NATIONAL REPORT

Seniors Housing

IPA INSTITUTIONAL PROPERTY ADVISORS

1H20

Seniors Housing Navigates Construction Cycle; Private Investors Step Forward as Institutions and REITs Streamline Portfolios

Development impacts independent living. New supply in the independent living sector remains at a cyclical peak, weighing on occupancy levels across the nation. Units under construction represent approximately 10 percent of existing inventory, limiting the potential for a rapid turnaround in operations this year. While competing new units are spread throughout the country, the most pronounced supply overhangs are in the Southwest and Southeast, where occupancy is below the market average and new construction represents more than 13 percent of inventory. Although the near-term outlook suggests some structural weakness in operations in these areas, long-term demand should help realign the supply-demand balance. Several markets in the Sunbelt are projected to add a substantial number of seniors over the next decade. Additionally, many retirees that are house rich and cash poor are unlocking that equity and moving into age-restricted apartments and later independent living facilities.

Assisted living operations turn corner as Continuing Care Retirement Communities (CCRCs) continue to improve. Similar to independent living, the assisted living sector faced over-development challenges for several years. However, in many markets supply additions have finally balanced with demand and the pipeline is waning as developers let fundamentals normalize. Outside the Mountain and East North Central regions of the country, under construction inventory is below 5 percent of existing inventory and has been trending lower over the past several quarters. As a result, occupancy will march higher this year. CCRCs, meanwhile, remain popular with seniors and represent the only sector with occupancy north of 90 percent, facilitating healthy rent growth. With one in 10 seniors living with dementia and healthcare costs rising rapidly, more older adults may consider moving into a CCRC.

Investors drawn to the seniors housing market during mature economic cycle. New construction has been a bonus for buyers, rather than a detriment in the current market. Recently completed projects present REITs with one-off investment opportunities as the number of large portfolios available dissipates. However, private investors make up the deepest part of the buyer pool. Large firms are streamlining their portfolios after several large portfolios were traded in 2018, providing smaller owners and owner-operators attractive acquisition targets. Assisted living assets are highly sought after, which has narrowed the average cap rate relative to independent living levels. Overall, the average cap rate for independent living trades is in the mid-5 to mid-6 percent area, assisted living assets trade for an average between 6 and 7.5 percent, and skilled-nursing properties change hands at an average in the high-11 to high 12 percent area, based on location and quality.

Executive Summary

- Supply additions in the independent living sector remain at a cyclical peak, weighing on occupancy levels across the nation.
- Assisted living absorption outpaced year-over-year inventory growth at the end of last year, lifting the outlook for the sector in 2020.
- Approximately 10 percent of Americans over the age of 65 suffer from Alzheimer's dementia, which will create demand for memory care units in the future.
- Occupancy at CCRCs, particularly entrance-fee models, continues to climb and is the highest in the seniors housing sector.
- Assisted living assets are highly sought after, which has pushed down the average cap rate closer to independent living levels. Last year, the spread between the two sectors narrowed to approximately 50 basis points for high-end properties.

