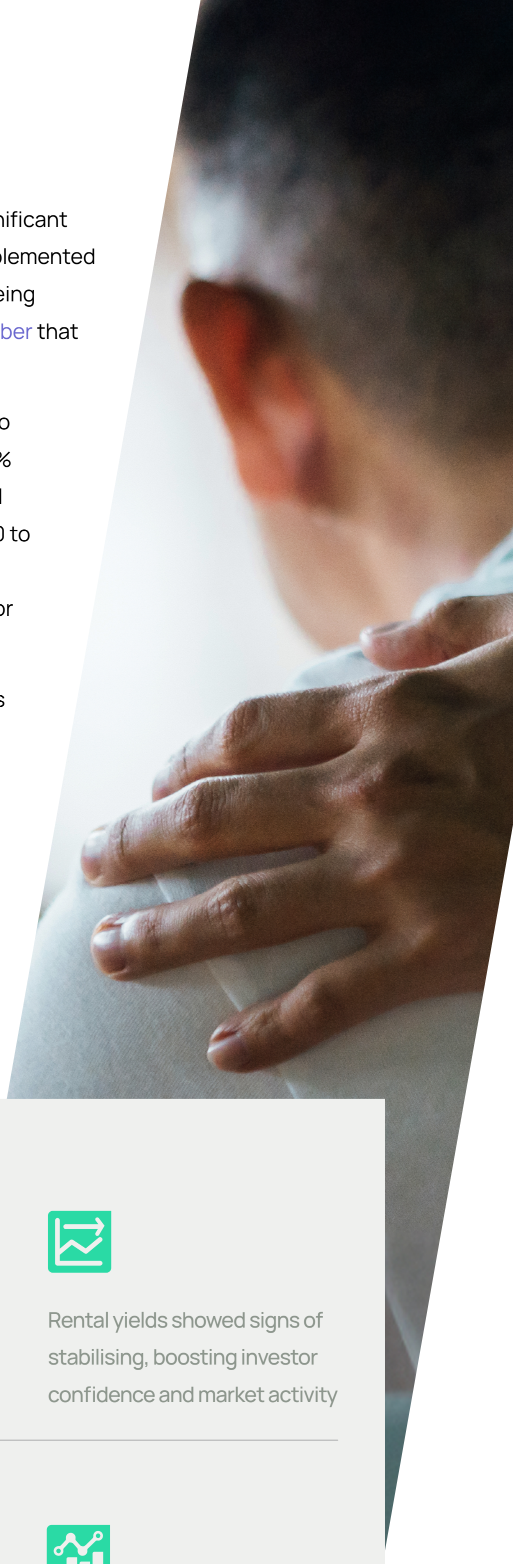
OakNorth Sector Pulse
December 2024

CARE

OakNorth



Industry overview

Since June when we published our last pulse report on care, the sector has continued to face significant challenges. A reduction in overseas care worker arrivals following stricter immigration policies implemented in late 2023, means the sector continues to grapple with severe workforce shortages. With an ageing population, these challenges are only expected to increase with Skills for Care estimating in October that the sector will need 540,000 additional social care workers by 2040 to meet demand.

The Autumn Budget brought further challenges for the sector with the National Living Wage set to increase by 6.7% next year, and employer National Insurance Contributions being hiked from 13.8% to 15%, with the earnings threshold at which employers begin paying these contributions lowered from £9,100 to £5,000 (partly compensated by the increase in Employment Allowance from £5,000 to £10,500 and removal of the £100,000 threshold for allowance eligibility). Together, these changes could inflate operating expenses, which coupled with increasing compliance costs (particularly for small and medium-sized operators), could put many in the sector under strain.

Credited to fee hikes and occupancy levels marching towards pre-pandemic levels, the sector has so far managed to counter the increasing odds. This together with reasonable valuations meant consolidation continued to shape the sector in the second half of the year, as larger operators and private equity firms sought to strengthen market share. Noteworthy M&A activity included Warwick Capital Partners' acquisition of Danforth Care Homes in July (funded by OakNorth), adding 25 purpose-built, sustainable facilities to its portfolio. Aedifica also invested £61.5 million in four care home properties in September through sale-and-leaseback agreements, underscoring investor confidence in the sector's long-term potential. Similarly, Simply UK expanded its presence under the Portland Care Group banner in August, prioritising the modernisation and enhancement of acquired facilities.

Key trends of the last six months

Metrics that matter

Over the last six months, rental yields showed signs of stabilising, boosting investor confidence and market activity. Operational performance improved significantly, with fee increases, pre-pandemic occupancy levels, and higher EBITDA enabling rental growth without compromising sustainable rent cover ratios.

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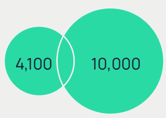
Positive investor sentiment

Despite ongoing challenges in the sector, investor sentiment over the last six months remained positive, with increased funding enquiries from operators looking to expand or enhance existing facilities, with a trend toward larger-capacity settings. We generally see the sector as stable and are bullish, especially when operators can demonstrate strong occupancy and compliance.

