EXTRACTING PROFITS THROUGH CARE HOME REAL ESTATE:
THE BILLION-POUND PROPERTY SPECULATION FUELLING BRITAIN'S CARE CRISIS

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Centre for International Corporate Tax Accountability and Research

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A Centre for International Corporate Tax Accountability and Research (CICTAR) Report

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KEY FACTS

£245bn	The size of the market for UK care real estate assets, with a yearly average of £1.5bn of transactions made over the past 5 years.
16%	Interest rate charged on Care UK's loan notes and preference shares after it was purchased, some of which were owed to its private equity parent firm Bridgepoint.
£3.7m	Average yearly rent paid from Care UK to related Luxembourg-based property development companies (the 'Silver Sea group'), equal to 8.8% of its total rent payments from 2014-19.
£113m	Profit made by the Luxembourg-based Silver Sea group from selling 21 care home properties for £289.5m, representing a 39% profit rate.
£71.7m	Dividends paid out to shareholder companies from the sale of these 21 care homes, equivalent to 25% of the sale proceeds.
£4.8-5m	(28-31%) increase in price when two Care UK homes were resold on after having been bought by third-party real estate investors in 2015.
£6,748	Yearly rent charged per residential place (£130 per week), for residents at Belgian real estate investor, Aedifica's UK-based care homes, including some Care UK homes. This is 15% of the average weighted weekly fee.
£5,635	Estimated yearly profit made per UK residential place by Aedifica, equivalent to £108 per week. This is 12% of the average weighted weekly fee.
£1.3bn	a year (**£24.8m a week**) estimated rent paid by all for-profit homes.
£515m	a year (**£9.9m a week**) estimated profit made by landlords from the rent paid by for-profit homes.
£3,181	profit per bed per year (**£61 per week**) made by landlords from the rent paid by all for-profit homes (at 85% occupancy), this is equivalent to **7% of the weekly average weighted fee for care**.

EXECUTIVE SUMMARY

While the current funding debate focuses on the profitability of care home operating companies, the additional wealth extraction that comes from care home property development and rental is often overlooked. Using a top 5 operator in the UK (Care UK) as an example of a group with separate operating and development companies, this report highlights and explores the vast profits being made, and provides recommendations to address the problems raised.

Why Are Investors Interested

Interest is growing for real estate investment in healthcare (particularly elderly care). The market for UK care assets is estimated to be worth £245bn, with a yearly average of £1.5bn of transactions made over the last 5 years.

Investors are attracted to the sector for a number of reasons: demographics (ageing population); shortage of capacity; and long-term secure income. These factors make the sector particularly attractive for pension funds and similar investors desiring long-term stable income. However, there are risks associated with the sector. Primarily the ability of a tenant to continue to pay rent and reputational risks if poor care is provided.

Why Private Investment Can't Be Relied Upon

The influx of investment has pushed up demand (and prices) for well-located care homes, whilst pushing down the yield.

Private investment is also highly selective in nature. Locations favoured are in wealthy areas (with a large proportion of private payers), leaving parts of the UK that are in need at a loss. This is in contrast to the levelling up needed.

Why Do Operators Do Deals With Property Investors

Care operators can benefit from investing with or selling properties to investors for a number of reasons. Real estate investors can provide a readily accessible source of funding, and quick profits can be made from building and then selling new homes (a Grant Thornton case study showed how a 43% profit can be made on an 80-bed home).

Operators can also use them to improve the financial performance of their homes through up-front investment (where buildings are instead bought by investors), while selling the property and operating companies separately can lead to a higher sale price.

Downsides Of Selling To A Property Investor

Despite making quick money, selling a home means operators are locked into long-term rental contracts that will rise annually with inflation (up to a yearly cap). This puts pressure on the operator, and ultimately the residents, to maintain fee increases, which may be more difficult to afford if high inflation persists. Flexibility to adapt is also hindered, as landlords may not readily want to invest in upgrading and refitting a home. Finally, financing for care operators is often secured against the properties, so selling properties can reduce their ability to borrow in future.

Care UK – A Brief Background

Care UK was acquired by private equity firm Bridgepoint for £281m in 2010.[1] Part of the debt taken to buy and delist Care UK was borrowed from Bridgepoint at 16% interest rates, giving an indication of the minimum rate of return originally expected.

A rapid buy and build strategy appears to have been initially chosen to make such a high return, where additional care homes are developed, or bought up, to increase the business's value. However, Care UK's strategy has changed since acquisition. Falling local authority spending means public fees have not matched cost rises, so Care UK increased the proportion of self-funding residents through the building of new care homes.

Deep Dive Into Silver Sea

Following the acquisition, Bridgepoint set up an independent property development group in Luxembourg headed by parent company Silver Sea Holdings, designed to build new care homes for Care UK, which was then obliged to rent out the premises. Silver Sea was owned by the same shareholders as Care UK, but independent of the group. Like many care sector investments, there were money flows between the care operations and the property arms. The Silver Sea group was bought by Care UK in 2019 and is now formally part of the UK care group.

Profitability Of Silver Sea's Property Development

Twenty-eight property development companies were subsidiaries of Silver Sea Property Holdings S.à.r.l., each responsible for the development of a single care home. Once built, the properties were either rented directly to Care UK by the Silver Sea Group, or sold to Care UK or a third party investor. This meant over time more rent was being paid by Care UK subsidiaries operating UK care homes to Silver Sea entities in Luxembourg.

From 2014-19 Care UK paid on average £3.7m in rent each year to Silver Sea (8.8% of its total rent payments). On top of rent, Silver Sea sold 21 properties for a total of £289.5m, and recorded a profit of £113m (a 39% profit rate).This profit was used to pay down debts, and provided a dividend of £71.7m to shareholder companies (representing 25% of sale proceeds).

Care UK's Third-Party Property Landlords

Despite the failure of care home group Southern Cross in 2011 due to unaffordable rent payments, the practice of sale and leaseback has returned to the elderly care home market. LaingBuisson estimate "approaching half of capacity among medium-to-large for-profit groups … may be subject to leasing arrangements".

Examining the extent of this trend, this report has identified the largest known third-party landlords for Care UK. Thirty were identified, with two being examined in detail. One of Care UK's largest landlords, Aedifica UK Limited is a property company owned by Belgian healthcare real estate company Aedifica S.A. In the UK the Aedifica S.A. group owns 102 care home properties valued at €822m. These properties generated a gross rental income of €48.6m, providing a yield of 5.9% (where yield is annual rental income / the property's purchase cost).

With 6,541 residential places, their rental income is met by an average £6,748 yearly rent charged per residential place (£130 per week) which is 15% of the average weighted weekly fee. This leads to an estimated yearly profit of £5,635 per resident (£108 per week) which is 12% of the national average weighted weekly fee. These high levels of profitability are not unusual for healthcare property owners.

[1] Private Equity refers to funds which invest in owning a range of private companies with the aim of selling them later for a profit. Typically funds are raised from investors, such as pension funds, insurance companies, and foundations, and returned after ten years along with a share of the profits made.

How Much Profit Are Care Landlords Making

With the estimate that around half of the sector's for-profit capacity is subject to leasing arrangements, if rent is charged at the same rate as by Aedifica (£130 per residential place per week), then the total rent paid to landlords is £24.8m a week (£1.3bn a year). This is before taking into account the unfilled places needing to be covered by paying residents. At 85% occupancy (pre-pandemic levels), the £24.8m of rent charged comes to £153 per bed per week (£8,000 a year): 17% of the weekly average weighted fee.

Using a profit margin (40%) from the lower end of our sample of care home property investors, the profit made by landlords is £9.9m a week (£515m a year). At 85% occupancy this works out as £61 profit per bed per week (£3,181 a year), which is 7% of the weekly average weighted fee.

These high profit margins reflect the nature of rental agreements, where operators pay most of the maintenance and repair costs. With average annual yields of 6%, investors will make back their investment within 17 years, with any rental payments beyond that being additional returns with little further social benefit i.e. economic rent.

RECOMMENDATIONS

An increase in transparency, through the already existing Care Quality Commission's (CQC) website, would both allow residents and payers to unpick how their fees are spent, as well as force a simplification of operations. This would encourage more spending on direct care costs, and reduce profit extraction through real estate.

Local authority ownership should also be revisited. As well as using public funding to cheaply and equitably commission new homes, with pension funds of their own local authorities may be better placed to act as landlords. With a more reasonable rate of return and oversight, it could allow different types of operators (such as community-led groups) to provide care, and help ensure funding is better spent on staff and direct care.

CONCLUSION

There is a growing need for new homes, but by relying on private investors, the UK risks sleepwalking into a crisis of rising costs and development catered to certain (wealthy) regions. There is still time to stop this system setting in, but a new policy approach is needed to level up the whole of the UK's care sector, and create the infrastructure needed for future quality care.

