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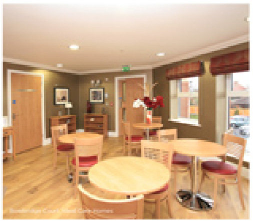
In the cross-hairs

Target Healthcare REIT has its sights set on building a high quality portfolio, but is moving cautiously finds ***Sunniva Davies-Rommetveit***

Target Healthcare REIT managing partner Kenneth MacKenzie has a measured and patient approach to building up a business in the healthcare sector. Having experienced the recession slowdown first-hand, his motto when it comes to investment in the industry is "stable, steady and long-term".



Considering that Target has snapped up 23 care homes UK-wide in the 18 months since it listed on the London Stock Exchange, the company has nonetheless grown impressively. To a large extent, this is down to prior experience.

The concept of investing in care homes began for MacKenzie in 2008 and two years later, he launched Kames Target Healthcare Fund in partnership with Kames Capital and invested in 13 care homes. Following this success, the idea for Target Healthcare REIT was born, and this bore fruit in March 2013, when the REIT listed.
"We raised around £45 million - £47 million the first time round and a further £5 million 10 weeks later. Last October [2013], we got another £45 million," explains MacKenzie.

At the time of listing, Target was already interested in three assets, which were speedily bought in Arbroath, Dundee and Huntly. The number quickly expanded though: "It was swift. Within a month we had already invested in six assets."
Though the company invests in physical assets, its philosophy is centred on the idea of improving care standards for future residents. MacKenzie explains that Target only invests in future-proof care homes, with spacious bedrooms and en suite bathrooms to make living standards as high as possible.

Longridge Hall and Lodge, Orchard Care Homes

"We are not really interested in buying a home that is essentially a block of bedrooms with a feeding area," he explains, "Wetrooms, for example, are very important as it aids the general care of the elderly."

St Ronan's Care Home, Balhousie Care

Kenneth MacKenzie, managing partner, Target Healthcare REIT

Given the numerous exposés in recent years about inadequate levels of treatment in care homes, it is important to lease the property out to the right tenant. Finding out whether or not a prospective tenant treats its staff well, and whether the staff in turn provide stellar care to residents, is paramount to the firm.
To do this, Target courts tenants-to-be. It visits operators' current care homes before agreeing the contract terms, which tend to have a lease timescale of 30 plus years.

"We're interested in meeting the care staff, care manager, middle management and the managing director, to try and understand their perspective and their short-, medium- and long-term objectives," MacKenzie explains. He adds that Target does not deliberately try to make tenants' lives difficult. However, they "wouldn't hesitate in elevating the issue" if quality standards were to fall seriously low.
The company, moreover, keeps a regular eye on tenants after the contract is signed, going into care homes regularly to see if standards remain up to scratch. "We have someone looking at a different care home each week," he explains. "Our tenants appreciate the contribution that we make. A number of our care homes, in fact, use our healthcare partners as mystery shoppers by inviting us to go in unannounced." The Panorama exposés and their terrible impact have not gone unnoticed by Target, then.

Size-wise, around 80% of the company's portfolio constitutes 60- to 70-bed care homes, with three being 40-beds. The 40-bed range, though, is the Holy Grail for Target. MacKenzie wistfully admits that he would buy 40-beds every day of the week if it were possible. This is because a 100-bed home requires filling many more beds before the business becomes a profitable one.
To compensate for the problematic lack of 40-beds in its portfolio, the company will not invest in larger homes unless its managerial structure is absolutely right. "In a 70-bed home, a wise manager would have

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unit managers. These would be the go-to people for both staff and the 20 or so residents in that unit," MacKenzie says.

The business model has kept Target's 150 or so investors happy so far. They include individuals from many of wealth management's household names including Investec, Brewin Dolphin Securities, CCLA Investment Management and Henderson Global Investors. The company aims to pay its financiers a 6% cover dividend which, it announced recently, will increase by 2% in line with the current inflation rate.

When it comes to doing some crystal ball gazing, MacKenzie says that his understanding of the healthcare world has taught him not to aim too high too fast. The fact that social care is being ruthlessly scrutinised nowadays has taught him, moreover, to be respectful and realistic when talking about returns.
"If you had spoken to me 20 years ago, I would have cast a vision that the company would be a billion pound company within five years, and all the rest of it," he smiles.

Along the way though, he realised that businesses like his have "a solemn responsibility to deploy the money that our investors entrust in us wisely". Doing that means that investors then tend to give the company a bit more money, he insists.

MacKenzie is not just cautious for his investors' sake, though. With shocking revelations about standards of care unwantedly popping up on front pages once again, he remains very cautious about portraying the right public image. "The healthcare sector's client group tends to be in distress. Do you really want to make super profits out of distress? Or do you want to be stable, long-term and provide the right facilities?"

This noble aim to increase standards and make residents as comfortable as possible can prove difficult, however, especially when there aren't enough suitable care homes being built. Attributing this to the recession, MacKenzie believes there should be a palpable push to build new, suitable care homes. With the demographic squeeze being the way it is, many would agree.

Currently a £103 million company, MacKenzie sidesteps a question about how big Target could become. He says that they intend to grow "cautiously" but "steadily". "There aren't usually £100 million businesses on the London Stock Exchange main market, they're often a lot bigger. So we're not planning on staying this size forever."

This measured approach is no doubt sensible MacKenzie aims to do well by both his investors and the residents who occupy the 23 care homes in Target's portfolio. He is also not shy to point out that this is a slow-burn business. MacKenzie is always viewing prospective homes, for instance, "several hundred to date" he says. However, getting the right assets requires patience, experience and excellent timing, all sprinkled with a bit of good luck.

He points out that the two words most important and obvious to remember when finding suitable assets are ironically often the most forgotten ones: "care" and "home". He's right of course - without the softer touches that make a building homely, and minus the facilities which enable care, a care home can never truly live up to its name. Thus far at least, remembering that has stood Target Healthcare REIT in good stead.

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