Increased funding enquiries looking to expand or enhance existing facilities

Diverse tenure models

The senior's housing market is increasingly embracing diverse tenure models to address varied preferences among residents. Age-targeted rental products and shared ownership options continued to gain traction over the last six months, with the pipeline of private rental units expected to nearly double from 4,100 to approximately 10,000 by 2027. Integrated Retirement Communities such as those being provided by our customer, Untold Living, are at the forefront of this shift, with operators incorporating rental options alongside sales to accelerate absorption rates and enhance accessibility.



Pipeline of private rental units expected to nearly double

Drive towards sustainability

Over the last six months, there was a marked increase in investments focused on modern, eco-efficient care homes, with operators emphasizing environmental sustainability and improved resident amenities as key differentiators. In September for example, Aedifica invested £61.5 million in four care homes equipped with renewable energy systems and top-tier energy efficiency ratings. Earlier this month, Octopus Real Estate announced a £40 million investment to fund the development of three high-quality, purpose-built care homes in partnership with Torwood Care. Each will be targeting BREEAM 'Excellent' certification being fully electric, powered by air source heat pumps, and equipped with solar panels. These developments are examples of a broader sector-wide shift toward sustainability and high-quality infrastructure, driven by both changing regulation and consumer demand.

Increase in investments focused on modern, eco-efficient care homes

> **Traditional ownership models have become increasingly inaccessible for many retirees due to high property prices and rising operational costs. New rental products, such as those offered by emerging developers such as OakNorth customer, Untold Living, are gaining traction. These models offer more flexibility and affordability, providing retirees with an alternative to traditional homeownership. These emerging developers cater to a broader range of consumer needs and budgets, helping bridge the affordability gap that has long plagued the sector. This trend reflects a broader move away from the "one-size-fits-all" approach, which previously focused heavily on high-end, amenity-rich developments that excluded large portions of the market."**
>
> Ben Barbanel
> Head of Debt Finance at OakNorth

Sector spotlight

MPS

Finance to support future growth

Earlier this month, we provided facilities to MPS Care Group, a leading provider of residential nursing and care homes for adults, to refinance and support its future growth. Founded in the 80s, MPS Care owns and operates a number of care homes with over 180 beds across the North West, North East and East Midlands.

DUKESMEAD Grosvenor Hill

Backing a joint venture as it embarks on its first supported living scheme

In October, we backed a new joint venture between Dukesmead Property Group, Kyte Property, and Grosvenor Hill, with a £2.25m loan to fund its maiden supported living scheme. The capital will be used to acquire a former NHS Health Centre in Bedfordshire, and convert it into a new supported living scheme, consisting of 18 one-bedroom flats. The site is located a short walk from a popular high street and will offer residents with large indoor and outdoor communal areas.

Helping ambitious operators achieve their growth ambitions

In July, we provided a £26.4m loan to later-living developer-operator, Untold living. Founded in 2022, Untold Living's mid-market offering bridges the gap between high-end later living properties and housing associations by providing an affordable product that extends the Integrated Retirement Communities model to as many people as possible. This is supported by its innovative customer value proposition, which relies on a deferred management fee and smaller service charges to keep barriers to entry low. The loan from OakNorth is helping the business develop its 77-unit integrated retirement community in Shropshire, as well as support the operations of its existing 68-unit Chantry Court site in Wiltshire. The business is actively seeking to expand its portfolio and is open to discussions with landowners, landlords and agents, targeting a GDV of £300m for its initial development pipeline.

Outlook for the next six months

Increasing investor interest

Over the next six months, anticipated reductions in the Bank of England base rate are likely to catalyse liquidity, attracting both domestic and international investors back to the sector. Rental growth will continue to counterbalance yield shifts, supported by rising trade performance, sustainable rent cover ratios, and improving development economics.

An existential threat for some, however

According to research published earlier this year, 816 care homes have been involuntarily closed by the Care Quality Commission since 2011 - the vast majority of which were for-profit facilities. The UK Autumn Budget exacerbated the financial strain on the sector, which has long been burdened by chronic underfunding and staffing challenges. Increased employer National Insurance Contributions and a higher National Living Wage are set to drive up costs significantly, raising the risk of a new surge in closures.

816

care homes have been involuntarily closed by the Care Quality Commission since 2011

Potential planning policy boost

The government's Older People's Housing Taskforce, with findings anticipated in early 2025, is expected to propose strategies to expand supply, such as removing planning barriers and incentivising developments such as Integrated Retirement Communities. Policy frameworks introduced by the Levelling-Up and Regeneration Act 2024, and the forthcoming National Development Management Policies aim to streamline planning processes and foster a more conducive environment for senior housing. While these could deliver a boost for the sector in the near-term, long-term success hinges on aligning development with demographic trends, ensuring regional equity in access, and delivering sufficient funding and policy implementation.

Get in touch with the team at questions@oaknorth.co.uk or visit oaknorth.co.uk for more information.