CONTENTS

KEY FACTS 4

EXECUTIVE SUMMARY 5

INTRODUCTION 11

Setting the context: Why are investors interested in owning care home properties? 12

- Why the sector can't rely upon on private investment 13

Setting the context: Why do care operators do deals with property investors? 14

Care UK as an example of the profitability of property development 17

- A brief background to the purchase of Care UK 17
- How could PE expect to make such a high return? 18

A deep dive into Silver Sea Holdings: Bridgepoint's Luxembourg-based property company 20

- How profitable was property development for the Silver Sea group? 22

A review of the third-party investors 24

- Who were the properties sold onto? 24
- A deeper dive into some of Care UK's third-party property landlords 24

How much profit are care landlords making each year? 30

CONCLUSIONS AND RECOMMENDATIONS 31

INTRODUCTION

Just how profitable are care home businesses? The current funding debate is focused on the profitability of care home operating companies, but often misses the additional wealth extraction that occurs through care home property development and leasing. How does this property development aspect of the business affect the care home residents, and does it take funding away from a sector under strain?

When it comes to medium and large care home companies, many run two businesses: a care home operating company (which provides care to residents) and a property development and/or rental company (which builds and rents out care home properties).

With investors keen to buy up and rent out care homes, the building and rental of care home properties is a lucrative business. Rising property prices boost the value of operators' businesses, allowing them to sell properties for an early profit, while investors are assured long-term rental profits in return. A trend that began in the US and has since spread to the UK and globally.

However, these up-front real estate profits come at a cost to the care operators and the welfare of staff and residents. By locking care homes into rental agreements where rents rise every year, the cost of care inflates while providing no extra benefits. This puts pressure on care fees, and means that elderly residents may be forced to sell their family home in order to support the rising rent payments of the care home operators.

On top of this, the increasing number of investors looking to cash in on these profits affects the sector at large. Pushing up property prices, care operators are forced to set higher fees to compensate for rising costs, which in turn sets new benchmark prices for the whole sector. These rising prices also influence investors, who actively seek out high value locations in which to build, and ignore relatively poorer parts of the UK that often need additional care home capacity the most. Combined, this wider context creates a loss for public and private payers, while property owners enjoy booming profits.

This report examines the property development business of Care UK (a top 5 operator in the UK), explores its business model, highlights the profits it has made, reviews the strategies and expectations of two of its third-party landlords, and considers the policy implications of this business model. Finally, we provide some recommendations to address the problems raised that could contribute to long term funding solutions.

Care UK was chosen as a case study because it provides a clear example of a group with separate operating and property development companies. Additionally, financial statements of Care UK subsidiaries provide greater transparency than is the case with many other care home operators or investors.

There is no implication that Care UK has done anything particularly unusual. Indeed, Care UK has an above-average number of highly rated homes amongst large operators.[2] The Care UK case study reflects the broader role of real estate investment across the UK care sector and the care sector globally. It begs the question that if profits made from care home real estate were capped or taken out of the equation somehow, would there be billions more in funding to improve front-line care for our elders?

[2] See for example: Care UK Holdings Limited (2022) 'Annual Report and Financial Statements. For the Year Ended 30 September 2021', p1.

Setting the context: Why are investors interested in owning care home properties?

For a number of years there has been a growing interest in real estate investment in healthcare assets, particularly elderly care. The market for UK care assets is estimated to be worth £245bn, and a yearly average of £1.5bn of transactions were made over the past 5 years.[3] Investment in the sector comes from a diverse range of investors such as: specialised real estate investments trusts (REITs), pension funds, asset managers, infrastructure funds, private equity, developers and care home companies themselves. A large proportion of investor interest is from overseas.[4]

Investors are attracted to the sector for a number of reasons:

- **Demographics:**
  As the UK's population continues to age there will be an increased demand for care home services and hence properties. Growing demand improves the chances that a well-built property will be rentable for many years.
- **A shortage of suitable capacity and a lack of commitment for public financing:**
  As quality requirements and needs have changed (for example a preference for ensuites with wet rooms) many existing care home properties will require upgrading or replacement. There has been insufficient public funding to upgrade, develop or build increased capacity. Investors are selectively stepping in to provide funding instead, with expectations of significant returns.
- **Long-term secure income:**
  During the recent pandemic, care home property values and rental streams have held up well compared to other property sectors.[5] This reflects the essential nature of the care services provided from these properties and government support. However, it is too early to determine how rising global interest rates will affect the appeal of property investment.

  In addition, care home rental contracts tend to be long-term (15+ years) and are often 'triple-net' which means that the tenant is responsible for the costs of property maintenance, insurance, and upkeep. Many contracts will include annual increases on top of the rent charged in order to compensate for inflation.

  Taken together these factors make care home property a particularly attractive investment for pension funds and similar investors who desire a long-term stable income which rises with inflation.
- **Additional returns available through an early sale:**
  Investors also benefit from property price rises as well as annual rental income. Demand for properties in the right location and specification has stayed strong relative to available supply and so investors can expect to sell properties for a decent return.[6]
- **ESG ratings:**
  ESG stands for Environmental, Social, and Governance, and encapsulates frameworks that help businesses, customers, suppliers, and communities understand how sustainable an organisation and its broader contributions to society are. Investment firms are increasingly reporting on ESG issues, and care home property investments have been viewed as providing social benefits.

[3] Knight Frank (2022) 'Healthcare Capital Markets Research 2022', p2. Available at: https://www.knightfrank.com/research/report-library/healthcare-capital-markets-2022-8997.aspx

[4] Knight Frank (2022) 'Healthcare Capital Markets Research 2022', p2. Available at: https://www.knightfrank.com/research/report-library/healthcare-capital-markets-2022-8997.aspx

[5] Many listed healthcare property funds dropped in value along with the wider property funds market in March 2020, but recovered their share price by Q1 2021 and remained stable. Or see for example how healthcare REITS experienced low price volatility. BNP Paribas Real Estate (2021) 'UK Care and Senior Living. Market Snapshot Q1 2021', available at: https://www.realestate.bnpparibas.co.uk/sites/default/files/2021-04/care_and_senior_living_market_update_q1_21_final_0.pdf

[6] See for example: Christie & Co (2021) 'Care Mid-Year Review 2021', p4. Available at: https://www.christie.com/news-resources/publications/care-mid-year-review-2021/

However, there are risks associated with care property investment. The major one is the ability of the tenant to continue to pay rents which increase yearly. This is a particular concern given the effect of the pandemic on care home occupancy levels (which affects income) and rising cost inflation, both of which reduce the surplus available to pay rent. To mitigate this, landlords typically assess and continuously monitor the finances of their tenants' businesses. Increasingly investors opt for 'step-in rights' which allow them take over operations (if there is a risk of collapse) in order to maintain the care service whilst they find an alternative care home operator.[7]

Linked to this is the reputational risk if poor care is provided at a home. Whilst the operator company may be replaced as a result, the local reputation of the home itself may still be negative. Yet again this requires landlords to maintain oversight of their tenants' businesses.

Why the sector can't rely upon on private investment

From a broader perspective the influx of investment can at first appear mixed. Until this year, interest rates had been very low (and falling) and this ability to borrow cheaply coupled with the hunt for financial return has pushed up demand (and prices) for desirable care home properties, whilst pushing down the yield[8].

However, this only benefits care operators who don't want to expand through establishing further care homes. Even large operators are unlikely to be able to borrow on as generous terms as many investment groups, and so the increased competition and prices adds to their costs of business, which forces up care fees.

Yet the main issue with relying on private investment to upgrade and build our care home housing stock is the selective nature of it. Investors typically favour care home properties in locations which have a large proportion of private payers, as fees are higher than for publicly-funded residents, justifying higher rents.[9]

This means that areas such as the South East of England are popular locations for new home building, whilst other parts of the UK are not experiencing a similar increase or upgrade to their care home capacity. Therefore, if the UK wishes to level up key infrastructure in all regions, either public fees need to rise significantly to attract private property investment, or care home development needs to be publicly financed.

For example Welltower, an American publicly-listed real estate investment trust which is one of the largest care home owners in the UK, has stated that its UK investment approach is to work *"with operators at the premium end of the market where private pay residents wishing for a superior experience are willing to pay fees that might be two, three, even four times higher than the fees offered by local authorities"*.[10] Welltower's portfolio of 125 UK care homes, including 26 operated by Care UK, are overwhelmingly in Greater London, the South of England and other areas of high personal wealth and rapidly increasing home prices.[11]

[7] See for example: Haunch, O. (2020) 'Care home real estate: a surprising investment option'. Grant Thornton. Available at: https://www.grantthornton.co.uk/insights/care-home-real-estate-a-surprising-investment-option/ (Accessed: 31st July 2022)

[8] Yield measures the annual return on the capital investment in a property. For example the gross yield is calculated as: Annual rent / Property value. A higher yield means a greater annual return on the money invested. Lower yields can be driven by rising property values e.g. when demand is high relative to supply.

[9] Grant Thornton (2018) 'Care homes for the elderly: Where are we now?', p38. Available at: https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/documents/care-homes-for-the-elderly-where-are-we-now.pdf

[10] Corder, R. (2016) 'Meet the biggest investor in new care homes in Britain today', 15th July 2016, *Care Home Professional*. Available at: https://www.carehomeprofessional.com/meet-the-biggest-investor-in-new-care-homes-in-britain-today/ (Accessed: 5th August 2022)

[11] See for example the Welltower Facility Address List. Available at: https://welltower.com/wp-content/uploads/2022/05/1Q22-Welltower-Facility-Address-List.xlsx (Accessed: 5th August 2022)

Setting the context: Why do care operators do deals with property investors?

