Conference edition

Golden opportunities from the graying population

Five investment prospects from global aging and institutional care

Introduction

The world is going gray. Our global population is aging at an unprecedented rate that is creating alarm for cash-strapped governments — but also attractive new opportunities for investors.

Much has been written about the scale of challenge facing governments as the world moves from 800 million over-65s today to 1.4 billion by 2030.[63] What are less well understood are the win-wins that the business community are creating through investment in innovative care service models and infrastructure to meet this growing need.

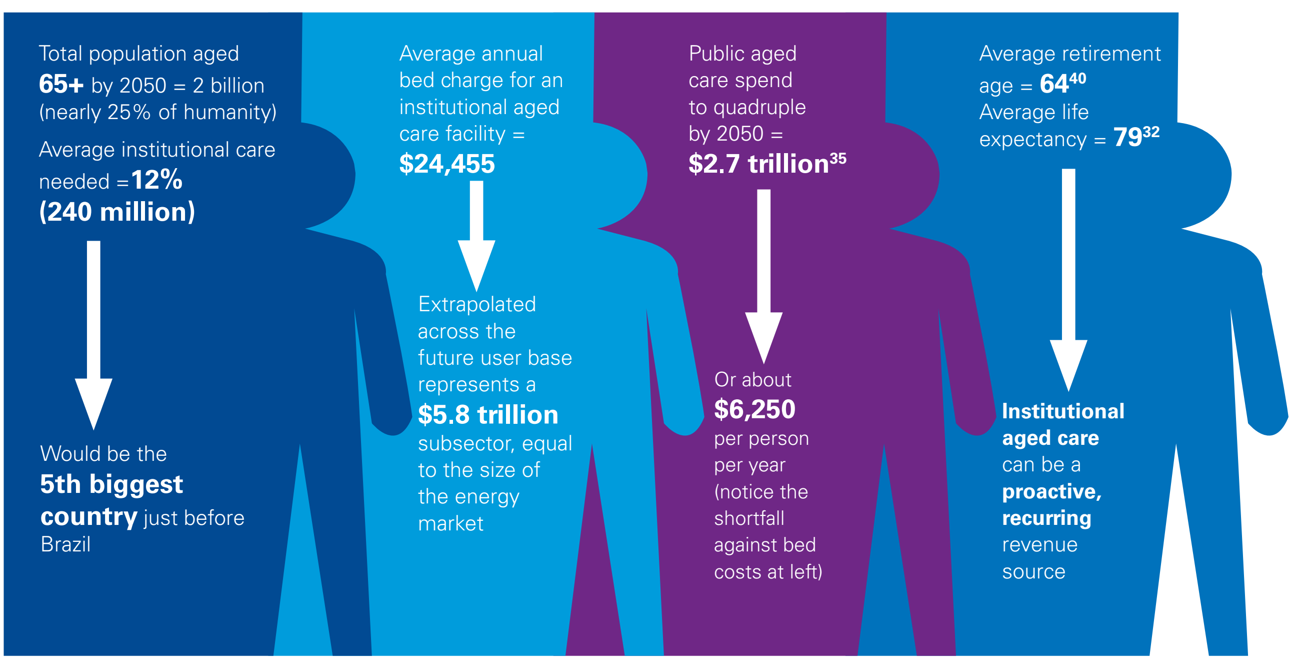
This issues brief — with input from experts in 20 countries — offers a concise overview of emerging trends involving aging populations from an investor perspective. In collaboration with Canning House, we asked how the private sector should be looking to intelligently impact institutional aged care to produce a positive return both financially and socially, converging on five key themes. The report also includes an overview of how some of these themes are playing out in the world's major aged care markets.

