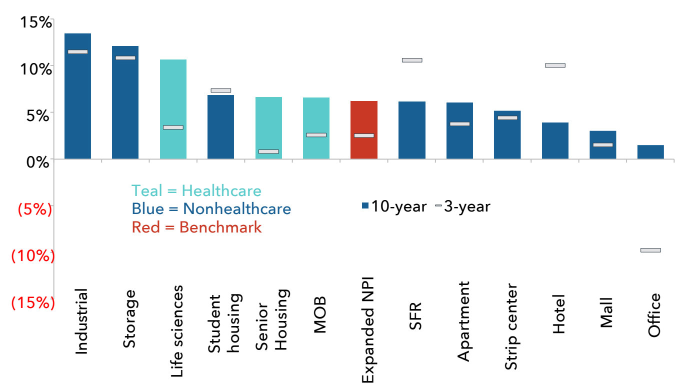
A positive prognosis for the healthcare property sector

Healthcare

Healthcare real estate (life sciences, medical facilities and senior housing real estate) is benefiting greatly from the growing demand for healthcare research and services fueled by the aging of the massive baby boomer cohort. By 2040, roughly one in five U.S. residents is expected to be older than 65,[1] and U.S. healthcare expenditures are expected to reach $7.7 trillion by 2032 – a 73 percent increase from 2022.[2] This anticipated rise in spending on drugs and therapies should promote continued investments in life sciences research. During the past 10 years, life sciences, senior housing and medical facility total returns have all outperformed the NCREIF Property Index (Expanded NPI), on the backs of favorable structural tailwinds in the form of demographic shifts and innovations in medicine and care (Figure 1). While healthcare property performance is no doubt tied to the broader economy and real estate cycle, utilization of healthcare real estate is largely need-based and tied to the growing demands of an aging population, effectively buoying absorption during down periods of the economic cycle and reducing volatility. Given these strong structural demand trends, healthcare property types should remain well positioned to drive attractive risk-adjusted performance in the years ahead.

Figure 1: Expanded NPI annualized total returns by sector

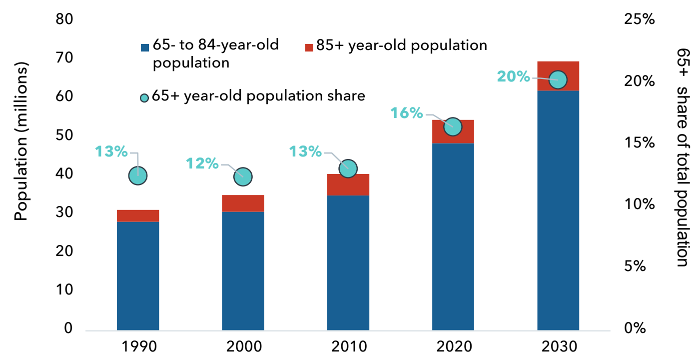


Sources: NCREIF, Clarion Partners Investment Research, Q2 2024. Note: Expanded NPI includes all NPI properties and all qualified alternative assets. Past performance is not indicative of future results. Please see the important disclosures at the end of this article.

Demographics and innovation are twin structural drivers of healthcare real estate demand

Demographic trends underscore the rising demand for healthcare-driven assets. Overall, due in large part to the country's declining birth rate and increased life expectancy, the U.S. population is aging rapidly. The 65-plus population in the United States is expected to grow at an average rate of 2.3 percent per year through 2030, six times the rate of the overall U.S. population (Figure 2).[3] The baby boomer cohort (people born between 1946 and 1964), which now accounts for 68 million residents, or 20 percent of the U.S. population, will undoubtedly drive a substantial rise in healthcare spending and innovation and greatly impact the healthcare system in the years to come.

Figure 2: Older age cohort population growth



Sources: U.S. Census Bureau, Moody's Analytics, Clarion Partners Investment Research, August 2024. Note: Past performance is not indicative of future results. Please see the important disclosures at the end of this article.

Innovation is another key tailwind for healthcare-driven assets. Elevated public and private funding and the continued growth in R&D spending should drive the formation of new healthcare technology companies, which, in turn, should fuel demand for life sciences real estate. The anticipated growth in healthcare spending should promote investments in life sciences R&D, as the country's aging population intensifies demand for innovative drugs and therapies. Although venture capital investment in life sciences companies has retreated from a historic high of more than $54 billion in 2021, annual venture capital investment into the sector has more than doubled since 2014.

Property types at the intersection of demographics and innovation

The intersection of an aging and wealthy demographic with the increasing prevalence of innovation-led industries is spurring demand for property types that directly facilitate healthcare innovation and serve the needs of an aging population: life sciences buildings, medical facilities and senior housing.