From the property investor's perspective ownership of a care home can be a very good deal, with rising long-term rents and capital gains for a highly valuable property. Care home operators can also benefit from this situation, although they need to be careful to ensure that they can cover rent increases and avoid the fate of Southern Cross, which collapsed in 2011, in part due to unaffordable rental payments. Care home operators can benefit from investing with or selling to property investors for a number of reasons:

A more readily accessible source of funding:

Care home operators can find it easier (and cheaper) to raise cash from selling some homes to property investors rather than obtaining a loan from a commercial bank. The funding received from property sales can then be used to finance a quick business expansion, refurbish existing properties, acquire new homes, or pay a return to the owners.

Quick profits can be made from building homes and selling them (or existing homes) on to investors

In parts of the UK where there is a strong demand for care home investment, operators who build a home in a desirable location can benefit from an immediate profit upon sale (to an investor).

Here's an example of a two-acre plot of land with planning permission for a new 80-bed care home in the South East of England (based on a case study by professional services firm, Grant Thornton).[12]

In this example we will look at four factors:

1. The cost of buying the land and building the home.
2. The annual profit that is expected to be made from running the home (EBITDARM)
3. The value a property investor would place on the care home property (based upon the rent that is affordable out of the estimated annual profit)
4. The profit made by the care home developer when they sell = Price paid by investor (3.) – cost of building (1.).

1. The cost of buying the land and building the home

Land with planning permission in such a desirable location (high proportion of self payers and near residential areas) can be sold for in excess of £3.5m.

The build cost for a modern home is approximately £100,000 per bed. So for an 80-bed home that comes to **£11.5m**.

Table 1: Estimated cost of buying land and building the home

	£ million
Land price	3.5
Build cost (80 beds x £100k per bed)	8.0
Total cost	**11.5**

2. The annual estimated profit from running the care home

Care home operators will typically focus on measuring profit using a metric such as EBITDARM. This measures the earnings before interest, tax, depreciation, amortisation, rent, and management charges (typically charged by other related companies). Effectively it is the profit made after paying staff costs, utilities, food, and other day-to-day expenses for the home, but before loans, rent, and other financing costs are paid. It gives an idea of the level of profits the home operator has to then allocate between these remaining costs and to itself as profits.

Using the case study, we can estimate this 80-bed home (targeted at self-payers) will make a forecast EBITDARM profit of:

80 beds x 90% occupancy (as not all beds will be occupied) x £1,250 fee per resident per week x 52 weeks x 27% profit margin = **£1.26m a year EBITDARM profit**.

3. The value of the home to a property investor

The property investor will be interested in the location of the asset, the future-proof nature of it (i.e. will it require much work to keep it up to care standards over the coming decades), and the proportion of self payers in the area.

[12] Grant Thornton (2018) 'Care homes for the elderly: Where are we now?', p38. Available at: https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/documents/care-homes-for-the-elderly-where-are-we-now.pdf

To calculate how much rent they can charge they will want to estimate the EBITDARM profit that will be made by the operator. From this they can charge a rent that is decent, but also provides leeway to the operator for when rent increases or profit fluctuates. Typically, this is done by deciding on a 'rent cover' value which is the number of times the estimated profits made must be greater than the rent charged.

In this case study the rent cover is 1.7x meaning that the property investor wants the care home operator's profit for this home to be at least 1.7 times larger than the initial rent.

Rent chargeable

= Estimated EBITDARM for home / rent cover

= £1.26m EBITDARM / 1.7 (rent cover)

Rent chargeable

= £0.74m per year

The investor will then use this annual rent figure to calculate the maximum they would pay for a property that provides £0.74m of rent a year. In this case study the property is in a prime location and there will be a lot of interest in owning this home so the price paid will be higher. A higher price means that the rent will be a lower percentage of the total property cost, this is the yield. In this case study the yield acceptable for the investor is 4.5%, so:

Property valuation

= Annual initial rent / yield investor wants

= £0.74m / 4.5% yield

Property valuation

= £16.5m

4. The profit that the care home developer/operator could make from selling the home

For the care home operator/developer by building the home and then selling it on to an investor the theoretical investment gain is:

Investment gain/profit

= Property valuation (by investor) – Total build cost

= £16.5m - £11.5m

Investment gain/profit

= £5m (a 43% profit)

A 43% return on investment in the 2-3 years it takes to buy land and build a home is a lot higher than the annual return from running a care home. This can be an attractive way for care home operators to realise a quick profit on new or existing care homes. But as discussed above it locks in a new cost to the business (rising rents) which ultimately has to be shouldered by residents.

NB. This case study works because of the fees charged to private payers. For those areas with a higher proportion of publicly-funded residents and a build cost of £100,000 per bed this is not considered an attractive investment.

A way of increasing the returns on investment (i.e. as a form of leverage):

Purchasing a care business with a property investor buying the real estate (e.g. a sale and leaseback) allows the care operator to put down far less money up-front. This means that the profits made by the operator will be a higher multiple of the initial amount invested in the business. A higher multiple is how investors measure financial performance and is particularly important for private equity (PE) funds who are incentivised to maximise returns over a few years.

For example: A care company wants to buy a home which generates £1m EBITDAR profit a year.[13] With a £1m EBITDAR, a maximum rent of £500,000 a year could be charged (at two times rent cover).

A property investor seeking a 6.75% yield would be willing to pay: £7.4m for a property providing £500,000 rent a year (excluding inflation considerations).[14]

If the care company can agree to buy the whole care business (with property) for £8m (8x EBITDAR being a reasonable multiple to value a care business) then the contribution to the £8m purchase price would be:

- £7.4m from the property investor
- £0.6m from the care company

[13] EBITDAR is earnings before interest, taxation, depreciation, amortisation, and rent. It is a common industry metric to measure a home's profitability.
[14] £7.4m = £500,000 / 6.75%

Now to compare how this will affect the care home operator's return on investment:

Table 2: Comparison of returns on investment with or without a sale and leaseback

	Without a property investor	With a property investor (e.g. sale and leaseback)
Overall purchase price for business and home	£8m	£8m
Breakdown of purchase price by party	Operator: £8m | Property investor: nil	Operator: £0.6m Property investor: £7.4m
EBITDAR profit (annual)	£1m	£1m
Rent payable	nil	£0.5m (to property investor)
EBITDA (EBITDAR minus rent)	£1m	£0.5m
Initial return on investment for operator (EBITDA / operator share of purchase price)	£1m / £8m = **0.13x (13%)**	£0.5m / £0.6m = **0.83x (83%)**

As can be seen in the table (above) for a £600,000 initial investment the care company makes £500,000 a year EBITDA, that's 0.83x (83%) the initial investment.

If on the other hand, the care company bought the care home (and property) by itself it would make £1m EBITDA a year (no rent to pay) on a £8m initial investment. That's only 0.13x (13%) the initial investment.

So purchasing a care business with a property investor can increase returns (effectively as a form of leverage) but comes with increased risks: rising rental payments and a lower business value when sold. However, for a short-term investor or one heavily focused on the multiple of returns made (such as PE) this can be a very attractive deal.

Splitting the property and operating company can often lead to higher sale price

When a care home company is sold together with the property, its value is based upon its annual EBITDA or EBITDARM profits. These are then multiplied by a sale multiple that reflects how much return a new buyer expects from the business.

If however the care home company splits its business into the company that provides the care in the home (operating company) and a separate company that owns the care home properties (property company) it can achieve a higher overall sale price.

This is due to the different risks and rewards associated with each part of the care business. Property ownership is considered less risky and so investors who are only interested in that aspect will be competing to buy the property company, whilst if the operating company and property company are sold altogether, they would likely not bid. So it allows the different parts of the business to be bid on by more interested parties, allowing for a higher overall sale price.

The downsides of selling to a property investor

For the care operator, the inclusion of a property investor means the chance to make a quick (and often high) return on their investment, but also locks in a long-term rental contract which rises annually with inflation (up to a yearly cap). This puts pressure on the operator and ultimately the residents to maintain fee increases (or cut costs) to afford rent.

Up till now, fee increases could generally cover rising rental costs and increase the operators' profits, however, if inflation continues to remain high for a longer period of time then it is uncertain whether fee increases will be able to keep pace. This could particularly affect operators with a high proportion of publicly-funded residents in their rented homes.

Landlords also may not be quick to invest in upgrading or refitting the care home when care standards change, as this can require extra investment and reduce the number of beds (as happened when homes moved from ward-style bedrooms to individual ones with ensuite). This reduces the flexibility of the care home operator to quickly adapt the home to meet new trends, and so could ultimately affect their business' success and profitability.

Finally, financing for care home operators is often secured against the care home properties that they own. Therefore, it is vital that they balance the immediate profit from a property sale against the need to retain some properties, in order to borrow for longer-term business plans.