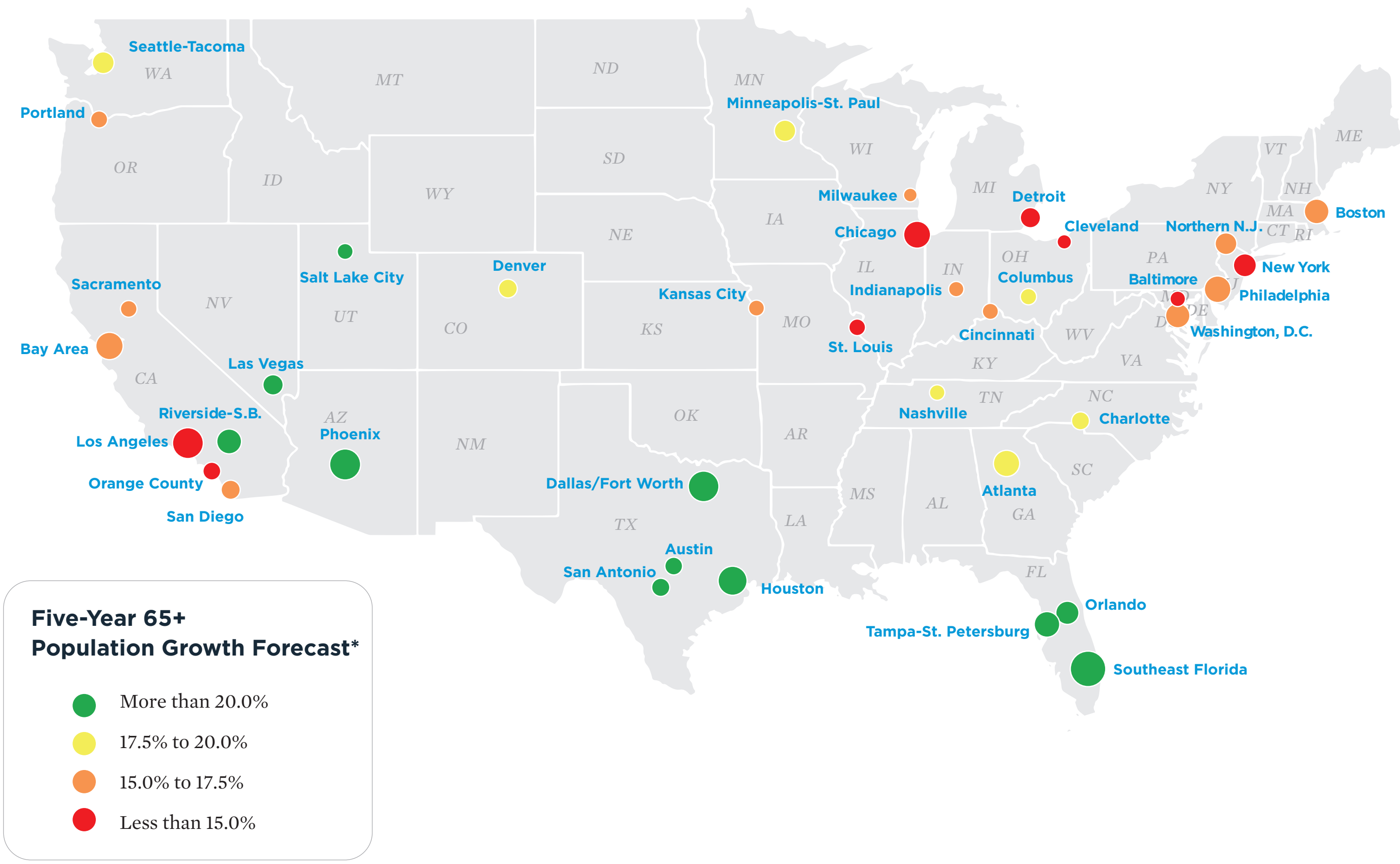
Economic Trends Impacting Seniors Housing

- **More Americans on Medicaid rosters, increasing potential demand for seniors housing.** Between 2010 and 2018, the number of people on Medicaid increased by 9.5 million. Additionally, the number of retirees on Medicare, which supports demand for assisted living and to a smaller degree skilled-nursing facilities, increased by 13.9 million over the same period. Collectively, a rise in these groups will help support demand for seniors housing this year.

- **Expenditures at skilled nursing and CCRCs soar over past eight years.** Healthcare expenditures have raised across all senior housing sectors due to the aging population and sizable growth in the number of individuals covered by health insurance. More than 36 million more Americans have acquired health insurance over the past eight years, supporting a 53 percent increase in personal healthcare expenditures. Despite wage pressure, expenditures at nursing homes and CCRCs advanced 29 percent to $169 billion.

- **Sunbelt attracting retirees, contributing to seniors housing demand.** All 10 markets with the largest projected increase in population in the 65-plus cohort are in the Sunbelt, which will support demand for independent living and assisted living properties. Although there is pressure on occupancy, particularly in the independent living sector, the rise in population should absorb the supply overhang over the next several quarters.

