NIC Investment Guide

Investing in Seniors Housing & Care Properties

FIFTH EDITION

EXECUTIVE SUMMARY

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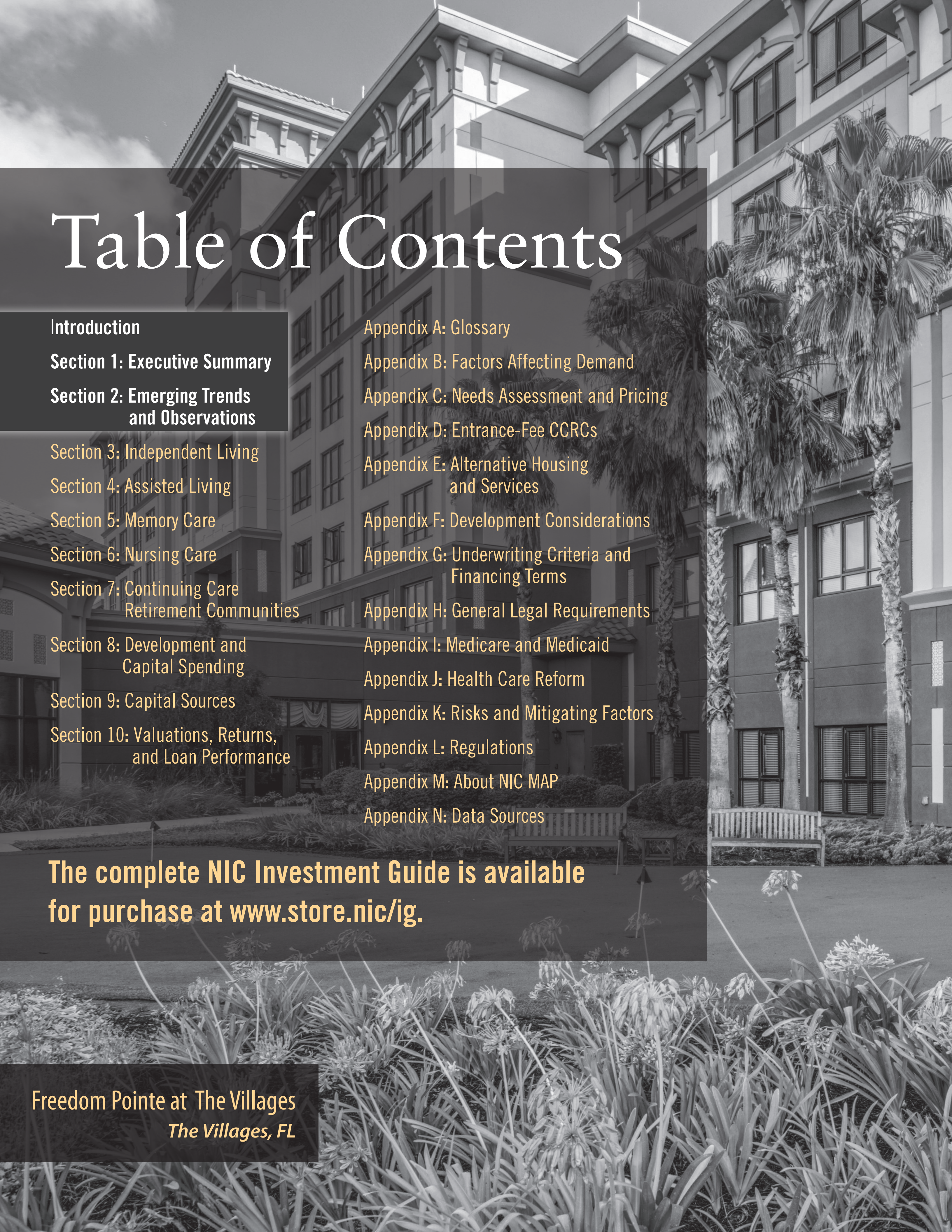
The complete NIC Investment Guide is available for purchase at www.store.nic/ig.



Freedom Pointe at The Villages
The Villages, FL

Introduction

The *NIC Investment Guide: Investing in Seniors Housing & Care Properties, Fifth Edition* provides an overview of the seniors housing and care sector based on current time-series data. This edition of the *Investment Guide* was prepared and reviewed by a task force of industry professionals within NIC's Future Leaders Council (FLC) and NIC staff. The guide helps fulfill NIC's mission to enable access and choice in seniors housing and care by providing data, analytics, and connections that bring together investors and providers.

