03

Doctor's orders

10 TRENDS FOR 2023

Investment into alternative real estate assets that fall beyond the bounds of traditional real estate sectors is on the increase. The healthcare sector is receiving growing attention due to its typically recession-proof nature and attractive demand characteristics, and the sector is a good example of how advanced analytics can help real estate investors identify opportunities and fully understand the complexity of non-traditional markets.

As we discuss in **Operational excellence**, real estate investors are increasingly targeting their investment towards sectors where their returns are more closely linked to the underlying operational business of the occupier. A good example is the healthcare sector, where several factors are combining to drive up demand and change the structure of the supply side of the industry in ways that are creating opportunity for real estate investors.

The details vary between countries due to their differing healthcare systems, but change is evident everywhere and many of the demand drivers are the same across the western world. In particular, we are seeing the aging of western populations coinciding with increased private provision of healthcare services, even in those countries such as the U.K. where basic health services are universally available from the government.[1]

The Covid-19 pandemic created additional demand.

The Covid-19 pandemic created additional demand for services and a backlog of treatments for other conditions which is still being dealt with; lengthy waiting lists are encouraging those who can afford it to seek private treatment. Pressure on public finances coupled with increasing innovation in the diagnosis and treatment of conditions, much of which can now take place outside traditional hospital settings, provides a further boost to restructuring of the medical sector. All of this is taking place against a backdrop of an increasingly affluent population that cares more about – and spends more on - health issues than ever before: in 2021, healthcare accounted for over 8% of U.S. household consumer expenditure.[2]

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North American expansion

Private healthcare has long been a major growth area in the United States, where public provision is more limited and medical real estate is already a significant sector in its own right. The pandemic drove an increase in virtual consultations or “telehealth”, long held out as a solution to increasing capacity and efficiency in service provision. But outside the mental health sector, where virtual services have been a huge success, its impact has been limited and usage has stabilized at about 5% of all U.S. healthcare claims.[3] Telehealth will continue to be an important offering for large providers to better engage with patients, particularly for preliminary consultations, but will usually form part of a process that directs them to downstream services that are almost always in-person – and are the most profitable elements of private provision.

In fact, demand for ambulatory and outpatient services has risen as hospitals have dealt with the backlog of more serious illnesses not treated during the pandemic. Waiting times have fallen back from their pandemic peak, but in general have increased across many specialty services over the last five years including Cardiology (+26%), Dermatology (+7%) and Orthopedic Surgery (+48%).

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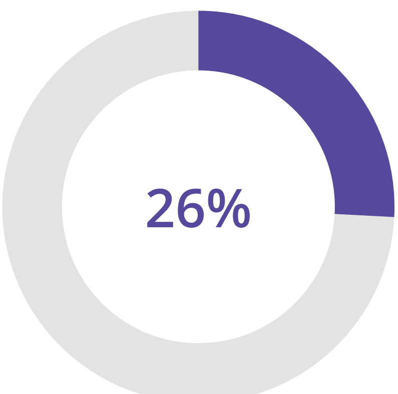
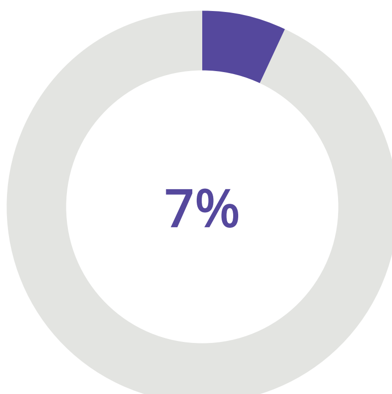


