TauroAdvisor

In the Bullseye

The US Senior Housing Market

Overview

Senior housing development took flight in the early 1980s when developers and investors recognized the potential to benefit from the anticipated surge of the elderly population in the United States. Numerous small, mom-and-pop, and not-for-profit operators dominated the industry during its infancy. The industry expanded significantly in the late 1980s when a U.S. Department of Housing and Urban Development (HUD) program was implemented, with the senior housing sector in mind, to insure lenders against losses on mortgage defaults. As a result, private capital began to flow into the sector. The mid-1990s witnessed the rapid growth of healthcare Real Estate Investment Trusts (REITs) and the emergence of the private commercial mortgage-backed securities (CMBS) into the Senior Housing market.

The securitization of loans collateralized by senior apartments and skilled nursing homes increased steadily during the late 1990s. Because of excess capital available from the public markets, the senior housing sector especially the assisted living segment was overbuilt during the late 1990s. The market outpaced itself as developers built properties at a rate that well exceeded demand, resulting in over-supply. Compounding the problem was the fact that product designs did not meet the needs of target markets. Consequently, average occupancy rates declined, and many projects failed to meet investment expectations. Depressed stock prices from 1999 to 2000 limited the supply of new equity financing, but offered attractive valuations for acquisition targets, prompting a surge of mergers and acquisitions (M&A) among senior housing REITs. At the same time, several healthcare REITs shifted from growth strategies to liquidation strategies in order to address debt problems. Finally, accounting scandals, operational issues, higher interest rates and excessive debt caused the industry to restructure and consolidate.

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According to projections in a study funded by the National Investment Center for Seniors Housing & Care and published online today by Health Affairs; fifty-four percent of the 14.4 million middle-income older adults in the United States will lack the financial resources to pay for senior housing and care by 2029. A combination of public and private efforts will be needed to address the looming crisis.

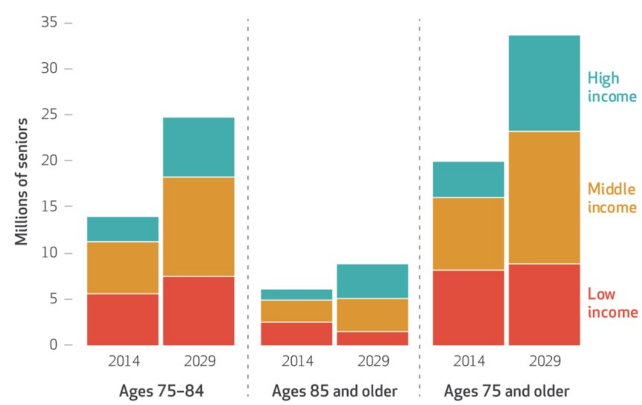

Figure 1: Sizes of Senior Population by age and income in 2014 and 2029 [1]

Figure 1 considers those who would be able to sell their homes and use all of their annual financial resources to pay for senior housing and care. The percentage increases to 81% if it includes middle-income older adults who would be able to keep their homes but commit the rest of their annual financial resources to cover costs associated with senior housing and care.

Today, industry business models have become more defined. Occupancy and operating margins are improving to near six-year highs and the industry is reporting healthy year-over-year revenue and NOI growth. As a result, institutional investors are increasing their acquisitions in the sector, the result of which is helping to drive cap rates to new lows. Although a variety of reimbursement and operational issues remain, both the near- and long-term outlooks for the senior housing sector are increasingly positive.

US Senior Housing Market Landscape - Pre COVID

The baby boomers (post-World War II babies) began turning 65 in 2011 and by 2030, the remainder will also reach age 65 and account for approximately 21% of the total United States population. As indicated in Figure 2, by 2050, the 65-plus age group is estimated to exceed 85.6 million, a more than 50% increase over its estimated 2020 population (56.1 million). The same graph for the 85-plus group is even higher. By 2050, the 85-plus age group is estimated to exceed 18.5 million, a 177% increase over its estimated 2020 population (6.7 million). Additionally, by 2035 the 65-plus age group is estimated to be larger than the population under age 18. By 2035, there will be 78.0 million people 65 years and older compared to 76.7 million under the age of 18. The projected growth in the senior population will present by 2035 the 65-plus age group is estimated to be larger than the population under age 18. By 2035, there will be 78.0 million people 65 years and older compared to 76.7 million under the age of 18. The projected growth in the senior population will present many challenges to policy makers and programs by having a significant impact on families, businesses, healthcare providers and, most notably, on the demand for senior housing.