Purpose

The *Investment Guide* is designed as a seniors housing and care primer that investors can use to investigate the opportunities, challenges, and risks of investing in the sector and help formulate an investment thesis. It serves as an introduction to the industry's investment characteristics, performance, and leading players. The *Investment Guide* is intended as a representative overview of the significant characteristics of the industry. Wherever possible, it provides information on seniors housing in comparison to other commercial real estate property. Sources used are listed in an appendix that readers can utilize to review more detailed information on the specific issues that interest them.

Data Used

This data-based overview has been made possible by the tremendous progress in data collection by the industry over the past 12 years. The NIC MAP® Data Service (NIC MAP), which now tracks and reports on 140 of the nation's metropolitan markets, has provided reliable time-series data for the past 12 years for industry performance on occupancy, rent growth, supply, and construction. For time-series data in this publication, unless otherwise noted, we use aggregates for the nation's 31 Primary Markets (i.e., metropolitan markets), because data from those markets is available starting from 4Q2005. For point-in-time comparisons, data for all of NIC MAP's 99 Primary and Secondary Markets as of year-end 2017 is used since it is more representative of the overall seniors housing and care market. See Appendix M for a listing of all the metropolitan markets tracked by NIC MAP.

Through NIC's strategic alliance with Real Capital Analytics, NIC MAP also reports pricing and volume metrics on closed sales transactions of seniors housing and care properties throughout the U.S. for the past ten years. The National Council of Real Estate Investment Fiduciaries (NCREIF) has tracked the investment return performance of seniors housing properties since 2003, and the expanded and improved State of Seniors Housing provides yearly snapshots of industry performance in key areas such as expenses and operating margins. Together, these data sources offer essential information on net operating income (NOI), margins, and investment returns.

For data consistency, wherever possible, the *Investment Guide* uses data as of the end of 2017.

Throughout the creation of the *Investment Guide*, we had to decide what information to include and what to exclude, either because the data integrity was questionable or because the information was considered beyond the scope of a primer. There were a number of places where the FLC task force and NIC staff recognized that quality data simply was not available and that further work was needed to collect and report such data in the future. NIC is committed to working with others in the industry to fill these data gaps for future editions of this publication. Please share any comments and suggestions you have to improve future editions of the publication and advance industry transparency.

Organization of the Report

The *Investment Guide* begins with an executive summary that provides an overview and roadmap to the entire report. The fifth edition also includes the popular Emerging Trends and Observations (Section 2) that was introduced in the third edition of the *Investment Guide*. While the majority of the publication relies on data to review past performance, the Emerging Trends and Observations section relies on expert opinions to provide a forward-looking perspective.

The technical chapters of the *Investment Guide* begin with a detailed description of each seniors housing and care community type that is covered in Sections 3 through 7. This fifth edition includes a separate chapter on properties focused primarily on memory care, rather than combining memory care properties with assisted living. The community type descriptions include resident profiles, supply data, industry operating structures, operating economics, and current trends. In Section 8, we discuss the development and construction of new properties and the acquisition of existing properties. Section 9 provides an overview of debt and equity sources of capital for the seniors housing and care industry. Finally, Section 10 discusses valuations, returns, and loan performance.

We have included a comprehensive set of appendices with information that will interest investors in seniors housing and care properties, such as demographics (Appendix B). The appendices also include detailed information on entrance-fee continuing care retirement communities, which are also referred to as life plan communities (Appendix D), and lender underwriting standards (Appendix G).

Notes on Data Sources and Footnotes

Appendix N includes a list of all data sources referenced in the *Investment Guide*. Numbered footnotes refer to the data sources in Appendix N. Sources in Appendix N are listed in order of those most frequently referenced in the *Investment Guide*. The numbering of the footnotes is often not sequential. In general, we have used the most timely, accurate, and reliable data available.

