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REPORT 2024

REHABILITATION CLINICS IN GERMANY: BACKGROUND, RISKS AND OPPORTUNITIES OF THE ASSET CLASS

With new data, insights and expert interviews

REHAB CLINICS

THE DEMOGRAPHIC SHIFT AND INCREASING MULTIMORBIDITY IN GERMANY GUARANTEE SUSTAINED DEMAND FOR REHABILITATION FACILITIES. LONG-TERM SECURED CASH FLOWS VIA OPERATORS WITH STRONG CREDIT RATINGS PROVIDE OPPORTUNITIES THAT INVESTORS INCREASINGLY APPRECIATE IN THIS ASSET CLASS.

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FOREWORD

Medical rehabilitation property enjoys great popularity in investor portfolios due to its stable utilisation rates, secure cash flows via long-term leases, low cost risks and attractive returns. However, the German operator market also presents challenges, characterised by fragmentation and smaller private providers operating their own properties. Currently changes in the financing structure, rising energy costs, stricter quality standards and a shortage of skilled labour are causing economic difficulties for small operators in particular. In-depth analysis of operator quality and profitability against the background of current and future requirements is therefore of crucial importance.

Over the last 30 years, the German rehabilitation clinic landscape has undergone major structural change: Alterations to the legal framework in the 1990s led to temporary challenges - for example, the number of people entitled to inpatient rehabilitation stays was reduced, the duration of service provision was more strictly limited and the interval between treatments was increased. In addition, the patient's contribution to rehabilitation costs rose by almost 50 percent and employers were now able to count days off for rehabilitation stays as vacation days taken. However, the increased demand for rehabilitation and preventive measures due to the changing world of work and the higher retirement age has stabilised the industry again. Despite the pandemic years of 2020 and 2021, facility and patient numbers have stabilised and utilisation rates have risen continuously.

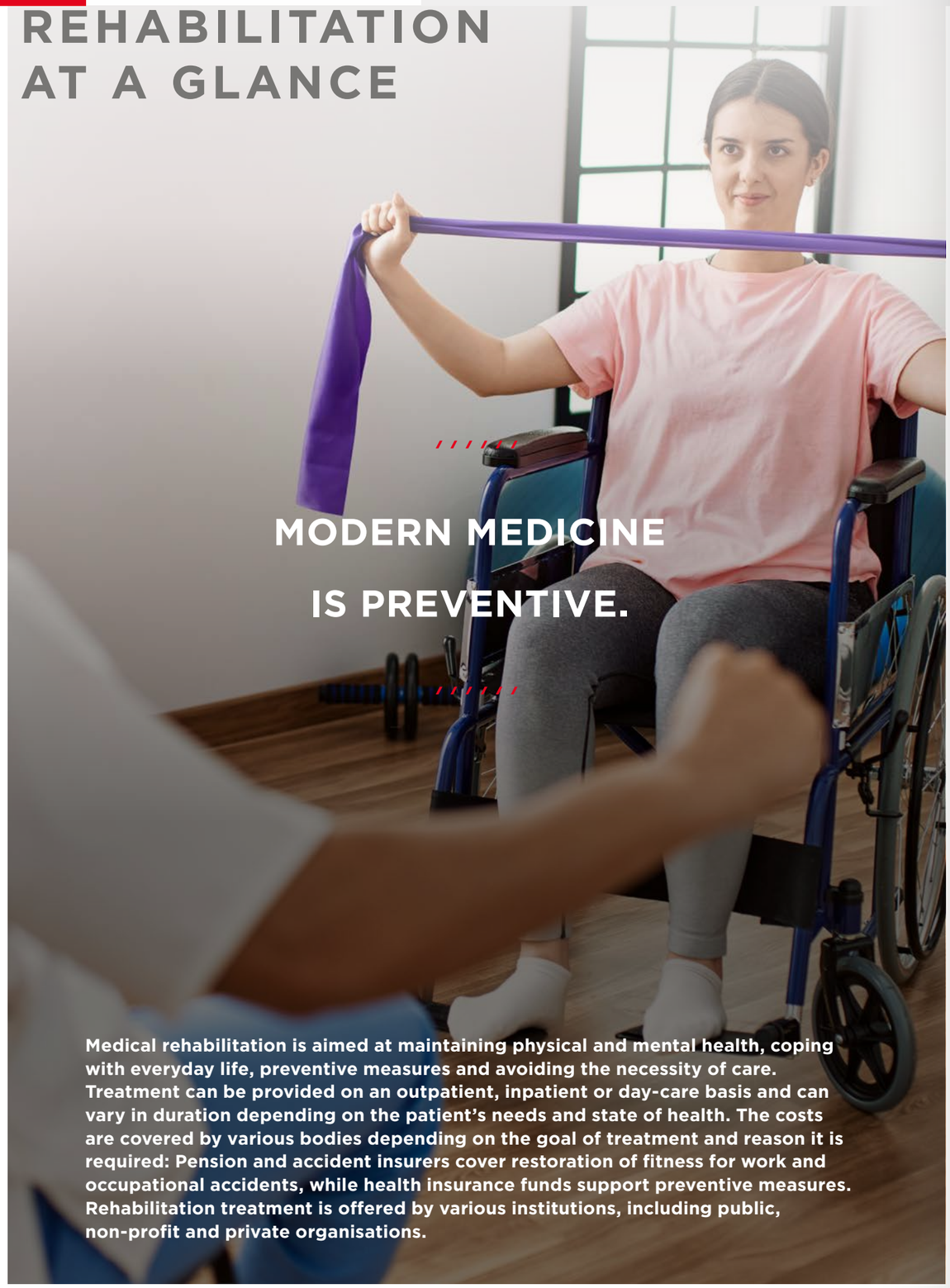
In recent years, the investment market has been characterised by extremely high demand and low product supply, with net initial yields of between 5.5 and 6 percent. A medium-term review shows strong volatility in transaction volumes due to fluctuations in product availability. The difficult financing environment is currently hampering M&A activities. Despite the current slight decline in transaction activity, rehab properties remain an attractive investment for institutional investors looking for long-term, stable income with indexation thanks to persistently high demand.

What is currently driving the German market for rehab properties in particular and what opportunities does this present? This follow-up to our 2021 report, provides well-founded background knowledge enriched with updated figures and analysis of the latest developments in the market, as well as information on the planned hospital financing reform. Expert interviews with Oliver Spiewak, Head of Transaction Management Healthcare at Primonial REIM, and Thomas Otto, Head of Acquisitions Commercial DACH at PATRIZIA Deutschland GmbH, also provide exclusive first-hand industry insights: Primonial REIM is known as a leading investor in the German healthcare sector, while the globally active PATRIZIA SE AG has been investing in property and infrastructure for 39 years.

We wish you an enjoyable and informative read.

Jan-Bastian Knod
Head of Residential Investment Germany
Head of Healthcare Advisory

MEDICAL REHABILITATION AT A GLANCE



MODERN MEDICINE IS PREVENTIVE.

Medical rehabilitation is aimed at maintaining physical and mental health, coping with everyday life, preventive measures and avoiding the necessity of care. Treatment can be provided on an outpatient, inpatient or day-care basis and can vary in duration depending on the patient's needs and state of health. The costs are covered by various bodies depending on the goal of treatment and reason it is required: Pension and accident insurers cover restoration of fitness for work and occupational accidents, while health insurance funds support preventive measures. Rehabilitation treatment is offered by various institutions, including public, non-profit and private organisations.

What is medical rehabilitation

Often colloquially referred to as a "cure" or "rehab", medical rehabilitation is a complex construct comprising various treatment fields, forms of treatment and cost bearers. The aim of medical rehabilitation is to maintain or improve an individual's state of health, to master an independent everyday life, to prevent a foreseeable illness and to avoid the need for long-term care. The forms of therapy used in medical rehabilitation encompass a broad spectrum of measures that are tailored to the specific clinical indications of those affected. These range from physiotherapy and occupational therapy to massages, therapeutic baths and psychotherapeutic counselling. In recent years, prevention has become increasingly important as a treatment concept, especially in old age and to prevent secondary diseases.

Ambulant, outpatient or inpatient - forms of rehabilitation

Medical rehabilitation can take a variety of forms, depending on the severity of the illness and the circumstances of the person affected. For out- patient rehabilitation, patients visit a therapy centre for certain treatments and rehabilitation measures. If the patient is not able to visit these facilities due to the state of their health, such measures can also be carried out by a mobile rehabilitation team at home. For inpatient rehabilitation, the patient lives in the rehabilitation facility for a certain period and receives 24-hour care. Semi-inpatient rehabilitation is also possible, where the patient stays in a rehabilitation facility close to their home during therapy hours and usually goes home at weekends and in the evenings.

The duration of treatment varies

The duration of rehabilitation measures can vary depending on the patient's clinical picture and age. However, for adults and adolescents aged 14 years and older, inpatient treatment is usually scheduled for three weeks and outpatient treatment for 20 days, whereby this can be extended if medically necessary. There is normally a waiting period of four to six weeks between two consecutive courses of treatment.

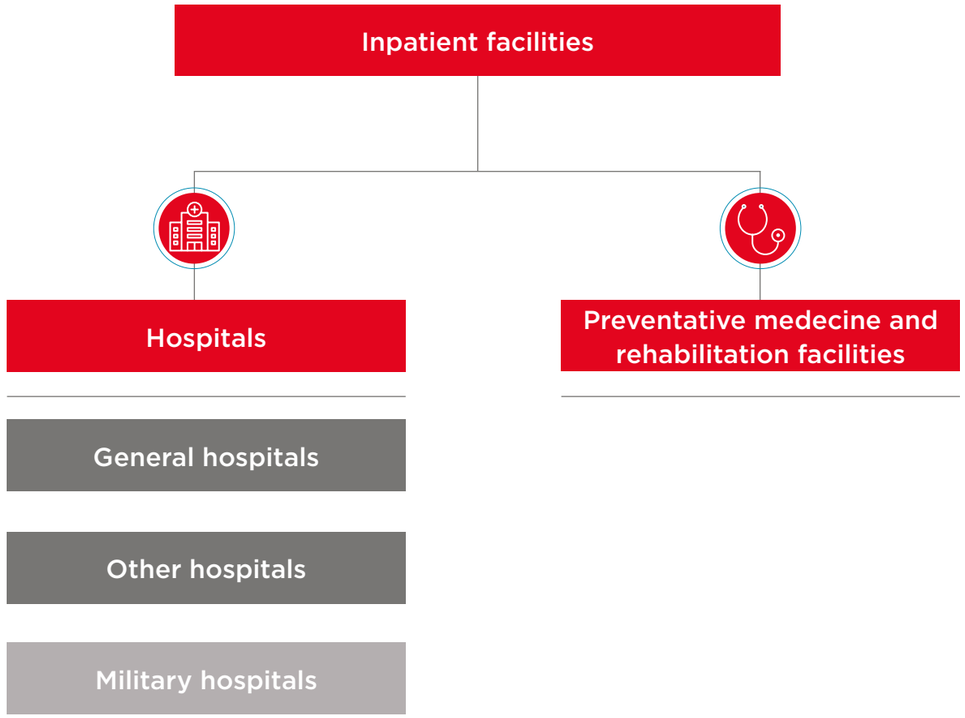
MEDICAL REHABILITATION AT A GLANCE

Funding bodies: Who pays for rehabilitation

Which funding body pays for medical rehabilitation depends on the aim of the rehabilitation measures and the reason rehabilitation is required and may be covered by different organisations. For example, the costs of rehabilitation aimed at restoring the ability to work are covered by pension insurers, while accident insurers cover the costs of occupational illnesses and accidents at work. In the case of rehabilitation to prevent a permanent disability or habituation to the consequences of an illness, the costs are borne by the health insurers.

Structuring of rehabilitation facilities

Preventive care and rehabilitation facilities are classed as inpatient care and are charged as hospitals in accordance with Section 2 (1) of the Hospital Financing Act (KHG). In accordance with Section 111 of the German Social Security Code (SGB) V, Preventive medicine and rehabilitation facilities are additionally categorised by type of licence into facilities with and without a care contract in place. Further sub-categorisation, based on the type of provider and legal form, discriminates between public, non-profit and private facilities.



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

MARKET ENVIRONMENT

THE IMPORTANCE OF REHABILITATION INCREASES WITH THE AGE OF THE POPULATION

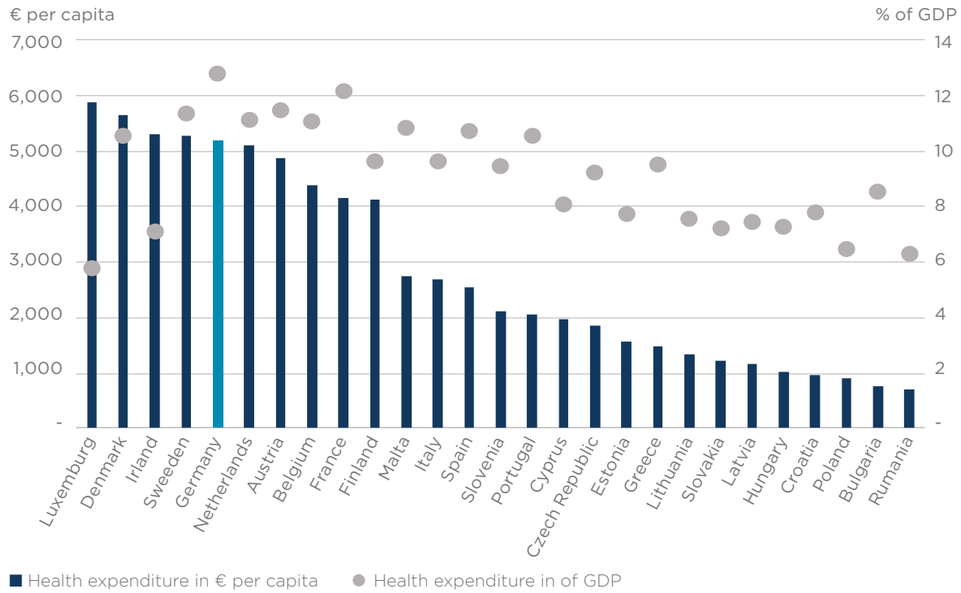
Medical rehabilitation is becoming increasingly important due to the ageing population in Germany. This is evident from the significant increase in sick days and the marked rise in healthcare expenditure. The German healthcare system is considered first-class thanks to its primary medical care and its focus on preventive and rehabilitative measures and its resilience was acknowledged worldwide during the COVID-19 pandemic. Nevertheless, the growing imbalance between individual contributions and per capita expenditure is creating difficulties that make it essential to adjust the financing structure: Without maximising efficiency in medical care, there is a risk of significant cost increases for future contributors in order to maintain healthcare services.

German rehabilitation system in a European context: High expenditure, high quality

With the introduction of a state health system in 1883, Germany took on a pioneering role worldwide and still has one of the most comprehensive and innovative medical care systems. In European comparison, Germany is the country with the highest per capita health expenditure in relation to its GDP after France. This is due both to the extensive services provided by the German health system and to the above-average GDP, which makes this expenditure possible.