Care UK as an example of the profitability of property development

A brief background to the purchase of Care UK

The private equity (PE) firm, Bridgepoint, acquired Care UK plc for £281m (total transaction size of £414m) and de-listed it from the London Stock Exchange in April 2010.[15,16] At the time Care UK operated over 200 facilities including 59 care homes, 304 mental health beds, 13 GP medical practices, community care services, and was the largest operator of independent sector treatment centres (ISTCs) on behalf of the NHS.[17]

To help pay for the purchase of Care UK, funding was raised through:[18]

- A high yield bond of £250m which had an interest rate of 9.75%, due for repayment in 2017 and secured against care home properties owned by the group.
- £136m borrowed with loan notes (a form of IOU) with an interest rate of 16% that were to be fully repaid in 2018.
- £126m of preference shares, a form of shares with a guaranteed annual dividend. The annual dividend was at an interest rate of 16%, added to the outstanding amount owed each year and were due to be repaid with interest by 2018.
- An £80m revolving credit facility (like a corporate overdraft) with interest of LIBOR + 2.5-4.0%, repayable in 2016.
- £4.5m of funds raised through the issue of ordinary shares (i.e. equity investment).

In short, a lot of debt was taken on to buy and delist Care UK. The loan notes and preference shares (with a 16% interest rate) appear to have been mostly borrowed from Bridgepoint (and the funds it manages) with small amounts (1%) owed to directors.[19] The ordinary shares were mostly owned by Bridgepoint but with 15% owned by directors and other key management personnel.[20]

The 2018 due date on the loan notes and preference shares (since extended) suggests that Bridgepoint expected to have sold the Care UK business before then. This timeline fits with the standard investment period for PE funds of under ten years.[21] In 2018 Bridgepoint attempted to sell Care UK but was unsuccessful.[22]

[15] Bridgepoint (2010) 'Bridgepoint confirms successful completion of £250m high yield bond for Care UK acquisition', 23rd July 2010. Available at: https://www.bridgepoint.eu/press-releases/bridgepoint-confirms-successful-completion-of-gbp-250m-high-yield-bond-for-care-uk-acquisition
[16] Bridgepoint (2010) 'Recommended proposals for the acquisition of Care UK plc by Bridgepoint', 3rd March 2010. Available at: https://www.bridgepoint.de/pressemitteilungen/recommended-proposals-for-the-acquisition-of-care-uk-plc-by-bridgepoint
[17] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p1-2.
[18] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p 43-46, 49.
[19] See for example Care UK Health & Social Care Holdings Limited (2011) 'Annual return made up to 16 February 2011'.
[20] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p58-59.
[21] Barber, F. & Goold, M. (2007) 'The Strategic Secret of Private Equity', *Harvard Business Review*. Available at: https://hbr.org/2007/09/the-strategic-secret-of-private-equity
[22] See for example: Bridge, S. (2019) 'Care UK's private equity owners blew £2.5m on the failed sale of the care services business', This is Money, 14th July 2019. Available at: https://www.thisismoney.co.uk/money/markets/article-7244669/Care-UKs-private-equity-owners-blew-2-5m-failed-sale-care-services-business.html

The high interest rate charges (16%) on the loan notes and preference shares gives an indication of the minimum rate of return that Bridgepoint and its investors may have originally expected on the investment. In addition, the high interest charges (when paid) could reduce the tax due upon sale of the business and/or the tax paid each year. However, since 2017 new restrictions on using interest payments to reduce corporation tax have been applied and could have affected recent tax advantages.[23]

How could PE expect to make such a high return?

A 16% rate of return seems high for an industry that is constantly described as unprofitable and on the brink of collapse. It also suggests that investors were (at least at the time) expecting social care (and healthcare) to be a highly profitable industry. So how could this high rate of return be achieved?

One way to increase returns is to borrow more so less investor's money is put into the business. Doing so increases the returns on investment, but also leads to a higher level of risk because the business is now burdened with more debt.[24] It's estimated that around 39% of PE's gross returns are due to additional financial leverage (debts) compared to similar public companies, and 33% mirrors the general rise in listed company values.[25] In other words, high levels of debt explain a significant share of PE's recent returns. Bridgepoint's extensive use of debt to purchase Care UK in part explains how it may have expected to make part of its return.

Secondly, the trend towards an ageing population, increasingly outsourced NHS services, and a rising proportion of self-funders makes for an industry which could expect growing revenue and profits. Part of Care UK's expected return would come from this rising tide.

Thirdly, there is a premium placed upon larger businesses, and so typically a higher return can be made upon sale. The high interest charge of 16% on the preference shares and loan notes suggests that Bridgepoint may initially have expected to sell the business within 3-5 years of purchase.[26] The short time frame and high expected return lends itself to a buy and build strategy, where a PE fund buys up (or develops) additional care homes or treatment centres in order to quickly accelerate the business' value and growth.

A rapid buy and build strategy seems to have been initially chosen, as noted in comments made at the time by chief executive, Mike Parish: *"the group plans to focus on acquisitions in the social care and healthcare markets"*. Buy and build is particularly useful when a business has not had the funding available to invest in its growth potential. Bridgepoint seems to have felt this way and is quoted as saying *"Care UK is a highly diversified business that could not realise its full growth potential as a publicly traded company due to funding limitations."* [27]

[23] HM Revenue and Customs (2017) 'Guidance Restriction on Corporation Tax relief for interest deductions'. Available at: https://www.gov.uk/guidance/corporate-interest-restriction-on-deductions-for-groups

[24] This is similar to investing in a property with a lower deposit (i.e. borrowing more) and then flipping it. If prices have risen then the 'return' on investment is higher the lower the initial deposit. However it's riskier because if values fall, the house is more likely to enter negative equity.

[25] Ernst & Young (2021) 'Annual report on the performance of portfolio companies, XIV', *BVCA*, December 2021. Available at: https://www.bvca.co.uk/Portals/0/Documents/Research/2021%20Reports/EY-Annual-report-on-the-performance-of-portfolio-companies-XIV.pdf

[26] The size of these related party debts and the interest rate means that the business' value (i.e. enterprise value) would have to grow at a faster rate in order for management's equity (15% at the start) to not be worth less upon sale. The longer the business is owned the greater these related party/investor debts will become and the harder it is for management to find ways to grow the business in order to surpass this rate. So a relatively short holding period would be needed to avoid this situation when there is a 16% interest rate and 15% management equity stake.

[27] KCS-Content (2010) 'Bridgepoint snaps up health and social care firm Care UK for £281m in cash', *City A.M*, 3rd March 2020. Available at: https://www.cityam.com/bridgepoint-snaps-health-and-social-care-firm-care-uk-281m-cash/

Finally, there is a potential to make additional returns from the property element of the care business. In recent years there has been a heightened demand for care and healthcare properties by specialist property investors, who are attracted by the long-term stable nature of the underlying businesses. Investors expect to make annual yields ranging from as low as 3% to around 6% on care home and healthcare properties, whilst care home operators (such as Care UK) benefit from being able to sell and then lease back properties from these investors.[28] In 2010, Bridgepoint set up an independent property development company in Luxembourg in order to develop new care home properties (discussed below).

Taken together these factors explain how the high expected rate of return could be reached. However, Care UK's strategy has changed since its acquisition. At purchase Care UK relied heavily upon the NHS and Local Authorities as funders, however since 2010 local authority net spending on care fell (in real terms) and there has been a recognition that public fees have not matched cost increases.[29,30] In 2014 Care UK undertook a strategic review of its business and decided to focus on two divisions: health care (primarily NHS and other healthcare services) and residential care services. It sold its Care at Home, Learning Disability, and Mental Health services in 2015 for £130m (roughly 10x their annual profits). This sale allowed it to reduce its debts and invest in its remaining services.[31]

It also intended to attain a *"higher proportion of self-funded care"* in its homes, seemingly mostly through the building of new care homes. Already by 2015 it had increased the number of care homes from 59 to 113.[32] At the same time, £60.8m of the 16% interest loan notes were converted into ordinary shares in 2015.[33] This suggests that Bridgepoint expected to hold onto to its investment for longer than initially anticipated.

[28] See for example: Knight Frank (2022) 'Healthcare Capital Markets Research 2022'. Available at: https://www.knightfrank.com/publications/healthcare-capital-markets-2022-8997.aspx
[29] National Audit Office (2021) 'The adult social care market in England, HC 1244', p18.
[30] Competition & Markets Authority (2017) 'Care homes market study. Final report', p13.
[31] Care UK Health & Social Care Holdings Limited (2016) 'Directors' report and financial statements Period ending 30 September 2015', p3.
[32] Care UK Health & Social Care Holdings Limited (2016) 'Directors' report and financial statements Period ending 30 September 2015', p2,7.
[33] Care UK Health & Social Care Holdings Limited (2016) 'Directors' report and financial statements Period ending 30 September 2015', p7, 71.

A deep dive into Silver Sea Holdings: Bridgepoint's Luxembourg-based property company

After Care UK was acquired, Bridgepoint and the management of Care UK set up an independent property development group headed by a parent company called Silver Sea Holdings in Luxembourg. The ownership of Silver Sea was split in the exact same way as Care UK, with the majority owned by Bridgepoint and its funds and Care UK's senior management owning around 15% of the shares.[34]

Silver Sea was established in order to: *"i) build residential care homes to Care UK's specifications, or ii) to oversee the development of residential care homes by third party property developers who will build care homes to Care UK's specifications and sell them to Silver Sea on completion"*. In effect this Luxembourg-based group of companies were set up to build (or commission) new care homes for Care UK, which was then obliged to rent out the premises.[35]

Whilst Silver Sea was owned by the same shareholders as Care UK, it was independent of that group and so its property profits and earnings were kept separate from the Care UK operating business. However, Care UK did lend money to Silver Sea to part-fund its new developments and Silver Sea paid for technical services from Care UK, so financially there were connections.[36] These transactions represent a broad pattern across care sector investments where money flows between the care operations and the property arms. In July 2019 the Silver Sea group was bought by Care UK and so from then on was formally part of the Care UK group.