Aging by the numbers — scale of the opportunity

Over the next 15 years, the proportion of people aged over 65 globally will grow from 11 percent to 17 percent, adding 600 million more elderly people. By 2050 this share will have doubled to almost a quarter of all humanity.[63]

Industry forecasts anticipate that around 12 percent of over 65 will use institutional care at any one time,[27] meaning that the number of potential care residents stands to grow by 68 percent over the next decade and a half. With the average institutional care bed costing around US$25,000 a year,[1,15,17,19,21,50] no government is currently positioned to afford these kind of rises in needs. For example, in the UK, demand is growing 9 percent per annum faster than public investment.[12]

Target market



New approaches and new sources of financing are needed to match demand with supply. The diagram on the previous page highlights some of the key figures for this subsector (primarily in OECD markets).

Furthermore, experts say changing demographics such as smaller family units and less-traditional lifestyles mean families are increasingly unlikely to take on direct care for their elderly — so the share of those in institutional care may go up. Quality is also a growing concern, with squeezed providers in some countries such as the US and UK leading to public scandals over mistreatment and poor coordination between care facilities and medical services.

While many governments are under duress, some commercial players are seeing an opportunity to innovate.

Individual and corporate investors alike are showing increased attention and market activity in aged care. A record number of mergers and acquisitions took place in the subsector in 2014, with more than 280 transactions (up 27 percent from 2013) worth an estimated US$25.75 billion (up 121 percent on the previous year).[52] Talking strategy with those that are most focused on growing the aged care industry, five key themes stand out:

1. Opportunities in private-pay models are large and attractive

For most investors worldwide, the contemporary option in institutional aged care so far appears to be in high-end retirement villages with a bolt-on care offerings that target the wealthy. Business interest and activity in this market continue to grow strongly, attracted by large and fairly quick returns, and in many cases less acute medical needs.

In Canada and Singapore, for example, skilled-nursing institutions that are well-positioned from a resourcing perspective are pivoting to become residential homes. India, meanwhile, is seeing an uptick in private care providers becoming interested in long-term facilities with geriatric services, although much remains conceptual to date. In the UK, while retirement villages remain at the infancy stage compared to other nations, there has been success in hotel and hotel-like upgrades for private elderly customers of residential care homes. Mexico has begun to see foreign market entry for privatized high-end aged care, via partnerships with hospitality groups such as those coming from Spain.

Beyond the high-end of the spectrum, an increasing number of services are being aimed at the middle-income market, which in most countries represents a growing and powerful purchasing group that includes tens of millions of boomers. Two-thirds of New Zealanders over 65 in fall into this category, for instance.[38]

The Netherlands has observed the traditional elderly care homes undergoing a reorientation, struggling with the heritage of real estate and lack of strategy, to attract more of the middle class buyers. This requires a streamlining of operations, lean management teams, but yet still solid quality to reduce the stigma of entering the homes during earlier phases of life. The high(er)-end private sector players in the Netherlands are also starting to design solutions for the middle class. At the same time, Indonesia is seeing non-health sector players getting engaged, including retail banks with contracted physicians providing basic health services to the elderly. ROI is attributed to healthier patrons increasing the likelihood to meet payment obligations and also being loyal customers for longer.

Closely related in the pure private sector is the need for people to better position themselves financially by managing personal assets more wisely and at earlier life stages, including areas like pensions and mortgages. Countries such as Argentina and India have underdeveloped social insurance programs in place and it's not uncommon for inflation to eat away at retirement savings over time. At the same time, even universal models like those in Switzerland are increasingly feared to be insufficient to support the soaring future demand outlook for elderly care.

In Brazil, the world's second-largest private insurance market, only 27 percent of people over age 60 have a health plan, a figure that drops to just 20 percent by age 80.[24] "We are in a sandwich situation — adults are not finished caring for their own children, yet also having to take care of their parents", said Ricardo Soares CEO and founder of Brazil Senior Living.

Nevertheless, new insurance models and products are appearing. In France less than 1 percent of long-term care spending came from private insurance in 2007, but 15 percent of the over-40 population have a protection plan in place now.[33] Countries like Japan, Singapore, and New Zealand are leading the charge on compulsory contribution schemes that start earlier in life and are expected to increase a reliance on aged care services while also available disposable income for cross-sell and up-sell opportunities.