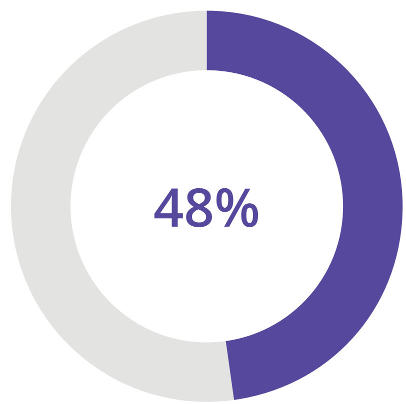
Cardiology

Increase in waiting times over the last five years



Dermatology

Increase in waiting times over the last five years



Orthopedic surgery

Increase in waiting times over the last five years

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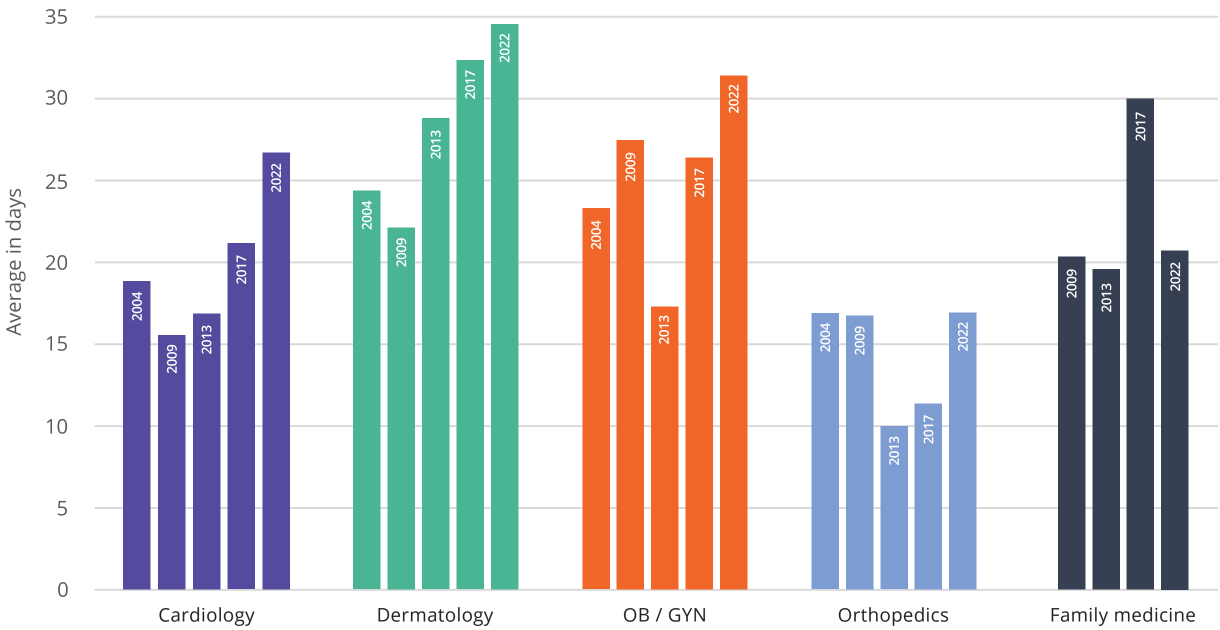
AVERAGE WAIT TIMES PER APPOINTMENT



Source: Macrobond

This rise in demand for outpatient care has been driven by improved clinical offerings and the growing cost of healthcare.[4] In the past two decades, there have been significant improvements to the number of procedures and treatments that can take place outside a hospital setting – and therefore in less specialised buildings closer to the patient's home. Additionally, healthcare continues to be a significant expense at a time when providers' costs are rising, hitting margins and budgets. There is increasing pressure from Medicare, Medicaid and private insurers to lower the cost of healthcare services.

This is encouraging an increased number of patient interactions to occur at non-hospital facilities, with outpatient volumes predicted to grow by 16% through 2032.[5] The healthcare real estate sector is therefore adapting to focus on the provision of these outpatient facilities. This will drive continued growth of the U.S. medical office building (MOB) market which has added over 60 million square feet of space over the last four years in the top 50 metro areas alone.[6]

In Canada, healthcare facilities represent low risk investments as primary services are financed by provincial and territorial governments and thus rental payments for privately owned properties are effectively guaranteed by the government. Here too demand for services will rise as the population ages, placing huge strain on public finances and an already overburdened health sector. Although over-65s make up less than 20% of the population, they account for nearly half of Canadian healthcare spending sector.[7] Demand for healthcare real estate is expected to remain strong, with the growing MOB market attracting significant interest from private investors as well as the country's specialist healthcare REITs. NorthWest Real Estate Investment Trust (REIT) is one of the larger players with 49 MOBs in its portfolio, showing strong revenue growth in recent years.[8] In November, NorthWest announced an expansion into the U.K. MOB market through a CAD$765 million (£500 million) joint venture with a U.K. institutional investor, showing that there is opportunity even in a market historically the preserve of the public sector.