The Silver Sea group's finances were complicated as it borrowed money from Care UK and external lenders. As an example, from the accounts for the year ending 31st October 2018:[37]

- There was £38,800 worth of equity put in via the purchase of 3,880,004 shares with a value of £0.01 each.
- Silver Sea Holdings S.A. owed £47.3m to affiliated companies. This consisted of an interest free loan from Care UK Health & Social Care Finance Limited of £11.95m, and a £35.37m convertible loan (including £2.39m of accrued interest) from Care UK Limited with a variable rate of interest.
- At the same time the company's shares in a subsidiary, Silver Sea Developments S.à.r.l. were used as security for a £120m group loan facility from external lenders.

This was the funding structure of parent company Silver Sea Holdings S.A. however beneath it were two main subsidiary companies: Silver Sea Developments S.à.r.l. and Silver Sea Property Holdings S.à.r.l. Silver Sea Holdings S.A. had lent £20.2m to Silver Sea Property Holdings S.à.r.l at an interest rate of 17%, which had accrued £1.4m of interest charges. It had £35.3m due of loans, cash advances, and interest due from its two subsidiaries within a year.

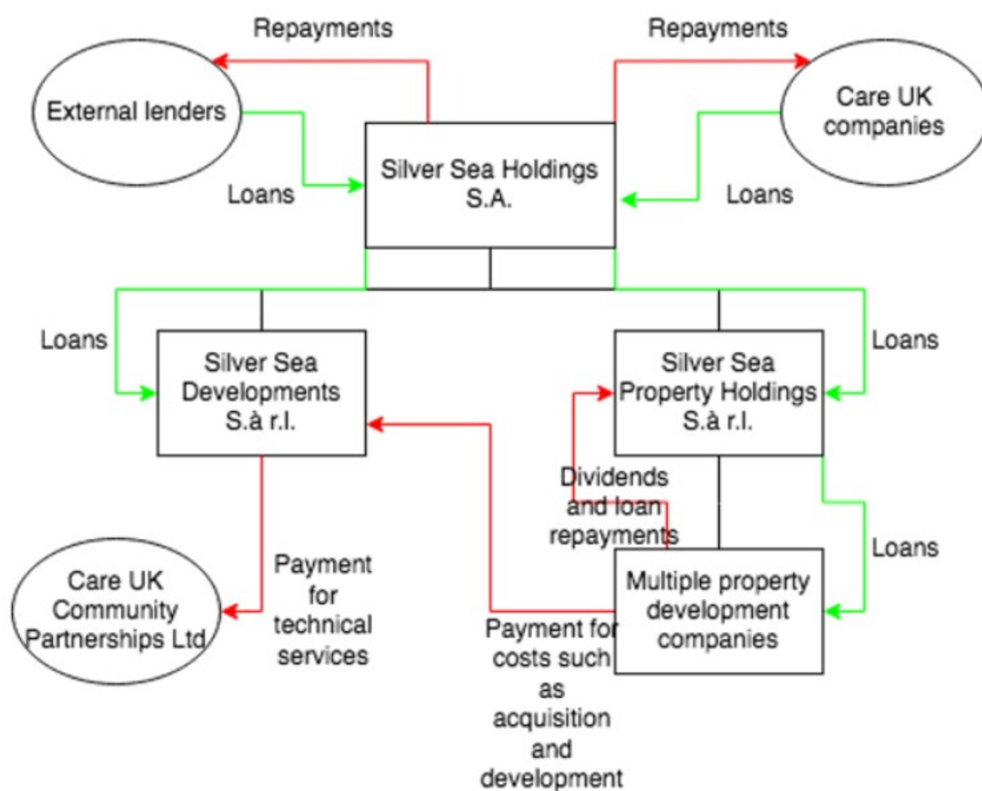
The subsidiaries were responsible for different aspects of the property development process. In 2018 Silver Sea Developments S.à.r.l. had no employees but charged costs of £26.3m to Silver Sea's property development companies for real estate acquisition and development services. It had a £342,000 interest free loan outstanding from Silver Sea Holdings S.A.[38]

[34] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p58.
[35] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p58.
[36] Care UK Health & Social Care Holdings Limited (2011) 'Directors' report and financial statements Period ending 30 September 2010', p58-9.
[37] All from: Silver Sea Holdings S.A. (2019) 'Exercise from 01/11/2017 to 31/10/2018'. Available at: https://gd.lu/rcsl/1j01rT
[38] Silver Sea Developments S.à.r.l. (2019) 'Exercise from 01/11/2017 to 31/10/2018'. Available at: https://gd.lu/rcsl/BPQ9N

Meanwhile the other subsidiary, Silver Sea Property Holdings S.à.r.l., held shares in subsidiary companies which owned each individual property development. For example, the Care UK home developed in Witney was managed by a subsidiary called Silver Sea Properties (Witney) S.à.r.l. In 2018 Silver Sea Property Holdings S.à.r.l. had lent £60.5m to these individual property development companies at interest rates of 0 or 17.25%. At the same time, it owed £62m to related companies. This consisted of two loans from Silver Sea Holdings S.A., a £33.5m interest free loan and a £20.2m loan at a 17% interest rate.[39]

In essence, in 2018 the Silver Sea group as a whole had borrowed from external lenders (at an unknown interest rate) and from Care UK at variable interest rates as low as 0%. The main parent company, Silver Sea Holdings S.A., had then lent money to its two main subsidiary companies (Silver Sea Developments S.à.r.l. and Silver Sea Property Holdings S.à.r.l.) at interest rates ranging from 0 to 17%. In turn Silver Sea Property Holdings S.à.r.l. lent money to the individual property development companies at interest rates of 0 or 17.25%.

Figure 1: Simplified diagram of the Silver Sea group and some of the financial flows amongst the companies



Source: Silver Sea Group company accounts as at 31st October 2018

NB Black lines indicate ownership and control. Arrows indicate flows of capital.

[39] Silver Sea Property Holdings S.à.r.l. (2019) 'Exercise from 01/11/2017 to 31/10/2018'. Available at: https://gd.lu/rcsl/6M4FmV

How profitable was property development for the Silver Sea group?

Twenty-eight property development companies were subsidiaries of Silver Sea Property Holdings S.à.r.l. Each company was responsible for the development of a single care home.

When the care home properties were developed, Silver Sea would either directly rent them to Care UK or sell them to a Care UK company or a third-party investor. This meant that over time more rent was being paid by Care UK subsidiaries operating UK care homes to Silver Sea entities in Luxembourg.

Table 3: Rent paid by Care UK to Silver Sea

Year	Rend paid to Silver Sea (£m)	Number of properties leased	Silver Sea rent as % of Care UK's total property lease payments
2014	1.7	7	5%
2015	3.1	6	8%
2016	3.9	6	10%
2017	3.9	6	9%
2018	5.2	6	11%
2019	4.1	Not mentioned	10%

Source: Review of accounts of Care UK Health & Social Care Holdings Limited

Whilst the properties developed by the Silver Sea group were only a part of the total properties developed and rented out by Care UK, it's noticeable how the rent rose each year to take up 10% of the total rental payment for the Care UK group.[40]

Whilst the Silver Sea group did collect rent on homes developed, it also sold properties as well. There were 21 companies where the developed care homes (or land) were sold, either to a Care UK company or to a third-party investor. Silver Sea subsidiaries made large profits from these sales and paid out dividends to shareholders (see Table 4).

In total, the Silver Sea group sold 21 care home properties and/or freehold land for a total of £289.5m, and ***recorded a profit on these sales of £113m, a 39% profit rate***. The proceeds of these sales were used by the companies to pay down external debts to RBS and HSBC, pay down the internal loans from other Silver Sea companies (at 0% or 17.25% interest), and provided a dividend of £71.7m (25% of sale proceeds) to shareholder companies.

The high levels of profitability upon sale of the homes shows how valuable the returns to care home properties can be. By separating out the property ownership from the Care UK companies that provide services, we can more clearly see how high a return can be made.

Assuming a three-year period from buying the land to building a finished property, the 39% profit rate works out at 13% a year.[41] As a comparison, over the same period (2015-19) Care UK's main care business EBITDA profit margin averaged 9%.[42] However, the EBITDA profit margin is not an immediate cash profit for Care UK, as it will likely be spent on repaying debts and investing in the business, whilst the return from a property sale is an immediate cash influx.

[40] We are referring to operating lease rentals for land and buildings.
[41] The three year period is in line with the number of financial years that it took Silver Sea companies to develop a home based upon a sample of group companies.
[42] This is the adjusted EBITDA margin for Care UK Community Partnerships Ltd, which records the majority of the Care UK groups' care home fee income. NB Both calculations exclude consideration of the time value of money.