Acknowledgments

NIC would like to express its sincere appreciation to several groups whose efforts were instrumental in the development and production of this guide. First, NIC would like to thank the members of NIC's Future Leaders Council (FLC) who contributed to this guide. This group's main responsibilities were writing an initial draft of the select sections in the report, reviewing chapters written by NIC staff, and providing authorship for the Emerging Trends and Observations section. Members of the FLC task force included:

- Lee Delaveris, Vice President, KeyBank Real Estate Capital
- Andrew Lavinder, Vice President, MidCap Financial Services, LLC
- Jerry Taylor, Director of Sales & Investments, National Health Investors REIT
- Sara Veit, Managing Director, Omega Healthcare Investors, Inc.
- Dustin Warner, Vice President, Harrison Street Real Estate Capital, LLC
- Kris Woolley, Founder and CEO, Avista Senior Living
- Jennifer Zhao, Assistant Vice President, AEW Capital Management

We would like to acknowledge the significant contributions of NIC staff members, including Lana Peck, who was the project leader extraordinaire of the entire guide, Leighann Garcia, Chuck Harry, Bill Kauffman, Liz Liberman, Beth Burnham Mace, Molly McCarter, Dan Raney, and Anne Standish. We would also like to thank Melissa Cohen, who consulted on select portions of the guide.

Abiitan Mill City
Minneapolis, MN

In this section

Section 1:
Executive Summary

The *NIC Investment Guide: Investing in Seniors Housing & Care Properties* serves as a primer for understanding the seniors housing and care property sector. The *Investment Guide* covers the investment characteristics of the sector, as well as its performance and the leading players. Our aim is to provide the most current and reliable industry data for investors to help them evaluate opportunities, risks, and returns, and fine-tune their individual investment strategies. The *Investment Guide* is an outgrowth and reflection of NIC's mission to provide data, analytics, and connections, all of which advance the access and choice of seniors housing and care for America's elders—from independent living, assisted living, and memory care, to skilled nursing and post-acute care.

1.1 Seniors Housing and Care Properties

The seniors housing and care industry provides both housing and an array of services to seniors, generally to those over the age of 75. Care segments are commonly divided into four categories:

- Independent living (IL)
- Assisted living (AL)
- Memory care (MC)
- Nursing care (NC)

Nursing care has traditionally been provided in an institutional-style setting, although there is a growing movement toward a more homelike setting. The other care segments typically are provided in a multifamily setting. Seniors housing and care properties also include continuing care retirement communities (CCRCs), also referred to as life plan communities, which must offer at least two care segments (i.e., independent living and nursing care) in a single community. For purposes of this report, the term "seniors housing" excludes nursing care properties and 55+ seniors apartments, whereas the term "seniors housing and care properties" includes all of the properties providing the care segments outlined previously but not 55+ seniors apartments.

In the U.S., there currently are approximately 23,500 investment-grade seniors housing and care properties containing 3 million units. For the purposes of this report, we use "investment grade" to define age-restricted properties with at least 25 units/beds that charge market rates for the housing and services offered. These estimates do not include many smaller "board and care" properties, which are not considered for purchase by the typical institutional investor yet serve a sizable population of seniors. The total value of this investment-grade seniors housing and care property market is estimated at $409 billion (assuming a $181,000 price per unit for seniors housing properties and an $84,000 price per bed for nursing care properties).[1]

Exhibit 1.a shows the number of properties and units offered within the different community types, campus types, and care segments. (See Appendix A for definitions of these terms.)

Exhibit 1.a
Supply of Investment-Grade* Seniors Housing and Care Properties in the U.S.
By Property and Unit Counts across Community Types, Campus Types, and Care Segments | Estimates as of 4Q17**

By Community Type	# Properties	# Units***
Independent Living (IL)	2,800	427,000
Assisted Living (AL)	7,200	595,000
Memory Care (MC)	1,400	73,000
Nursing Care (NC)	10,300	1,344,000
CCRC/Life Plan Community	1,800	604,000
Total	**23,500**	**3,043,000**
By Campus Type	**# Properties**	**# Units*** **
CCRC/Life Plan Community	1,800	604,000
Combined	6,900	845,000
Freestanding	14,800	1,594,000
Total	**23,500**	**3,043,000**
By Care Segment	**# Properties**	**# Units*** **
Independent Living (IL)		695,000
Assisted Living (AL)		659,000
Memory Care (MC)		215,000
Nursing Care (NC)		1,474,000
Total		**3,043,000**

* Current estimates are not comparable to estimates from prior years due to different estimation techniques.
** Estimates are representative of properties with at least 25 units/beds that charge market rates and/or accept Medicaid for the housing and services offered.
*** One nursing bed is equivalent to one unit. *Source: NIC MAP® Data Service, NIC*

Care segments are defined as the type and level of services offered by properties. Community types are classified by the plurality of units by care segment offered. (For example, an assisted living community with 10 independent living units, 60 assisted living units, and 30 nursing care beds is classified as an assisted living community, as is any combined property with a plurality of assisted living units or a freestanding assisted living property.)