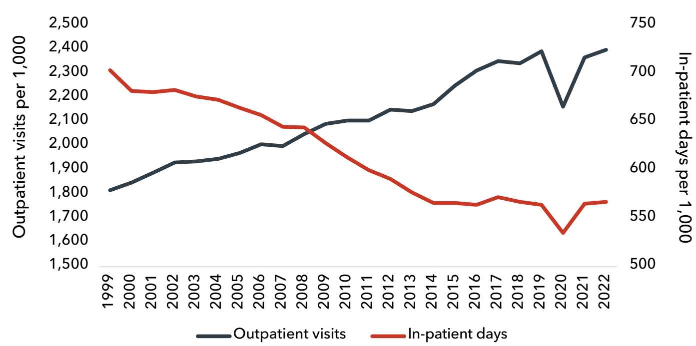
Life sciences and lab office

Propelled by public and private investment in life sciences R&D and a wealth of innovation spurred by novel drug discovery and the successful commercialization of new technologies, demand for life sciences real estate has increased dramatically during the past decade — a trend accelerated by the COVID-19 pandemic. Market conditions, however, have softened during the past couple of years, as a sizable supply wave pushed lab office vacancy rates to historic highs. Despite the broader sector's lackluster showing as of late, there has been a notable divergence in performance, with properties located in established life sciences clusters and/or owned and operated by experienced sponsors having outperformed. This delta in relative performance is expected to continue in the near future. The continued growth in R&D spending, anticipated rebound in venture capital investment and shrinking lab construction pipelines are reasons for optimism, moving forward.

Medical facilities

Supported by favorable demographic trends and a rise in demand for healthcare services, market fundamentals in the medical facilities segment remain healthy. The segment's relative outperformance during the volatile post-pandemic period is consistent with its historically steady performance across economic cycles, which is due in large part to its long-term lease structure, sticky tenant base, and need-based demand drivers. As healthcare systems look for ways to reduce costs, there has been a notable shift in medical visits from in-patient to outpatient care, which should continue to fuel medical facilities demand moving forward, while the anticipated lull in medical office completions in the coming years should benefit market fundamentals (Figure 3).

Figure 3: U.S. outpatient vs. in-patient visits



Sources: KFF, 1999–2022 AHA Annual Survey, Copyright 2022 by Health Forum LLC, Clarion Partners Investment Research, 2024 Q2

Senior housing

Considering the sheer size of the baby boomer cohort, meeting the healthcare and housing needs of this aging generation will be a challenge. The baby boomer generation is close to entering their 80s, and by 2044, all baby boomers will be over the age of 80 — the age when the demand for long-term care services becomes more acute. This demographic tailwind should provide strong support for senior housing demand in the coming decades. Supported by elevated home prices and stock portfolios, the median net worth of persons aged 75 years or older reached $334,000 in 2022, up from $296,000 in 2019, and nearly double the age cohort's median net worth in 1989, on an inflation-adjusted basis.[4] Today's aging households are in better shape financially relative to previous generations, which should contribute to outsized demand relative to prior cycles.

Outlook

Life sciences, medical facilities and senior housing are all poised to benefit from favorable demographic and innovation-related tailwinds, namely an aging population, increased investment in life science R&D, medical technology breakthroughs leading to longer life expectancies and an expected boost to healthcare spending. Additionally, shrinking construction pipelines across all healthcare property types should support healthy market conditions. With potential interest rate cuts on the horizon, what should be a more accommodative interest rate environment over the next couple of years should further aid fundamentals and performance for these three emergent asset classes.

Notes:
[1]U.S. Census; Moody's Analytics Forecast, August 2024
[2]Center of Medicare & Medicaid Services 2023–2032 National Health Expenditure Projections
[3]Moody's Analytics, August 2024 Forecast
[4]Federal Reserve, Survey of Consumer Finances: 1989–2022

CONTRIBUTORS

Indraneel Karlekar
Managing Director, Global Head of Investment Research

Jeremiah Lee
Senior Vice President, Research Officer

Robin Trantham
Senior Associate, Research Officer

CORPORATE OVERVIEW

Clarion Partners has been a leading U.S. real estate investment manager for more than 40 years. Headquartered in New York City, the firm has offices in major markets throughout the United States and Europe. With $73.2 billion in total assets under management as of Sept. 30, 2024, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk/return spectrum to its approximately 500 domestic and international institutional investors.

CORPORATE CONTACT

Hugh Macdonnell, Head of Client Capital Management | clarionpartners@clarionpartners.com | +1 212-883-2500 | www.clarionpartners.com