Table 4: Profits made by Silver Sea subsidiaries upon sale of developed care home or freehold land

Subsidiary Name	Sale year	Sale price	Profit made	Profit rate	Interim Dividend declared	Dividend rate	New owner (if known)
Angmering	2019/20	£438,800	£59,510	14%	0	0%	Care UK Angmering Ltd
Ashford	2019	£14,429,796	£2,703,559	19%	£2,400,000	17%	Universities Superannuation Scheme Ltd
Bristol	2019	£12,600,000	£2,677,046	21%	£1,650,000	13%	Care UK Bristol Ltd
Bromsgrove	2019	£17,690,000	£6,751,413	38%	£5,200,000	29%	Care UK Bromsgrove Ltd
Cheadle	2019	£20,220,000	£12,106,332	60%	£10,650,000	53%	Care UK Cheadle Ltd
Chester	2018/19	£14,137,130	£3,121,157	22%	£2,900,000	21%	Universities Superannuation Scheme Ltd
Colinton	2015	£16,983,234	£8,128,538	48%	0	0%	Unknown, but resold for £21.75m in 2021 to a RE investor
Hailsham	2015	£15,903,480	£7,591,192	48%	0	0%	Unknown, but bought in 2016 by British Overseas Bank Nominees Ltd and WGTC Nominees Ltd
Horndean	2018/19	£16,869,861	£6,186,682	37%	£5,350,000	32%	Blackrock UK Long Lease Property Fund
Hythe	2019	£14,244,568	£3,131,328	22%	£2,850,000	20%	Universities Superannuation Scheme Ltd
Leamington Spa	2017	£15,735,000	£8,648,957	55%	£7,330,000	47%	Unknown
Murrayfield	2019	£17,400,000	£6,248,850	36%	£4,800,000	28%	Care UK Murrayfield Ltd
Orpington	2015	£16,013,286	£7,736,023	48%	0	0%	Unknown, but resold for £21m in 2021 to Railway Pension Nominees Ltd
Portobello	2018/19	£15,889,316	£6,837,567	43%	£5,800,000	37%	KFIM Long Income Property Unit Trust
Quorn	2019/20	£4,261,452	£848,799	20%	0	0%	Care UK Quorn Limited
Sale	2018/19	£13,667,888	£3,105,092	23%	£2,850,000	21%	Universities Superannuation Scheme Ltd
Sarisbury Green	2019/20	£4,835,708	£77,458	2%	0	0%	Care UK Sarisbury Green Ltd
Shinfield	2019/20	£9,289,072	£2,123,967	23%	0	0%	Care UK Shinfield Limited
St Ives	2017	£16,765,000	£10,427,194	62%	£6,740,000.00	40%	Unknown
Whitstable	2018/19	£14,243,823	£3,198,756	22%	£2,860,574.43	20%	Universities Superannuation Scheme Ltd
Worcester	2018/19	£17,883,765	£11,307,083	63%	£10,300,000	58%	Blackrock UK Long Lease Property Fund
Total		**£289,501,180**	**£113,016,501**	**39%**	**£71,680,574**	**25%**	

Source: Review of Silver Sea companies accounts and Land Registry data as at 2nd September 2021.

NB When the profit made upon sale was not declared, we used the sum of the value of land and buildings and the capitalised building construction costs as the cost of the property sold.

A further 6 Silver Sea property companies were sold (the company along with its care home properties and land) to healthcare investors. Some were still in development when sold.

Table 5: Silver Sea sales of property companies

Subsidiary Name	Company sale date	New company owner
Banbury	18/12/2018	MedicX Healthfund Subco 1 Limited (Guernsey). Ownership shifted to Octopus Healthfund Subco 2 Ltd in 2021.
Cheltenham	21/12/2018	MedicX Healthfund Subco 1 Limited (Guernsey). Ownership has changed since.
Cringleford	30/04/2019	MedicX Healthfund Subco 1 Limited (Guernsey). Ownership shifted to Octopus Healthfund Subco 2 Ltd in 2021.
Horsham	21/12/2018	MedicX Healthfund Subco 1 Limited (Guernsey)
Ware	21/12/2018	MedicX Healthfund Subco 1 Limited (Guernsey). Ownership has changed since to Octopus Healthfund Subco 3 Ltd (Guernsey).
Witney	30/04/2019	MedicX Healthfund Subco 1 Limited (Guernsey)

Source: Review of Silver Sea companies accounts and company accounts

A review of the third-party investors

Who were the properties sold onto?

A number of the Silver Sea properties were sold onto Care UK's property companies ahead of or shortly after the purchase of the Silver Sea group by Care UK on 31st July 2019. The Silver Sea group was purchased by one of Care UK's property companies, Care UK Property Holdings Ltd, for £122.5m.[43] Ultimately this transaction did not change the overall beneficiaries of the rent and development activities of the Silver Sea and Care UK group, because both are owned by Bridgepoint (and its funds) and the senior management of Care UK.

A number of the other properties were sold onto third parties. In these cases, the profits made benefited the Silver Sea group, whilst the long-term lease costs rested with the Care UK group. The profits from these sales are effectively an early return on the investment made by Bridgepoint, although it may have chosen to reinvest the proceeds in its businesses. Profits of £113m from the sale of 21 properties/land compare well to the £281m original purchase price for Care UK's shares. These profits are substantial, even if only the £40m of profit made on the 8 property sales to third parties are included.

It's also interesting to note the resales of some of these homes to new owners. In the cases of the two homes in Colinton and Orpington, both were resold in November 2021 to new owners for £4.8-£5m (28-31%) more than their initial sale prices in 2015. The new owners are Ivy Care Homes 1 Limited (for Colinton) which is owned by Tristan Capital Partners, a real estate investment boutique, and Railway Pension Nominees Ltd (for Orpington) which is part of the UK's principal railway industry-wide pension scheme.[44]

A deeper dive into some of Care UK's third-party property landlords

Despite the 2011 failure of major care home group Southern Cross, because of unaffordable rent payments due to its landlords, the practice of sale and leaseback (selling a care property for an up-front return and then leasing the home back) has returned to the elderly care home market. Industry analysts LaingBuisson estimate that *"approaching half of capacity among medium-to-large for-profit groups ... may be subject to leasing arrangements"*, and that typically investors were seeking initial yields of between 5-7%, and rents that rise annually by fixed amounts or with inflation.[45]

Land Registry data (at September 2021) was used in order to examine the extent of this trend and to identify the largest third-party landlords for the Care UK group. The accounts and strategies of two care home property investors were further examined to understand the motives and returns. Using these datasets, 30 landlords were identified, and there were some we couldn't identify.

[43] Care UK Property Holdings Limited (2021) 'Annual Report and Financial Statements. For the period ended 30th September 2020', p39.
[44] These were identified using Land Registry datasets (February 2022 release)
[45] Laing, W. (2021) 'Care Homes for Older People UK Market Report 31st edition', *LaingBuisson*, p16-17.

Table 6: Third party companies which owned care homes (freehold titles only) operated by Care UK

Landlord company name	Number of property titles	Country of incorporation
AEDIFICA UK LIMITED	11	UK
LEGAL AND GENERAL ASSURANCE (PENSIONS MANAGEMENT) LIMITED	4	UK
UNIVERSITIES SUPERANNUATION SCHEME LIMITED	3	UK
THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF ISLINGTON	3	UK
W.G.T.C. NOMINEES LIMITED	3	UK
BRITISH OVERSEAS BANK NOMINEES LIMITED	3	UK
NT PROPERTY NOMINEES 1B LIMITED	2	UK
DGM LONDON ROAD LIMITED	2	UK
NT PROPERTY NOMINEES 1A LIMITED	2	UK
THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF HAMMERSMITH AND FULHAM	2	UK
K/S WEYBRIDGE	2	DENMARK
THE SECRETARY OF STATE FOR HEALTH	1	UK
THE SCOTTISH AMERICAN INVESTMENT COMPANY PLC	1	UK
THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF RICHMOND UPON THAMES	1	UK
PARHAM INVESTMENT LIMITED	1	UK
UK LONG LEASE PROPERTY NOMINEE 1 LIMITED	1	UK
THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF HILLINGDON	1	UK
UK LONG LEASE PROPERTY NOMINEE 2 LIMITED	1	UK
BNP PARIBAS DEPOSITARY SERVICES LIMITED	1	JERSEY
POSSFUND CUSTODIAN TRUSTEE LIMITED	1	UK
OLD HOUSE DEVELOPMENT LIMITED	1	UK
NHS PROPERTY SERVICES LIMITED	1	UK
BNP PARIBAS DEPOSITARY SERVICES (JERSEY) LIMITED	1	JERSEY
MEDICX HEALTH (THIRTY THREE) LIMITED	1	GUERNSEY
MEDICX HEALTH (EIGHT) LIMITED	1	GUERNSEY
K/S ERMYN WAY	1	DENMARK
INSIDE HOUSING SOLUTIONS LIMITED	1	UK
HABINTEG HOUSING ASSOCIATION LIMITED	1	UK
COMMUNITY HEALTH SERVICES LIMITED	1	UK
MEDICX HEALTH (TWENTY FIVE) LIMITED	1	GUERNSEY

Sources: CQC directory of all places in England where care is regulated (6th October 2021), and Land Registry datasets (2nd September 2021 release). Information from the HM Land Registry datasets is Crown copyright 2021.