As a result, Germany has succeeded in establishing a health care system which not only guarantees excellent primary medical care, but also preventative and rehabilitative medicine, thus contributing to an increase in life expectancy. For example, there has been a sharp decline in cardiovascular disease in recent years and the average life expectancy at birth in 2020/2022 was 78.3 years for men and 83.2 years for women, slightly above the European average of 77.2 years for men and 82.9 years for women. This development shows a positive trend - five years ago, German citizens still had a slightly below-average life expectancy in a European context.

Health expenditure 2020 in European comparison



Source: Eurostat, Cushman & Wakefield, 2023

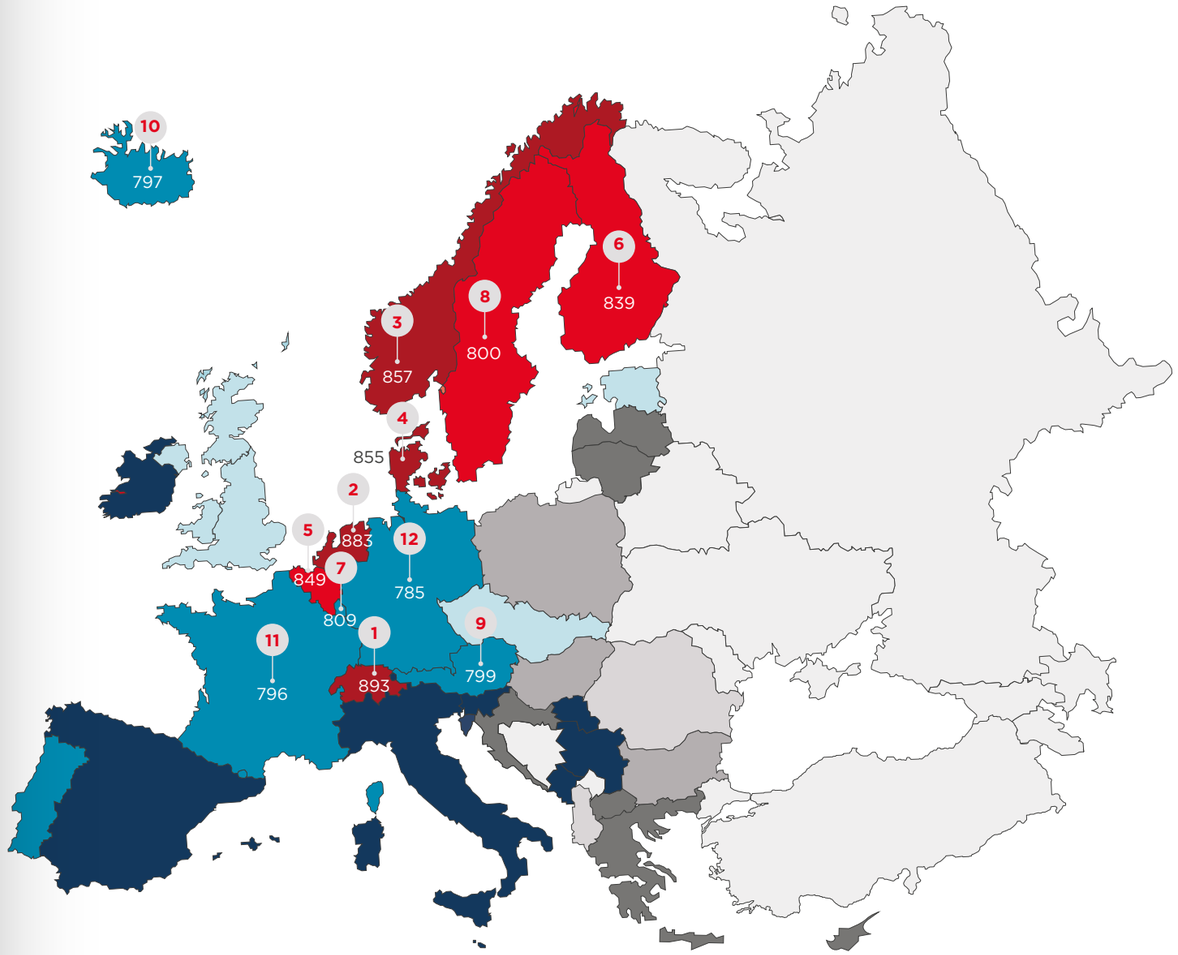
GERMANY IN EUROPEAN COMPARISON

Euro Health Consumer Index 2018: Germany ranked 12th out of 35

Despite its quantitatively strongest parameters for medical care, the Euro Health Consumer Index (EHCI) of 2018 does not rank Germany at the top of the table within Europe. Health Consumer Powerhouse's EHCI, one of the most prestigious public benchmarks of national health systems, compares the health systems of 35 European countries according to six criteria.

COUNTRY	RANK-ING	PATIENT RIGHTS & INFORMATION max. 125	WAITING TIME FOR TREATMENT max. 220	PROVISION OF RESULTS max. 300	AVAILABILITY OF SERVICES max. 125	PREVEN-TION max. 125	PROVISION OF MEDICINES max. 100	TOTAL SCORE max. 900
Switzerland	1	113	225	278	99	95	83	**893**
Netherlands	2	125	175	256	125	113	89	**883**
Norway	3	125	138	278	120	119	78	**857**
Denmark	4	121	175	267	120	95	78	**855**
Belgium	5	104	213	244	115	101	72	**849**
Finland	6	113	150	278	120	101	78	**839**
Luxembourg	7	100	188	244	109	95	72	**809**
Sweden	8	117	113	267	125	101	78	**800**
Austria	9	108	175	244	104	89	78	**799**
Iceland	10	121	188	222	104	107	56	**797**
France	11	104	188	233	104	83	83	**796**
Germany	12	104	163	244	83	101	89	**785**

Source: Björnberg, Phang, Cushman & Wakefield, 2018



Source: Björnberg, Phang, Cushman & Wakefield, 2018

The first place is occupied by Switzerland, which has gained an excellent reputation, especially with short waiting times for treatment. In terms of the accessibility of service points and the prevention of diseases, few countries compete with the Scandinavian countries of Denmark, Finland, Norway and Sweden. While Germany lags far behind in terms of patients' rights and information transparency, it does rank equal first together with the Netherlands in terms of the provision, cost coverage and timeliness of medicines.

EUROPEAN COUNTRIES BY EHCI SCORE

- 850–900
- 800–850
- 750–800
- 700–750
- 650–700
- 600–650
- 550–600
- 500–550

GERMANY IN EUROPEAN COMPARISON

Special characteristics of rehabilitation in Germany

Despite increasing convergence, historic differences between the individual countries shape the picture of the social and health systems in Europe. This also applies to medical rehabilitation. Compared to other European countries, medical rehabilitation in Germany, which is largely similar to the Austrian system, has several special characteristics when comparing to other European countries. These include treatment being predominantly inpatient and the limited rehabilitation duration of three weeks, as well as the strict demarcation of the funding between pension funds health insurers, accident insurers and others. In addition, the free application for rehabilitation, the specialisation of rehabilitation facilities by clinical picture, the acute medical orientation of the treatment and the medical dominance in interdisciplinary treatment teams are some of the most atypical features in European comparison

A perspective on the differences within Europe

In contrast to the German system, a large proportion of medical rehabilitation in Finland is carried out in approximately 230 municipal health centres, which also provide the country's basic medical care. Only a small proportion of medical rehabilitation is carried out in inpatient clinics, which are all privately owned. Similarly, in the UK, regional health centres with ambulant services dominate the rehabilitation landscape. In some cases, medical rehabilitation is even carried out at home on the basis of text descriptions. In contrast to Germany, the UK does not rely on interdisciplinary treatment teams under medical supervision, but nurses/carers usually manage the rehabilitation measures.

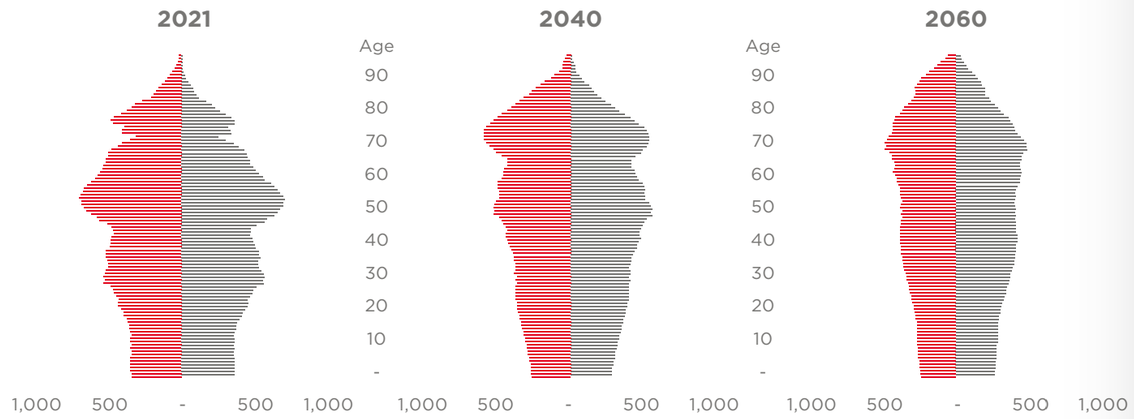
Rehabilitation in France is more similar to the German system however, and is often carried out in an inpatient setting, although in France separate rehabilitation departments are attached to acute medical hospitals. However, in France as a whole, approximately 40% of acute hospitals have rehabilitation facilities. In a further variant, Switzerland makes no legal distinction between acute hospitals and rehabilitation clinics. Thus, when a patient is admitted to a rehabilitation clinic, no further referral/approval from a hospital is required. Furthermore, in contrast to the German health system, the remuneration of service providers is not regulated. In the Netherlands, the prevention or remediation of a reduction in earning capacity is usually the main focus of medical rehabilitation. In this context most medical rehabilitation measures are prescribed by occupational physicians.

DEMOGRAPHIC SHIFT AS A COST DRIVER

Rising demand for health and care provision

Ambulant care is defined as treatment by a doctor in private practice, in the outpatient clinic of a hospital or an outpatient rehabilitation facility. Inpatient treatment is defined as admission to a clinic for care and treatment involving at least one overnight stay. For many years, Germany has been undergoing both demographic and medical-therapeutic change: The ageing population requires a higher level of care, rehabilitation and medical treatment, and this is being fulfilled via immense progress in inpatient and outpatient medical care.

Structural change in age demographics in Germany

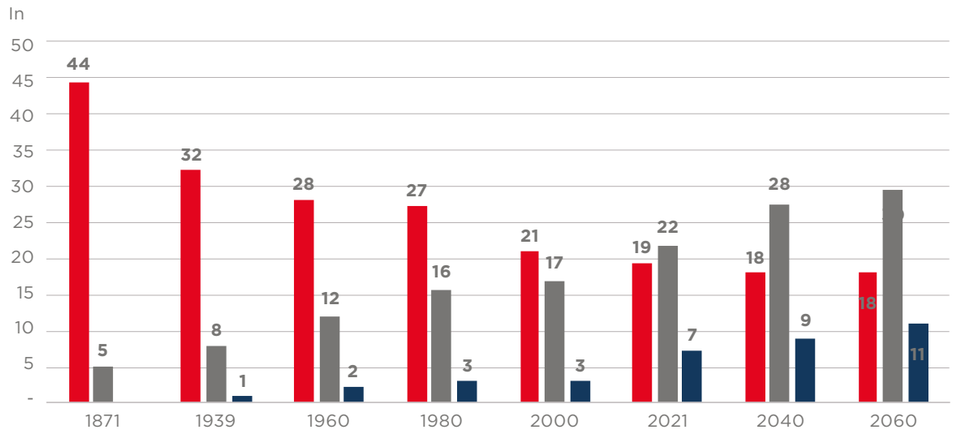


Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Demographic structural shift due to increase in generation 60+

Life expectancy in Germany is rising continuously, even though it has recently fallen slightly due to the COVID-19 pandemic. The Federal Statistical Office predicts that with a moderate increase, life expectancy is expected to be 88.2 years for women and 84.6 years for men by 2070. At the same time, the growing proportion of the 60+ age group poses a massive challenge for the German healthcare system. Already today, more than 25 percent of German citizens belong to this age group, which corresponds to about 20 million people. In view of increasing multimorbidity in old age, in which multiple chronic diseases have a sustained impact on the state of health and require continuous treatment, care for the elderly and medical rehabilitation are becoming increasingly important and are facing inevitable structural change. In 2017, for the first time in the history of the Federal Republic of Germany, the health expenditure threshold of one billion euros per day was exceeded. Thus in 2017, almost 375 billion euros were invested in health care, which corresponds to 11.5 percent of the gross domestic product. This figure rose by 4.4 percent to 390.6 billion euros in 2018. Employees and employers financed almost half of all health expenditure in 2018 through social security contributions. From 2018 to 2022, healthcare expenditure increased by a further 27 percent to over 498 billion euros, of which 54 percent was borne by statutory health insurance and 8 percent by private health insurance companies. Health expenditure was equivalent to 12.9 percent of GDP in 2022, down by 0.3 percent compared to 2021.

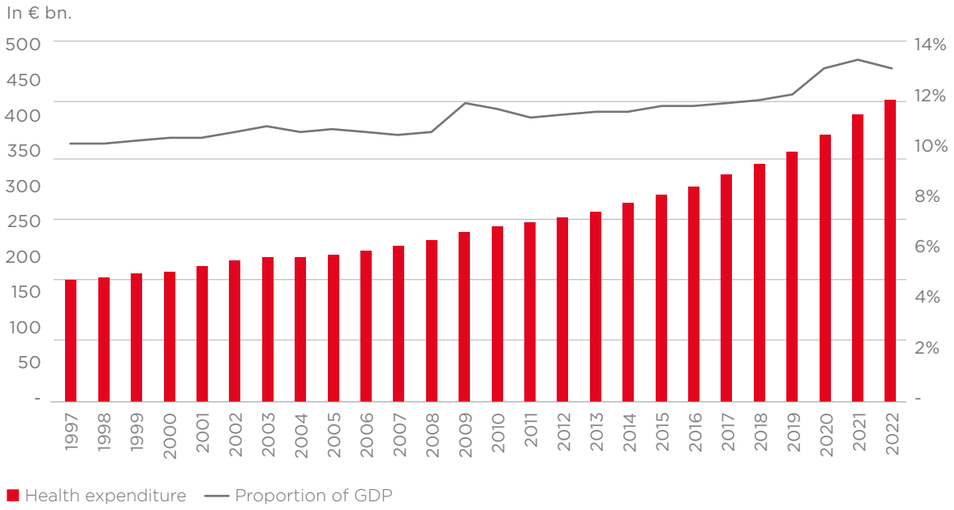
Age cohort change and forecast 1871 to 2060



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

DEMOGRAPHIC SHIFT
AS A COST DRIVER

Health expenditure and proportion of GDP



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Pay-as-you-go system at its limit: Reforms becoming imperative to curb costs

The growing imbalance between contributors and per capita expenditure requires an adjustment of the payer landscape and greater efficiency in medical care. The current pay-as-you-go system of the statutory health insurance funds contrasts with a significant increase in the costs for future contributors to finance health services for an ageing population.