Sunbelt Markets Anticipated to Receive Outsized Share of Seniors

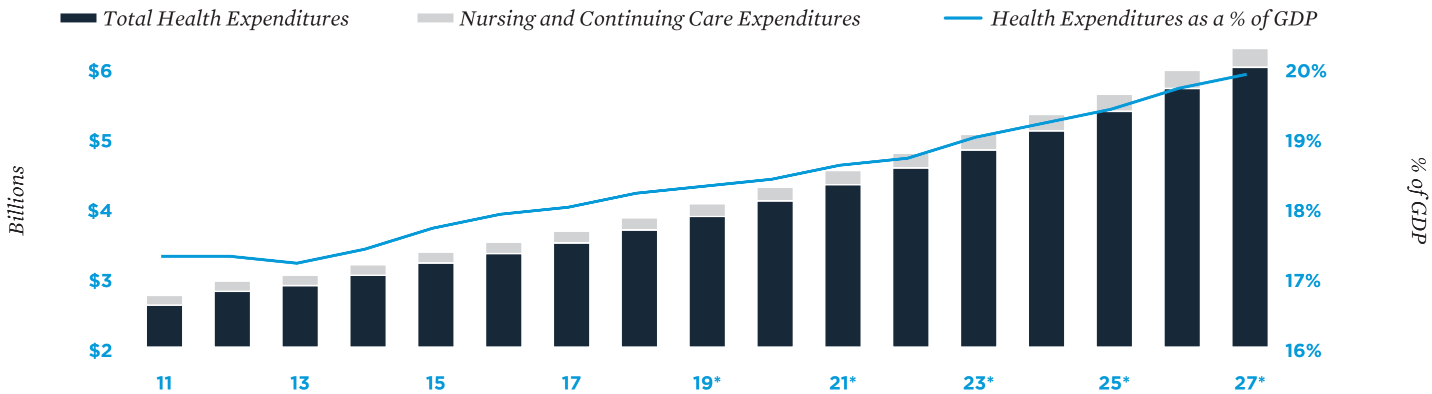


**Bubble size represents absolute growth.*

** Forecast*
Sources: Marcus & Millichap Research Services; Federal Reserve: Consumer Finance Survey; National Association of Realtors; Social Security Administration; U.S. Census Bureau

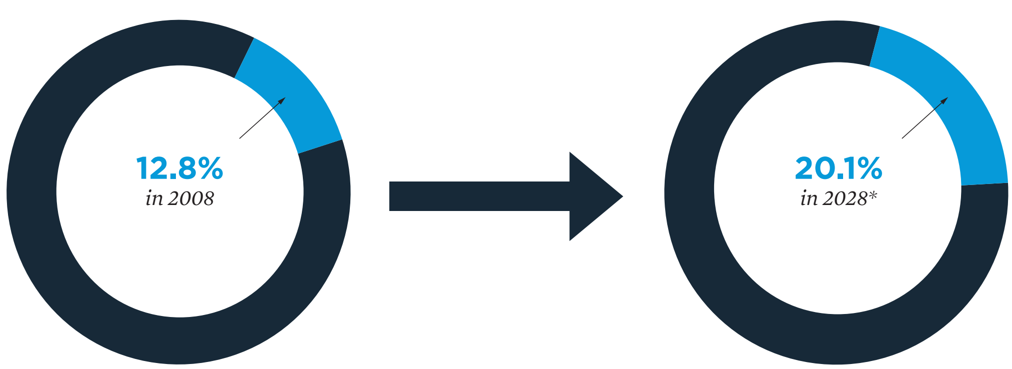
Economic and Operational Hurdles Facing Care Providers

