The loved one?

The arrival of US operator Sunrise Assisted Living and its backing by PRICOA show that the private care home sector could be returning to favour, despite having given investors grey hair for years. By Elaine Knutt

Last month's announcement by PRICOA of a £150m joint venture with US operator Sunrise Assisted Living suggests that the private care home sector has some of its best years ahead of it. The upmarket US chain plans an ambitious roll-out in the UK and Germany in the next five years (see box, p76).

Jonathan Short, PRICOA chief executive, points to the "demographic shift" and his company's relationship with Sunrise in the US as the main drivers of the deal. "The homes are real estate assets, but it's all about the management. If you've got a good operator, you shouldn't worry," he says.

Venture capitalists have certainly seen the case for greater involvement in the sector. In the past 18 months, there have been three venture capital-funded management buyouts of care home operators. When 3i buys Westminster Health Care, L&G Ventures buys Craegmoor and Duke Street Capital buys Milbury Care, the implication is that care home chains are undervalued, and that the returns available to venture capitalists are also available to bullish property investors.

Highly regulated, difficult vehicles

But speak to Quercus, one of the few property-related funds in the business, and a more cautionary tale emerges. A 23:77 joint venture between Quintain and Morley Fund Management, Quercus owns 120 homes and is valued at around £200m. According to Quintain director Edward Dugdale: "It's a difficult vehicle. It's highly regulated, the covenant strength is not high, the operators get themselves into all sorts of trouble and we have to be prepared to go in and help out."

And then there's MEPC, which sold a 38-home portfolio to its managers last September. According to spokesman Steven Vaughan: "We'd had good returns, but the

Old economy: since 11 September, investors have been looking again at care homes, known to be a difficult sector

Sunrise Assisted Living schemes in Elstree (above) and Esher: the interiors are over-the-top Victoriana

market wasn't getting any easier. An opportunity arose to get out, so we did." In doing so, it joined the brewing chains, hotel operators and pension funds that have quit the sector in the past four years.

So which side is right? The answer is both, because the private care home sector spans Fawlty Towers to five star, and is still mid-way through a period of turmoil that is shaking out the losers and casting up winners that operate on 25-30% margins. Depending on their location, the surrounding residential and labour markets, the market segment they address and the type of operator, investing in care homes can either promise a solid income stream or a disaster waiting to happen.

According to research firm Laing & Buisson, there are 525,900 bed spaces for the elderly and physically disabled in the UK, a total that fell by 12,600 in 2001. Local authorities fund around 70% of places, with the private sector providing the rest. There are about 50,000 fewer beds than five years ago, following a round of closures when operators found themselves squeezed between frozen local authority fees and rising wage bills and running costs.

Owner-operators, which account for much of the fragmented care home sector – GVA Grimley's Healthcare Unit identifies only 20-25 operators with more than 1,000 beds – have struggled to meet loan or rental obligations. Often, in areas with high residential values, it makes more sense to sell for residential conversion than to soldier on.

However, GVA Grimley partner Andrew Sidwell believes that the supply/demand balance has now tipped in the operators' favour. "There are not enough care home beds in parts of the country, fees are rising in certain areas and there's a shortage of new development. Well-managed homes are trading at high occupancy levels, and starting to make reasonable returns." Sidwell reports that institutional appetite for the sector is returning after a three-year absence.

Demographic time bomb

2002 Under-40s outnumber over-60s 2:1

2020 Ratio of under-40s to over-60s at 1:1

2030 20% more over-60s than under-40s

Other commentators agree. William Laing of Laing & Buisson says: "There'd been an oversupply, and now there's an undersupply. Now lots of private equity companies and venture capitalists are keen. They're looking to a traditional area of the economy that's also quite sexy."

David Jones, director of Deloitte & Touche, points out: "Since 11 September, venture capitalists and other investors have been looking for recession-proof investments, and healthcare fits into that mould. Recent transactions have encouraged people to look at the sector to see what they've missed."

This means, as MEPC has found, that groups holding investments can now get out at a reasonable price.

But property investors are still a rarity. As Quintain's Dugdale says: "It's not a sector for the general property investor. As with all operating businesses, the surveying profession is not best equipped to deal with it. When you've got 40 elderly people who need looking after, it's not like managing a vacant unit in a shopping centre. Our experience is that it's very difficult."