"The private sector appears best-positioned to develop innovative models of care, source capital, and deliver gains to both individuals and their families," said Chai Chua, New Zealand's Director General of the Ministry of Health. "The private sector is better placed to respond to changing preferences and demands of older people who are increasingly aware of the options available to them."

The trend toward private and to some extent public protection schemes is also expected to generate downstream opportunities such as the acquisition of operators by insurance funds observed in Japan and other financing mechanisms like the Immediate Needs Annuities policies developed in the UK.

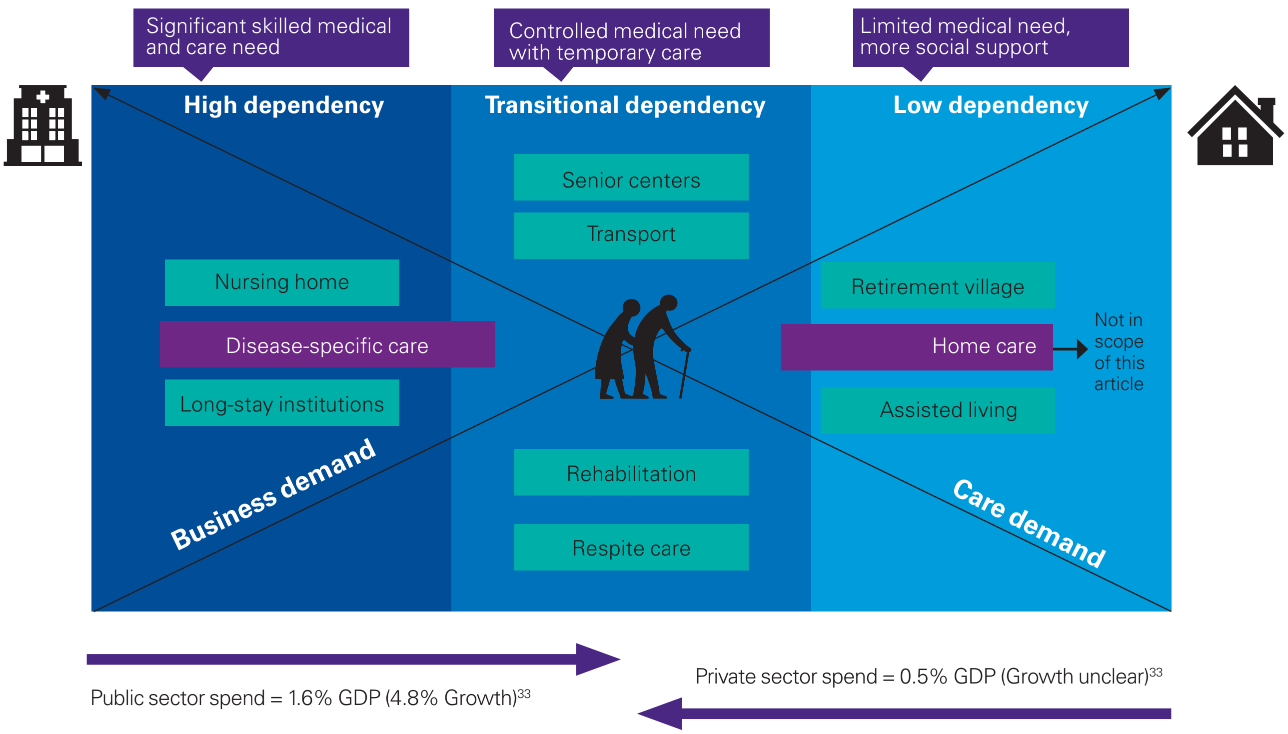
2. But the public sector offers its own opportunities

The almost exclusive focus of some investors on the private sector is creating opportunities for businesses that can engage with the struggling public sector to offer new approaches to meet demand, potentially reduce the cost of delivery, and make a return. The diagram below shows the various types of institutional aged care and the tendency for public and/or private funding for each. Interestingly the care demand for high-dependency facilities is increasing due to demographic trends, yet the provision of low-dependency areas (such as retirement facilities) appears to be the current focus.