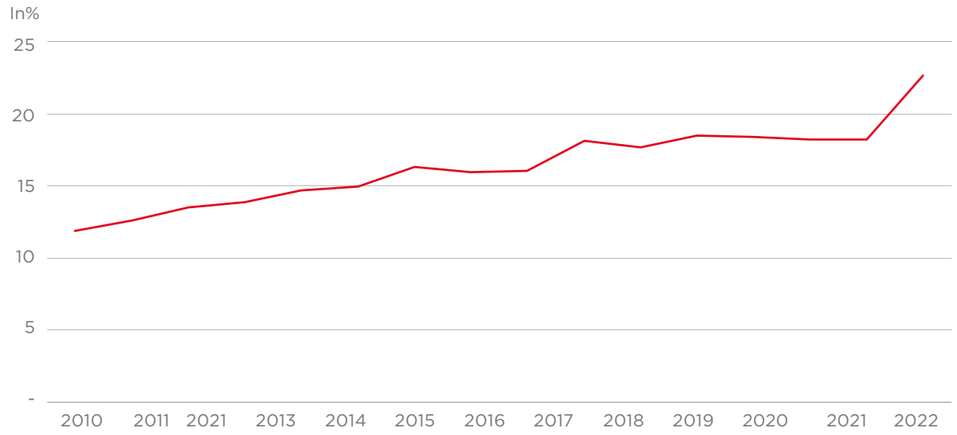
This becomes clear when looking at the German health insurance system: every citizen is obliged to take out health insurance. Persons with statutory health insurance pay at least 14.6 percent of their contributory income into a health insurance fund, with this contribution being borne equally by the employer. The health fund, including state subsidies, distributes these funds in accordance with certain criteria to the statutory health insurers, who are then responsible for paying for patient treatment.

The contributions of the private health insurance funds are calculated exclusively according to the scope of benefits and the state of health of the contributor, regardless of gross income. Unlike people with statutory health insurance, privately insured people have to pay for medical treatment in advance, but are reimbursed. In contrast to private health insurance companies, statutory health insurance companies are not required to build up reserves. This will make it more difficult to settle the mismatch between contributors and per capita expenditure in the coming years.

Sick days as a cost driver

However, it is not only the ageing of the population, but also the increase in multi-morbidity and the average number of sick days that are putting a strain on the German healthcare system. Since 2011, the average number of sick days per compulsorily insured member of company health insurance funds (including recipients of unemployment benefit, excluding pensioners) has risen by 35 percent from 14.7 to 22.6 days. While the majority of cases of illness do not last longer than a working week, the significant increase of sick days can be partly attributed to the aging of the population and increasing multimorbidity. On the other hand, it is largely due to COVID-19 and more frequent infections, due to weakened immunity after the lockdown and the easing of restrictions. The majority of cases of illness (63.2 percent) do not last longer than one working week, and 80 percent of employees are back at work after two weeks at the latest, according to the umbrella association of company health insurance funds

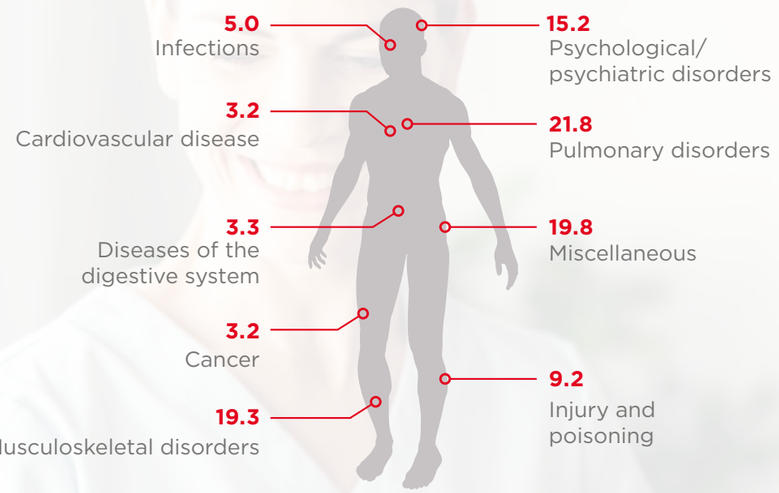
Average number of sick days since 2010



Source: BKK Dachverband, Cushman & Wakefield, 2023

DEMOGRAPHIC SHIFT
AS COST DRIVER

Percentage of sick days in 2021 accounted for by ...



Source: BKK Dachverband, Cushman & Wakefield, 2023

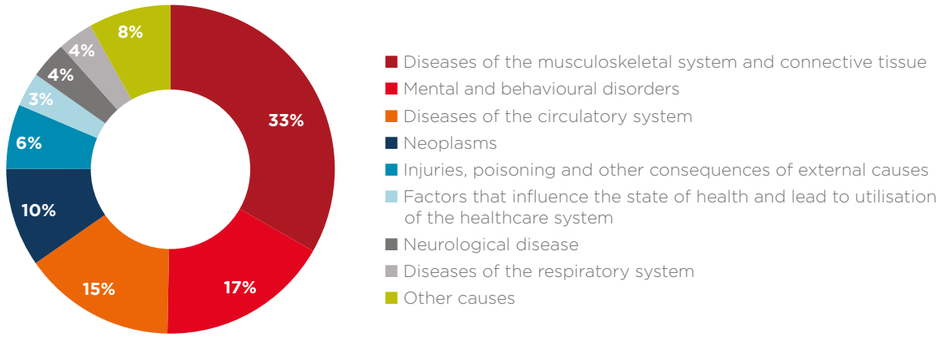
Due to the increasing age of the population, the proportion of sick days due to musculoskeletal disorders is increasing immensely and was 19.3 percent in 2022. In addition, mental disorders (15.2 percent) and injuries and poisoning (9.2 percent) are increasingly causes of employee absenteeism. The high proportion of respiratory diseases (21.8 percent) as the current leading cause of sick days is mainly due to the COVID-19 pandemic. Together, they account for more than two-thirds of medical costs in Germany, accounting for 66 percent.

Multimorbidity is also becoming increasingly common in old age. Age not only causes increased downtime, it also increases the average recovery time. For example, the average duration of absenteeism for employees over the age of 55 is twice as long as for those aged 35 to 39. Due to demographic change, the number of extended absence due to illness is expected to continue to rise. Employers must therefore expect increased costs due to the employee absence.

The inpatient focus of rehabilitation in Germany is also driving up costs: In 2022, for example, 1.5 million patients were treated in preventive care and rehabilitation facilities. At 33 percent in 2022, diseases of the musculoskeletal system and connective tissue were the most common cause of inpatient rehabilitation stays, followed by mental illnesses and behavioural disorders at 17 percent and diseases of the circulatory system at 15 percent.

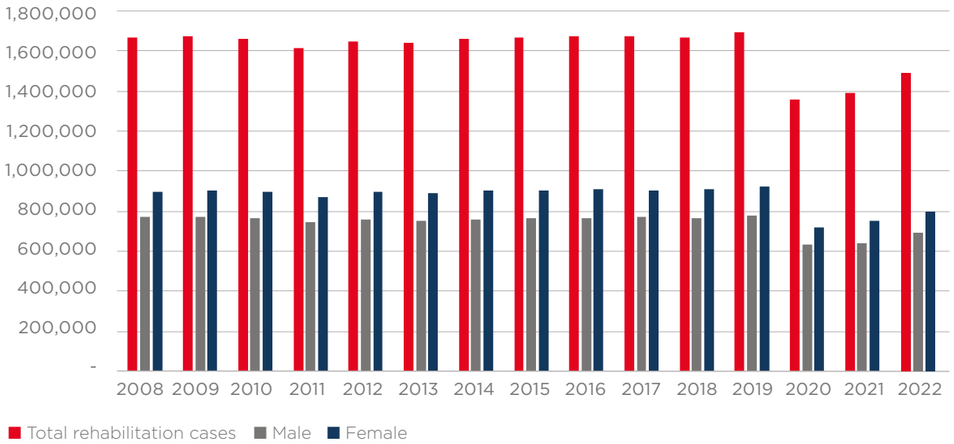
PATIENT STRUCTURE FOR INPATIENT TREATMENT

Reason for rehabilitation and proportion of cases in 2020



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Development of inpatient rehabilitation measures by gender



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Relatively fewer inpatient stays with more sick days

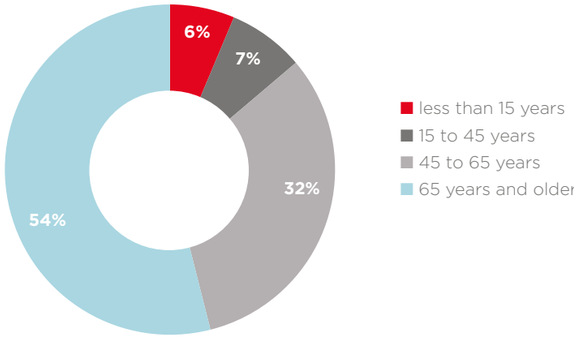
Between 2008 and 2019, the number of inpatient rehabilitation stays remained relatively stable. The number of male patients increased by 1.6 percent and the number of female patients by 2.6 percent.

The distribution of rehabilitation stays by gender has also remained stable: in 2019, 54 percent of stays were attributable to female patients and 46 percent to male patients. In relation to the number of rehabilitation stays, both the number of sick days and the number of hospital stays have developed more dynamically. The average number of sick days per employed person per year has risen by 46 percent in the same period, while the number of inpatient stays has increased by 11 percent. This means that with increasing (multi-)morbidity and inpatient treatment, proportionately fewer inpatient rehabilitation measures are being prescribed.

Elderly patients account for the majority of inpatient treatment

Overall, the elderly population is increasingly making use of inpatient rehabilitation. For example, 32 percent of patients are between 45 and 65 years old, while 54 percent are over 65 years old. Patients over the age of 45 thus account for more than 86 percent of all cases. Patients under 15 years of age account for only 6 percent of cases, and those between 15 and 45 years, 7 percent. In view of the increasing life expectancy in Germany, it may be assumed that the demand for rehabilitation measures, especially from older people, will continue to rise.

Number of cases by age range



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

REHABILITATION FACILITIES

DEMAND FOR REHABILITATION REMAINS HIGH, BUT OBSTACLES ARE INCREASING

The development of rehabilitation facilities in Germany is subject to constant change. The rehabilitation boom of the 1990s steadily waned due to economic deficits and changes in legislation. Today, fewer people are entitled to inpatient rehabilitation stays, the duration of benefits has been shortened and the interval between treatments has been increased. In addition, patient participation in the costs of rehabilitation has risen by almost 50 percent and employers can now count days off for rehabilitation stays as vacation taken. Despite these changes, utilisation of the facilities has risen due to demographic change and the increase in musculoskeletal disorders.

Goals of rehabilitation facilities

The objectives of preventive care and rehabilitation facilities are defined by law in § 107, para. 2 of the Social Security Code (SGB) V:

- Eliminating a deterioration of health which may lead to illness in the foreseeable future
- Combating threats to children's healthy development (prevention)
- Curing, or preventing a worsening, of diseases
- Alleviation of disease symptoms
- Ensuring and consolidating the success of inpatient hospital treatment. This also includes averting and mitigating impending disability or becoming dependent on care or consequences of dependency on care (rehabilitation)

Rehabilitation facilities are subject to statutory requirements

Preventive and rehabilitation facilities pursue the goal of improving the health of their patients with the help of a medical treatment plan, supporting the development of healing and strengthening the body's defences. The implementation of the medical treatment plans is carried out under constant medical supervision and is supported by professionally trained specialist medical staff. In addition to physiotherapy, movement therapy and speech therapy, medical treatment plans can also include occupational therapy, depending on the clinical indications. During inpatient treatment, the rehabilitation facility must ensure not only the implementation of the medical treatment plan but also provide accommodation and meals for the patients. When the health insurer bears the costs of medical services for preventive or medical rehabilitation, both inpatient and outpatient facilities must be able to submit a care contract in accordance with § 111 Social Statute Book (SGB) V.

REGULATION OF PROVISION

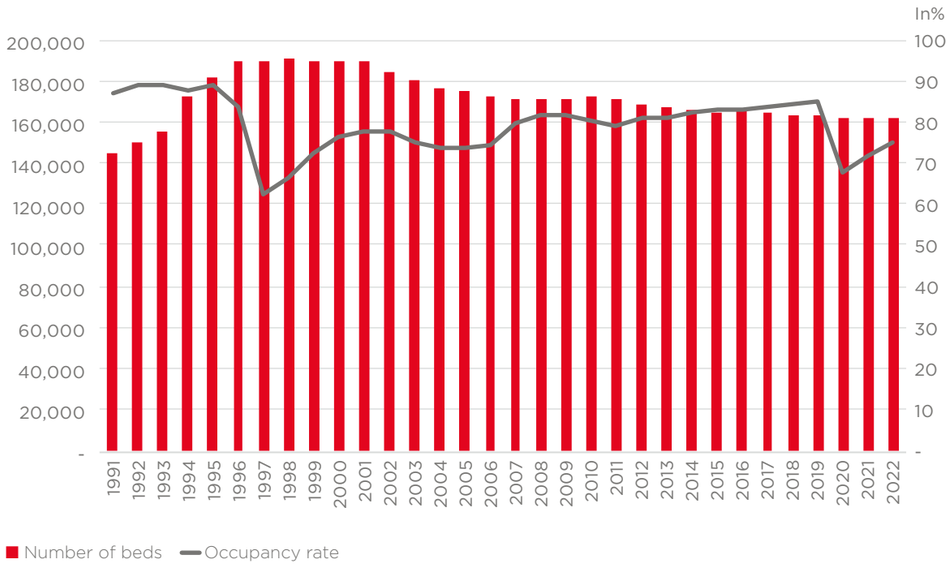
From rehabilitation boom to restrictions

From the early to mid-1990s, the newly-reunited Germany experienced a veritable rehabilitation boom: Both the statutory pension insurers and the statutory health insurance schemes generated surpluses until the early 1990s - their full coffers were reflected in the generous approval of rehabilitation measures.

However, in the early 1990s, the statutory pension and health insurers increasingly began to operate at a deficit. With the passing of the Growth and Employment Promotion Act in 1996, the rehabilitation landscape in Germany changed permanently. The number of people entitled to an inpatient rehabilitation stay was reduced, the duration of treatment was limited to three weeks and the interval between two courses of rehabilitation measures was increased from three to four years. In addition, the patient's contribution to the rehabilitation costs increased by almost 50 percent and employers were now able to count days off for rehabilitation stays as vacation taken.