National Health Expenditures Trends

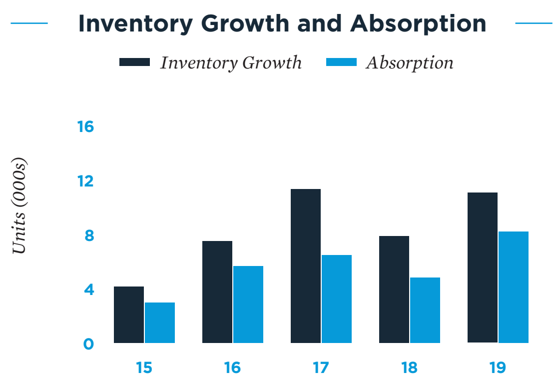


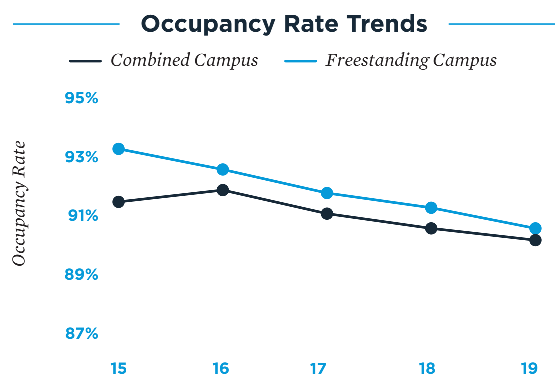
- **Medicaid and private-pay make up largest share of skilled nursing and CCRC payments.** According to the most recent data from the Centers for Medicare and Medicaid Services, 66 percent of payments come from some form of insurance. Total expenditures in the sector are expected to rise 63 percent to $271 billion between 2017 and 2027. Medicare and Medicaid will amount to 55 percent of payments to skilled nursing and CCRCs.
- **Florida, Texas and the Southwest top the list of aging demographics.** Over the next five years, Orlando is projected to see a 29 percent rise in the 65-plus population, or nearly 120,000 people. Southeast Florida and Tampa are also among the top 10 markets. Austin, Dallas/Fort Worth and Houston will add 27 percent, 23 percent and 23 percent, respectively, in the 65-plus population, totaling more than 460,000 residents. Phoenix, long a destination for retirees, will add 213,000 older residents in the next five years, the most in the nation.
- **Seniors unlocking home equity to enjoy retirement in rental independent living communities.** Contrary to national trends, homeownership among seniors is falling modestly. Retirees were largely unscathed by the housing downturn, while those between 35 and 44 years old saw a significant decrease in the homeownership rate. Nationally, homeownership has climbed 220 basis points since 2016 to 65.1 percent in the fourth quarter of 2019. In the 65-plus cohort homeownership has fallen 260 basis points from 2012 as seniors increasingly rely on home equity to finance their retirement and provide the ability to afford seniors housing options when they are needed.

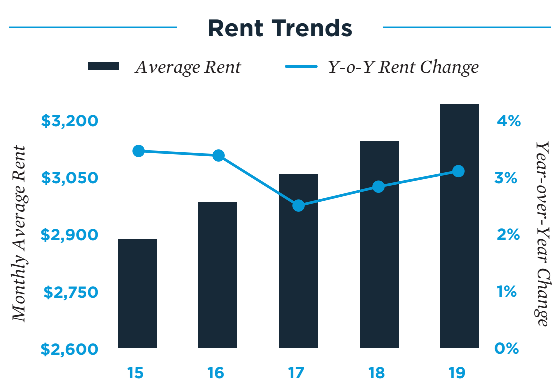
65+ Population Grows as a Percentage of Total Population



* Forecast
Sources: Marcus & Millichap Research Services; BLS; JAMA







Source: NIC MAP® Data and Analysis Service (www.nicmap.org)

Construction Cycle Beginning to Slow, Providing Relief to Independent Living Sector

New supply remains the largest challenge to independent living operations. According to NIC MAP Data Service, occupancy dipped 50 basis points last year to 90.3 percent as development weighed on fundamentals. Little relief is on the horizon as the current pipeline remains near the cyclical peak. Underway projects account for more than 10 percent of existing inventory, which will test market demand over the next several quarters. The Mid-Atlantic and West North Central regions face the largest supply pipelines, though development is elevated everywhere. Demand, meanwhile, should be sufficient to return fundamentals to historical norms when the current construction cycle winds down.

Investors overlook supply-side pressure, though deal flow limited by listings. The ease of owning independent living facilities relative to other multifamily properties continues to attract crossover capital to the sector. However, existing owners are reluctant to list assets in the current market. Although the sector is struggling with a supply overhang, rent growth remains healthy and the outlook remains bright. Additionally, independent living properties perform better than market-rate apartments during an economic downturn, encouraging existing owners to hold assets given the maturity of the economic cycle. Buyers will remain active when presented with opportunities, particularly for newer properties in Sunbelt retirement destinations. Elevated construction in these fulfill some investor demand as new assets are listed.

2020 Independent Living Outlook

Construction
11,000 units

Last year, deliveries increased to 11,000 units, lifting inventory by 4.6 percent. In the prior year, 7,900 units were completed across the nation. Currently, there are 27,000 units under construction.

Occupancy
down 50 bps

Stabilized occupancy fell to 90.3 percent in the fourth quarter, marking an annual decline of 50 basis points. New construction has eroded 200 basis points from occupancy since 2014.

Rent
up 3.1%

An increase in high-quality units supported a 3.1 percent increase in average asking rent to $3,239 per month. In the prior year, independent living rent advanced 2.8 percent.

Investment

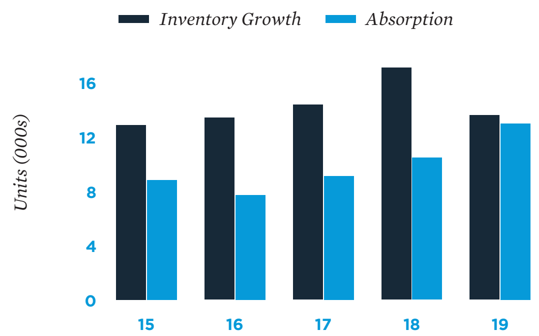
Investors will be discriminate when pursuing assets this year, potentially shying away from the markets that have a supply glut. Capital from traditional multifamily buyers will explore opportunities.