The campus type of a property depends on the number and possible combination of care segments offered:

- CCRCs offer independent living and nursing care at the same property (although assisted living and memory care are generally offered as well).
- Combined campuses offer at least two different care segments (e.g., independent living and assisted living). However, these do not include properties that offer independent living and nursing care, because they are considered CCRCs.
- Freestanding campuses offer only one type of care segment (e.g., independent living only).

Exhibit 1.b highlights the array of services offered across the different property types. Besides housing (including both shelter and amenities), seniors housing and care properties offer residents myriad services:

- Hospitality services—meals, transportation, housekeeping, entertainment, and concierge services.
- Care services—assistance with bathing, grooming, dressing, eating, medication management, and other activities of daily living (ADLs).
- Medical services—skilled nursing, rehab therapy, and chronic care.

The care and medical service mix at the property increases with the residents' needs. Independent living typically serves the most able residents and offers primarily hospitality services. Nursing care, on the other hand, serves the residents with the greatest medical needs and, accordingly, has the most intensive services.

A continuing trend in seniors housing and care has been the rising acuity levels of residents upon initial move-in across the care segments. As a result, independent living and assisted living operators often care for residents who already have some ADL needs. In addition, skilled nursing operators increasingly are serving residents in need of short-term rehabilitation services or those with high-acuity medical care needs who were previously served for a more extended period of time in an acute care hospital, a long-term acute care hospital, or an in-patient rehabilitation facility. Some independent living and assisted living operators now provide home healthcare, therapy, and other services to residents in order to better meet the needs of residents in their properties. Others allow residents independently to engage third-party service providers to meet care needs that could not otherwise be accommodated in their properties either by the decision of the operator or by the state regulatory framework.

