

MARKET FOR NURSING CARE IN GERMANY

Structure and market situation



 **SGI Health Care AG**

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PRELIMINARY REMARK

The senior care market is a dynamic growth market that is becoming more and more important due to the increasing demographic change. Health and social care properties have established themselves as a popular asset class and have attracted growing interest, including among international investors, concerning investment in properties, as well as in operating companies. However, there are numerous specifics to be aware of in the German nursing care market. The following description presents the basic structures and conditions of the senior care market in Germany.

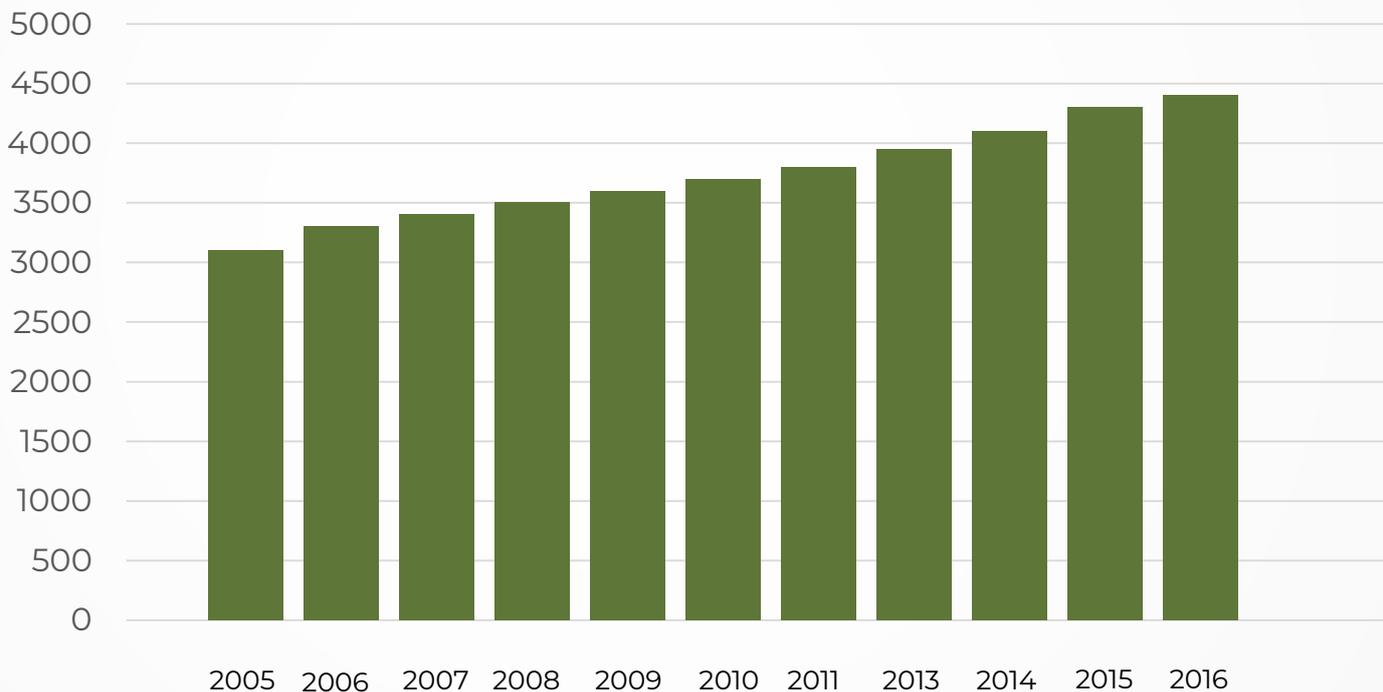
Nursing care insurance was introduced in Germany in 1995 as compulsory insurance to cover the risk of requiring long-term care and has since become its own branch of social insurance. Under this system, care is divided into three areas: inpatient treatment in nursing homes, outpatient care at home by healthcare providers or care given by family members. In terms of investing in this sector of social welfare, inpatient care of senior citizens plays a key role due to their reliance on special-purpose facilities.

The nursing system is subject to strict legal regulations. This concerns both the financing of care services and inpatient care, as well as legal regulations for operating nursing homes and the structural design of health and social care properties. While social insurance law, including nursing care insurance, is regulated on the national level as federal legislation, the laws on operating nursing homes and for their structural design have been exclusively under the jurisdiction of the Federal States since the 2006 federalism reform. This means that while numerous legal regulations must be observed, it offers the advantage that reliable and predictable framework conditions are in place.