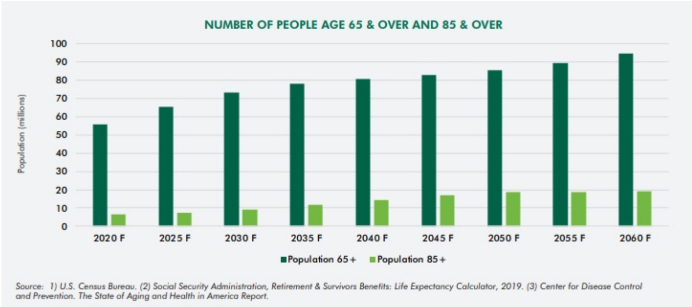

Figure 2: Senior Population growth over next few decades [2]

One of the primary drivers in trends for the aging population is mortality rates. Survivorship rates have shown consistent improvement for many decades. In the United States in 1972, the average life expectancy of a 65-year-old was 15.2 years(80.2 years of age). By 2017, this metric increased by 5.2 years to approximately 20.4 years (85.4 years of age). Additionally, it is estimated that about one out of every four 65-years olds will live to be 90 years old, with one of every 10 expected to live past 95 years of age. Driving this increased life expectancy, and consequentially average population age, is the advancement in public health strategy and medical treatment. Life expectancy in the United States has increased by approximately 30 years over the past century, primarily due to the reduction of acute illness threats. However, an unforeseen consequence of longer life expectancy has been the increased prevalence of heart disease, cancer and other chronic diseases as the leading causes of death. As Americans age during the next several decades, the elderly population will require a larger number of formally trained, professional caregivers as a direct effect of these chronic diseases, which often affect independence and mobility. Moreover, the problems facing the United States aging population can be witnessed as a global phenomenon. Fifty countries had a higher proportion of people aged 65-plus than the United States in 2010. This number is expected to increase to approximately 98 countries by 2050.

Annual United States healthcare services expenditures totalled almost $3.5 trillion in 2017. Healthcare is one of the largest line items in Federal and State Government spending. Healthcare spending is estimated to grow at an average of 5.5% per year from 2018 through 2027. Furthermore, over the same period, healthcare spending is estimated to grow 0.8% faster than GDP per year. As a result, healthcare as a percentage of GDP is expected to rise from 17.9% in 2017 to 19.4% by 2027.

There are approximately 23,500 professionally managed senior housing and nursing care communities (with 25+ beds) in the United States, representing 3.04 million professionally managed units/beds nationally. The combined projected total value is $420 billion based on values reported in NIC MAP's 5th Edition Investment Guide. The breakup of the community has been detailed in Figure 3.

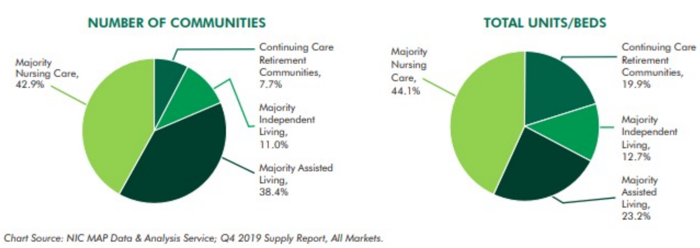

Figure 3: 2020 Total Retail Sales Growth [Y-O-Y] [3]

US Senior Housing Market and the Impact of COVID

Pandemic Pressures Impact Construction Timeline; New Design Strategies Emerge Slowdown in construction allows operators to catch up. Development activity had started to wane entering 2020, falling from a cyclical peak reached in 2018 when seniors housing construction totalled 9.3 percent of current inventory. Construction continued to fall in the fourth quarter of 2020 with more developers delaying or cancelling projects, which will help markets to rebalance supply and demand more rapidly during the recovery. Metros were starting to achieve parity prior to the pandemic as overbuilding had hit some segments in anticipation of a demographic wave, particularly independent living, which had weighed on property performance. In the fourth quarter of 2020, 23,500 independent living units were underway across the country, representing 9 percent of current inventory.