Exhibit 1.b

Property Types by Services Provided

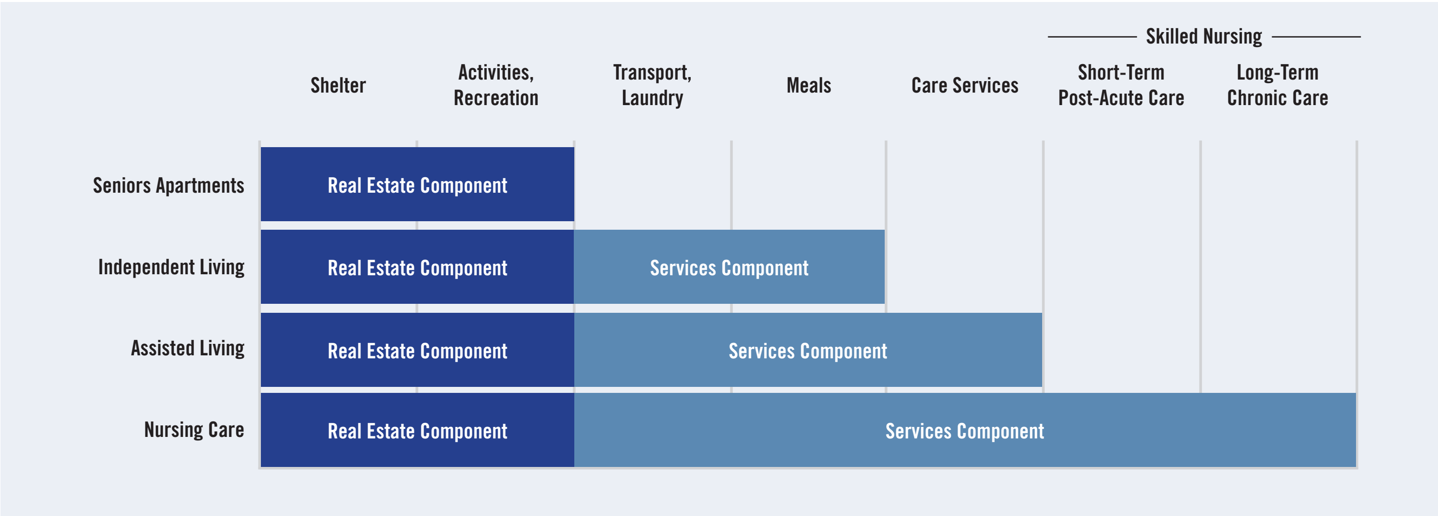


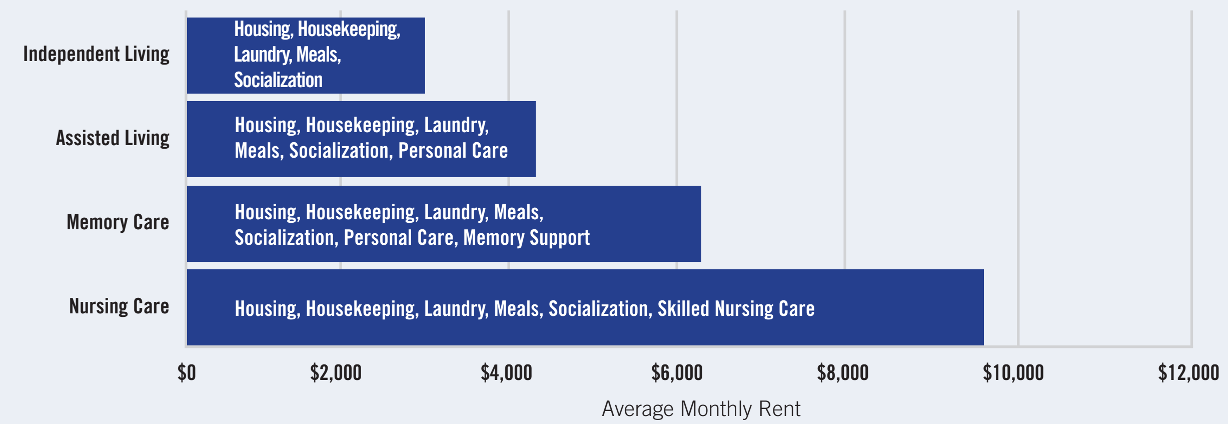
Exhibit 1.c highlights the average asking monthly rents for each care segment, reflecting the needs level and the accompanying service mix. (See Appendix C for more detail regarding needs assessment and pricing.)

Exhibit 1.d provides select metrics that further quantify some of the distinctions between the different seniors housing and care community types.

Exhibit 1.c

Average Monthly Rent by Care Segment

As of 4Q17



*The nursing care monthly rent is the average private-pay per diem rate calculated on a monthly basis; see Section 6 for the Medicaid and Medicare rates.

Source: NIC MAP® Data Service

Exhibit 1.d

Selected Metrics by Community Type

As of 4Q17

	Independent Living Communities	Assisted Living Communities	Memory Care Communities	Nursing Care Communities	CCRC/LPCs
Average Monthly Rent	$3,050	$4,577	$6,301	$9,463*	$3,119
Median Number of Units	136	78	48	120	290
Median Age of Buildings (years)	19	19	15	38	33

* The nursing care average monthly rent is the average private-pay per diem rate calculated on a monthly basis; see Section 6 for the Medicare and Medicaid rates.

Source: NIC MAP® Data Service

1.2 Seniors Population

Seniors who are in need of services and their families drive demand for seniors housing and care properties. For purposes of this report, the average age of residents in seniors housing is believed to be presently in the mid-80s, while the average move-in age is in the low- to mid-80s. The population of individuals aged 80 years or older provides a reasonable benchmark for potential demand. The population estimate of individuals aged 80 years or older for 2016 was 12.2 million, which represented 4% of the U.S. population.

Exhibit 1.e shows the breakout of age cohorts by individuals and by households.[7]

The sizes of the 80+ and 85+ populations are expected to increase at a rate of approximately 2% and 1.2% per year, respectively, during the remainder of the decade, while the early part of the next decade will see elderly population growth accelerate—averaging 3.4% and 2.1%, respectively, from 2021 through 2025. (See Exhibit 1.f.) More precision can be found by looking at the 82- to

86-year-old age cohort, which best captures the average move-in age of seniors housing residents. This population cohort is projected to expand by 1.4% in 2018 and then accelerate through the next several years, averaging 2% growth over the balance of the current decade and then 4.3% per year from 2021 through 2025.