In 1997, these measures led to a rapid decline in rehabilitation treatments and thus in the utilisation of rehabilitation facilities. The utilisation rate of inpatient facilities fell from 83 percent in 1996 to 62 percent in 1997, a fall of around 25 percent. The number of beds in rehabilitation facilities remained static until the turn of the millennium and has been falling slightly since then, although it is increasingly stabilising. Since 2005, the utilisation rate has risen by twelve percentage points from 73 percent to 85 percent in 2019. Due to the COVID-19 pandemic, the occupancy rate fell again in 2020 and 2021.

Development in the number of beds and utilisation rate



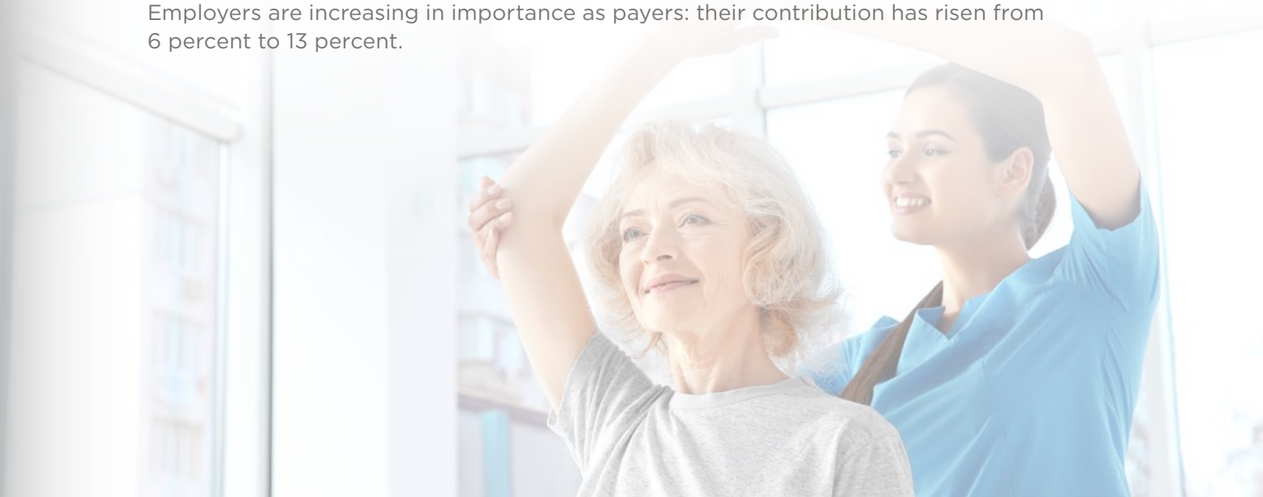
Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

Funding bodies and providers of medical rehabilitation

Who funds preventive and rehabilitation measures depends on their goal and the cause of the underlying disorder. § 6 of the Social Security Code (SGB) IX defines the following funding institutions for the costs of treatment:

- **Statutory health insurers**
- **Welfare providers for victims of war**
- **Federal employment agency**
- **Public youth welfare organisations**
- **providers of statutory accident insurance**
- **Institutions responsible for social integration aid**
- **Providers of statutory pension insurance**

Health expenditure on preventive care and rehabilitation facilities by various payers has risen by more than 80 percent since 1992. Almost 70 percent of this is covered by the statutory health insurance (GKV) and the statutory pension insurance (GRV). This share is decreasing slightly, while expenditure from the public budget is gradually increasing. While the share of statutory health insurance has remained unchanged since 1993, the share of statutory pension insurance has fallen by 10 percent. Employers are increasing in importance as payers: their contribution has risen from 6 percent to 13 percent.



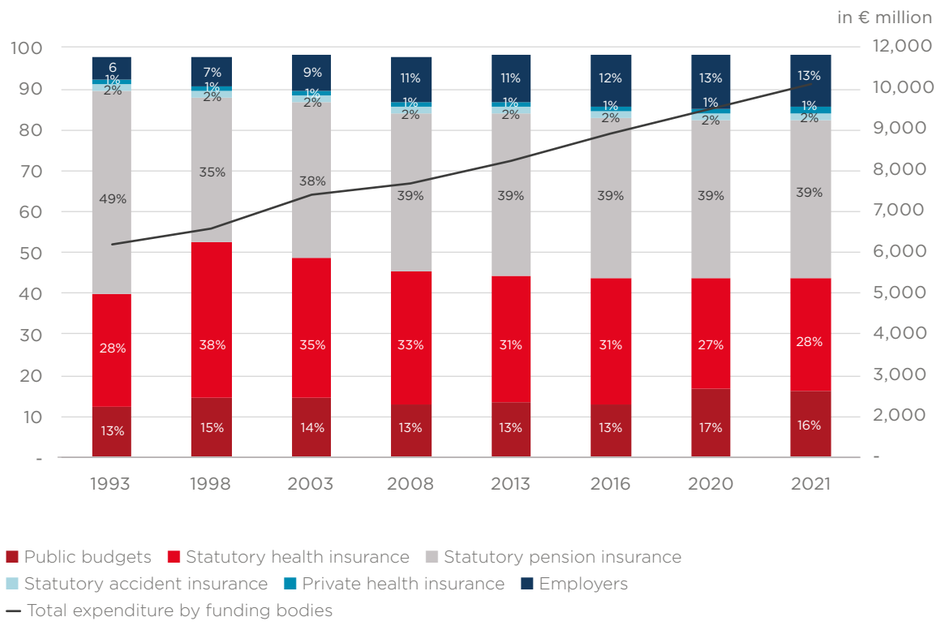
REGULATION OF PROVISION

Rehabilitation rather than pension - the preventive principle

"Rehabilitation rather than pension" is the guiding principle of the statutory pension insurers (SPI), the largest funder of preventive and rehabilitation measures. The legal definition of rehabilitation by the SPI is in accordance with § 9 of the Social Statute Book (SGB) VI. The aim is to avert or delay the premature withdrawal of patients with acute or chronic illnesses from working life. Via targeted measures, those affected can thus return to their previous job or enter another occupation via vocational reorientation.

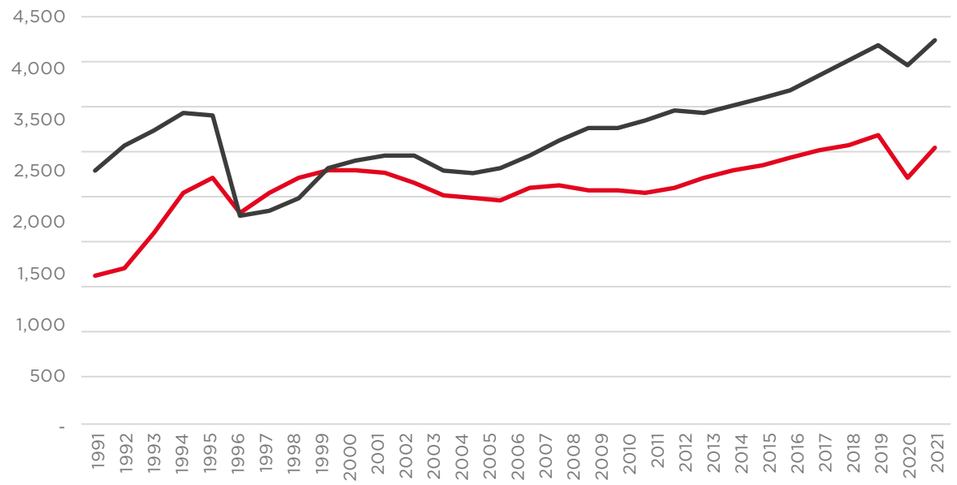
The principle of "rehabilitation rather than care dependency" is applied by the second-largest funder of preventive and rehabilitation services, the statutory health insurance (SHI). In contrast to the SPI, which focuses on returning to work, the SHI pursues the goal of averting or delaying imminent disability or dependency on care. The legal definition of medical rehabilitation by the health insurance funds is set by Social Statute Book (SGB) V. § 11 para. 2.

health care expenditure for preventive medicine and rehabilitation facilities



Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

Health expenditure by statutory health insurers and statutoryurers pension insurers for preventive medicine and rehabilitation facilities



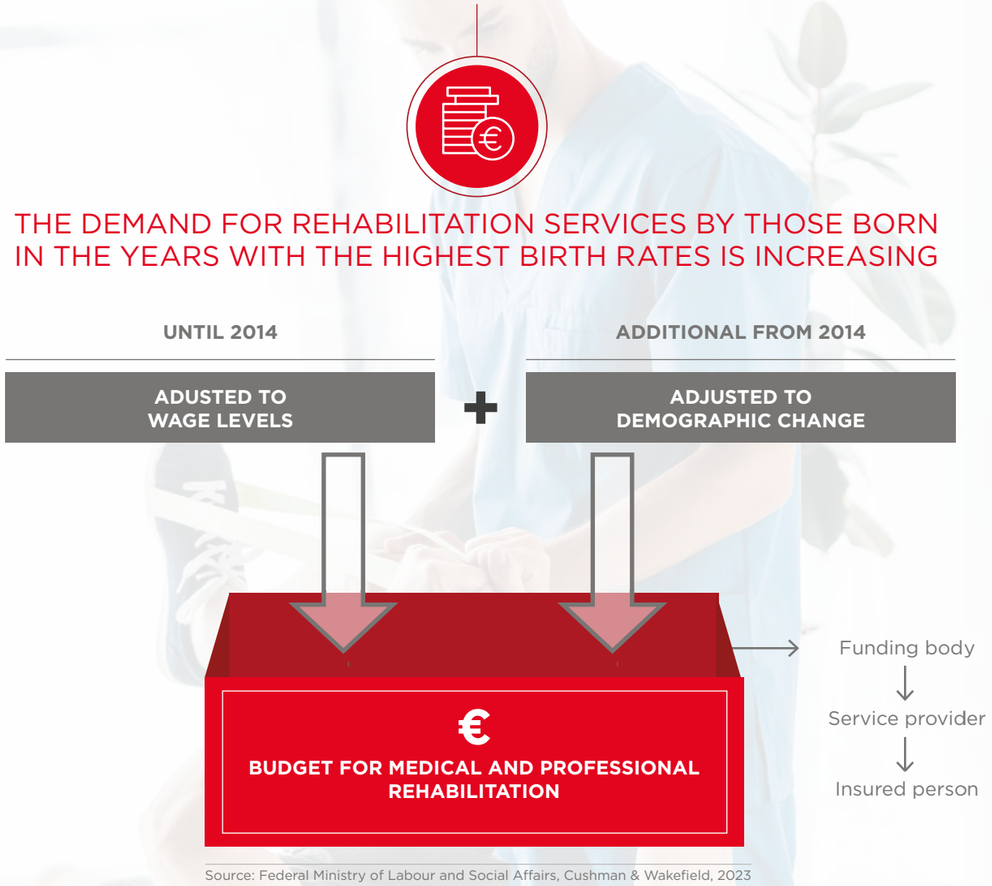
Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

REGULATION OF PROVISION

Budget für Rehabilitation:

Adjusted to demographic change

THE DEMAND FOR REHABILITATION SERVICES BY THOSE BORN IN THE YEARS WITH THE HIGHEST BIRTH RATES IS INCREASING



Source: Federal Ministry of Labour and Social Affairs, Cushman & Wakefield, 2023

New parameters in budgeting

The Growth and Employment Promotion Act came into force in 1997, introducing a capped amount, which is redefined annually, available to the providers for rehabilitation services paid for by the statutory pension insurers - the so-called rehabilitation budget. Until 2013, this annual budget definition was based solely on the change in gross salaries per employee. However, the rehabilitation budget no longer increases in proportion to salaries, as the rehabilitation budget also takes into account the low-wage sector and part-time employees. The demographic shift has only been taken into account since the introduction of the Pension Insurance Benefit Improvement Act in 2014.

Nevertheless, the lifetime working hours, and the spectrum of illnesses and treatment options that influence the need for rehabilitation are not currently taken into account when calculating the rehabilitation budget. The introduction of the second component, age-related needs, led to an increase in the rehabilitation budget until 2017, but this is being gradually reduced, from 2017 onwards, as the baby boomers of the 1950s and 1960s reach retirement age.

Remuneration of rehabilitation measures: Contractual basis and criticism of the day and case- fixed-rate system

For the remuneration of rehabilitation measures, the funding agencies have contracts with the rehabilitation facilities listing the services to be provided. These contracts are based on joint and uniform care provision agreements between the health insurers' regional associations and are only specified with the individual facilities. Remuneration is based on fixed payments per case and per diem. In most cases, flat rates per case are charged when the costs are covered by the statutory health insurers and charges per day are more likely when the costs are covered by the statutory pension insurers.

However, due to the predefined length of a patient's stay in the institution, the daily rate totals charged are tending to converge ever more with the flat rates charged per case. A differentiation of the remuneration is only made depending on the department providing the treatment. A major critique of the system is that it is only approximately indication-specific, and takes into account neither the severity of the case nor the success of the treatment provided.

Operating and investment costs are covered by this system. However, there is no representative data regarding the level of compensation. Analyses show, however, that remuneration is not growing at the same rate as input prices, which is putting additional pressure on service providers.

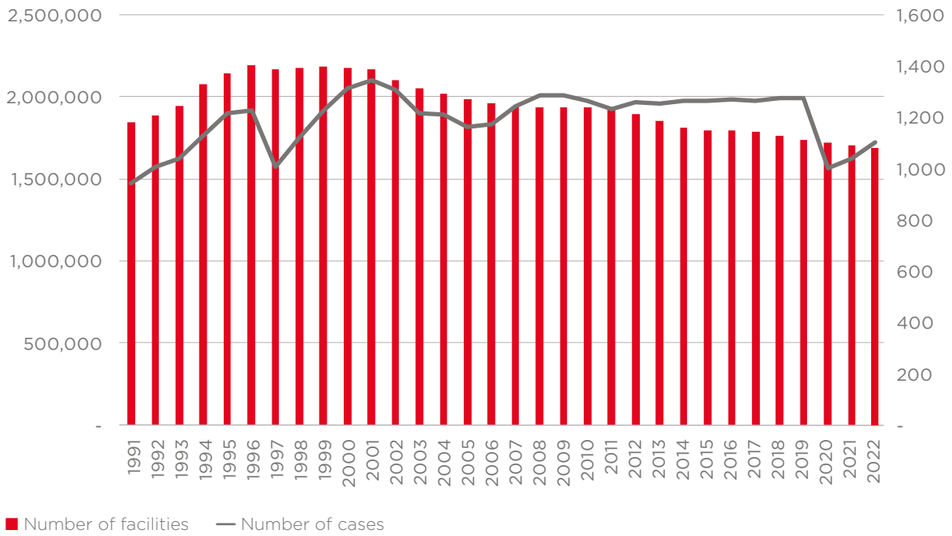
GROWTH AND DEVELOPMENT

Rising utilisation rates since the 2000s

After the adoption of the Growth and Employment Promotion Act and the subsequent slump in the number of rehabilitation measures prescribed, the utilisation rate has risen again since the early 2000s. The primary reason for this is demographic change: The baby boomer generation reached the age of 50+, which is associated with an increased susceptibility to multimorbidity and wear and tear on the joints.