THE IMPORTANCE OF THE NURSING CARE MARKET FOR THE SOCIAL ECONOMY

The nursing care market is an important economic sector of the social economy. Since 2005, the German nursing care market has recorded an annual growth of around 5%, making it the third largest segment in health care after hospitals and outpatient medical care. The following illustrates the current situation of the social economy using graphs.

Health expenditure in EUR per resident

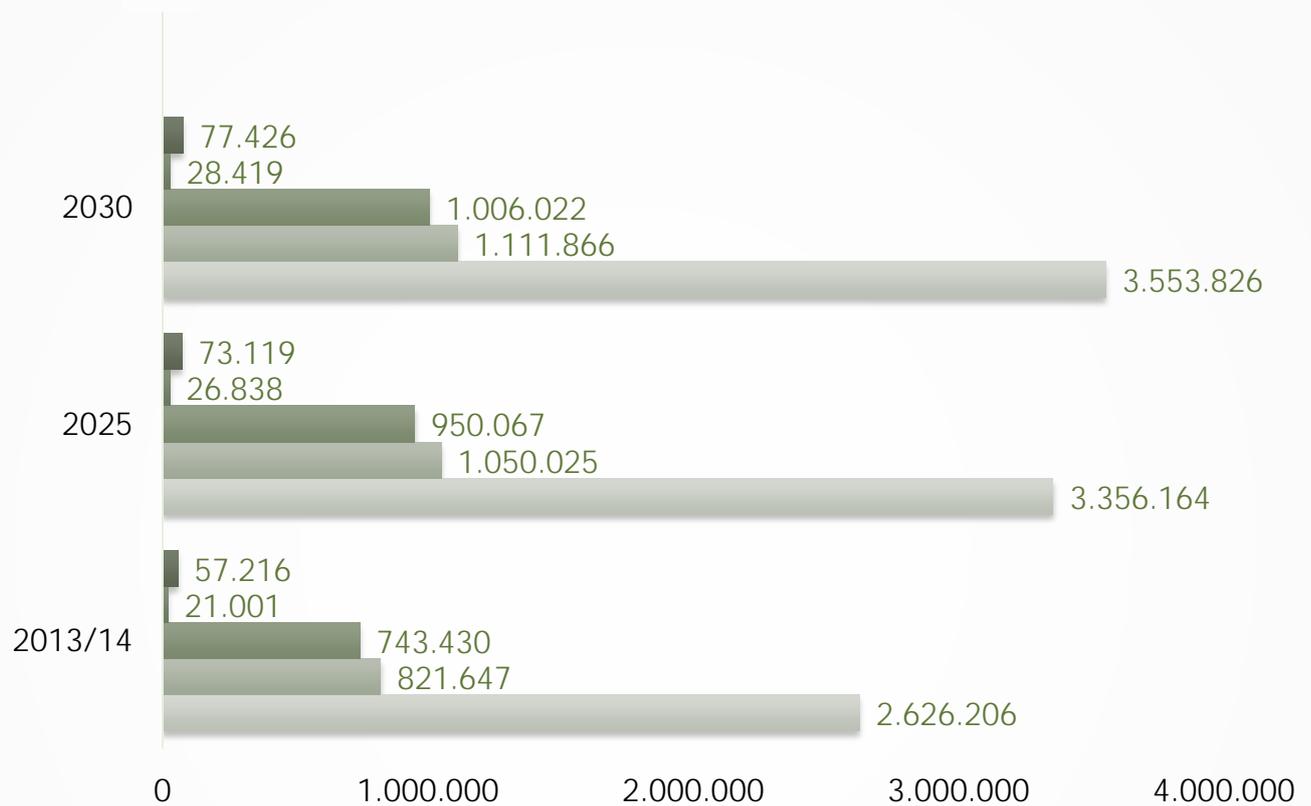


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As can be seen in the statistics above, health expenditure per resident has continued to rise in Germany since 2005. The nursing care market is both of great economic relevance, as well as of increasing significance for senior citizens.