Countries are increasingly embracing mixed systems of financing and provision in aged care. Even traditionally public-dominated markets such as the UK have made widespread use of private providers to deliver aged care, as the Netherlands and Australia have also been doing for some time. A recent step-change in the New Zealand market means 60 percent of aged care is now for-profit[5], and in Italy nearly the whole subsector is private.

These mixed models are leading to far greater experimentation with new financing and partnership models between public and private sectors. One emerging trend is governments tendering for private sector partners to renovate and expand aging and under-sized facilities. In Canada, 75,000 care beds have become available for licensing,[5] which is seen as an AAA-credit type of receivable for investors. In Australia, a reform package worth

Dependency levels



US$2.75 billion has been launched to improve access, promote choice, and modernize contributions[5] — all with support from the private sector. China's state-owned enterprises are already raising money overseas. Russia has seen its first successful Public-Private Partnership (PPP) project to build aged care homes with integrated facilities.

Social bonds, meanwhile, are generating attention. In Australia, operators are seeing payments linked to the quality of accommodations via bonds in roughly the US$150,000 to US$750,000 range and called 'retirement deposits'.[5] In New Zealand, the social bonds concept is being tested with the commercialization of social housing. Social bonds in the UK promise a 7 percent annual return plus 5 percent of net profits in the real estate sector.[5]

That said, questions were raised as to whether social bonds can be scaled to work everywhere, such as in LATAM countries where aged care challenges are particularly daunting and complex. And taxes were noted by several interviewees as being prohibitive in the subsector, such as in Russia and Spain with their application of Value-Added Tax (VAT) on aged care services, which do not face such treatment in markets like Germany, Switzerland, or the UK.

Other public-private interactions have included the conversion of not-for-profit entities in Japan to being authorized to accumulate up to 30 percent in profits amid government distress and the desire to make investment more attractive.[5] Meanwhile, innovative crowd-funding campaigns in the US are driving some projects: one entity raised US$1.8 million in pooled online investors in less than a month, while another fully-funded two senior housing projects by committing to 20 percent returns over 5 to 10 years.[16]

There are opportunities as well for private investors to work with governments to design the mechanisms around the increasing trend of direct payments to patients and families that can combine both health and social allotments — rather than paying the providers directly. Australia, for example, has moved to this format over the last 5 years.

On the informal workforce front — which includes but is not limited to the untapped labor of families and care givers supporting the elderly community — economic loss is cited in the form of lower productivity and time away from work. But there appears to be an opportunity to better-mobilize such human resources domestically and internationally to offset a lack of appropriate staffing. Staffing usually represents the primary expense for aged care facilities and causes the subsector to appear unprofitable and unattractive, particular in the wake of minimum wage increases in places like the UK.

Singapore has launched tax breaks for children who live near their parents and provide care, and Japan has instituted the concept of 'time banking' — a system that rewards people with credits for volunteering to help the elderly or disabled and allows volunteers to use these credits for their own care later in life.

Germany as well reimburses care givers for their time, while in the US elders can pay an annual fee of US$30 to join a community of informal volunteers (and up to US$300 for higher levels of assistance).[3] Similarly, it is becoming increasingly common to employ the elderly themselves. In the UK, one in 10 people over 65 are working thanks to flexible schedules that are now available.[5] In Japan, more than 800,000 elders have joined part-time work centers — a start-up concept.[5]

3. Consolidation and construction of facilities is on the rise

A clear trend according to experts interviewed is the move toward maximizing of resources by combining facilities. Many noted that the subsector is fragmented, as in Spain, with the five biggest players there serving only 9 percent of the market, while in Australia 92 percent of all operators have just six facilities or fewer.[5]

"Fragmentation of health systems and financing leads to fragmentation of services like aged care," said Ferdinando Regalia of the Inter-American Development Bank.