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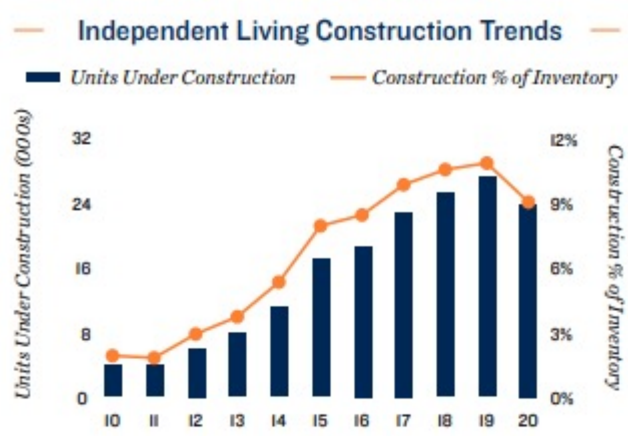

Figure 4: Construction Trends [4]

Focus on Senior Living

Avenue Development

Avenue is a national full-service real estate healthcare development and advisory company. Headquartered in Indianapolis, it is focused on innovative solutions for wellness centered healthcare and senior living properties totaling over 1.5 million square feet of current developments from medical offices and value-based care clinics, to the full care continuum of senior housing and skilled nursing. Avenue was founded in 2015 on the pillar of Development with Purpose, to go beyond the walls of a building, and provide developments that positively impact the communities in which the developments serve.

Avenue's senior living expertise spans the care continuum as well as the country. Core tenents to the Avenue development approach include, focusing on high-barrier to entry markets from a demand or entitlement standpoint, as well as being experts in the business model of their operating partners which sets them apart from other developers focused only on bricks and mortar. The convergence of traditional healthcare and senior living is creating a paradigm shift in the senior housing sector, and Avenue is at the forefront of this transformation by creating unique partnerships with health providers and creating flexible and functionally designed buildings and technological capabilities ensuring developments meet the future evolution of senior care.

It's this future that has the Avenue team motivated to be continuous innovators in the senior living industry. They forecast three large tailwinds advantageous to senior housing: 1) increasing demand from favorable demographic trends, 2) a recession resistant sector fueled by a needs-based decision of the older adult and their families, and 3) long-term potential for increased federal funding for hybrid forms of assisted living and memory care options through CMS' Home and Community Based Services program. Avenue also sees tremendous opportunity in partnering with healthcare providers in age-restricted housing models to help improve resident health outcomes while allowing them to age in place and is forming a new operational model with this vision. https://avenuedev.com

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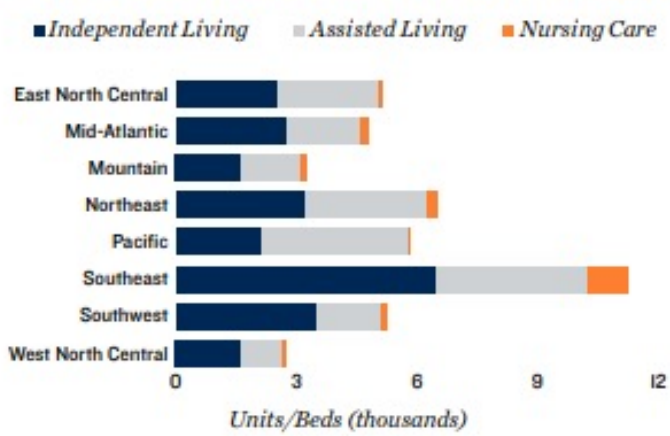

Figure 5: 2020 Occupancy by Location [4]

Supply growth is more balanced in the assisted living segment, where construction accounts for 4.7 percent of inventory and more than 18,900 units were underway at the end of last year. Development of skilled nursing facilities has been minimal with 2,100 beds underway, representing 0.3 percent of inventory. Many projects under construction have extended their timelines amid numerous pandemic pressures, which will help the market absorb existing units. Challenges to construction financing disrupt new projects. The health crisis has halted developments and placed plans on the shelves as developers face an uncertain investment climate and are challenged with obtaining financing for new projects.