Changing needs

Estimated number of people in long-term care



- Partial inpatient care
- Short-term care
- Long-term full inpatient care
- Total number of people in long-term care in nursing homes
- Total number of people in long-term care

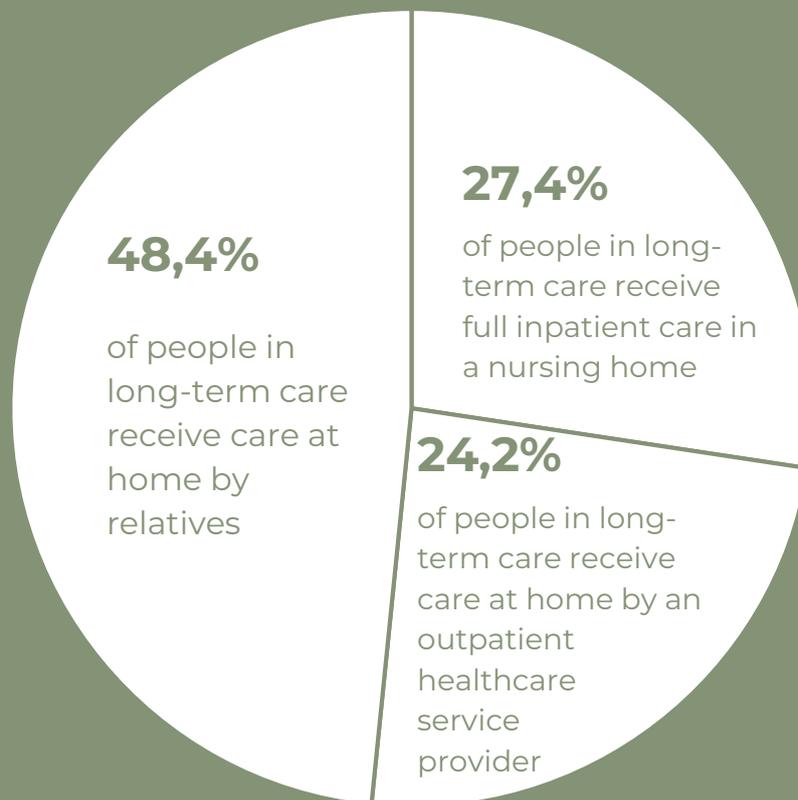
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The number of people in long-term care is expected to increase by a total of 26.1% by 2030. This development brings both challenges and opportunities for the market.

NURSING CARE MARKET - STRUCTURE ACCORDING TO TYPE OF CARE

Senior care is divided into three areas: inpatient treatment in nursing homes, outpatient care at home by professional healthcare providers or care given by family members. All three types of care are supported by nursing care insurance. There are nursing rates that are negotiated with the insurance companies for inpatient and outpatient care, and fixed cost rates to support caregiving relatives.

People in long-term care according to type of care



© Federal Statistical Office (2015)

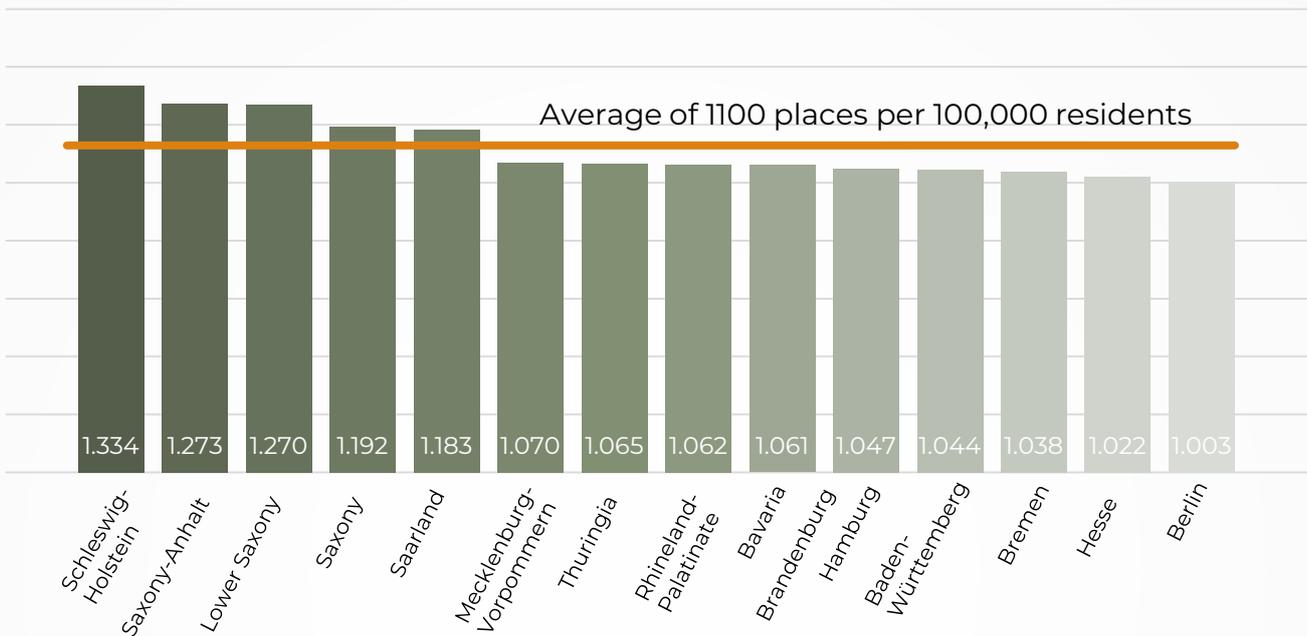
As can be seen on the diagram, around half of the people in long-term care in Germany are cared for at home by relatives. However, multimorbidity and the increasing occurrence of cognitive illnesses are making the issue of care increasingly complex.