MEPC's Vaughan agrees: "Care homes are small properties, and don't justify the management time. It's unlikely we'd venture back in. Unless you can get a chain's value up to £100m, it doesn't make an impact on the bottom line."

A further round of care home closures can be expected as a result of the arrival in April of a new regulatory regime, run by the National Care Standards Commission. Alongside the Care Standards Act 2000, it gives inefficient operators the choice of expensive upgrades or leaving the market.

Opportunities to enter the market

But while this means distressing disruption for elderly residents and their families, Jones believes that weeding out the remaining weak links leaves the field clear for new development and investment finance. "Fees and demographics are going in the right direction. There are opportunities to get into the market and consolidate," he says.

Until recently, one brake on new schemes, especially in the South East "hot spots", has been the price of land because of competition from deep-pocketed residential developers. However, Laing believes that Sunrise's entry to the market shows that this pattern can be broken. "The care home sector has always undersold itself, and there's been a belief that it can't pay high enough prices for good residential land. But Sunrise is going for high-quality sites and the top end of the private-pay market." Others may follow.

Sunrise Assisted Living

All-American outfit plots ambitious UK roll-out

Sunrise Assisted Living is an all-American entrant to the UK care home sector. From the white-glazed smiles of founding couple Paul and Terry Klaassen in the corporate brochure to the "Eight Principles of Sunrise Service" that all staff endorse, the 21-year-old company exudes wholesomeness and commitment to service.

It's also an all-American success story. Results to 31 December 2001 show that the company's 186 homes for 13,000 "seniors" delivered a profit of $49.1m on turnover of $428.2m, up from $24.3m and $344.8m in 2000. In the past six years, it has developed $1.25bn of real estate, including a two-home toehold in the UK.

Now, Sunrise is using a joint venture with PRICOA Private Property Equity to fund an ambitious roll-out of its Assisted Living concept in the UK and Germany. Targeting sites in the affluent towns and suburbs where their customers' middle-aged relatives live, Sunrise expects to build at least five homes a year in each country in the next five years.

In the UK, its home in Elstree opens in early 2003; sites in Reigate, Caversham, Esher and Crowthorne have outline planning permission and an application has been submitted for one in Banstead. Next, Sunrise will target Bristol and Bath.

David Driscoll, a veteran of Grand Metropolitan, Bass and Pizza Hut, is European development director in charge of site acquisition and development management. After three years with Sunrise, he is a true convert to its smiling corporate culture. "This is a product we can be proud of, both as a property developer and for what it's trying to achieve for people," he says.

He points to the £12m development cost of Sunrise's second UK home in Virginia Water, which houses 80 residents in 58,000 sq ft (5,400m^2). But Sunrise can expect to recoup its investment faster than other operators: at a basic rate of £85 a day, plus top-up charges for "personal care" services, the fee structure is around 20% above market norms for private nursing care, based on a weekly average of £393 (Laing & Buisson, April 2001).

In each Assisted Living home, residents have their own en suite rooms, and share a dining-room, games room and communal areas. Decor and furniture are over-the-top Victoriana across all Sunrise homes, a look that Driscoll says emulates an octogenarian's idea of the grand houses of their youth.

Each Sunrise care home also has a "Reminiscence" suite filled with mementos of the past, where Alzheimer's sufferers – paying £113 a day – enjoy the same facilities as other clients but in a safer environment and with a higher staff ratio.

The search for suitable sites is not straightforward. Out of the six sites in progression, Driscoll is in two bidding wars with residential developers. He also finds it frustrating that "local plans often make a reference to ageing populations, but then make no specific provision for them".

But he believes planners will be won over by the Sunrise concept of high-density, employment-generating development that brings little extra traffic. An additional card up his sleeve is that care homes are not liable for section 106 requirements for affordable housing, a valuable competitive edge in bid situations. He is looking for 1-1.5 acres (0.5ha) on main roads and close to "quality residential and retail".

In the US, Sunrise has pursued a strategy of sale and long-term manage-back, using each deal to fund two further homes. "Once a home is stable and occupied, we sell 75% of the freehold to institutions, and take a 30-year management contract. The institution takes an operating return and most of the capital appreciation."

Sunrise is considering this approach for the refinancing of its first UK scheme, Frognal House.

Driscoll believes the assisted living concept should appeal strongly to UK investors. "It's like pubs 10 years ago. No-one was interested until Nomura saw an angle. That's what we're trying to achieve."