Assisted Living Sector Turns Corner as Development Begins To Abate; Private Buyers Raise Due Diligence

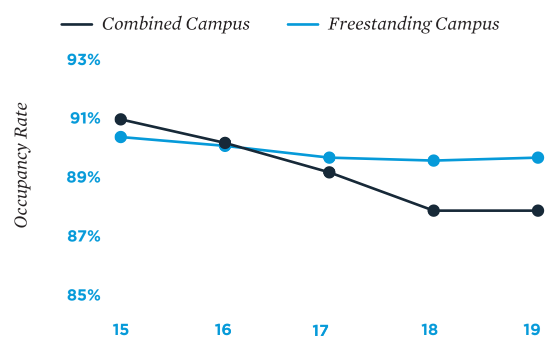
Occupancy remains stable in 2019 and poised to increase this year. An allotment of new supply has pulled occupancy lower since mid-2016, according to NIC MAP®Data Service. Although inventory growth remains elevated, the pace of gains has begun to recede and align with demand. Annual absorption outpaced year-over-year inventory growth at the end of last year, lifting the outlook for the sector in 2020. The number of units underway constitutes 6.1 percent of existing inventory, the lowest since the end of 2016, when the inventory-to-construction ratio was 8.8 percent. As a result, occupancy, which ended the year at 88.3 percent, should tick higher by year end. Rents, meanwhile, should gain more traction as operators grow more confident regarding future operating conditions.

Assisted living investors drive cap rates lower. Buyers are keen on the assisted living sector, though the sharp decline in REIT transactions has lowered overall deal flow from a recent peak in 2018. Last year, publicly traded REITs were the buyer on less than 10 percent of transactions, while participating as the seller in nearly 40 percent of deals. REITs are expected to continue paring assets to streamline their portfolios this year, leaving the door open for private investors to add to their holdings. However, investors purchasing one or two properties are being more selective to avoid overextending in the current economic climate. As a result, average cap rates have compressed close to 6 percent, down 100 basis points from a peak in 2018 when large REITs were indiscriminate when acquiring assets.

Inventory Growth and Absorption



Occupancy Rate Trends



2020 Assisted Living Outlook

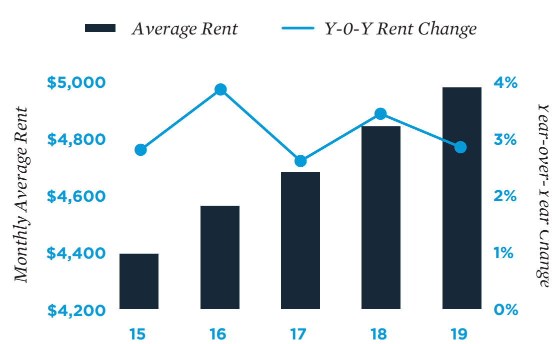
Construction 13,600 units — A slowdown in construction is relieving pressure on the sector. Builders completed 13,600 units in 2019, down from 17,100 units the prior year. Developers have 23,500 units underway.

Occupancy no change — Supply and demand came into balance last year for the first time since mid-2016. Occupancy finished the year unchanged at 88.3 percent, following a 90-basis-point decline in 2018.

Rent up 2.8% — The average rent increased 2.8 percent annually to $4,977 per month, a modest slowdown from the prior year when rent climbed 3.4 percent. The pace of rent growth should remain relatively stable this year.

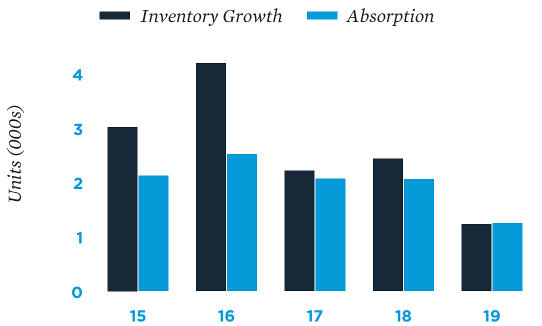
Investment — Buyers await listings from large portfolio owners shedding assets acquired during 2017 and 2018. Many of those properties are not aligned with sellers long-term strategies, providing opportunities to smaller buyers.