Strategies include vertical consolidation — services offering residential, nursing, and even higher-touch options like "memory care" communities for dementia patients, as seen in Australia and Netherlands. Where facility downsizing is not an ideal solution, horizontal integration is occurring, including co-locating aged care with related services such as chronic care, retirement communities — or even with infant nurseries.

This is the case in Spain where, due to low coverage ratios as compared to peer countries (4.2 percent versus 5.2 percent) and a 700,000-person waiting list, no bed reductions have been observed (despite a push toward home care) by moving chronic-disease patients into aged care facilities.[14] Admittedly the transfer process is not easy due to hospital services typically being free, unlike residential services.

"Home care services are not necessarily a substitute for residential care though," said Inaki Ereno of Sanitas (Bupa entity in Spain). "Home care services have been growing significantly over the last few years, but mainly due to political optimism that home care will solve the financing issues of the health system. There will always be a need for residential care services".

Spain is also interested in quality accreditation for institutional aged care, something that's expected to improve professionalism and drive consolidation for the subsector.

In Russia, we were told that too many entities focus on "mono-profile" models due to complexities in licensing, investment requirements, and marketing of a diversified services portfolio. Ultimately there is a play here in the form of integration and also in creating an aged care ecosystem that allows the businesses to function as a one-stop shop for a diverse range of aged care needs.

In Italy, the opportunity for investors to buy the pieces, integrate the services, and then exit was noted by industry experts we interviewed. Divestitures can occur as well, and such is the case in the UK, where a major private operator sold off its learning disabilities arm in order to focus on its residential care business.

Surprisingly, there are relatively few examples of international operator brands in aged care, due in part to local market nuances, myriad regulatory policies, and in some cases, even domestic protectionism. Still, Australia is seeing some progress here, with several multi-billion-dollar organizations being listed on the stock exchange — a move seen as intent on raising capital to then go abroad.

Brazil, meanwhile, enacted FDI legislation last year that includes efforts to push institutional aged care beyond predominantly mom-and-pop operations and toward an influx of foreign entrants looking to develop franchise models. Canada is also encouraging opportunities that go beyond the many family-run operations, while Japan is seeing more cross-border transactions in elderly care in the form of PE investors rather than care operators themselves.

There was some debate among interviewees on the topic of construction, including around built-to-suit elderly facilities amid increased consumer awareness of available options and rising expectations for tailored services.

LATAM nations have seen increased construction of day centers to better meet user needs. In India, built-to-suit designs featuring handrails, trained staff, nearby hospitals, and doctors on call have become more common although it was commented that the related build-to-sell-quickly strategy probably isn't realizing the value of land appreciation there.

We heard similar feedback about build-to-sell in China, with investors seeking quick returns but failing to improve aged care overall. In the ASEAN region there is strong interest in Greenfield projects and building of international brands for longer-term payback.

Land values are indeed generating an interesting discussion. Australia's government is hesitant to deregulate the aged care subsector due to potential arbitrage on land values, while New Zealand operators are cashing out on the same: of 32,000 beds in the country, half are more than 20 years old[5]. Rather than invest in rebuilding the business for longer-term gains, the operators are making a quick buck on land appreciation buy-outs. In Spain likewise, there are concerns over the high land and business valuations, and overall lack of risk-sharing among investors.

As for ownership rights, the model in India is for the family to purchase and retain a residential unit for use by current and future generations. In the ASEAN region the elderly want to own property rather than rent — in contrast to the developers and their concerns about upfront capital and exit flexibility. Here the concept of long-term leasing has begun to take hold to share the risk. Buy-to-let schemes have appeared in the UK too, although these are still considered to be somewhat controversial.