Fewer relatives are able to care for their family members who require long-term care at home. Furthermore, the number of single households is increasing.

There is a trend currently emerging of an increasing number of seniors living alone whose family members often do not live nearby. This negatively impacts the potential for them to receive care at home. Since approx. 90% of caregiving relatives are female, care provided at home by relatives is expected to decrease due to the increasing number of women who work. It can be assumed that the percentage of people in long-term care who can no longer be cared for by family members will be distributed between inpatient and outpatient care.

THE CURRENT MARKET SITUATION

Inpatient care places per 100,000 residents



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There are currently approx. 11,400 inpatient care facilities throughout Germany, offering a total of 920,000 full inpatient care places. As can be seen in the graphic, an average of 1,100 full inpatient care places per 100,000 residents are offered in Germany. By contrast, there are around 3 million people in long-term care throughout the country. Inpatient nursing homes in Germany are, on average, at 90% capacity. Since the German nursing care market is highly fragmented, the over or undersupply of care cannot be quantified according to each Federal State. The demand for nursing care places varies greatly at the regional level.

The distribution of sponsoring companies also shows substantial differences in comparison to the state level. The number of private sponsoring companies is proportionately high, particularly in the Northern States of Lower Saxony, Bremen and Schleswig-Holstein with an average of 71.3%, while non-profit sponsoring companies are prevalent in Bavaria and North Rhine-Westphalia. Municipal sponsoring companies are rather underrepresented throughout Germany.