Rent Trends

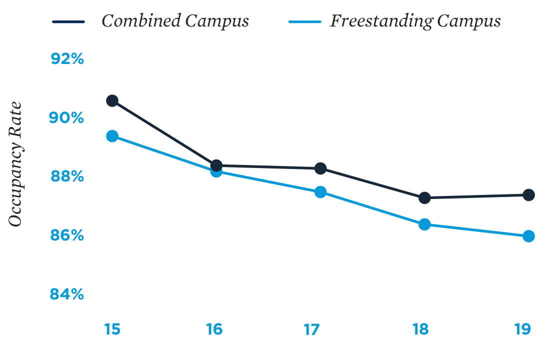


Source: NIC Map® Data and Analysis Service (www.nicmap.org)

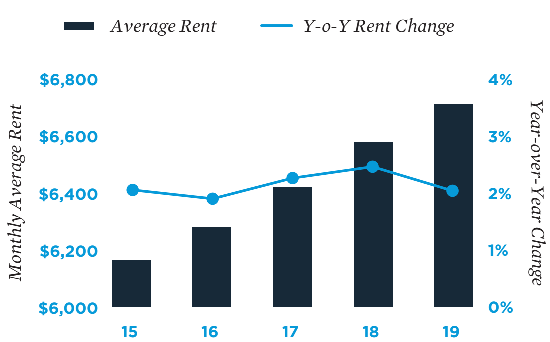
Inventory Growth and Absorption



Occupancy Rate Trends



Rent Trends



Source: NIC MAP® Data and Analysis Service (www.nicmap.org)

Builders Out in Front of Demand; Pipeline Dissipating for Majority Memory Care Facilities

The impending wave of dementia patients encouraged hasty development. However, demand for these beds remains in the distant future, and the sector appears to be overbuilt currently. According to NIC MAP® Data Service, occupancy in the sector was 86.2 percent at the end of last year, down 30 basis points from the prior period. Demand will arrive as the baby boomers age, however, as approximately 10 percent of Americans over 65 suffer from Alzheimer's dementia. On the surface, it appears that demand should be sufficient to fill beds, but pricing can be prohibitive for a significant share of the population. More than 80 percent of care is provided within the home by a family member rather than in a memory care facility. At an average of $6,709 per month at the end of 2019, many families lack the financial wherewithal to commit a family member to a memory care facility.

High-care facilities lead memory care sales. As the focus on the rising costs of labor and a shallow qualified talent pool amplifies, facilities that leverage both skilled nursing and memory care beds are attractive to investors. Majority skilled nursing properties accounted for half of the deals in 2019, while assisted living contributed the second largest. Although these two sectors had the most in terms of total deals, they each lost ground in market share to majority independent living properties. Buyer interest in the memory care sector may amplify this year, though freestanding campuses could pose challenges. The synergy found in combined campuses are attractive as a risk-diversion strategy.

2020 Memory Care Outlook

Construction 1,200 units — Supply growth is slowing in the majority memory care sector. After 2,400 units were added during 2018, developers only added 1,200 during 2019. Only 2,100 units are underway.

Occupancy down 30 bps — Despite easing supply growth, stabilized occupancy declined 30 basis points to 86.2 percent. In the prior year, occupancy retreated 100 basis points.

Rent up 2.0% — Rent gains slowed modestly during the last 12 months. The average asking rent increased to $6,709 per month last year, following 2.4 percent growth in the previous year.

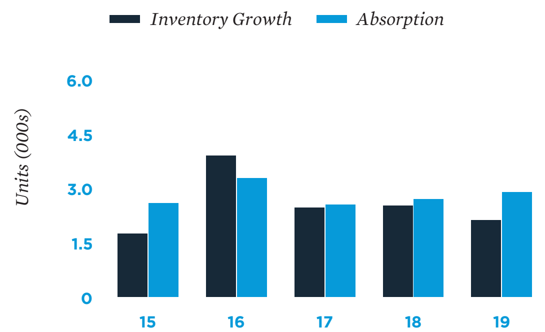
Investment — When available, investors will target memory care facilities with healthy cash flow and a favorable census of patients.

