

INVESTING IN HEALTHCARE: A RISK/RETURN ANALYSIS

As the demand for healthcare is structural, this property type is often more defensive against downturns in the economy than other property types. As such, total returns stayed in positive territory in 2023 according to MSCI (+0.8% y/y). However, global yield adjustments and market uncertainty hampered overall liquidity and squeezed prices, although to a lesser extent than other real estate property types. Yet thanks to brighter economic newsflow, with inflation easing and interest rates likely following suit from mid-2024, investors may be wondering whether it is now time to revisit this market to seek stable, long-term allocations.

Key findings

- Healthcare is more resilient to downturns, but not immune.
- The expected total return suggests good momentum for investing.
- Risks are still on the downside given the current economic headwinds for healthcare operators.

CYCLICAL REBOUND: HEALTHCARE RETURNS REGAINING APPEAL IN 2024

Against a backdrop of rising real estate yields, healthcare assets seem relatively protected. In Europe, the prime yield for this property type increased by an average of 110 basis points between 2021 and 2023, while it rose by around 140bp for offices and 120bp for logistics. This lesser rise shows that the perceived risks to invest in healthcare properties is lower than for other property types. We identified three main reasons:

- Rental fundamentals are based on long-term trends and are therefore less correlated with economic cycles, unlike in the office, logistics or retail sectors.
- Healthcare yields have remained relatively high, which has enabled a significant risk premium to be preserved despite the rise in bond yields
- The associated risk for other property types is increasing, especially in the office sector, due to the widespread adoption of remote working.

Despite a brighter economic newsflow, investors are feeling that risks are still on the downside and need to assess whether the risk adjusted return is attractive.

LIQUIDITY IS LOW AND SHOULD NOT INCREASE SIGNIFICANTLY IN 2024

Investment in healthcare assets has risen significantly over the last decade. In 2010, it accounted for less than € 1.0bn. In 2023, despite an annual decrease of -30% compared to 2022 due to rising interest rates, it reached € 5.9bn. This institutionalisation of the market has led to better liquidity for investors, especially for nursing homes and senior housing, the two main market segments.

As such, the liquidity premium slightly diminished over time as the time to transact decreased. Moreover, private equity players are also investing in the healthcare industry and might be willing to outsource the real estate assets in the coming years, increasing again the depth of the market.

However, as the number of healthcare solutions is rising (hospitals, nursing homes, labs, Rehabilitation, dentistry, etc.), the offer for investors is wider and increasingly specialized. We expect that investment in healthcare will remain a niche market and will continue to be supported by specialists. Therefore, investors will still have to price the liquidity risk, with strong heterogeneity across sub-sectors.

INVESTMENT MANAGEMENT



LIVING THOUGHTS

A BNP Paribas REIM Research Paper

OCTOBER 2024

OPERATORS ARE AT THE CORE OF A SUCCESSFUL INVESTMENT

Investment in healthcare depends on structural fundamentals as well as on the tenants operating the assets. Indeed, the value of the asset is partly determined by the financial viability of the operator.

With the rise of inflation and interest rates over the past two years, the financial strength of operators has been sapped. Insolvencies have even hit record levels in the UK and are close to doing so in Germany and in France. Today, the main financial constraints of operators stems from occupancy rates that is still, on average, below the breakeven (estimated around 95%).

With the current economic environment, investors will have to select carefully the operators to reduce their risks.

MANAGING DEPRECIATION: THE RELATIONSHIP BETWEEN INVESTORS AND OPERATORS IS KEY

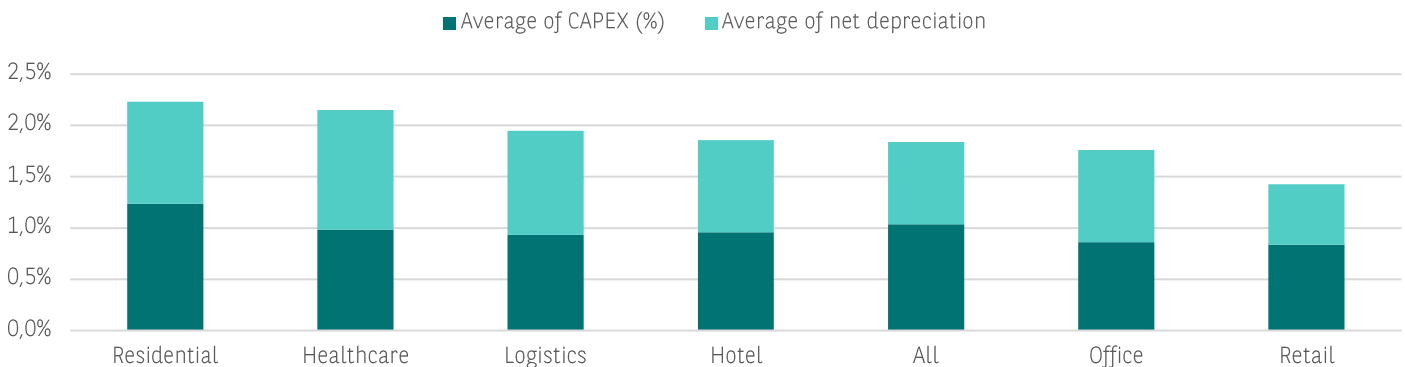
We estimated the empirical evidence on the magnitude of depreciation in healthcare investment in Europe.