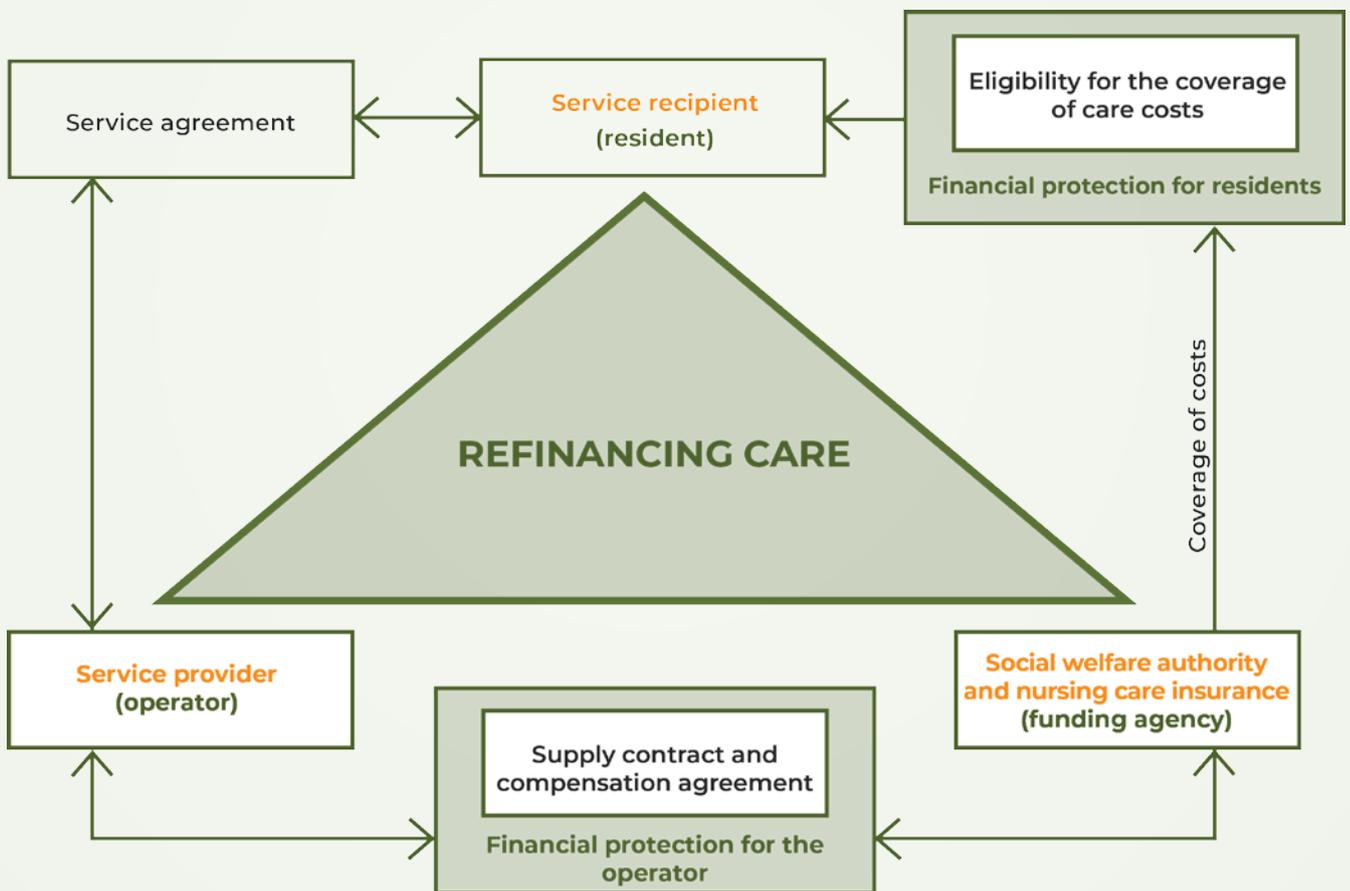
HOW THE GERMAN NURSING CARE MARKET WORKS

In Germany, a social triangular relationship exists between the person entitled to receive care, the service provider and the responsible public service and funding agency. Those requiring care are entitled to receive a non-cash benefit, such as basic care, from the responsible service and funding agency, e.g. the care insurance company. Since the public service and funding agency does not provide this service itself, it enters into a contract with the facility operator as the service provider. This ensures that the person in long-term care receives specific assistance from the service provider.

While there is an obligation for the funding agency to cover costs of services for the resident, the facility operator is normally paid by the funding agency as well as by the resident. If the person in long-term care has no income and therefore cannot pay their share of costs, the costs are covered completely by the social welfare authority. This ensures that people in long-term care are provided with care and lodging, which secures rent or lease payments to the facility operator. As a result, the social triangle effectively reduces the investment risk.

The social triangle

Nursing home contracts: investor-operator-resident



THE STRUCTURE OF NURSING HOME FEES

Nursing home fees are made up of three parts: nursing costs, board and lodging costs as well as investment costs.

Nursing costs

Nursing costs are negotiated separately for each facility between the facility operator and the care insurance companies. These nursing costs are used to finance care services for people in long-term care, regardless of the assigned assessment level, medical treatment, unless these costs covered by the health insurance companies, as well as social care.

Nursing insurance aims to meet the needs of all people in long-term care by providing comprehensive services. In order to meet this objective, both statutory and private nursing insurance companies pay contributions, including for inpatient care for people in long-term-care, which are capped as follows, depending on the assigned assessment level of the insured:

- **Assessment level 1: EUR 125 / month**
- **Assessment level 2: EUR 770 / month**
- **Assessment level 3: EUR 1.262 / month**
- **Assessment level 4: EUR 1.775 / month**
- **Assessment level 5: EUR 2.005 / month**

The assessment level is determined by the MDK (Health Insurance Medical Service) and is conveyed to the nursing insurance companies as an entitlement to support.

However, the nursing home costs for insured residents in long-term care are the same, regardless of the assessment level, as the last reform of care legislation introduced a flat-rate contribution specific to each facility (EEE). This is the basis for calculating the nursing costs and is defined as the difference between the actual nursing costs and the contribution paid by the insurance companies. Therefore, German nursing insurance offers only partial cover. On average, this contribution to nursing costs is higher particularly in the south of Germany compared to the other regions. The lowest contributions are paid in the new Federal States. The nationwide average flat-rate contribution is EUR 19 per bed and day.