CCRCs Retain Position at Highest-Performing Seniors Housing Sector

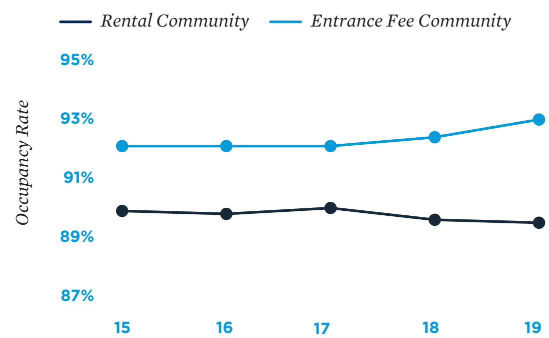
Measured supply growth amid healthy demand improving fundamentals at CCRCs. The number of properties under construction has fallen to the lowest level since 2014, per NIC MAP® Data Service. Less than 10,000 units are under construction across the nation, and no more than 1,700 units have broken ground in any of the eight regions. As a result, occupancy will continue to climb this year, surpassing the 92 percent threshold. Most of the strength is at entrance fee communities, where occupancy is 380 basis points above strictly rental models. The entrance fee model accounts for approximately 65 percent of CCRC inventory, though level development between the two types could shrink that percentage this year. The spread in occupancy levels could indicate that rents are becoming prohibitive for prospective seniors.

CCRCs attract a handful of investors every year, though deal flow is light. Last year, private investors outnumbered REITs on the buy side, a trend mirroring other seniors housing sectors. The average price per unit was $106,300, down from the prior year when more institutional-quality properties changed hands. Transactions were spread across the nation in 2019, as buyers were undeterred by location and focused on available listings. More rental CCRCs changed hands in 2019, though availability rather than type can dictate trends. With construction limited and entrance fee occupancy elevated, transactions may be limited in the coming months as existing owners opt to retain their holdings. Some properties that trade could be within large portfolios if institutions reverse course.

Inventory Growth and Absorption



Occupancy Rate Trends



2020 CCRC/LPC Outlook

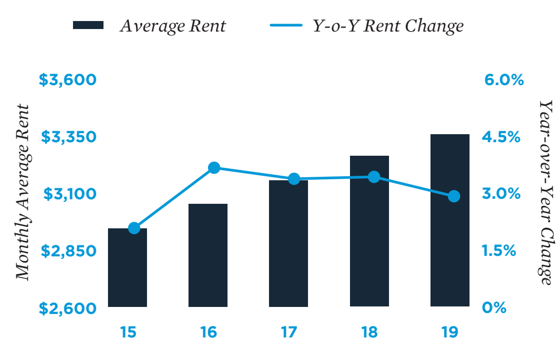
Construction 2,100 units — Development eased in the most recent yearlong period to 2,100 units, following the completion of 2,500 units in the prior year. Construction is balanced between entrance fee and rental units.

Occupancy up 30 bps — Occupancy at CCRCs climbed to 91.6 percent at the end of the fourth quarter, building on a 10-basis-point rise in the prior year.

Rent up 2.9% — Average rent advanced 2.9 percent to $3,353 per month over the last 12 months. The average entrance fee rose 3 percent year over year to $367,000.

