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Alternative Investment in Healthcare: Transitioning from Niche to an Established Asset Class

There are a number of factors holding back thematic alternative allocations over the past years, ranging from a re-evaluation of global priorities following the pandemic to the escalation of the war in Ukraine. These factors are also combined with a dimming economic outlook as inflation and interest rates rise present new challenges for institutional and retail investors. However, despite all the challenges the aging population and the increase in healthcare expenditure have become important demand drivers for healthcare services and healthcare real estate, including long-term residential care facilities. Thus, as European senior housing and healthcare attract more institutional capital, they are becoming less alternative and continue creating new opportunities for global investors.

Demography as an investment opportunity in Europe

According to recent research by BNP Paribas Asset Management, changes in global demographics have led European investors to healthcare opportunities that are "significantly attractive". Approximately 95% of European and Asian investors indicated that healthcare is critical to their asset allocations in Europe, the US, and Asia.

As a result, new opportunities also arise and investing in sectors that can meet these demographic challenges provide long-term opportunities. Asset managers across Europe are already seeing a

shift toward thematic investing, including senior housing, as investors seek to meet specific needs and take advantage of longer-term trends as part of a diversified investment strategy.

Senior living: where the new opportunities lie

Savill's latest research report reveals that nursing homes have proven to be a countercyclical asset class that performs strongly during economic downturns. The European elderly care home market was worth €115bn in 2022, according to Healthcare Business International. The private sector accounts for 40%, or €46 billion, while the UK and Germany - the

two largest private markets for nursing homes - account for the majority of this, €32 billion (70%), according to Savill's.

The nursing home sector in Europe, supported by compelling supply and demand fundamentals and an aging population, nevertheless has many nuances. In order to succeed in this industry investors need to understand all the specifics of regulation, spending and cultural approach towards senior care in each market. Although many nursing home operators and investors have increased their market share in recent years, the European nursing home markets remain highly fragmented. For example, accord-

ing to Savill's, consolidation rates - the market share of the five largest operators in England, France, Spain and Germany - range from 11% to 13%. Belgium is the most consolidated market at 25%. This offers opportunities for investors and operators to expand their portfolios to other countries on the continent.

ESG in healthcare: an absolute must?

Some industry experts claim that the senior housing and healthcare sector meets all three ESG criteria. If you look closely, it is indeed true: a well-designed ESG plan is now an integral part of any investment strategy, and this trend is being driven by investors and lenders rather than regulators. Regulation may also differ depending on the country, so companies need to adapt and be proactive.

In the health sector, it is common for the social impact to come first and the sustainability aspect to be considered later, while the environmental aspect is usually achieved through the capex improvements that reduce service charges.

However, recent scandals involving elder care facility operators have shown us that it is not always possible to check all three ESG boxes even in the health-

care industry. The lack of robustness of some operators, particularly post-Covid-19, continues to be a major concern for investors and once again underscores the importance of ESG when considering new investments.

Why invest in healthcare alternatives

Alternative investment in healthcare has proven to be economically resilient compared to other sectors and offers investors more confidence in the market.

From a real estate perspective, long-term leases indexed to CPI, averaging 15-25 years with operators, as well as rent levels that reflect the economic potential of individual projects, are distinct advantages of investing in this sector. Experienced fund managers typically look for properties with redevelopment potential to hedge against the risk that leases will not be renewed and to find another use for the property, for example as residential accommodation.

The underlying growth in the care providers sector, as well as the potential for companies consolidation and transformation also provides attractive opportunities for Private Equity investors. The combination of strategic financial investors with seasoned entrepreneurs offers a distinctive value proposition to

capitalize on long-term market dynamics, increasing further privatisation due to public expenditure reduction.

It is also important to ensure that the fund manager has the necessary expertise to access capital, find local over-the-counter opportunities, and structure the deals. Partnerships with operators with a strong reputation and recognized financial capabilities, and adherence to ESG and sustainability principles are important factors to look for when investing in the sector, especially in a modern environment where investors primarily work with funds that share their values and vision of this world.

Conclusion

Compared to other asset classes, healthcare private markets offer attractive returns, despite increasing competition among investors. In case of an upcoming recession this sector will have more defensive qualities. Seasoned investors who are looking for compelling investment opportunities and take a holistic approach are increasingly integrating healthcare investments into their investment strategy with sustainability and ESG in mind thus making the industry more and more open to all types of investors. ●

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