The latter part of the 2020s will see the beginning of significant acceleration in this population, with the 80+ population growth rate averaging roughly 4.8% per year from 2026 through 2030. The 85+ population cohort will not grow quite as fast but still will average nearly 4.0% over the same period, while the 82–86 cohort will average 5.3% per year.[6]

A way to measure the utilization of seniors housing by seniors is the penetration rate. Industry penetration can be calculated in a variety of ways and will vary by region, age, or population cohort. Dividing the total U.S. inventory of seniors housing units by the U.S. population aged 80 years or older yields an estimate of 12.6% as of 2017, while dividing it by the U.S. population aged 75 years or older yields an estimate of 7.6%. Other measures of penetration rates use U.S. households older than 75 or, in some instances, population and household estimates are income qualified. (See Appendix B for more details about demand drivers.)

While more than 1.4 million people live in seniors housing, demand may be constrained by many seniors' hesitancy to leave their homes and anxiety concerning monthly rent payments, particularly

Exhibit 1.e

U.S. Population and Households by Age Cohort*

	Population (Millions)		Households (Millions)	
	Number	% of Total	Number	% of Total
45-64	84.2	26%	46.6	39%
65-74	28.6	9%	18.2	14%
75-84	14.2	4%	*Not Available*	
75+	20.6	6%	13.6	11%
80+	12.2	4%	*Not Available*	
85+	6.4	2%	*Not Available*	

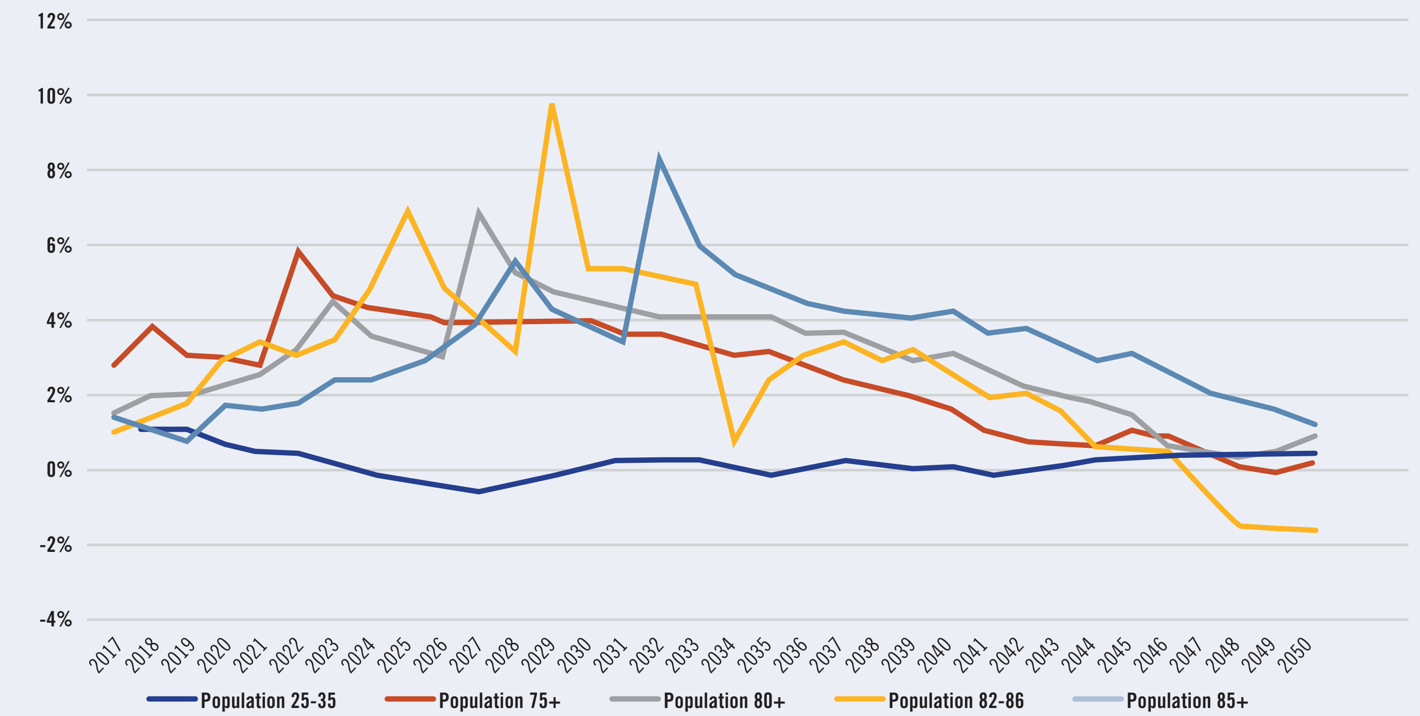
* Population estimates for 2016 and household estimates for 2017