As a result, there has been an increase in the number of rehabilitation measures prescribed and an increasing utilisation rate. By 2019, this had risen to up to 85 percent, which is much closer to the level of utilisation in the 1990s. The temporary, pandemic-related decrease in occupancy has now reversed again, with the utilisation rate at 74.9 percent in 2022 – in 2020 it was 67.8 percent

Development of the number of rehabilitation facilities and case numbers



Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

Fewer facilities versus rising cases

The number of institutions initially continued to increase into the late 1990s, despite the adoption of the Growth and Employment Promotion Act. With the turn of the millennium, however, there was a decline in the number of facilities and a slight increase in the number of cases. Since 2009, the number of facilities has been gradually decreasing again. In 2022, for example, there were 12 percent fewer facilities than in 2009, while the number of cases fell by 13 percent over the same period. In 2022, 20 percent of facilities had fewer than 49 beds and 28 percent had more than 200 beds. The average utilisation rate for all beds was 74.9 percent. While smaller facilities with up to 49 beds had occupancy rates below average, larger facilities often showed slightly higher occupancy rates.

Preventive care and rehabilitation facilities by number of inpatient beds (2022)

Number of beds	Number of facilities	Total number of beds	Occupancy rate	Average length of stay in days
<49	216	6,657	70.8%	35.0
50-99	219	16,092	76.8%	23.1
100-149	156	19,564	72.2%	26.6
150-199	195	33,855	76.3%	24.6
>200	303	85,557	74.9%	24.6
Total	**1,089**	**161,725**	**74.9%**	**25.4**

Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

The smaller the facility, the longer the stay

The correlation between the size of the facility and its utilisation rate is due to the number of fields covered the facilities and their degree of specialisation. While facilities with large numbers of beds often also cover many fields, smaller facilities specialise in only a few and are therefore more dependent on the number of cases with specific medical indications.

On the other hand, the length of stay of patients in smaller facilities is significantly longer. For example, facilities with up to 49 beds recorded an average length of stay of 35.0 days, while the segments with 150 to 199 beds and 200 and more beds had the shortest length of stay at 24.6 days.

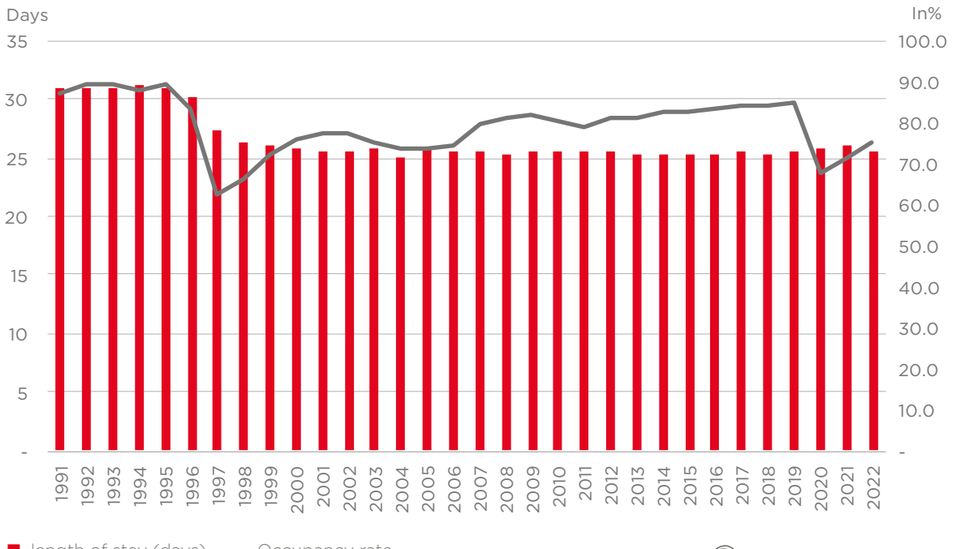
GROWTH AND DEVELOPMENT

Length of stay: Guideline 20 days

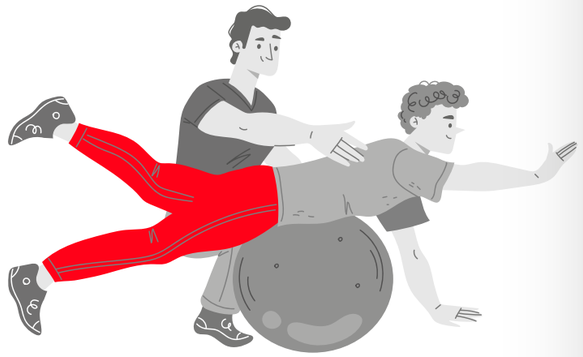
Since 1997, the duration of inpatient rehabilitation has been limited to three weeks or 20 days of treatment. Exceptions here are psychosomatic and neurological measures, for example for the treatment of depression, the initial duration of which is usually five to six weeks, depending on the case. If an increase in medical success is expected from a stay of more than 20 days of treatment, the stay can be extended with the consent of the cost bearer.

The average length of stay for inpatient rehabilitation was 25.4 days in 2022. Since 2005, the occupancy rate of rehabilitation facilities has increased continuously. In 2016, for the first time since the adoption of the Growth and Employment Promotion Act,utilisation rate of over 83 percent was achieved, which rose to 85 percent in 2019. The pandemic years 2020 and 2021 are excluded from the upward trend. Since the end of the pandemic, however, the utilisation rate has gradually risen again, reaching 74.9 percent in 2022.

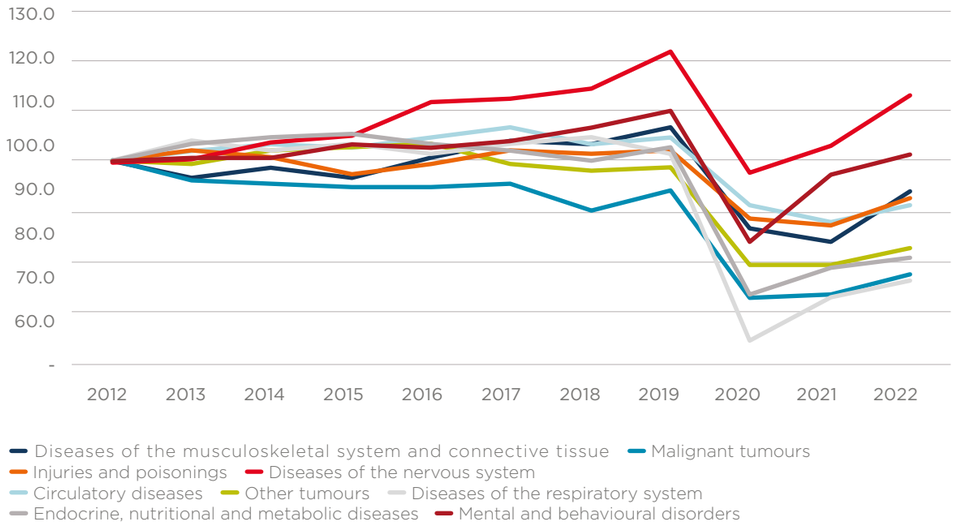
Development of length of stay and occupancy rate



Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023



Development of case numbers by diagnosis from 2012 until 2022



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

Musculoskeletal illnesses – The No. 1 reason rehabilitation is required

One third of all rehabilitation measures are due to diseases of the musculoskeletal system and connective tissue and have been a major long-term driver of the number of inpatient rehabilitation stays in Germany. From 2012 to 2019, the number of cases here increased by almost 7 percent, and from 2021 to 2022, it jumped by 11 percent in a single year.

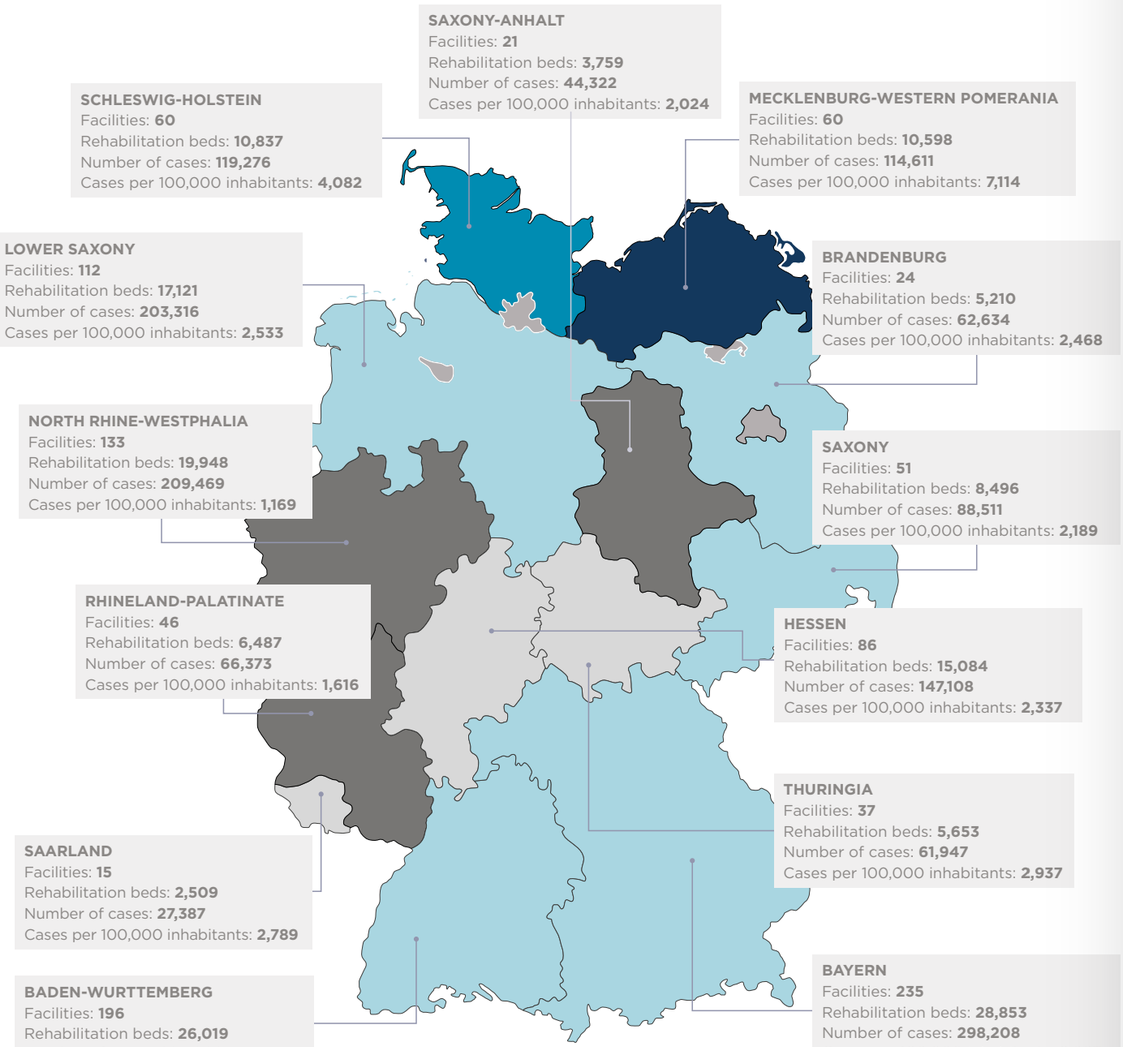
The second most common cause behind the prescribing of inpatient rehabilitation measures was mental illnesses and behavioural disorders (17 percent) and diseases of the circulatory system (16 percent). While cardiovascular diseases only recorded an increase of 5 percent, the number of rehabilitation stays due to mental illness and behavioural disorders increased by 10 percent.

It is true that the number of rehabilitation measures prescribed for mental behavioural disorders in 2020 and 2022 also fell compared to previous years. Nevertheless, from 2020 to 2022, there was a 20 percent increase in these cases. The number of cases of diseases of the respiratory system also increased by 13 percent – both of which are strongly related to the COVID-19 pandemic.

Between 2012 and 2019, there was also an increase in the number of cases due to rehabilitation measures due to diseases of the nervous system as well as endocrine, nutritional and metabolic diseases. Diseases of the nervous system, in particular, rose by 21 percent and thus recorded the strongest growth. The sharpest decline in the number of rehabilitation measures carried out was recorded for malignant neoplasms (6 percent) and other neoplasms (1 percent). The drastic decrease in the number of rehabilitation patients in 2020 and 2021 can be attributed to the impact of the COVID-19 pandemic

A LOOK AT THE GERMAN FEDERAL STATES

Rehabilitation in Germany 2022



CITY STATES:
Facilities: **13**
Rehabilitation beds: **1,169**
Number of cases: **11,081**
Cases per 100,000 inhabitants: **178**

Source: GBE, Cushman & Wakefield, 20203

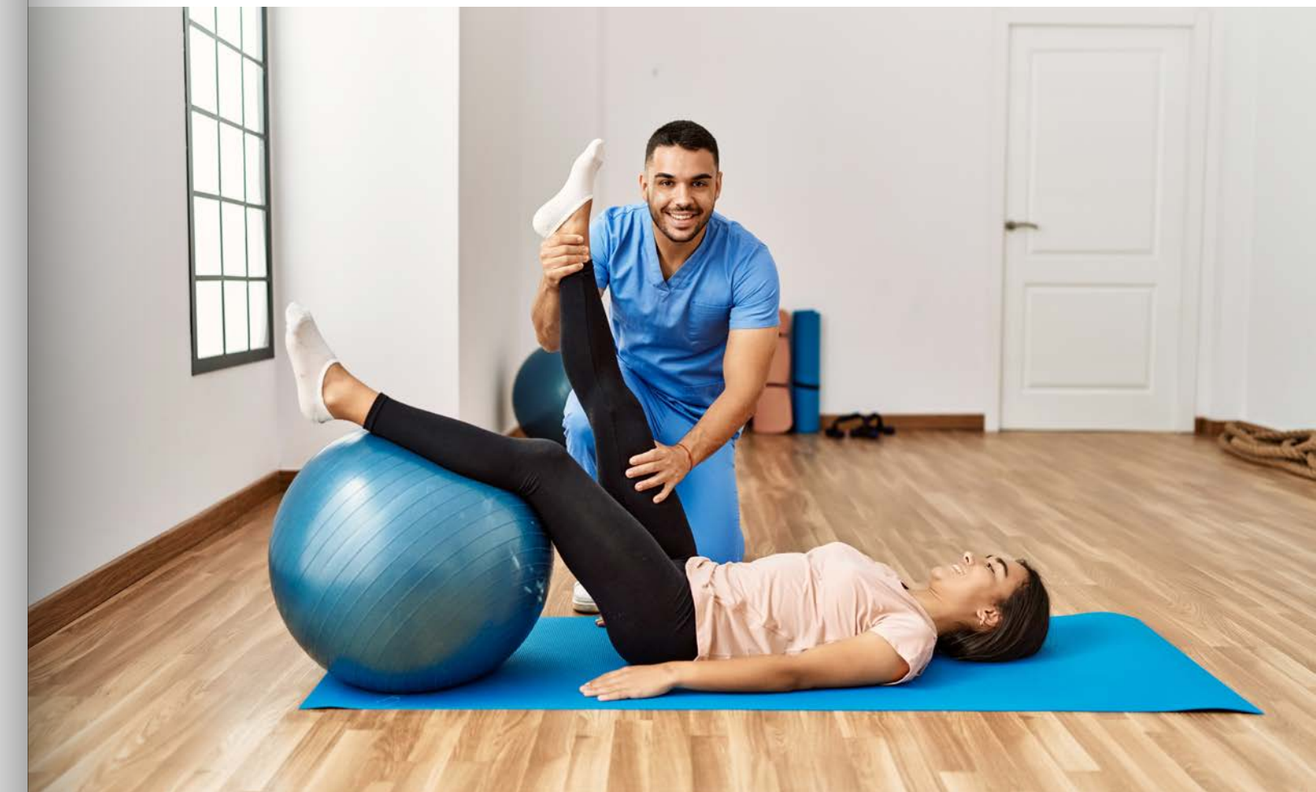
The more inhabitants, the more facilities

The most populous federal states are also those with the most rehabilitation facilities in Germany. With 235 facilities in 2022, Bavaria has the largest number, followed by Baden-Wurttemberg with 196 and North Rhine-Westphalia with 133.

