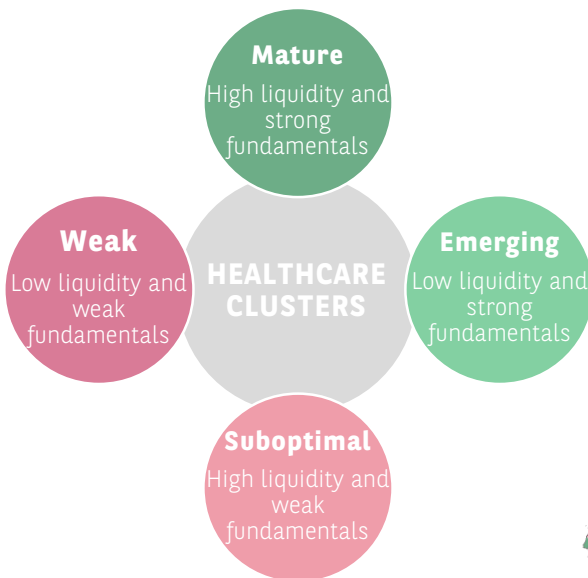
In times of uncertainty, investors are looking for stable income streams and are identifying places with dynamic rental markets. Taking into account demographics and economic structural trends for the healthcare market is crucial to understand growth prospects and future resilience.

As a result, both future population growth and the variation of the old age dependency ratio should be among the main structural factors to identify solid investment locations. GDP per capita has also been included in the scoring as we expect costs for care to grow and regions with a higher GDP per capita should have a better rating. Moreover, wealthier populations of senior citizens are also more likely to access (private) medical services and to do so more frequently. Finally, GDP growth expectation will also help determine regional dynamism.

We used our internal data and forecasting to enhance this scoring methodology to identify markets with the most attractive risk/return profiles. Expected total return and future rental growth should continue to drive any investment decision.

Liquidity is seen as one of the main challenges for the healthcare sector. Indeed, the lack of available assets to buy might hold back investment in targeted regions, as it could be difficult to penetrate the market. However, the low level of liquidity should not prevent investment in areas where market fundamentals are strong. We used the liquidity factor as a hurdle rate to determine whether an asset is located in a mature location or in an emerging market.

## EUROPEAN SEGMENTATION OF THE HEALTHCARE SECTOR



INVESTMENT MANAGEMENT

Source : Eurostat, Moody's Analytics, BNP Paribas Real Estate



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We put each European region into one of four categories:

- **MATURE:** markets with high liquidity and strong fundamentals;
- **EMERGING:** low liquidity but strong fundamentals;
- **SUBOPTIMAL:** market with strong liquidity but weak fundamentals;
- **WEAK:** low level of liquidity and weak fundamentals.

Unsurprisingly, the mature markets are located around the biggest cities in Europe, such as Paris, London, Berlin or Madrid. These cities are densely populated and wealthy and thus attractive for healthcare investment. However, new development might be limited due to high rents and land costs.

## A POSITIVE OUTLOOK FOR THE HEALTHCARE SECTOR

The healthcare market is booming and, in the wake of the Covid-19 pandemic, the need for high quality healthcare assets is strong. However, high barriers to entry suggest that the mismatch between demand and supply is set to last in the short term and there is room for private development. The investment strategy that we have defined, based on the main drivers of the healthcare sector, may help investors

Emerging markets offer investors value-creation opportunities as the demographic and economic fundamentals are strong. The prospects for rental growth and exit yield could be better than for other markets. Some of these regions are located in the South of France (driven by heliotropism and the migration of retirees), Spain, Northern Italy and a significant part of Poland.

There are few suboptimal markets, where liquidity is high, but fundamentals are actually weak. With general lack of supply, investors are still willing to buy in these locations, although we would avoid them given their long-term weaknesses.

Finally, investors should probably avoid the weakest markets identified as they lack opportunities and the fundamentals do not promise growth potential.

to navigate their exposure within this maturing asset type.

Finally, governments intervention to regulate market practices, but also to ensure the highest quality of care might increase the need for capital expenditure to comply with these new regulations. Healthcare investment will become more sustainable, increasing the social impact of institutional investors.

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