From a consolidation and construction financing perspective, interviewees commented on the changing scene in terms of moving away from traditional bank loans and toward a cast of new sources such as construction companies themselves, developers, international private equity houses, start-ups, as well as other private sector players like utilities companies, insurers, and technology groups.

4. Investors are looking for business model innovation

All of the above is driven by the need for institutional aged-care services to innovate. Hot topics at the moment include asset-light models and light-touch care, which emphasize close partnerships with other vertical players — hospitals and community centers — and horizontal players in transportation, technology and housing.

One innovative investment concept emerging in China involves an online-supported model designed to provide elderly customers with easy access to an array of custom services and assistance in areas such as travel, shopping, and even financial management.

In the Netherlands conversely, government downsizing of beds, to the tune of 25 percent, in favor of light-touch care has since led to overcapacity and shrinking margins in the subsector.[5]

We asked interviewees to identify the innovative qualities they would look for among businesses to invest in (technology aside), and their responses included:

Innovative qualities

A strategy for case-mix balance (public, private, awareness of social inequalities)
Location science for placement of facilities (devolution trends, urbanized vs coastal, demographic targeting)
Upgrades and hotel-like options for incremental revenue streams
A grip on streamlined operations, such as workforce wages
Strong management teams that are both business and quality-minded

In the UK, high-end operators are maintaining a mix of public and private consumers in order to capitalize on health and social funds, although admittedly many of the companies are trying to reduce reliance on government patients.

In India, location is critical and we were told that too many prospective players are targeting countryside sites rather than the more logical urban opportunities, which enable better connectivity between elders and family members.

Spain likewise described the need for lean techniques in what today is a labor-intensive operation featuring one care staff member for every two residents. New Zealand fund managers are buying aged care services — but only if the operators can demonstrate a viable commercial model. Sounds obvious in most industries, but aged care is experiencing a transformation in thinking.

"Productivity improvements will become a key theme of the sector over the next decade", said Chua. "This may take many forms, like how to use family and informal care givers, how to better use technology, or how to measure and demonstrate value".

Institutional aged care is also increasingly expected to be consumer-oriented and with emphasis on the appearance and desirability of facilities being offered.

"People are entering a nursing home only for the last 10 months of their life", said Jorden Sleeth with KPMG Canada. "The perceived low quality of nursing homes is seen by people as a last resort or optional at best".

An ASEAN survey conducted by KPMG revealed that priorities today among consumers seeking care in those nations were operator brand reputation and the reputation of hospitals and medical services in partnerships.

"Branding has become increasingly important as a means of ensuring access and quality to a broad customer base and demonstrating success to the investors", said Grainne Moss of Bupa NZ.

5. Turning cultural adaptation from barrier to asset

Perhaps the most-overlooked and difficult to quantify aspect of forward-thinking business opportunities in institutional aged care is the influence of culture, customers, and traditions on market expansion. We heard this comment time and again across the 20 countries interviewed, and it includes the need for attention to traditional family structures, customs of owning vs renting property, attitudes toward birth and death at home, and the view of institutional aged care in general that still in some cases carries negative connotations.

Cultural barriers seem particularly significant among BRIC nations and in the LATAM region, where previous efforts to deliver copy-and-paste projects based on North American or European approaches have proven inappropriate, unpopular, and unsuccessful.

In many of these markets, such as Brazil, the concept of a retirement center does not really exist. Instead, the country is looking at investments in hotels offering medical assistance capabilities that are easy to reach for family members.

"The decision to use an aged care facility is not rational, it's mostly based on emotion — I would say 90 percent emotional and 10 percent rational", said Soares.

Brazil is also creating a point system to determine eligibility — the higher the score (need), the higher the level of assistance provided. There have been some negative case studies in Brazil to learn from too, such as a doctor who had a few elderly patients and decided too quickly to start a side business with 25 to 30 beds and a hired operator. The initiative was a failure, delivering poor quality, low revenue, and ultimately an abandoned venture.