Strong east-west divide in the number of facilities

In Germany, there is still a clear east-west divide in the distribution of rehabilitation facilities more than 30 years after reunification. Mecklenburg-Western Pomerania leads the “new” federal states (those which formerly comprised “East Germany”) with 60 facilities and was the only state with more than 55 facilities in 2021. However, Mecklenburg-Western Pomerania has the highest coverage rate with almost 7,000 cases treated per 100,000 inhabitants. The situation is similar in Schleswig-Holstein, which is in second place with almost 4,000 cases per 100,000 inhabitants. In contrast, North Rhine-Westphalia with around 1,000 cases and the city states of Berlin, Hamburg and Bremen with 178 cases per 100,000 inhabitants have the lowest rates.

Thuringia and Brandenburg are the only federal states with an average utilisation rate of over 80 percent. Hesse and Bavaria, in contrast exhibit utilisation rates of around 70 percent.



EMPLOYMENT MARKET AND PERSONNEL STRUCTURE

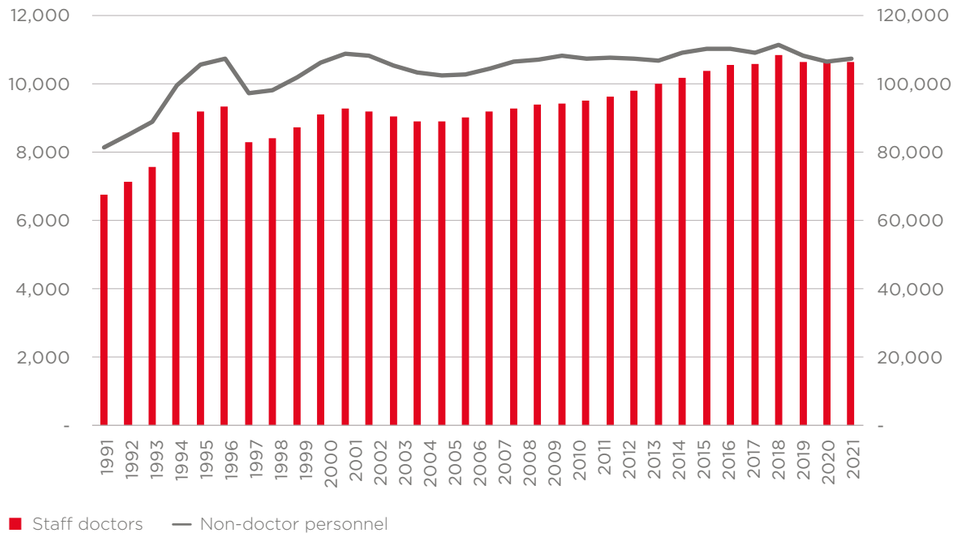
Who works in the rehabilitation sector?

Medical rehabilitation in Germany is always under the direction of a medical doctor who is a specialist, while the measures are usually carried out by professionals who are not doctors such as physiotherapists, speech therapists, occupational therapists, psychologists, psychotherapists, occupational educators and nursing staff.

The number of full-time employees rose sharply between 1991 and 1996, but saw a significant decline after the Growth and Employment Promotion Act was adopted followed by a renewed increase in staff. It is noticeable here that the proportion of full-time employees who are specialist doctors has continuously increased strongly, while the proportion of non-physician staff has only risen slightly. In 2022, the proportion of specialist medical staff was 9 percent, while the proportion of non-physician specialist medical staff was 91 percent. At the end of 2022, a total of 118,175 people were employed in the rehabilitation sector, of which 10,633 were physician practitioners and 107,542 non-physician practitioners.

As with utilisation rates and case numbers, the years 2020 to 2022 also saw a slight decline due to the COVID-19 pandemic.

Number of employees in oreventive care or rehabilitation facilities



Source: Statistisches Bundesamt (Destatis), Cushman & Wakefield, 2023

The shortage of specialised staff requires solutions

As in other social and medical professions, the shortage of specialised staff is also one of the key challenges in medical rehabilitation. While the Nursing Staff Strengthening Act only supports the recruitment of additional nursing staff in hospitals, it neglects the shortage of care staff in rehabilitation facilities. In addition, the basic wage rate applicable in rehabilitation leads to lower remuneration for care staff compared to hospitals, which makes working in rehabilitation facilities less attractive.

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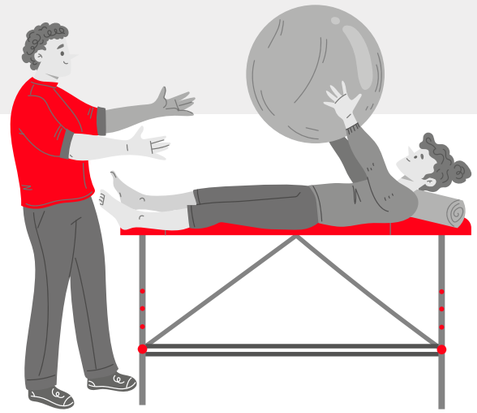
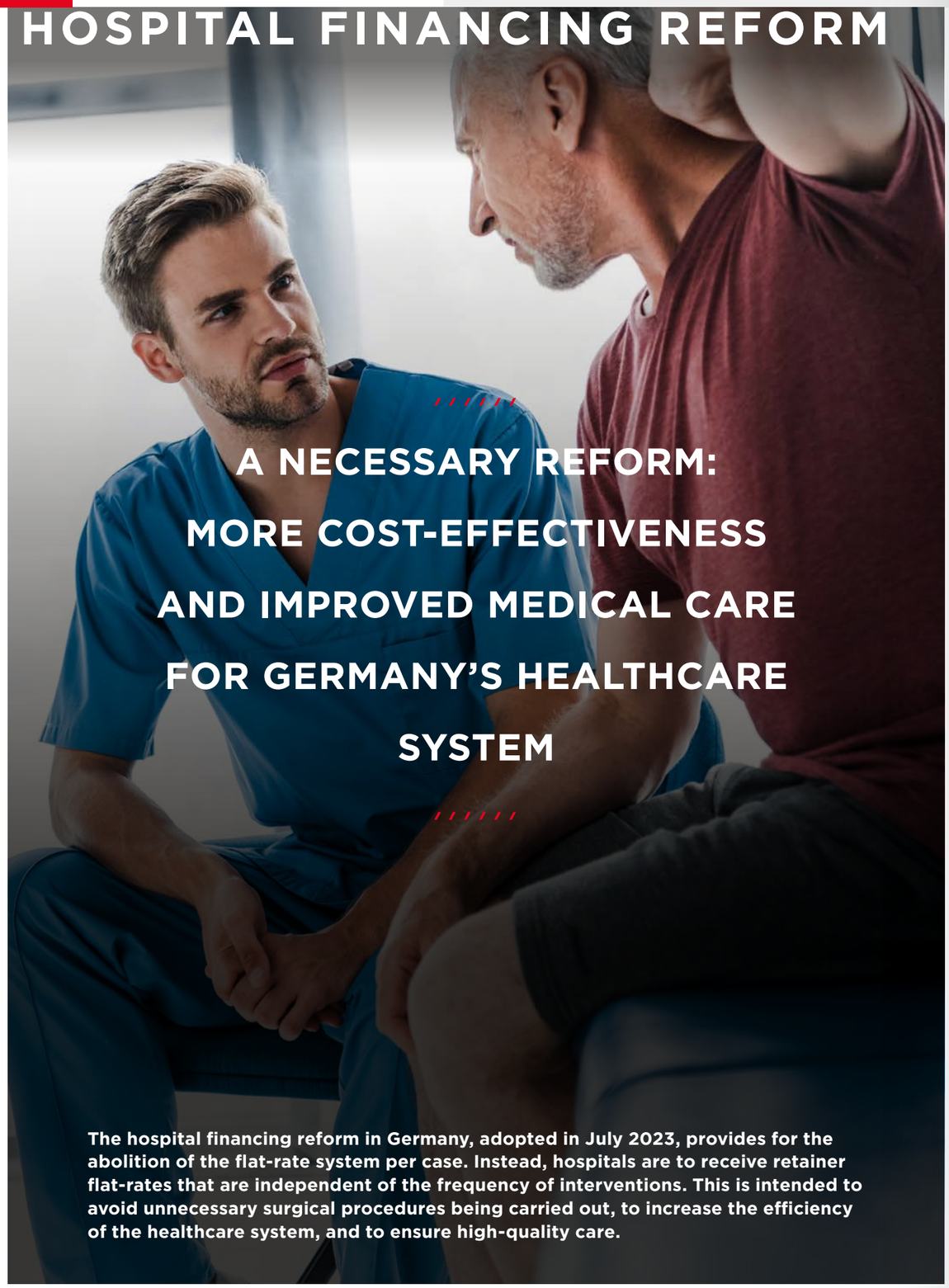


SUPPLEMENTARY INFO

HOSPITAL FINANCING REFORM



A NECESSARY REFORM: MORE COST-EFFECTIVENESS AND IMPROVED MEDICAL CARE FOR GERMANY'S HEALTHCARE SYSTEM

The hospital financing reform in Germany, adopted in July 2023, provides for the abolition of the flat-rate system per case. Instead, hospitals are to receive retainer flat-rates that are independent of the frequency of interventions. This is intended to avoid unnecessary surgical procedures being carried out, to increase the efficiency of the healthcare system, and to ensure high-quality care.

Economic financing, needs-based supply

On 10 July 2023, the federal and state governments agreed on the main features of the upcoming hospital financing reform. The reform mainly affects conventional medical hospitals and therefore has no direct impact on rehabilitation facilities. Nevertheless, similar trends towards improved transparency for patients can also be seen in rehabilitation clinics and it is thus apparent that the trends resulting from the hospital financing reform, such as greater patient self-determination, greater efficiency and improved medical care, will be relevant to the entire German healthcare system in the future.

Abolition of the flat rate per case system

The most important step in this reform is the abolition of the flat rate per case system. In future, hospitals will receive so-called "retainer flat rates", which are independent on the frequency of procedures performed. This is to avoid medically unnecessary procedures being performed solely in the interest of a hospital's finances. Hospital closures are also being considered in order to have more staff available in fewer facilities. This is intended to ensure improved care and funding per inpatient.

Financing until 2023 **100% flat rate per case**		Financing until 2024 **60% Service retainer rate / 40% Flat rate per case**
Hospitals are paid per diagnosis (DRG – diagnosis-related group		Hospitals are paid to retain the availability of certain services (Service provision system)
Hospitals have to achieve a certain number of cases in order to finance themselves	Hospital financing reform	The economic pressure on hospitals should be reduced – they also receive payment independently of the number of diagnoses and treatments

More transparency for patients

The nationwide transparency portal also went online on 1 January 2024. Here, patients can see how often and with what quality certain services (such as surgical procedures or nursing care) are provided. This transparency enables patients to select the hospital where the desired procedure - for example a knee-cartilage operation - is performed frequently and with high quality.

Rehabilitation clinics are also undergoing a similar development regarding patient autonomy with the introduction of the right to choose. This makes it easier for them to choose their own clinic. The right to choose leads to greater transparency in the market while also increasing the competitive pressure between existing facilities, whose location and reputation are now becoming increasingly important.

OPERATOR MARKET

THE MARKET IS DOMINATED BY PRIVATE OPERATORS, WITH MERGERS OUWEIGHING NEW ENTRANTS.

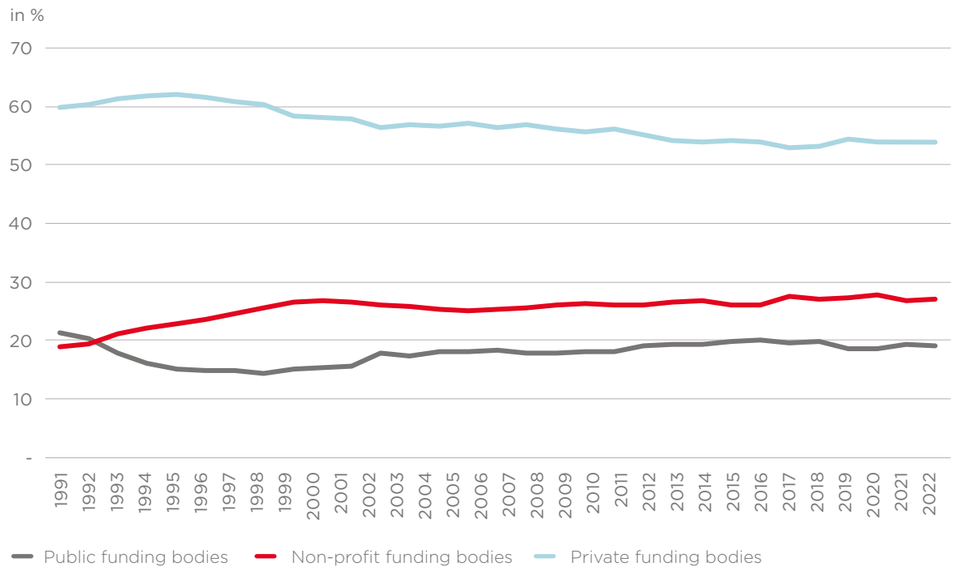
Despite a decline in the number of privately run rehabilitation clinics following the Growth and Employment Promotion Act of 1997, private operators continue to dominate the market. In 2022, they accounted for a market share of 54 percent with 594 facilities. Although the number of private rehabilitation clinics has fallen by 28 percent since 1994, they still outnumber public operators, which only account for 19 percent. The market is characterised by mergers and acquisitions, as smaller clinics are bought up by larger operators rather than new operators entering the market.

Shift in the balance of power in the rehabilitation clinic market: Private operators dominate despite losses

The Growth and Employment Promotion Act, which came into force in 1997, led to a reorganisation of the market, which resulted above all in a decline in the number of privately run rehabilitation clinics. Falling by 30 percent since 1997, following an increase of 19 per cent between 1991 and 1997. Nevertheless, private providers continue to dominate the operator landscape and accounted for a market share of 54 percent in 2022 with 589 facilities.