Source: U.S. Census Bureau

Exhibit 1.f

Annual Population Growth Rate Projections

2017–2050



Source: U.S. Census 2017 Population Projections for those households who own their homes. Because of this preference, many businesses provide services to seniors within their existing homes as an alternative to the housing and services offered by seniors housing and care properties. We refer to these services as "alternative services." (Detailed descriptions of alternative housing and services are provided in Appendix E.)

1.3 Performance Comparisons

For many investors, the combined components of real estate, hospitality, and needs-driven services give seniors housing and care properties a unique resiliency, offering the benefits of real estate investment along with the characteristics of the health care field. This resiliency was evident during the real estate downturn of 2008–2009, when seniors housing and care properties outperformed other commercial real estate property types in terms of investment returns and rent growth.

The NCREIF Property Index (NPI) is a leading U.S. quarterly time series composite total rate of return measure of investment performance (gross of fees) of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. NCREIF is the acronym for the National Council of Real Estate Investment Fiduciaries. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors—the great majority being pension funds. As such, all properties are held in a fiduciary environment. As of 4Q2017, the NPI comprised 7,527 properties with a combined market value of $559.8 billion.[9]

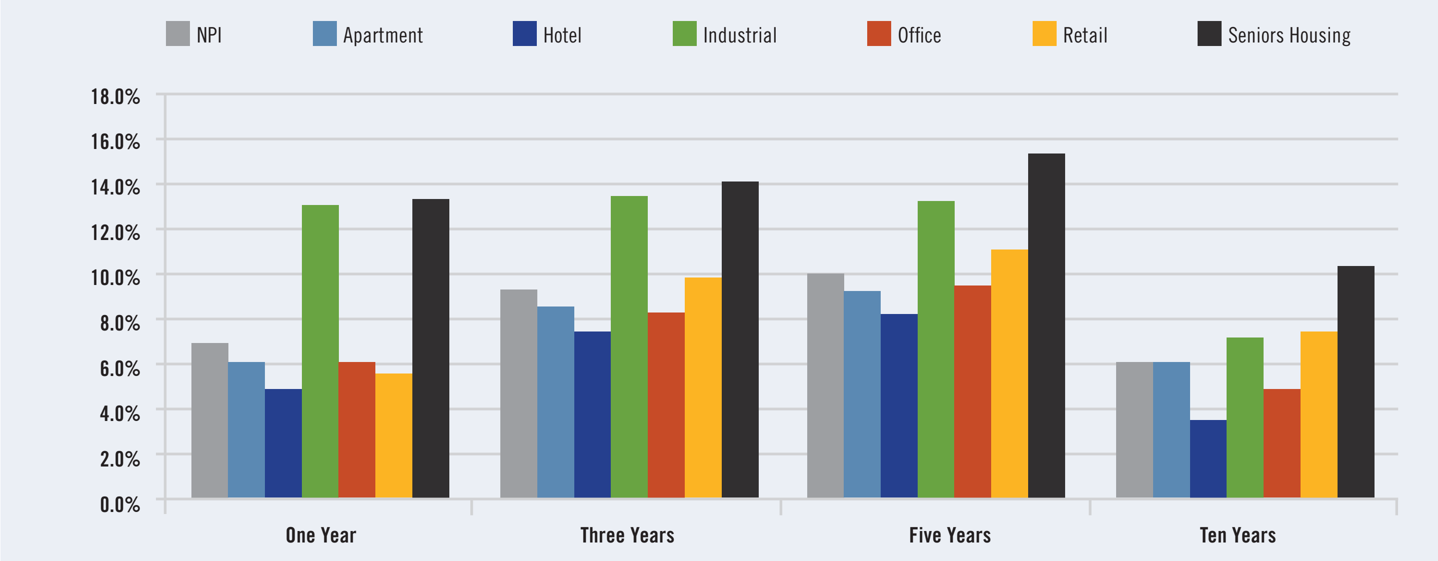
Over the past 10 years, as seen in Exhibit 1.g, the nominal returns on the seniors housing properties within NCREIF's database (but which are not included in the NPI) have outperformed the nominal performance return measurements for the broad NPI as well as for the other individual NPI indices. As of 4Q2017, seniors housing properties had generated an annualized return of 10.4% since 4Q2007. This compares to an annualized return of 6.1% for the entire NPI. Seniors housing has also outperformed the NPI property types in terms of the appreciation and income components, both of which are discussed in Section 10. As of 4Q2017, data on 100 stabilized seniors housing properties was reported to NCREIF. The value of these assets totaled $4.9 billion.[9]