Similarly there are stories of others in Brazil charging far too much or focusing on the high-dependency population, causing operating costs to soar and confidence in payer support to decline. Brazil is moreover learning to target the mid-to-high-end market, rather than extreme wealthy customers who can instead afford home care, as well as using shared rooms to increase affordability.

Elsewhere in the world, India has a no-lease attitude and facilities are sold upon completion. Families buy individual rooms for long-term possession, generally paying the equivalent of US$40,000 to US$120,000[5]. In Singapore, assisted living is still seen as optional and thus adoption rates are low. Rather, multigenerational facilities are built so that families can stay together. Similarly, in Russia, it's common for two or more generations to occupy the same residential unit and to help take care of elders.

Malaysia is one of the more advanced ASEAN countries regarding institutional aged care and has found success in a model that is better for developers and operators but is challenging the cultural paradigms — that of a "lifetime lease", whereby ownership of the property returns back to the lending firm once the occupier is deceased.

Chile, with a low number of aged care beds despite a high GDP/capita (a misleading indicator due to the social inequalities), is looking at cultivating the informal market and also the outbound expansion of insurers and other large corporations with cash, with interest in diversifying. In Mexico, where the domestic market is not attractive enough, new facilities are catering to institutional aged care among foreigners, especially those retiring from the US.

Conclusion

The world's aging population — a trend the United Nations describes as "without parallel in the history of mankind" — is creating alarming issues for governments. The response involves the scale and challenge of reforming dated care systems, and finding new sources of investment and finance.

"The current model is unsustainable due to growing out-of-pocket payments and demographic variations across the country", said Alberto De Negri of KPMG in Italy. "The whole system is undergoing a review."

"Typically if you have the means to contribute, you will," said Nicki Doyle of KPMG Australia. "While there is still heavy government subsidization, we are seeing new payment models formed and also increasing expectations for and from the consumers".

"A variety of players are interested in the subsector now due to the rapidly-aging population", said Darren Loh of KPMG in Singapore. "But the key challenge has been adoption, from a cultural perspective".

A vast array of investment opportunities are emerging to offer practical, affordable relief for the elderly as well as attractive and sustainable returns for investors amid ongoing societal changes.

"Aged care is a critical challenge across the world, and the demands on the sector are only going to increase", said Roger Widdowson of the KPMG Global Health Centre of Excellence. "It's fascinating to see how countries are starting to innovate with new approaches to common challenges of insufficient supply and changing social norms".

"There won't be a 'one size fits all' model, but aged care should remain attractive for investors globally, including on the institutional front", continued Widdowson. "The future is likely to see more collaborations between public and private financing with a perpetual investment cycle as capacity is increased and modernized. We look forward to monitoring developments in the sector, and expanding our research over the coming months to review the evolution of home care models too".

Appendix: An overview of major markets

In **Canada**, another land of ageing baby boomers who now account for about 27 percent of the population, "retirement home demand is on the rise, with higher-end facilities charging residents the equivalent of up to US$4000 monthly", said Sleeth.

In the **US**, there is "growing investment interest and activity that's been diverse and innovative amid the search for productive solutions to an institutional aged care dilemma, hitting the country particularly hard as its vast bulge of baby boomers continue to age", said Darron Gill of KPMG in the US.

"Among primary investment opportunities in the US are Skilled Nursing Facilities (SNFs), Long-Term Care (LTCs), and Continuing Care Retirement Communities (CCRs)", said Janet Nicoll of KPMG in the US.

"Facilities need to be well-run as margins are relatively thin", said Nicoll, "and investors are being advised to ensure that their acquisition or development of facilities includes strong management expertise to ensure successful operations and returns".

In **Mexico**, "foreign investors already have aged care in their sights", said Lorenzo Gomez Morin of KPMG in Mexico, "where strong demand for care in various forms is outstripping supply at the moment. Mexico has begun to see foreign-investor interest and activity in privatized, high-end aged care via partnerships with hospitality groups."