Many banks are focusing on servicing existing clients and are resistant to assess new projects, which has led to substantial delays of up to 120 days for some developers. Projects that secured financing prior to the pandemic are underway, though many have contended with labor and materials shortages that have caused construction costs to surge.

Figure 6: Assisted Living Construction Trends [4]

As more people receive the vaccine and the occupancy rates begin to recover, construction financing should return and delayed projects will resume. Property design is shifting to increased infection control. Senior living providers and developers are rethinking community design, placing greater focus on pandemic-resilient design and how to prevent the spread of infections. Improved HVAC systems, fewer touch points, larger floor plans and enhanced outdoor spaces for residents will be top considerations in a post-pandemic environment. Some operators are also focused on increasing the healthcare capabilities of their communities with on-site clinics and dedicated spaces for telehealth appointments as they work to ensure the health and safety of residents. Other features that care providers are touting include larger apartment layouts with cooktops and a full-size refrigerator as opposed to smaller kitchens, improving the quarantine experience for residents.

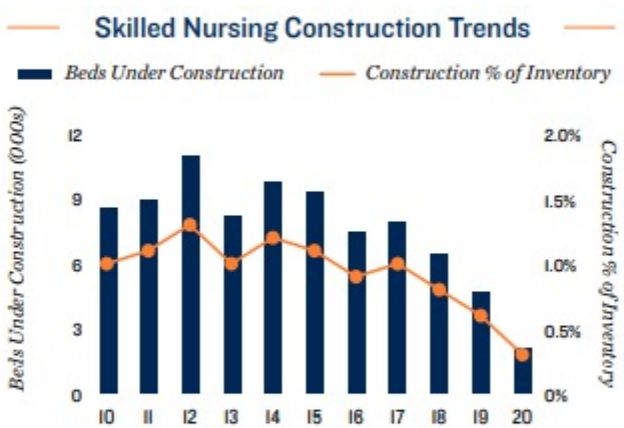

Figure 7: Skilled Nursing Construction Trends [4]

A large inventory of older and outdated communities will require greater capital expenditures to modernize their properties and provide the amenities that residents will demand, which will be a challenge for struggling operators. Many of these types of protocols will be key in regaining confidence among prospective residents.

Senior Housing Market - Outlook & Future

Seniors Housing is entering a transformational period, reshaped by the health crisis and the Seniors housing industry has forever changed. After a challenging year that stretched staffing, impacted finances, and will forever reshape the senior housing industry, the rollout of the COVID-19 vaccine is a light at the end of the tunnel for operators. Care providers face a long path to full recovery, characterized by new operational initiatives and an increased focus on clinical care, utilizing lessons learned through the health crisis to restore consumer confidence. Senior housing will play a more significant role in the healthcare continuum, as it has during the pandemic, developing and implementing evidence-based outcomes to improve the quality of life and safety of residents and staff. Assisted living, has cemented its position in the healthcare marketplace, while the care segment's role in the healthcare industry will continue to grow. Sector recovery will be closely tied to vaccine distribution.

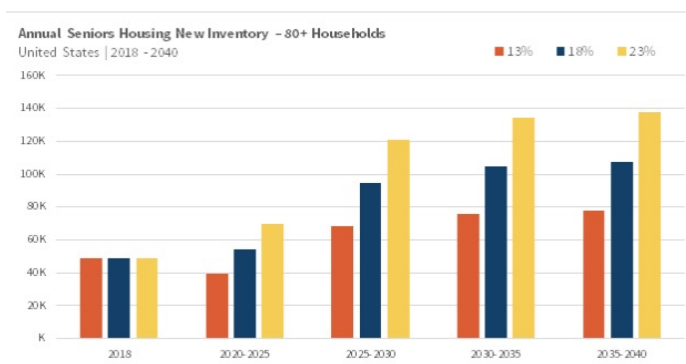

Figure 8: Projections of Seniors Housing Inventory for future [5]

Figure 8 shows new senior housing supply necessary to accommodate demand through 2040 based on penetration rates of 13%, 18% and 23%.

