



## Long term care - a safe bet for investors

Looking ahead in Italy

Real Estate Update

10 Nov 2015

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The structure of the world's population is undergoing significant change. The OECD forecasts that globally the proportion of those aged over 65 will more than double to 16.2 per cent by 2050, with the percentage of people aged 80 and over trebling.

At the same time, in Italy, as in the rest of Europe, the requirements for health and social care services, and the connected public and private costs, will increase exponentially, especially as regards long term care services. The latest report from Italy's Ministry of Economy and Finance (RGS) notes a health and social care services bill constituting 1.9 per cent of Italian GDP in 2010 (around 33 billion euros) that is estimated to reach 3.3 per cent of GDP by 2060. Between 2007 and 2013 the public expenditure on health care services did not increase (principally because of the financial crisis), however, private expenditure in this area more than doubled.

Italy is in a unique position among its European neighbours, given the strong involvement of family members in care provision. Informal and home-based care provided by caregivers or relatives has historically prevented significant growth in the formal institutional care market. However, increased female participation in the workforce combined with low fertility rates and the new policy of medical assistance in hospitals (where, more and more, only

those with serious illnesses are assisted), have begun to change the traditional model.

"The considerable level of fragmentation means that there is substantial room for new entrants" In the area of services for the elderly (ie nursing homes providing long term care) the 2013 report by ISTAT (the National Public Institute of Statistics) notes that Italy has a significantly lower number of beds than in other countries and this limited development, coupled with excessive demand, has had a positive impact on occupancy rates, which range between 93 and 98 per cent for the majority of care homes.

Further, the top five private operators account for a relatively small number of those beds: the Italian care market has avoided consolidation, with the market still dominated by independent operators with one or two facilities. This is not the case in other countries, where the market has seen significant consolidation: in France and Germany the top three and five operators respectively manage a significant number of the beds available.

## The regulatory system

Following the 2001 reform of Title V of the Italian Constitution, the Italian health care system is now divided between the state and the regions, both having regulatory power in some areas. As a result, Italian health legislation varies from region to region, despite the government's attempts to establish the essential principles with national legislation, in order to coordinate and supervise services, and to guarantee an equal level of health care provision for all citizens throughout the country.

Regardless of the variation in the different regional regulations, the current system of health care provision is typified by a very high level of regulation, both in qualitative and quantitative terms. Certain requirements must be met, specifically: (a) structural requirements, related to the characteristics of the building where services are provided, (b) organizational requirements, related to the number of personnel and their qualifications and (c) technological requirements, related to the presence of specific technological equipment. Compliance with the numerous regulatory requirements is a prerequisite for obtaining and maintaining the administrative authorization which allows providers to offer health care services with the costs borne by both users and the National Health Service.

## Effect of higher levels of regulation on market participants

The considerable level of fragmentation means that there is substantial room for new entrants and potentially greater consolidation of private homes. The very small, small and medium sized independent facilities (on which the system was founded) are now in crisis due to the higher levels of regulation noted above. Such facilities are often typified by a family run management and it is thus very difficult for them to build economies of scale.

Against this background, we are witnessing a revolution in the provision of care services, with only those who have reached a high level of professionalism able to maintain the levels of competitiveness and profitability that allow them to stay in the market.

## Innovative financial schemes

Because of the huge costs connected to the construction and/or the acquisition of the buildings where services are provided, the use of innovative financial schemes is becoming essential.

The twin phenomena of growth and the increasing need for operators' professionalism allow for the development of economies of scale that ensure both the economic sustainability of the system and a level of competitiveness and profitability that boosts return on investment.

As a result, interest from investors in this asset class has increased, further enhanced by the relative stability of cash flows and the profitability of the initiatives. A few years ago, investors making a foray into this sector for the first time were rare and, notably, not based on an analysis and risk assessment approach specific to the sector (but rather on a purely traditional approach to real estate assets). Currently, however, models of structured collaboration between investors and professional operators are emerging.

In this scheme of cooperation, the operator has a precise scouting role as regards possible investment

opportunities and the subsequent management of the facilities acquired. In the leasing agreements (to be entered into between the investor and the operator) the parties agree to rules of governance, rights of exit, compensation schemes, information flows and collateral in the event of default by the operator.

It is easy to envisage a model similar to the one developed in the hospitality industry emerging: this model has, in fact, encouraged the entry into the Italian market of foreign investors focused on purchasing the real estate component of hotels, the management of which is then entrusted to large dedicated companies.

In addition, any risk still perceived by investors can now be further mitigated by the fact that the health care sector features systems of monitoring and accountability that guarantee a high quantity and quality of information, covering the level and quality of services provided, needs, and operators' performances.

## Return to Real Estate Gazette Issue 22

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