Mexico is also seeking to take advantage of the large base of consumers who have moved to the resort areas from abroad, especially those coming from US.

In **Brazil**, recent changes to legislation have affected services to some degree, for example making it more difficult and expensive to employ nurses in personal homes. There has been growing interest among PE investors to develop care homes, rehab centers, and other innovative delivery to meet growing demand.

In many cases, developers build and then lease to operators, who traditionally are being funded by banks. In the **UK**, "primary investment opportunities currently include a focus on higher-end retirement villages, care homes, and REITs", said Steven Bunn of KPMG in the UK, "with strong demand driven by an increasingly wealthy elderly population who are more aware of the options in later life".

"To some degree, the private market is trying to reduce dependency on public clients when government funding constraints remain an issue, and implement hotel-like facilities", said Bunn. "Retirement villages with bolt-on care services are in the infancy stage compared to other markets abroad but are beginning to become more popular".

Spain offers an attractive opportunity to capitalize on the aging population and changing attitudes toward institutional care, although there is some caution amid the country's ongoing economic turmoil. Investments are involving various private equity or public-private partnership schemes along with traditional retirement and nursing home operators that moving into other areas such as home care and innovative remote-monitoring services.

"Market consolidation is happening in Spain and there is room for more", said Candido Perez Serrano of KPMG in Spain.

"People still prefer a retirement home to a nursing home if they can afford it," said Sleeth, adding that Canada has seen some foreign entrants into the private-model sector of the market. Developers typically have been constructing facilities and then selling them to operators.

India's key investment areas include retirement villages and assisted-living residences, and "as demand is increasing, so are investment opportunities", said Satya Aggarwal of KPMG in India. "The public system has to a large degree overlooked geriatric care and this is becoming an increasing focus area for the private sector", said Aggarwal.

Although much is still conceptual thus far, India is also seeing increased interest in creating longer-term private residences that are built-to-suit for the elderly and led by construction companies and existing care providers. Facilities are sold upon completion under a system typically seeing families purchasing a residential unit that then stays within the family's property holdings for future use.

In **China**, "senior living is a hot topic", said Jenny Yao of KPMG China. "Compared with developed countries like Japan, UK, and US, the senior living sector is at early stages of development. However, with a-fast aging population and the impact of the 'one-child policy', the demand for affordable and high-quality senior living care will only become greater. This creates huge commercial opportunities for both domestic and global investors", said Yao.

“A number of property developers and insurance companies entered the aged care market over the last 5 years”, said Yao, “but many of them are struggling to find a profitable business model. But this has not stopped the interest in the sector, now attracting more innovative players as mentioned in this report”.

In **Japan**, KPMG experts say financial investors have been active in the aged care space, including a recent major deal that saw an insurance company acquire a leading facility operator. “Funds are also looking to invest, and now three REITs are listed on the exchange,” said Keiichi Ohwari of KPMG in Japan. “Growth in privatized elderly care is booming, although we’ve seen limited movement to date from foreign operators”.

In the **ASEAN** region, there is growing demand — and investor interest — in assisted living residences, as well as nursing homes although to a smaller degree to date. Existing hospital and nursing home operators also are trying to expand or diversify into elderly care.

“PE groups are becoming more interested in nursing homes on a returns basis”, said Loh. “That end of the market is not very sexy, but it’s expected to boom”.

Australia’s institutional aged care has historically been state-based and dominated by not-for-profits, particularly among nursing homes compared to retirement communities. “But changes are emerging”, says Scott Mesley of KPMG Australia.

“We are seeing increased private-sector penetration, including by PE funds”, said Mesley, noting the existence of multi-billion-dollar companies now active on the country’s stock exchange. Making headlines in Australia in the last few years was the launch of publicly-traded Japara Healthcare Limited, an Australia-based residential aged care operator with about 35 aged care facilities and four retirement complexes. Activity in the private sector is targeting the higher end of the market; that said, there is also opportunity for efficient operators to meet mid-market demand.

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Notes

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