An 18% penetration rate is an assumption that may not come to pass. If the rate increased to 23%, an additional 247,000 units would be needed through 2030 to meet demand. It is worth noting, NIC adds, that these estimates are based on demographic demand and do not take boomers' consumer preferences into consideration.

"This is particularly important because the emerging cohort for seniors housing is the baby boomers and they are known as a generation that does not do things the same way as prior generations," the report stated.

Those consumer preferences almost certainly include the growing interest in active adult and age-restricted senior housing. Senior-only apartments have emerged as their own standalone product type, according to JLL's 2019 Seniors Housing Survey of over 1,000 lenders, operators and industry consultants.

The pandemic's unprecedented financial and operational challenges weighed on property performance and brought occupancy to record lows for all care segments. The return to pre-pandemic property metrics will be long and uneven across markets and care segments and will hingw on the successful procurement of the COVID-19 vaccine, and strong operators. The race to vaccinate the nation began last December when regulatory bodies approved two vaccines, though a decentralized distribution model and varying guidance at the federal, state, and local levels have created challenges and bottlenecks. Care providers that have been quick to adapt during the crisis and leverage their healthcare relationships will be on a faster path to recovery, while some smaller operators and unlicensed facilities could be more challenged. The senior housing sector has been forced to evolve in a new environment that has placed closer scrutiny on operations, design, amenities and infectious disease control. Advancements in technology will play a key role in a post-pandemic world, connecting residents virtually to families, staff and physicians. Eased regulations accelerating the use of telehealth will be essential to provide high acuity care at lower costs, driving care providers to invest in new technologies moving forward. Through the recovery, staffing and maintaining appropriate levels of care will be a top priority. The health crisis highlighted areas in need of improvements, including staffing, and has drawn the attention of regulators. Some states have already taken steps to enforce stricter minimum staffing levels and lower resident-to-nursing assistant ratios for the skilled nursing sector. More regulations could be on the horizon with a change of leadership at the Centre for Medicare & Medicaid Services.

Conclusions:

- The outsized projected growth of the 65 and older cohort over the next five years and more stable property metrics provide a strong tailwind to a range of markets. Orlando will lead the nation, increasing its 65-plus population by 25.1 percent by the end of 2025.
- Development challenges and a steady growth of the baby boomer generation provide a stout tailwind to existing communities in San Francisco and San Jose.
- Sunbelt markets are attracting more retirees as they seek out warmer climates, a lower cost of living and a favourable tax environment, creating a positive outlook for other Florida markets as well as Southwestern metros. Austin, Miami-Dade, and Phoenix will all record strong growth of the older generation, helping to align future supply trends.

- Favourable economic and migration trends will support senior housing recovery in Charleston, Denver, and Seattle-Tacoma. These markets also face minimal threats from new construction, keeping supply and demand better aligned over the coming quarters.
- A mix of secondary and tertiary markets including Portland, Raleigh, and Sacramento have been able to sustain relatively stable property operations and will record steady expansion of the 65 and older population, supporting a positive outlook.
- A preference to live outside of dense metros and instead in smaller markets as American's age is a bright spot for secondary and tertiary markets over the coming years.
- A wave of new supply will weigh on the recovery for Riverside-San Bernardino and Salt Lake City.
- An aggressive development pipeline could create challenges for a handful of markets as they work to bring property operations back to pre-pandemic levels, which could lead to an elongated recovery for Atlanta, New York City and Washington, D.C.
- Markets that will register weaker expansion of the seniors over the next five years in contrast with the rest of the nation could face challenges in filling available units, placing Baltimore, Chicago, and Detroit on the lower end of the spectrum.
- Some metros have posted steep declines in occupancy for an array of reasons in 2020, creating more ground to cover over the coming quarters for Louisville, Philadelphia, and St. Louis. These markets are also anticipated to record weaker growth of the older population, leading to a bumpy recovery.