Despite the market power of private providers, the Federal and State Pension Insurance Scheme, one of the public funding entities, is Germany's largest operator of rehabilitation clinics with 102 facilities. Overall, however, public bodies account for only 19 percent of the total market. In terms of private operators, the Median Group has by far the largest chain of rehabilitation clinics with 97 facilities, followed by Asklepios, which has 40 facilities.

Development of preventive and rehabilitation facilities by operator type in the total market



Source: Gesundheitsberichterstattung des Bundes (GBE), Cushman & Wakefield, 2023

CONSOLIDATION PROCESS

Consolidation in a fragmented market

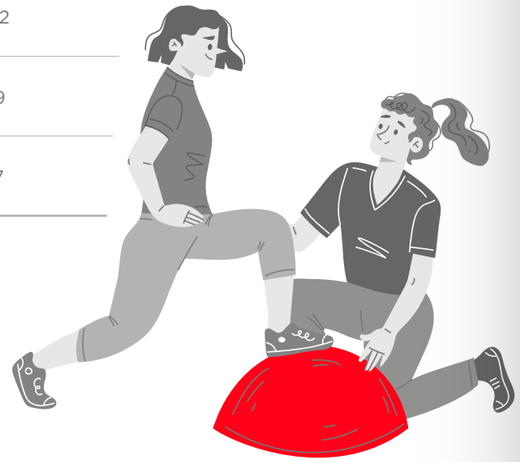
Despite the restructuring of the German operator market at the end of the 1990s, it is still characterised by a high degree of fragmentation, especially among private operators of rehabilitation facilities. In recent years, there has been increasing consolidation in the private operator sector. In 2014, for example, Waterland acquired the shares of Advent and Macrol in Median Kliniken, before the latter was merged with RHM Klinik- und Altenheimbetriebe, which also belongs to Waterland. Later, Median Kliniken and the AHG Allgemeine Hospitalgesellschaft, which had a portfolio of 45 facilities and ambulant services, were merged. In the years that followed, there were further takeovers of individual clinics. In 2018, the rehabilitation and care division of Helios was taken over by the Austrian healthcare real estate company Vamed. Other transactions were mainly in the smaller-scale segment, involving individual facilities.

Due to the slight decline in the number of inpatient facilities, there are few entries by new operators or operator chains, and the market is instead mainly characterised by mergers and acquisitions of individual facilities by larger operator chains. The trend towards the purchase of individual facilities is supported by the generational change in owner-managed rehabilitation clinics, for which there is often no suitable and financially liquid successor.

The largest rehabilitation clinic operators

Operator	Number of rehabilitation clinics
Deutsche Rentenversicherung	102
Median Unternehmensgruppe B.V. & Co. KG	97
Asklepios Gruppe	42
Vamed AG	19
Celenus Gruppe	17

Source: Cushman & Wakefield, 2023



HABILITATION CLINICS AS AN ASSET CLASS

PATIENTS' EFFECTIVE SUSTAINABLE RECOVERY IS OF SYSTEMIC IMPORTANCE

Extremely high demand and net initial yields of between 5.5 and 6 percent – investing in rehabilitation clinics has been in vogue in recent years. No wonder, when you look at the demographic development and the associated increase in chronic diseases and operations. Rehabilitation will therefore continue to gain in importance in our society. From an economic point of view, it is also essential to reintegrate sick people into the world of work – especially because there are fewer and fewer pension contributors and all the more benefit recipients due to the ageing population. This makes rehabilitation clinics an attractive asset class, but with obstacles: The outdated structure of many clinics built in the 1980s and 1990s requires considerable investment in renovation and equipment. Independent clinics, in particular, are struggling to raise these funds, as legal regulations on structural standards and accessibility continue to increase costs.

Cost driver ageing buildings

As previously described, inpatient rehabilitation experienced a boom in Germany from the late 1980s to the mid-1990s. In order to meet the demand for inpatient rehabilitation places, numerous rehabilitation clinics were built during this period, many of which are still in operation today. With the introduction of more restrictive allocation of rehabilitation treatment in the mid-1990s, construction activity in the sector declined, resulting in a relatively old building stock in the rehabilitation clinic landscape; many of the facilities currently in operation are 35 years old or more. This has led to high levels of investment being required for refurbishment measures and to improve fit-out and equipment, thus helping to maintain and improve competitiveness. However, particularly for independent, owner-managed rehabilitation clinics it is often difficult to raise the necessary funds.

Building requirements

The structural requirements for rehabilitation clinics are determined by the German State Pension Insurer. The fit-out and equipment required can vary depending on a facility's treatment focus. For example, rehabilitation clinics must have training rooms, functional rooms such as training kitchens, exercise rooms and pools, rooms for individual consultations and individual treatments as well as rooms for group activities, depending on the focus of treatment. Regardless of the treatment focus of the facilities, accessibility must be fully ensured in every rehabilitation clinic in accordance with the Disability Equality Act (§ 4 BGG) so that people with disabilities can make full use of all structural facilities and other equipment and systems.

Location: The climate must be right

Rehabilitation clinics are often located in scenic or rural regions, while there is a shortage in urban centres. In addition, there is an increased density of rehabilitation clinics in regions with a stimulating climate, which is considered a healing factor, especially for respiratory and skin diseases. These regions primarily include the seaside resorts on the North and Baltic Seas as well as climatic health resorts in the mountains. Due to the average age of the facilities, there is also a difference between the old and "new" federal states in terms of the number of rehabilitation clinics. One exception is the federal state of Mecklenburg-Western Pomerania, due to its stimulating climate on the Baltic coast.

Letting and investment market

As previously stated, rehabilitation clinics are run by private, public or non-profit operators. These operators either hold the properties in their own portfolio or conclude a general operating lease with the property's owner. As with other healthcare properties, such a general operating lease is in most cases index-linked, often to the consumer price index (CPI), and structures the costs of maintenance and repairs as double or triple net. General operating leases are concluded on a long-term basis due to the planning horizon, which ensures a relatively secure and long-term cash flow for the owner of the property.

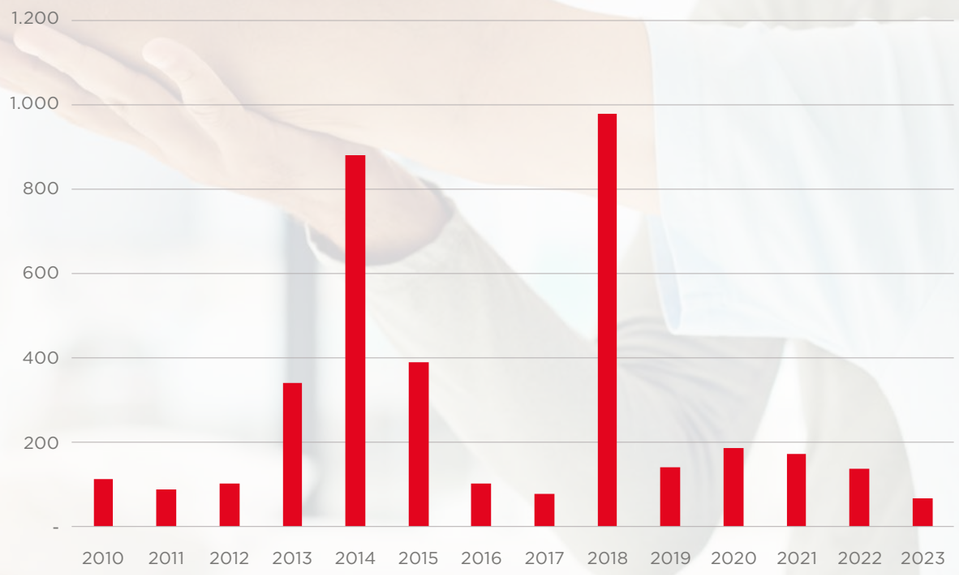
CHALLENGES AND OPPORTUNITIES

A look at transaction activity in the healthcare sector in 2023

Transaction activity in the healthcare sector indicates that the current financial challenges are hampering M&A activity for both hospitals and rehabilitation clinics. In 2023, there was an increase in sales due to insolvency in the hospital sector, while only 22 takeovers and mergers were recorded. There was also a slight decline in transactions in the rehabilitation sector, both ambulant and inpatient. Although the market saw some recovery in 2022, it has not yet reached pre-pandemic levels.* Despite these challenges, we at Cushman & Wakefield are experiencing high demand for product, although supply and the difficult market situation are significantly limiting transaction activity.

*Source: PWC, 2023

Development of rehabilitation clinic transaction volume



Source: Cushman & Wakefield, 2023

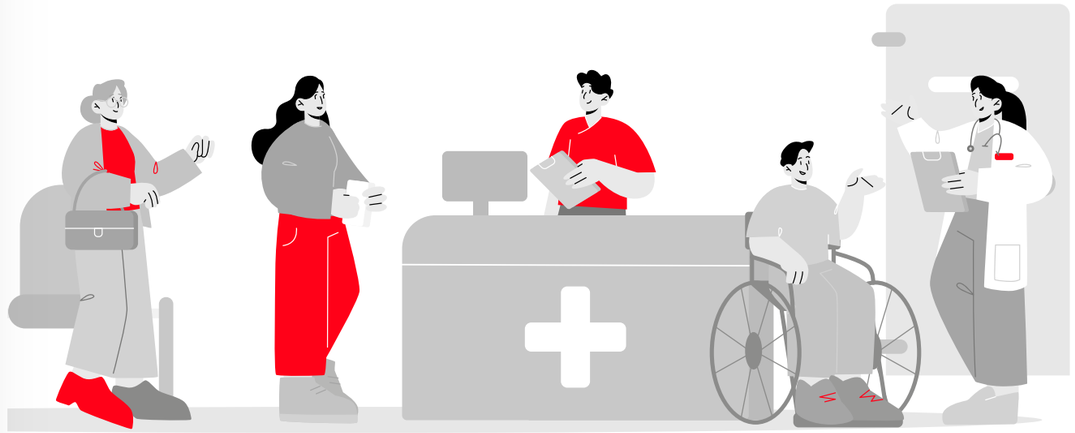
Significantly more demand than supply

Despite the current tight financial situation, rehabilitation clinic have enjoyed growing interest as an asset class in recent years, while the transaction volume developed dynamically at the same time. Nevertheless, the asset class is less established than others in the healthcare segment, such as nursing care properties, although both are experiencing an increase in demand due to demographic change as well as economic similarities.

The dynamic development of the transaction volume is due to fluctuating product availability. Demand for this asset class significantly exceeds supply, and clinics specialising in treatments that have seen strong increases in patient numbers in recent years are expected to become increasingly popular with investors. These include, for example, indication-specific clinics in the fields of psychosomatics, orthopaedics and cardiovascular diseases. The market has typically been characterised by purchases of individual or small numbers of clinics – large-volume transactions have remained the exception in recent years.

Net initial yields for such operator properties depend on the location, the quality of the building, the key points of the general lease and the operator's creditworthiness as well as the future viability of the treatment concept. They range between 5.5 percent and 6.0 percent for core investment opportunities.

It is assumed that the majority of rehabilitation treatments will continue to be carried out on an inpatient basis in future. There are a number of reasons for this: For example, inpatient treatment makes it very easy to bundle different forms of treatment without the patient having to commute daily between different locations and their place of residence. In addition, group treatments can be carried out easily for all participants without having to take into account the patients' personal commitments and, particularly in the case of psychosomatic illnesses, therapy away from home is often more promising. In addition, patients with lung and respiratory diseases in particular often require a stay in a stimulating climate zone in order to achieve the desired treatment success.



IN CONVERSATION WITH OLIVER SPIEWAK

> We see long-term and stable cash flows with corresponding indexation here, and there is also a highly predictable demand for certain forms of treatment and corresponding product in the market.

OLIVER SPIEWAK
Primonial REIM
Management Healthcare

How long has Primonial REIM been involved in rehabilitation clinics as an asset class?

As the market leader for European healthcare property, Primonial REIM has been involved in the rehabilitation clinic asset class since 2013. We always keep an eye on all forms of treatment in order to achieve broad diversification in terms of operators, regions, range of medical indications treated and regulations in our portfolio. In Germany, we acquired the first rehabilitation clinics as part of a sale and leaseback transaction in 2020.

What advantages do you see in investing in rehabilitation clinics compared to other asset classes?

We see long-term and stable cash flows with corresponding indexation here, and there is also a highly predictable demand for certain forms of treatment and corresponding product in the market. We focus on the operator's creditworthiness in terms of size and treatment focus as well as the operator's general level of professionalisation. We are aware that the rehabilitation clinic asset class is small compared to the residential or office market. However, the key factors here are expertise in the main areas of treatment, refinancing and close partnerships with the operators. We have built up our expertise over many years and can therefore negotiate on an equal footing with sellers and operators when another sale and leaseback transaction presents itself.

What strategic impact has the acquisition of Icade Santé had on your expansion in the rehabilitation clinic asset class and what differences are there between the markets in which you invest?

The acquisition of Icade Santé, enabled us to strengthen our position in the European market and also further advance our diversification strategy. We have succeeded in expanding our portfolio in France to include the largest operators of clinics in the psychosomatic and rehabilitation sectors. In view of the continuing trend towards ambulant care, including in the clinic sector, new investments are always scrutinised in terms of their profitability.

The biggest difference between Germany and France is that the majority of treatment in Germany is still provided on an inpatient basis, whereas in France the majority of the system is already organised on a day-care or ambulant basis. When looking at the range of medical indications for which treatment is provided, there are fewer differentiations in France compared to Germany. The focus in France is mainly on the rapid restoration of function and less on the additional preventative nature of a treatment.

What do you see as the major challenges for rehabilitation clinics in the current market environment?

The biggest challenges will lie in the changing demands on treatment methods. The outpatient and inpatient areas will have to meld even more closely in future in order to meet the megatrend of the ambulantisation of numerous treatments without medical quality suffering as a result.

Furthermore, with regard to the shortage of specialised staff: personnel as a resource and the correct deployment of dwindling numbers of staff is becoming increasingly important. As in many other areas, the key to a successful business model is, above all, a qualified workforce to provide treatment and care. In contrast to nursing homes and hospitals, the quota of trained nursing staff required for rehabilitation clinics is lower, but the demand for specialists is higher.

IN CONVERSATION WITH OLIVER SPIEWAK

In your opinion, what criteria must rehabilitation clinics fulfil in order to be considered for future acquisitions? Are there similar risks to those of the care market with regard to operator insolvencies?

As rehabilitation clinics are usually pure operator properties with one main tenant, it is crucial to understand the exact business model and examine its long- term viability. Political and regulatory developments, such as the forthcoming hospital reform, play a significant role in our evaluation. As a property investor, we consider the long-term rental and operator lease income to be extremely secure, provided that these are at a sustainable level that is acceptable to both parties - tenant and landlord.