Two of the landlords were examined in detail due to the number of Care UK properties owned and because they represent two prominent types of care home investor: Aedifica UK Limited (owned by a Belgian-listed real estate investment company) and Universities Superannuation Scheme Limited (part of a large UK pension fund).

Aedifica UK Limited and Aedifica S.A.

Aedifica UK Limited rents out and manages care home properties based in the UK, and by the end of 2020 owned 92 properties worth £476m.[46]

In the period to the end of 2020 it received rental income of £29.8m, which represents a gross yield of 6.3% on its UK care home properties. Taking into account all of its income (including investment and other income) the company made a profit of £18.1m: i.e. a profit rate of 47%.[47] From this it paid out £13.6m of dividends on ordinary and preference shares.[48]

Aedifica UK Limited is in turn ultimately owned by Aedifica S.A., a publicly listed Belgian healthcare real estate investment company. Aedifica S.A. owns over 580 properties across eight European countries (Belgium, Germany, Finland, Ireland, Netherlands, Spain, Sweden, and the UK).

Aedifica S.A.'s largest care home operator tenants by size of rents are:

Table 7: Aedifica S.A.'s largest tenants by share of contractual rents in 2021

Tenant Group name	Share of total contractual rents paid to Aedifica	Countries in which properties are rented
Korian	11%	Belgium, Germany, Netherlands
Colisée	7%	Belgium
Azurit Rohr	6%	Germany
Orpea	5%	Belgium, Germany, Netherlands
Maria Mallaband	4%	UK
EMVIA	4%	Germany
Vulpia	4%	Belgium
Bondcare Group	4%	UK
Attendo	4%	Finland
Burlington	3%	UK
Other (each <3%)	48%	n/a

Source: Aedifica S.A. 2021 annual report, p35.

Its strategy is to invest in *"a real estate sector [healthcare] with strong growth potential"* due to an ageing population that is living longer, and in a climate where:

"governments only have limited resources to meet the growing demand and, hence, focus more often on financing care and care dependency rather than on providing care as a public operator. As a result, both private operators and public authorities are counting on private investors to provide and finance real estate infrastructure that responds to the care and housing needs of the ageing population." [49]

This is a common theme for real estate investors who see a growing demand for healthcare properties, as private operators are increasingly relied upon to provide publicly funded essential services to the elderly.

[46] Aedifica UK Limited (2021) 'Annual Report and Unaudited Financial Statements. For the period from 05 December 2019 (Date of Incorporation) to 31 December 2020, p2,6.
[47] This is profit after finance costs but before tax and unrealised losses on the fair value of investment property.
[48] Aedifica UK Limited (2021) 'Annual Report and Unaudited Financial Statements. For the period from 05 December 2019 (Date of Incorporation) to 31 December 2020, p7,8.
[49] Aedifica 'About Us'. Available at: https://aedifica.eu/about-us/ (Accessed 11th July 2022). Also see Aedifica S.A. (2022) 'Annual Report 2021', p86.

In 2021 (Jan – Dec), Aedifica S.A. received €232m of gross rental income from properties valued at €4.9bn, providing a gross yield of 4.7%. Its EBIT profit margin was 83.5%, while in contrast the Care UK group made a negative EBIT margin of -4.5%.[50,51] Its profit before tax figure was €340m, which is higher than its rental income, partly because its investment properties increased in value in 2021 by €160m.[52]

Since 2006, Aedifica has experienced an almost tenfold increase in the value of its property portfolio from under €500m to €4.9bn. This is due to rising property prices and the value of acquired properties, which translates to a compound annual growth rate of 24%.[53]

Like many healthcare real estate investors, Aedifica can make high EBIT profit margins due to the nature of its rental contracts, which transfer most of the financial risk to the tenant.

For example, it often signs 'triple net' contracts which means that the tenant (and not Aedifica) is responsible for the property's operating charges, maintenance costs, and paying rent on empty spaces. This means that the net yield (gross yield minus expenses) is the same as the gross yield. Triple net contracts are in force in the UK, Belgium, Ireland, and often in the Netherlands.[54]

In addition, the rents rise with inflation, which can greatly increase the cost of rent (to the tenant) over time given the average Aedifica rental contract has 20 years left on it (22 years in the UK).[55] Aedifica estimates that for every 100 bps (1%) increase in the index of inflation, it receives an additional €2.6m of rental income.[56]

However, Aedifica is exposed to the risk of rents being renegotiated to lower levels if tenants struggle to fill spaces in the homes or are on the verge of financial default. To manage this, it expects oversight of the care home operator's business to ensure that *"there is a thorough analysis of the business plan of the operators, that there is constant monitoring of the financial performance of existing tenants"*.[57]

In the UK Aedifica owns 102 care home properties.[58] These properties have a value of €822m (increasing in value by €26m in 2020) and generated a gross rental income of €48.6m, providing a yield of 5.9%.[59]

Table 8: Number of sites by tenant group in the UK for 2021

Tenant Group name	Number of sites	% total (global) contractual rents
Maria Mallaband	16	4%
Bondcare Group	21	4%
Burlington	21	3%
Care UK	12	2%
Renaissance	9	1%
Excelcare	3	1%
Harbour Healthcare	5	1%
Other	15	4%
Total	**102**	**20%**

Source: Aedifica S.A. 2021 annual report, p65.

[50] Aedifica figures from Aedifica S.A. (2022) 'Annual Report 2021', p52, 166-7, where EBIT is 'operating result before result on portfolio'. Care UK figures for consolidated group from Care UK Holdings Limited (2022) 'Annual Report and Financial Statements. For the Year Ended 30 September 2021'.
[51] EBIT stands for Earnings Before Interest and Taxation. For Aedifica rental income includes rental related charges, and €4.9bn represents the value of investment properties. For Care UK EBIT was measured as operating profit/loss.
[52] Aedifica S.A. (2022) 'Annual Report 2021', p166.
[53] Aedifica S.A. (2022) 'Annual Report 2021', p60.
[54] Aedifica S.A. (2022) 'Annual Report 2021', p16.
[55] Aedifica S.A. (2022) 'Annual Report 2021', p61.
[56] Aedifica S.A. (2022) 'Annual Report 2021', p143.
[57] Aedifica S.A. (2022) 'Annual Report 2021', p144.
[58] Aedifica S.A. (2022) 'Annual Report 2021', p65.
[59] Aedifica S.A. (2022) 'Annual Report 2021', p159, 161. Gross rental income as defined by EPRA Best Practice.

These 102 homes have 6,541 residential places and had contractual rents due of £44.1m in 2021.[60] This works out to **£6,748 of rent per residential place each year, which is £130 per week**. Using national data this level of rent would make up 15% of the weighted average weekly fee paid.[61] With a group EBIT profit margin of 83.5% this leads to **an estimated profit of £5,635 per resident per year, or £108 per week**, which is 12% of the weighted average weekly fee paid.[62]

Table 9: Residential places, contractual rent, and rent per resident for Aedifica's UK properties by tenant group in 2021

Tenant Group name	Residential units/places	Contractual rents (£)	Rent per resident (yearly)	Rent per resident (weekly)
Maria Mallaband	1,142	9,144,799	8,008	154
Bondcare Group	1,484	8,821,881	5,945	114
Burlington	1,234	7,108,554	5,761	111
Care UK	740	3,894,546	5,263	101
Renaissance	512	3,077,489	6,011	116
Excelcare	244	2,247,000	9,209	177
Harbour Healthcare	339	1,567,662	4,624	89
Other	846	8,277,625	9,784	188
Total in UK	**6,541**	**44,139,556**	**6,748**	**130**

Source: Aedifica S.A. 2021 annual report

However, this assumes that all the residential places in a home are occupied and paid for. If they are not (as is often the case) then the tenant (care operator) will usually still be expected to pay rent on the unused spaces. This increases the cost of rent per occupied place.

As an example, for Care UK in 2021, its average occupancy was 75.7% which was lower than previous years due to the covid pandemic, and its average weekly fee was £1,040.[63] Assuming that these figures are representative of homes rented from Aedifica, this would lead to a rent per occupied residential place of £6,952 a year or £134 per week, which is 13% of the weekly fee, up from 10% at full occupancy.[64] This shortfall in occupancy increases the rent due from each occupied bed by 32%, and so is a good illustration of how rent compels operators to maximise occupancy in order to preserve income for non-rent expenditures and profits.

Aedifica's high levels of profitability do not appear to be unusual for healthcare property owners. At a 5.9% yield (for the UK) it would take an average of under 17 years for Aedifica to pay off the cost of purchasing the properties.

Rents earned above this are in effect a form of economic rent, that is, payments in excess of the cost of constructing/purchasing the buildings. Unlike with a bank loan, once the property cost is paid off the landlords can continue to demand a market rent and so this cost will continue to be borne by payers through their fees. **Payments of economic rent such as these could be considered a waste of limited public and private resources in an already underfunded sector.**

[60] Contractual rents are not always the same as rent paid in a year. Aedifica defines contractual rent as: "Indexed rents, including rental guarantees, but excluding cost of rent-free periods for occupied surface area". Aedifica S.A. (2022) 'Annual Report 2021', p72.
[61] LaingBuisson (2022) 'Care Homes for Older People UK Market Report, 31 edition'.
[62] Aedifica S.A. (2022) 'Annual Report 2021', p72-74. We consider that the group EBIT margin is applicable to the UK, which has the highest gross yields of all countries (see Aedifica S.A. (2022) 'Annual Report 2021', p60)
[63] Care UK Community Partnerships Ltd (2022), 'Annual Report and Financial Statements. For the Year Ended 30 September 2021', p2.
[64] Using Care UK Community Partnerships Ltd's average financial occupancy percentage of 75.7%.