Appendix

The senior housing sector is generally composed of five segment types, defined by the level of care and amenities provided in conjunction with the living setting. The industry has developed well-defined business models for each segment.

Active Adult Communities and Senior Apartments (for-sale and for-rent): Active adult communities are typically condos, co-ops or single-family homes with minimal or no services offered. These communities have an age requirement of 55-plus and offer a number of amenities, such as clubhouses, which appeal to active adult homeowners. Senior apartments tend to be larger, multi-unit facilities with a rental payment structure. In addition to age restrictions, many communities have income restrictions because they are developed under low-income housing tax credit programs.

Independent Living Facilities (ILFs): Also known as congregate care facilities, ILFs offer a multi-family design to those seniors who are less active and who may have difficulty with routine housekeeping. These facilities are similar to senior apartments, but offer several additional services, such as meals, housekeeping, transportation and organized group activities. Residents typically rent apartments at ILFs at a premium to local market rents in order to cover the cost of common area charges and the additional services provided.

Assisted Living Facilities (ALFs): ALFs are multi-family properties with personalized support services for seniors. Typically, ALFs cater to individuals who need assistance with daily activities, but do not require nursing home care. The units and common areas are designed to accommodate a higher level of support, while still retaining the characteristics of residential apartments. ALFs are a cost-efficient alternative to in home care because they primarily provide nonmedically intensive support activities. A property that specializes in the care of residents with Alzheimer's or other forms of dementia is also considered an assisted living property. These memory care facilities can be freestanding properties or wings or floors within a traditional assisted living property.

Skilled Nursing Facilities (SNFs): SNFs provide the highest level of care, are hospital-like in nature and are, consequently, the most expensive of all senior housing options. In addition, SNFs are also the most highly regulated of the senior housing facilities, typically requiring state licenses. Many SNFs offer acute and intensive medical care, and post-hospitalization and rehabilitation therapies. Medicare and Medicaid programs cover a large portion of these expenses, with such government reimbursements accounting for a significant portion of revenue at these facilities.

Continuing Care Retirement Communities (CCRCs): CCRCs combine attractive residential living with high levels of service designed to address the comfort, health wellness, security and developing needs of aging seniors. Essentially a "one-stop shop," CCRCs offer comprehensive, continuing-care services at one location, by providing skilled nursing facilities mixed with large numbers of independent living and assisted living units. Residents may also receive medical care on-site, the costs of which are all reimbursable by Medicare and Medicaid programs. In addition to a monthly fee, there is typically a large, onetime entry fee to enter a CCRC. CCRCs, many of which are not-for-profit and are religiously-affiliated, are the smallest segment within the senior housing market because they are costly to build, and due to the complex local regulatory approval process, time-intensive to develop.

References

1. [1] **Figure 1: Sizes of Senior Population by age and income in 2014 and 2029**: https://www.mcknightsseniorliving.com/home/news/54-of-middle-income-seniors-could-need-housing-care-help-by-2029-nic-funded-study-finds/

2. [2] **Figure 2: Senior Population growth over next few decades:** https://www.cbre.com.mx/-/media/cbre/countryunitedstates/media/files/services/senior-housing/shmiq2-2021.pdf https://www.linkedin.com/pulse/senior-housing-market-insight-q4-2018-year-review-lisa-a-widmier

3. [3] **Figure 3: Senior Housing Supply: Page 7** https://www.cbre.com.mx/-/media/cbre/countryunitedstates/media/files/services/senior-housing/shmiq2-2021.pdf

4. [4] **Figure 4,5,6 and 7: Construction Trends - Page 103** https://leclaireschlossergroup.com/wp-content/uploads/2021/03/2021-U.S.-Commercial-Real-Estate-Investment-Outlook-Report.pdf

5. [5] **Figure 8: Projections of Seniors Housing Inventory for future** https://seniorhousingnews.com/2019/10/07/nearly-1-million-new-senior-living-units-needed-by-2040/