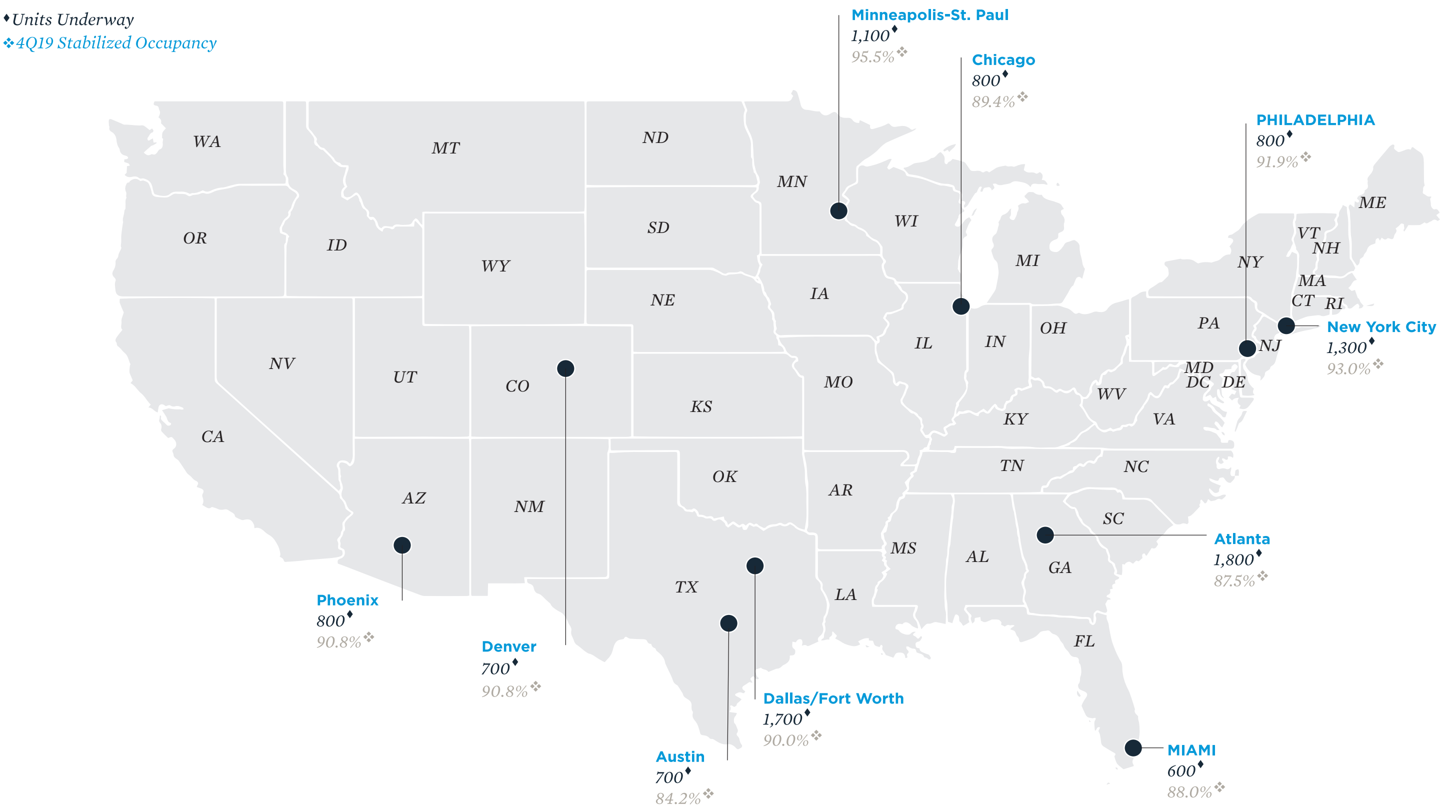
Investment — Assets with a unit mix that is well aligned with local demographics attract buyers as they broaden their geographical focus to find deals.

Rent Trends



Source: NIC MAP® Data and Analysis Service (www.nicmap.org)

Top 10 Seniors Housing Construction Markets 4Q19



Source: NIC MAP® Data and Analysis Service (www.nicmap.org)
Units underway and stabilized occupancy represent Majority IL communities which may include some skilled nursing and memory care units when part of a community.

National IPA Seniors Housing Division
Jeffery J. Daniels
Senior Vice President, National Director
Tel: (212) 430-6127 | jdaniels@ipausa.com

Prepared and Edited by:
Steve Hovland
Senior Analyst
Tel: (602) 707-9633 | stephen.hovland@marcusmillichap.com

For information on seniors housing trends, contact:
John Chang
Senior Vice President | National Director,
IPA Research Services Division
Tel: (602) 707-9700 | jchang@ipausa.com

Price: $1,500

Seniors Housing Capital Markets

- The Federal Reserve will balance a whirlwind of economic and geopolitical forces this year as it sets policies to sustain domestic growth. In 2019, it cut the overnight rate by 25 basis points three times in an effort to offset recessionary risk. Based on policy statements in early 2020, few changes are expected this year, but Chairman Jerome Powell has reemphasized that the committee will continue to monitor conditions as they develop and set policy accordingly.
- Lending conditions tighten modestly amid abundant liquidity. Debt financing remains readily available for seniors housing investments, but underwriting standards are tightening for certain segments of the market. Individual financing terms will vary based on the quality of the asset, its performance metrics and location, as well as the strength of the borrower.
- Coronavirus induced uncertainty sparks stock-market volatility, placing downward pressure on interest rates, which could be more volatile this year as the market navigates the riskier global economic outlook.

Sources: IPA Research Services; American Health Care Association; BLS; Federal Reserve: Consumer Finance Survey; Irving Levin Associates, Inc.; JAMA; Moody's Analytics; National Association of Realtors; NIC MAP® Data and Analysis Service (www.nicmap.org); Real Capital Analytics; TWR; Social Security Administration; U.S. Census Bureau