Universities Superannuation Scheme Limited

Universities Superannuation Scheme Limited is the corporate trustee to the Universities Superannuation Scheme (USS), which is the principal pension scheme for university and other higher education employees. USS invests payroll contributions from members into assets (property, bonds, public and private companies) in order to generate income and capital returns to pay out pensions.

At the end of March 2021, USS had £53.1bn invested in public shares and bonds, and £22.2bn in private companies and property on behalf of 476,000 beneficiary members. Some of its major private market investments include: wind farms, 60 Moto service stations, 35 crematoria, Heathrow Airport, National Air Traffic Services (NATS), and other properties and infrastructure.[65]

Property makes up 5.3% of USS's main investment fund, which is lower than the 6.5% allocation in its Reference Portfolio (used as benchmark to measure USS's relative performance). USS invests a lot more in private companies (and their bonds) and less in public companies because: *"Private assets are expected to reward patient investors over a long time horizon due to the greater governance rights we have and the higher return we expect to earn in exchange for the investments' illiquidity"*, i.e. private investments (such as property) are harder to sell (than listed shares) but in return provide more control and potentially higher returns. Part of the additional return (over publicly listed shares) is from the relative lack of buyers: *"Private market assets such as critical infrastructure, property investments, and green energy businesses are typically difficult and expensive for individuals to own"*.[66]

By the end of March 2021, USS had property investments with a market value of £2.5bn, and this property generated £121m of gross property income (£113m net of property-related expenses). Within the year the property provided a 4.8% gross yield (4.5% net) and also a 2% (£45m) return from increasing property values.[67]

Detailed analysis of the rents charged by USS and the returns from its care home assets are not publicly available.

[65] Universities Superannuation Scheme (2022) 'Report and Accounts for the year ended 31 March 2021', p3.
[66] Universities Superannuation Scheme (2022) 'Report and Accounts for the year ended 31 March 2021', p20,22
[67] Universities Superannuation Scheme (2022) 'Report and Accounts for the year ended 31 March 2021', p69.

How much profit are care landlords making each year?

Using our case studies and industry information we wanted to estimate how much rent is being paid each year to care home landlords and how much profit that is likely to make them.

We started with LaingBuisson's estimate that around half of the capacity of medium-to-large for-profit care home groups is subject to leasing arrangements, which suggests that around 190,478 (50%) of the beds run by the whole for-profit sector may be rented.[68]

For the average weekly fee we weighted the average fee for nursing and residential places by their proportion of the total number of beds in the industry, that came to a weighted average fee of £879 per week.[69]

Yearly rent paid to landlords

If rent is charged at the same rate as by Aedifica (£130 per residential place per week) then those 149,992 places **are charged rents of £24.8m each week (£1.3bn a year)**.[70] This is a large figure for a sector which is struggling.

However, some of the places in the homes will be unfilled due to gaps between residents' stays or a lack of demand. The cost of these unfilled places will need to be covered by the paying residents. Before the pandemic occupancy tended to be around 85%, meaning that residents had to cover rent for the 15% of unfilled spaces.[71]

At 85% occupancy the £24.8m of rent charged comes to **£153 per bed per week (£8,000 a year)**, which is **17% of the weekly average weighted fee**. Our estimate is in line with LaingBuisson who consider that rent *"typically absorbs 20% of revenue for homes subject to leasing"*.[72]

Yearly profit made by landlords

Following a review of three elderly care home REITs and the Care UK property-owning companies we found that EBIT margins varied from 49% to 85%, whilst profit before tax margins varied from 35% to 87.8%. Given the mix of investor-types we chose 40% as a conservative profit before tax margin for landlords.

At this margin, the profit made by landlords is **£9.9m each week (£515m a year)**. At 85% occupancy this works out to **£61 profit per bed per week (£3,181 a year)**, which is **7% of the weekly average weighted fee**.

Yearly profit versus yield

The high EBIT margin and profits for some landlords reflects the nature of care home rental agreements, where many of the maintenance and repair costs are passed onto the care home operator (i.e. tenant). This means that each year the landlord makes a large profit on their rental income.

At a 6% yield the landlords have invested around £413m into these care home properties.[73] For them a 6% yield means that they will make back their investment within 17 years (excluding inflation), the remaining years of the rental contract (typically 20-30 years) being additional returns with little further social benefit received i.e. economic rent.

[68] Laing, W. (2022) 'Care Homes for Older People UK Market Report 32ndedition', *LaingBuisson*, p10,229.
[69] Laing, W. (2022) 'Care Homes for Older People UK Market Report 32ndedition', *LaingBuisson*.
[70] Aedifica's UK rent per residential place was a mid-point between two UK elderly care home focused REITs: Impact Healthcare REIT and Target Healthcare REIT.
[71] Laing, W. (2022) 'Care Homes for Older People UK Market Report 32ndedition', *LaingBuisson*, p1.
[72] Laing, W. (2022) 'Care Homes for Older People UK Market Report 32ndedition', *LaingBuisson*, p247-8.
[73] Yield estimate from: Laing, W. (2022) 'Care Homes for Older People UK Market Report 32ndedition', *LaingBuisson*, p99-100, 245.

CONCLUSION & RECOMMENDATIONS

When looking at medium and large care home companies, many run two businesses: a care home operating company and a property development and/or rental company. Using Care UK as an example, this report has aimed to explore the additional wealth extraction that occurs through the building and renting out of care homes, as well as how this model affects the residents that live in them, and the impacts on the wider sector.

For operators and/or property developers, such as Care UK, the building and sale of well-located care homes can generate profit margins of around 40% and provides easy funding for expansion or additional returns for the owners.

For the growing cohort of care property landlords, yearly profit margins of over 80% are achievable, with rental contracts that not only insulate them against the day-to-day costs of maintaining a property but also guarantee yearly rises in rents.

However, the costs of building a modern high-specification care home, coupled with a desire to maximise the rent charged, leads to the uneven development of care homes. With wealthier parts of the UK particularly favoured by developers, despite a need for new and upgraded care homes across all regions, relying on private investment alone will not allow the UK to level up this essential infrastructure. Instead, a major change to public fees or attitudes to public investment is needed.

In addition, rental contracts, set to rise annually with inflation, add a growing long-term cost to the price of care. Unlike with a bank loan to buy a property, once the cost of the property has been paid off, further rent paid to the landlords provides little additional social benefit in return. Rising rent costs are a ticking time bomb which will put pressure on fees to continually increase, particularly if high inflation persists. In a system which is already chronically underfunded, we are potentially losing an estimated £500m a year, perhaps more, to landlords' profits.

For those who have to sell their home to pay for care, the addition of further rising costs to pay for new avenues of profit-making will seem unfair. For others whose area does not offer an attractive enough business proposition for new homes, their needs may not be adequately met at all.

It's clear that the current approach does not best serve the needs of our social care sector. One solution could be to increase public fees, which may encourage more development in under-supplied regions, but this still locks in unnecessary long-term rental costs.

At a minimum, greater transparency over key costs and metrics (such as labour costs, spend on utilities, and real estate related costs, including whom and at what rate payments are made) should be made mandatory for greater public disclosure. This could be through the existing Care Quality Commission's (CQC) website, which already contains some care home-level information. In America, Medicare already provides quality, staffing, and ownership information for nursing homes.[74] Publishing each care home's largest expenditures would both put real estate costs in context, and help residents and payers unpick how much of their fees are spent on the front-line service. Increasing transparency could also force a simplification of operations, encourage more spending on direct care costs, reduce profit extraction through real estate, and inform broader reform and regulatory efforts.

Existing restrictions on local authority (or public) ownership of care homes should also be revisited. Public funding could be used to cheaply and equitably commission and/or develop new care properties, particularly in areas of greatest need. Alternatively with pension funds of their own, it's possible to imagine that local authorities may be better placed to act as landlords for properties in their areas for a more reasonable rate of return.

The enhanced ability to oversee their tenant's businesses could help ensure more funding is spent on staffing and direct care costs, and may provide an advanced warning of possible care failures and business collapse. If they are not pressed to make an immediate or maximal return, local authority landlords may be more willing to allow different types of operators to provide care such as community-led groups.

With a growing need for new and upgraded care homes, coupled with rising inflation, the UK risks sleepwalking into a situation where the care sector is either locked into escalating costs, or is unable to provide new care homes at all in many regions. Government must act now to prevent this two-tiered system from becoming the norm. A more considered policy approach is necessary to provide the chance to level up all regions, and create the infrastructure needed for future quality care.

[74] See https://www.medicare.gov/care-compare/

Previous reports on Australia’s largest for-profit aged care operators and more information about CICTAR can be found on CICTAR’s website.

www.cictar.org