Nursing care insurance does not cover costs that would not have been incurred without the insured person requiring care. This relates particularly to the costs for board and lodging.

Board and lodging

Costs for board and lodging are also negotiated separately for each facility between the facility operator and the care insurance companies. These costs cover the provision of food and drink, the provision of energy, water and waste disposal, cleaning of the rooms, the maintenance of the building and technical facilities as well as payment of other operating costs.

The board and lodging costs are to be paid by the people requiring long-term care themselves or by means of a supplementary social welfare benefit.

Investment costs

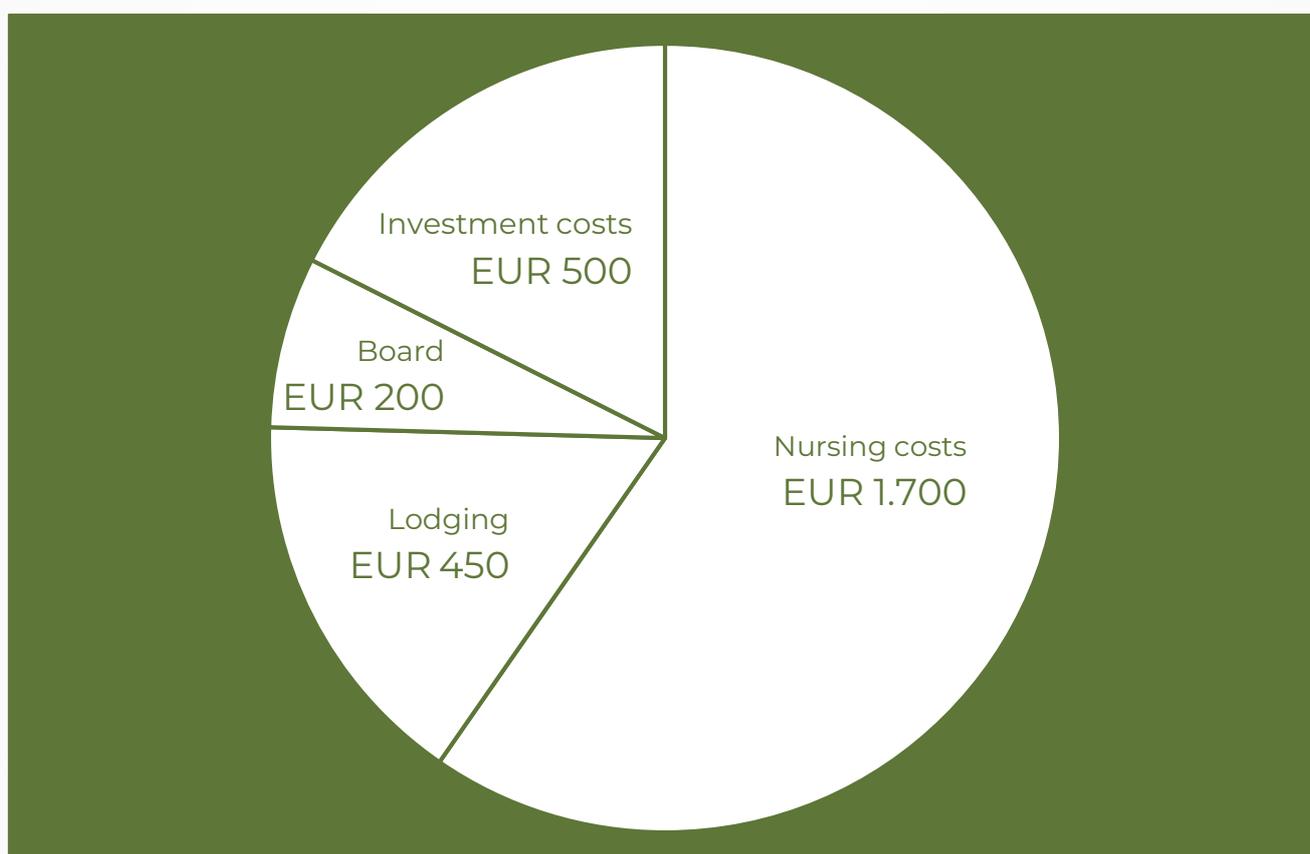
Investment costs are used to refinance the costs that are incurred for the use of the property and other assets that are required to run the nursing home. These costs generally include the construction and maintenance of the building, refinanced by rent or lease payments. The investment costs are based on the actual costs of the facility operator. These costs are calculated depending on the location and the facilities of the care property. An additional factor for the calculation is that investment costs are also dependent on the age and state of the care property and therefore vary between facilities. There is also great diversity between the different Federal States. In some cases, the investment costs are also dependent on ongoing funding. However, these funds to build the property no longer exist.