We consider the issue of operator insolvencies in the care market to be a temporary phenomenon. We assume that the worst is now behind us and that operators will gradually utilise and implement the refinancing options available to them under the statutory framework.

About Primonial REIM

Primonial REIM Germany is part of the Primonial REIM Group, a leading European asset manager, the management companies (Primonial REIM France, Primonial REIM Germany, Primonial REIM Luxembourg, Primonial REIM Italy and Primonial REIM Singapore) with assets under management of approx. 42 billion euros (as at 5 July 2023), of which approx. 18 billion euros is in the healthcare sector.

This makes Primonial REIM the leading European investor and asset manager for healthcare property. Primonial REIM brings together more than 450 employees in six countries and applies its core values of passion and social commitment as well as its expertise at European level to design and manage property funds for its national and international clients, whether private individuals or institutional investors. As part of its strategy for this asset class, Primonial REIM has built an in-house team with strong operational expertise specialising in the acquisition and management of healthcare real estate, as well as a dedicated German platform of healthcare real estate experts with more than 80 employees. These cover the entire spectrum of services from property to asset management.

IN CONVERSATION WITH THOMAS OTTO

> Painstaking analysis of operator quality and profitability remains key

THOMAS OTTO
PATRIZIA Deutschland GmbH
Head of Acquisitions Commercial DACH

PATRIZIA is one of the leading healthcare property investors in Germany. Since when and why have rehabilitation clinics been part of your acquisition strategy?

Our investment volume for healthcare properties now totals around EUR 1.5 billion, which makes us one of the largest German investors in this segment. As part of our healthcare property strategy, we have also been a portfolio holder in the rehabilitation clinic asset class for almost 25 years.

Rehabilitation properties are considered a niche product and contribute to the diversification of our investors' property portfolios. The asset class instils confidence due to its good utilisation rates and secure cash flows with long-term leases and low cost risks. Rehabilitation properties are therefore considered a stable product and an anchor of stability within our investors' portfolios.

It also ensures more attractive yields that other real estate use-types.

Despite the current state of the property market and the shortage of product, we continue to selectively review the acquisition of properties for our funds and concentrate on existing properties with high operator quality in well-functioning locations.

What opportunities and risks do you see for rehabilitation clinics in the current market environment and what do you pay particular attention to?

Rehabilitation clinics are considered to be of systemic importance and will continue to play an important role in people's effective recuperation in the future. The demographic trend with an increasing number of older people, necessitating increased care and rehabilitation services, guarantees continuous demand in this segment. This continues to make the asset class attractive for specialised investors in the healthcare sector.

The German operator market is characterised by fragmentation, with numerous small private companies, some of whom are owner-occupiers. Challenges such as changing financing structures, rising energy costs, the tightening of quality standards and the general shortage of skilled labour in the healthcare sector can have a negative impact on the profitability of smaller companies in particular. A thorough analysis of operator quality and profitability therefore remains of central importance. In addition, the operator concept must be closely scrutinised with regard to the current demand situation and future requirements.

In contrast to fully inpatient care homes, which offer a largely standardised service throughout Germany, the rehabilitation sector requires detailed examination at various points. This includes questions about the range of medical indications for which treatment is offered, the cost bearers, the main referrers in the region and, of course, the staffing situation at the location. In view of the numerous particularities that have to be taken into account, specialised expertise is essential when investing in healthcare and rehabilitation properties.

What role does ESG play when investing in rehabilitation clinics?

The topic of ESG (Environmental Social Governance) in healthcare properties plays a decisive and forward-looking role in all its aspects. The "S" in ESG is particularly relevant, as such facilities are essential for society and represent great social added value. In addition, regulatory energy efficiency and reporting requirements such as the GEG or the EU Taxonomy must also be complied with and implemented.

PATRZIA therefore pursues an integrated and active ESG strategy as part of its healthcare property focus. To this end, energy status descriptions are initially commissioned in the form of energy audits, and energy-saving measures are identified and implemented accordingly.

In addition, social aspects are integrated and discussed with the operators. A key factor in the successful implementation of an ESG strategy is the mutual exchange of ideas and successful collaboration between landlord and tenant. ESG strategies can only be implemented successfully with active cooperation.

IN CONVERSATION WITH THOMAS OTTO

In your opinion, what are the major regulatory challenges for rehabilitation clinics?

The rehabilitation sector is a legally regulated market. With the strengthening of the right of choice, insured persons will be able to choose their own rehabilitation clinic even more easily in future. The location and reputation of the facility will now play an even greater role than previously in the purchasing process. The right to choose will increase transparency in the market, but will also increase competitive pressure between existing facilities still further.

One of the major challenges is, and will remain, the shortage of specialised staff – it is becoming increasingly difficult to find qualified personnel. The majority of rehabilitation clinics have difficulties filling medical service vacancies. The future-oriented management of specialised staff will determine the success of the respective operation or company. The focus here is not only on appropriate remuneration, but in particular on attractive working conditions. The reduction of bureaucracy is one of the main measures demanded by industry representatives.

The specialisation of companies, adapted to the current demand situation, is also becoming increasingly important. In PATRIZIA's view, neither less-specialised small-scale businesses, nor facilities in less sought-after locations, will survive the intense competition.

About PATRIZIA SE

PATRIZIA operates worldwide, and has been offering investment opportunities in property and infrastructure for institutional, semi-professional and private investors for 39 years. PATRIZIA currently has around 58 billion euros of assets under management and has around 1,000 employees at 28 locations. Since 1984, PATRIZIA has been investing with the aim of making a positive contribution to society, since 1992 by supporting the nationwide "Bunter Kreis" initiative in Germany to care for seriously and chronically ill children and since 1999 by supporting the PATRIZIA Foundation. Over the past 24 years, the PATRIZIA Foundation has provided more than 600,000 children and young people worldwide with access to education, healthcare and a safe home to give them the chance of a better, self-determined life. Further information can be found at www.PATRIZIA.ag and www.PATRIZIA.foundation.

OUTLOOK

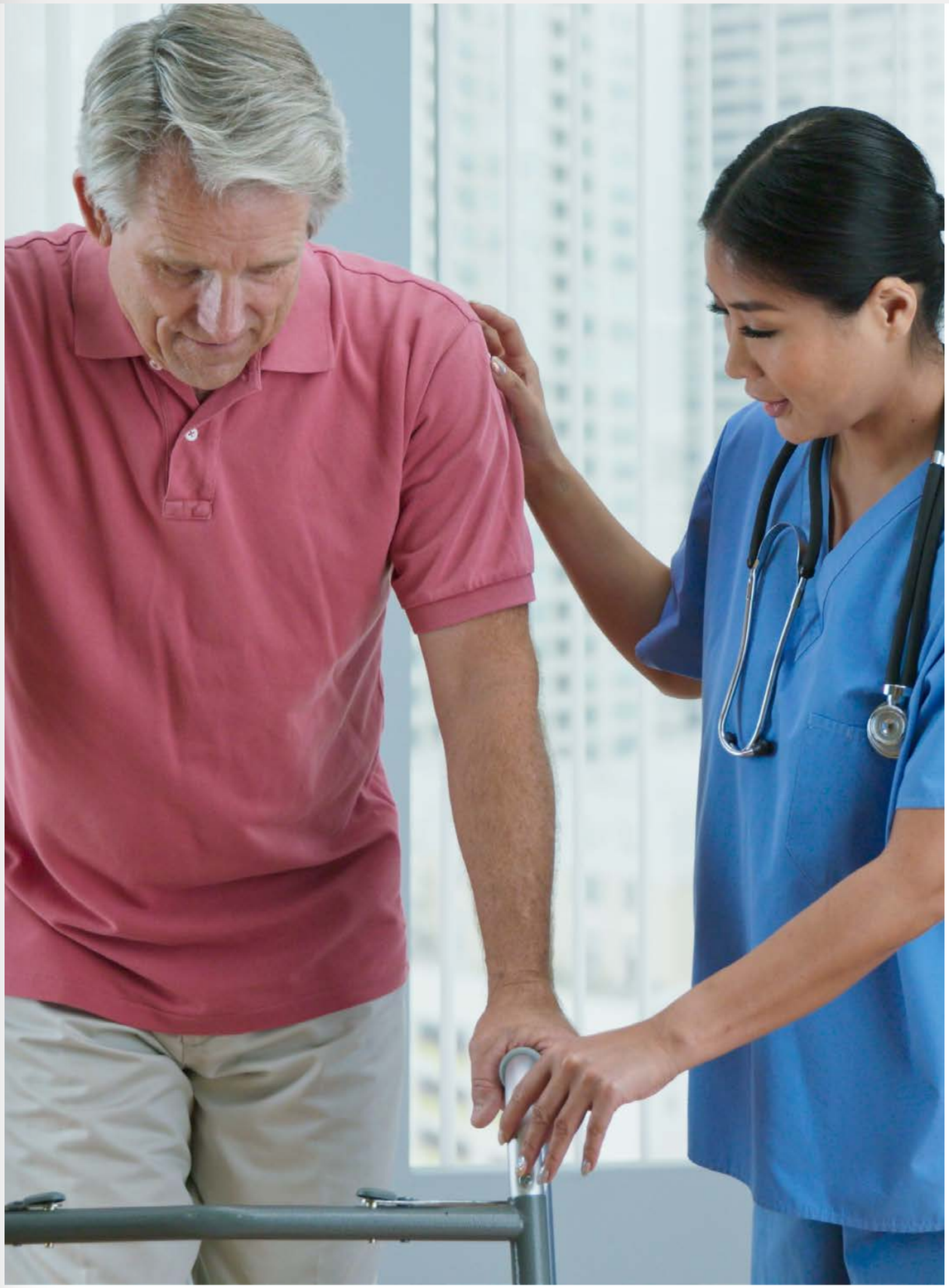
Where is the German rehab property market heading?

Secure cash flows and attractive yields on the one hand, outdated buildings and a fragmented operator market on the other – rehabilitation properties have proven to be a solid investment, but require specific industry knowledge. This is all the more true as they are less established than other asset classes in the healthcare sector.

Demand clearly exceeds supply and it is assumed that clinics whose treatment specialisations have seen strong patient growth in recent years will increasingly become the focus of investors. These include, for example, indication-specific clinics in the fields of psychosomatics, orthopaedics and cardiovascular diseases. The market is currently seeing very few entries of new operators, but is instead characterised by mergers and takeovers of individual facilities by larger operator chains. This trend is reinforced by the generational change in owner-managed rehabilitation clinics, for which there is often no suitable and financially solvent successor available.

In their role as a niche product, rehabilitation clinics offer an attractive diversification opportunity within the property portfolio, but also require investors to keep a close eye on market developments that may affect the structure and profitability of the asset class. The megatrend of ambulantisation of care, which will lead to a necessary melding of the outpatient and inpatient sectors in Germany, will also bring further changes.

Another noteworthy development is the strengthening of the right of choice, which will make it easier for insured persons to choose their own rehabilitation clinic in future. This means that the location and reputation of the facility will play an even greater role than before. Overall, rehabilitation property remains a promising investment opportunity, particularly due to the demographic trend in Germany. The key to success is a thorough analysis of operator quality and profitability against the background of current and future requirements - then rehabilitation property can serve as an anchor of stability in a diversified property portfolio and offer investors sustainable long-term yields.



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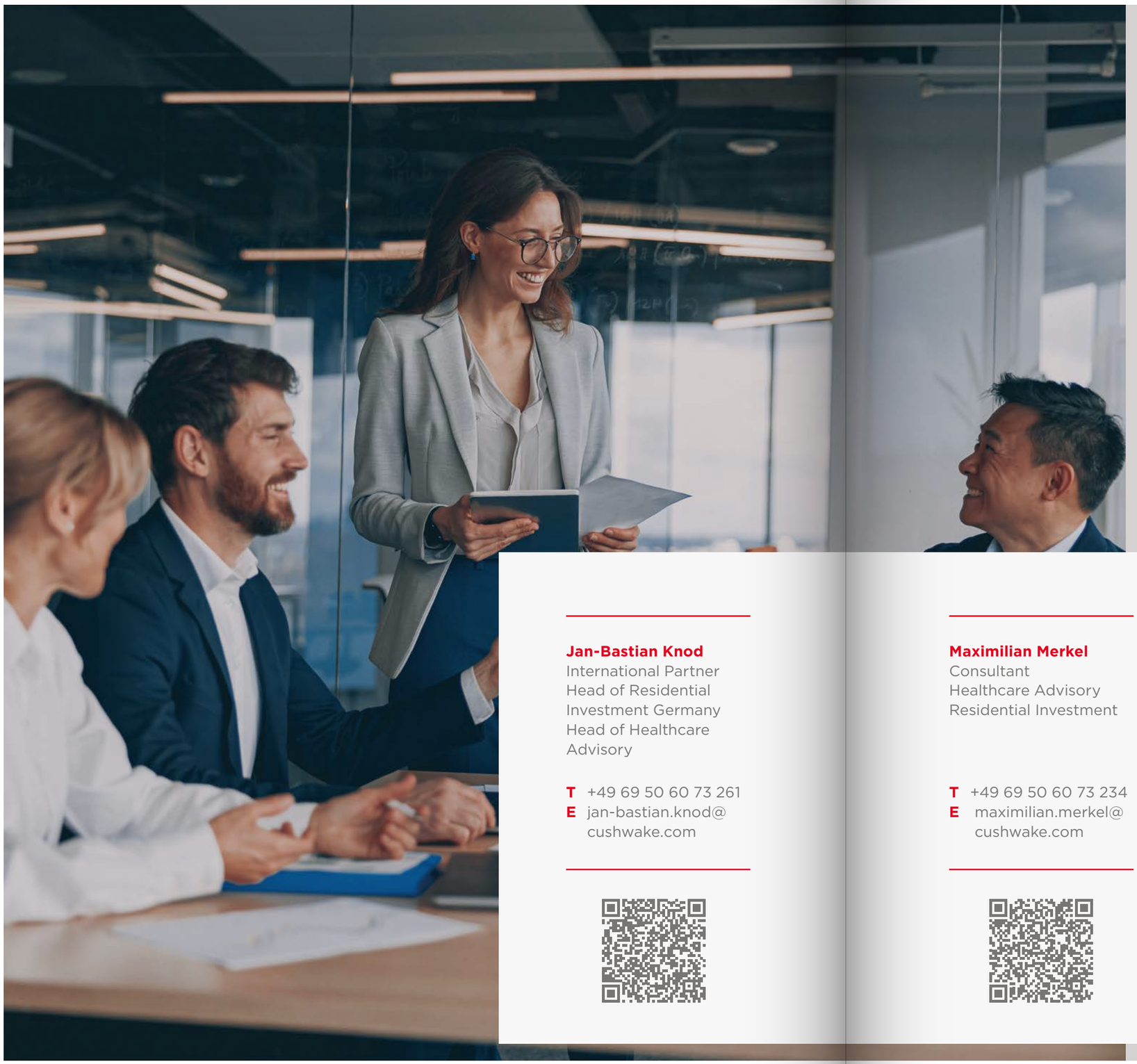

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