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U.K. evolution

Although general practice medical service provision is still funded predominantly by the public sector, approximately half of the medical centre real estate sector in the U.K. is made up of privately held assets. Historically, many general practitioner (GP) doctors providing front-line community care operated out of their own homes, utilising part as a surgery, or as multi-practitioner practices working together out of a converted residential building. These buildings are let to, or operated by, the medical practices under contracts with the U.K. government’s National Health Service (NHS). The NHS funds GP’s operational costs, including rent on leasehold and an equivalent notional rent on owner-occupied assets. Practices are increasingly appearing in high street units, shopping centres, out of town retail malls or even within large food stores. However, many are migrating to purpose-built facilities similar to north American-style medical offices.

Half of the medical centre real estate sector is privately held.

MSCI data on total returns across real estate sectors found that healthcare assets performed with greater consistency than office and retail in the U.K. from 2017-21. Over this five year period, healthcare returns hovered around 7% to 11% annually while retail returns fluctuated between 2% to 14%, and office returns ranged from 1% to 8%.

Crucially, the sector has lower volatility due to the long term, secure nature of the income stream. In the case of leasehold assets, lease lengths are typically long – often 25 years. Whilst rent growth is usually modest, yields have historically been low reflecting the fact that the rent roll is underpinned by the NHS covenant. This government rental guarantee coupled with long lease terms and growing demand from an ageing population is making the sector increasingly attractive from a real estate perspective.

The key to successful investment is identifying where the demand will come from.

Around the world, demand for healthcare is on the increase. But the demand dynamics are very different to those in the office and industrial – or even retail and residential – sectors. The key to successful investment is identifying which service areas are set to grow, and where – which relies on understanding where the demand will come from within the population, and where that population lives.

Data-driven solutions

Healthcare operators are looking to simultaneously expand outpatient care and service provision whilst lowering operational expenditure, requiring greater efficiency in site selection and real estate management. Along with real estate developers and investors keen to provide the properties they need, they are turning towards data-driven solutions to harness analytics relevant to patient diagnoses and facility visits. Identifying where the demand will lie requires the use of ‘non-traditional data’ and our use of advanced analytics in healthcare real estate via our **AVANT** by Avison Young data platform is proving the predictive power of these non-traditional variables.

Real estate developers and investors are turning towards data-driven solutions.

While data on previous leases and transactions has long played a role in real estate, it does little to predict the future value of operational assets where performance is reliant on the success of the occupier. Combining traditional indicators such as market performance and leasing history with non-real-estate location analytics such as community demographics and specific data variables highlights relevant demand drivers for the sector, helping maximize the value of operational assets.

It also helps operators, developers and investors identify and assess the markets, submarkets and micro-locations best suited to their needs.

The use of advanced analytics to determine the location of healthcare and medical office assets demonstrates the capabilities of this technology. Our proprietary AVANT Analytics platform helps build efficient real estate strategies and improve site selection for the development of new assets. In the United States, portfolio analytics are being used to identify investment, development and operating locations based on demographic, medical and other datasets alongside more traditional real estate variables.

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Similar approaches have been developed in other countries. In the U.K., Avison Young’s Primary Care team is using AVANT Analytics to highlight trends in the numbers of patients registered at GP practices. Planning application data is also being used to identify new supply from the healthcare development pipeline, as well as potential increased local demand resulting from other kinds of development. Together with government ratings of practice care standards, the analysis provides insight into service demand trends as well as asset and market-level performance over time.

Use of non-traditional data is in its relative infancy within the real estate industry, but McKinsey believes such data can account for around 60% of the predictive capability of real estate rental value forecasting models.[9] Increased computing power coupled with the growing availability of an enhanced range of public and private datasets is enabling ever more sophisticated modelling incorporating the huge range of variables which influence both supply and demand aspects of real estate. Such advanced analytics is transforming real estate decision-making, particularly in areas of the market where understanding the complex operational dynamics of the underlying occupational businesses is at a premium.

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