The investment costs are to be paid by the residents of the nursing home, who may receive support from the social welfare office if they are unable to pay this from their own funds.

The costs for self-payers can be invoiced by the nursing home operator and must merely be reported to the social welfare authorities. The costs for social welfare recipients must be negotiated with the social welfare authorities and are usually lower than the costs for self-payers.

Example calculation of nursing home fees

The following diagram shows an example of the distribution of costs that are incurred individually depending on the home. An example calculation shows the total costs for inpatient care of a person in long-term care with assessment level 3.



The costs shown in the diagram add up to a total of EUR 2850. After deducting the benefit amount paid by the insurance company, which is EUR 1262 for assessment level 3 for full inpatient care, a flat-rate contribution (EEE) of EUR 438 to be paid for care services and overall costs of EUR 1588 for the total service (care, board, lodging and investment costs) for the resident.

In summary, it can be said that there are many factors for competitiveness for German care market players particularly relating to costs.

DEVELOPMENT TENDENCIES AND TRENDS

If current studies are used as a basis for the future development of senior care, they show a growing supply gap as the current new construction activity is not enough to cover future demand. There is great potential for investments in this area. Essentially, the additional demand for care services is the result of three factors:

1. Demographic development

In future, the percentage of the population who are over 65 and over 80 will increase dramatically. While over 65-year-olds made up only 23% of the population in 2016, this will be 29.1% in 2030 in relation to the entire population of Germany.

For the over 80-year-olds, this percentage will increase from 6.1% in 2016 to 7.9% in 2030.

2. Threat to holdings

Many nursing homes no longer comply with legal requirements in the medium term. For example, the single-room quota is not met. In several Federal States, new buildings must also have a high quota of single rooms, including in the existing portfolio after a transition period. Furthermore, action is required due to a maintenance backlog and the necessary renovations to older nursing homes, as well as due to the lack of market conformity, i.e. older properties no longer meet market requirements, regardless of legal provisions.

3. Fragmentation of the operator market

The inpatient care market is very fragmented despite the many operator mergers and takeovers that have occurred recently. There are many smaller operators that will not be able to work economically in the long term.

These trends offer considerable investment opportunities:



Investing
in new buildings



Investing
in existing properties
and their refurbishment



Investing
in facility operators
and their restructuring

OPPORTUNITIES AND RISKS OF THE CARE MARKET

Opportunities

- The number of people in long-term care will continue to rise over the next few years.
- The nursing home rate, i.e. the number of people receiving inpatient care in nursing homes will increase proportionally.
- The increase in cognitive illnesses, such a dementia, is also driving demand, as this requires inpatient treatment and therefore additional care places.
- Increasing importance of care properties due to the shorter time spent in hospitals and rehabilitation clinics.
- Long terms for rental and lease agreements (often 20-25 years and extension options of 1 x 5 years or, more frequently, 2 x 5 years).
- Stable basis for refinancing by social insurance systems (nursing care insurance and investment costs covered by social welfare if necessary).

Risks

- There may be future changes to legal framework conditions. This particularly concerns legislation of the Federal States in terms of structural requirements. As there are longer transition periods for this, this risk remains limited.
- The competitive situation for nursing staff is expected to increase further in future due to the lack of skilled staff.
- The potential to refurbish older existing buildings must be examined carefully as not all properties are suitable. However, there is great potential in this area. New buildings may be constructed to replace properties that cannot be renovated or restructured.

7 REASONS FOR INVESTING IN THE CARE MARKET

1. Investment independent of economic conditions
2. Continuous market growth due to demographic change
3. Secondary market for resales: attractive appreciation
4. Stable rental returns due to long-term rental and lease agreements
5. Reliable rental returns from operators with good creditworthiness
6. Guaranteed rental income from the state guarantee to refinance investment costs
7. Investment security due to detailed location analysis

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