Depreciation measures the long-term or secular decline in property value due to physical deterioration, wear and tear, ageing and locational obsolescence.

Although healthcare assets are in the high range, depreciation remains manageable. Indeed, longer leases are partly offsetting the strong specialization of the sector (with more expensive replacement costs and repairs). In addition, operators and investors are contributing together to maintain the value of the asset, by investing CAPEX. Therefore, the knowledge of the sector and the relationship between the landlords and the operators are key.

Gross depreciation rate across sectors in Europe - 2023

Source : BNP Paribas Real Estate, MSCI



INNOVATION WILL CHANGE THE MARKET

To reduce the risk of depreciation, investors can improve care navigation and implement new specialization with dedicated room to diversify the activity. The depreciation risk of the asset could also be reduced by improving its versatility.

Some of the risks associated to healthcare investment will also be reduced by innovation. Indeed, artificial intelligence is transforming the real estate sector and healthcare is no exception with potential impact on patient care, but also cost management of facilities.

Improvement of patient care will evolve with integrated patient data to detect diseases and limit unnecessary medical tests. Artificial intelligence will also have significant impact on healthcare assets, with cost savings or usage improvement.

Finally, operators' profitability will also be enhanced using AI to adjust their energy consumption in real time (heating, ventilation, and air conditioning) or improve cleanliness and maintenance among other things.

AI could therefore also help investors to slow the depreciation of healthcare assets, improve the financial viability of operators and, ultimately, reduce the associated risks.

Therefore, the expected risk/return for healthcare investment is then looking attractive as liquidity, operators' financial strength and depreciation rate are improving.

INVESTMENT MANAGEMENT



**BNP PARIBAS
REAL ESTATE**

CONTACT



Benoit Lefebvre

PhD, MRICS

Head of Research

Mobile: +33 6 70 05 75 93

benoit.l.lefebvre@bnpparibas.com

With BNP Paribas REIM, you invest in REAL ESTATE AS LIVING ASSETS.

BNP Paribas REIM, a business line of BNP Paribas Real Estate, provides a wide range of real estate funds and investment solutions for investors, based on strong convictions. Deeply European, we have a close understanding of local markets, a view of every square metre, every street, every neighbourhood, every urban eco-system. With our 360 employees, we care for assets as we care for living beings, aiming to build a better living environment for our 220 institutional investors and 150,000+ private investors. We believe in ESG to reconcile social, environmental and financial performance. We apply innovation in order to better adapt to the risks and opportunities of today and tomorrow.

At the beginning of 2024, BNP Paribas REIM managed €26,1 billion of living European assets on behalf of institutional and private investors.

BNP Paribas Real Estate Investment Management is composed of regulated entities in the following countries:

BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT FRANCE
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT GERMANY GMBH
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT ITALY SPA
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT Luxembourg SA
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT UK LTD
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT LTD
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT BELGIUM SA
BNP PARIBAS REAL ESTATE INVESTMENT MANAGEMENT SPAIN SA

BNP Paribas Real Estate Disclaimer clause

All rights reserved. The report was prepared by BNP Paribas Real Estate. All data provided in the publication have been carefully verified, however the authors of the report shall not be held liable for any damage or loss which may arise from the use of the data published. Reproducing, modifying or using any of the contents hereof without the permission of the authors of the publication is prohibited under the provisions of the applicable law. It is permitted to quote the contents of the publication only where clearly stating the source.

BNP Paribas Real Estate is part of the BNP Paribas Banking Group

All rights reserved. This report is protected in its entirety by copyright. No part of this publication may be reproduced, translated, transmitted, or stored in a retrieval system in any form or by any means, without the prior permission in writing of BNPPRE.