On a 10-year basis, as seen in Exhibit 1.h, publicly traded health care real estate investment trusts (REITs), for which seniors housing and care properties represent a significant share of their investment portfolios, outperformed the FTSE NAREIT Equity REIT Index (NAREIT) but slightly lagged the S&P 500 Index. However, the health care REIT sector underperformed the S&P 500 since 2015 as investors shifted out of dividend stocks including REITs. Health care REITs also underperformed the NAREIT Index since 2015.[19]

Exhibit 1.g

NCREIF Annualized Total Returns Across Select Property Types

As of 12/31/2017



Source: NCREIF, NIC

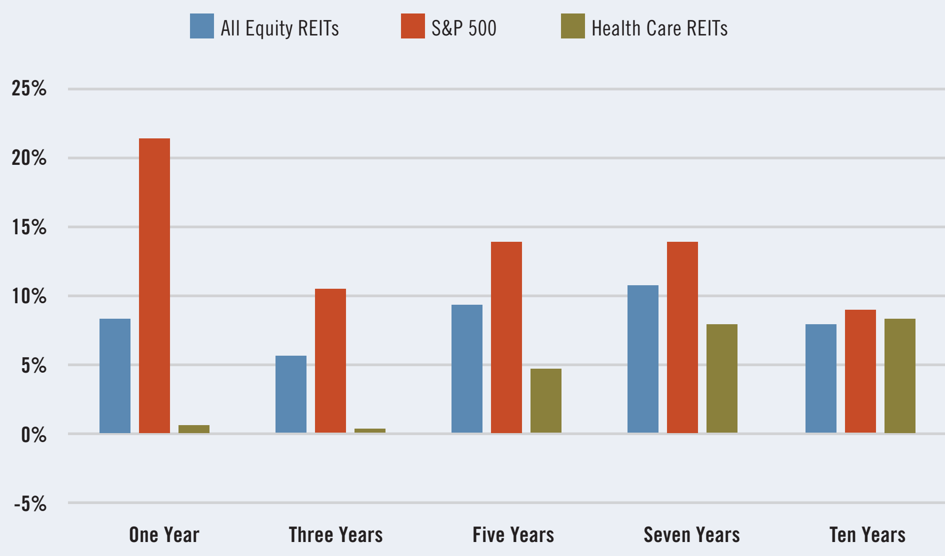
Much of the strength in the 10-year investment performance of seniors housing and care properties can be attributed to relatively steady leasing trends when compared with other real estate property types, especially during the recession of 2008–2009. As compared with the property types within the NPI, seniors housing and care is the only real estate property type that did not experience declining asking rents during the economic recession. Asking rent growth for seniors housing reached a cyclical low of 1.1% in 4Q2010, which was well above the cyclical lows of the core commercial real estate types of apartments and offices (-7.0% and -15.0% in 2009, respectively). From 2011–2017, asking rent growth averaged 2.5% for seniors housing properties, roughly half the pace of apartments, which experienced outsized rent growth following the rent declines incurred during the recession. It is also notable that rent growth in seniors housing, as seen in Exhibit 1.i, is steadier and less volatile than other commercial real estate.[1, 18]

1.4 Property Ownership and Large Operators

Exhibit 1.j and Exhibit 1.k outline the property ownership composition within seniors housing and care. The largest owner category of seniors housing and care properties are for-profit entities, with ownership of 69.5% ($199.4 billion) of units at seniors housing properties and 76.0% ($92.6 billion) of units at nursing care properties. Publicly traded REITs own a significant share of the investment-grade units, with ownership of 14.5% ($41.7 billion) of units in seniors housing properties and 8.9% ($10.8 billion) of units in nursing care properties.[1]

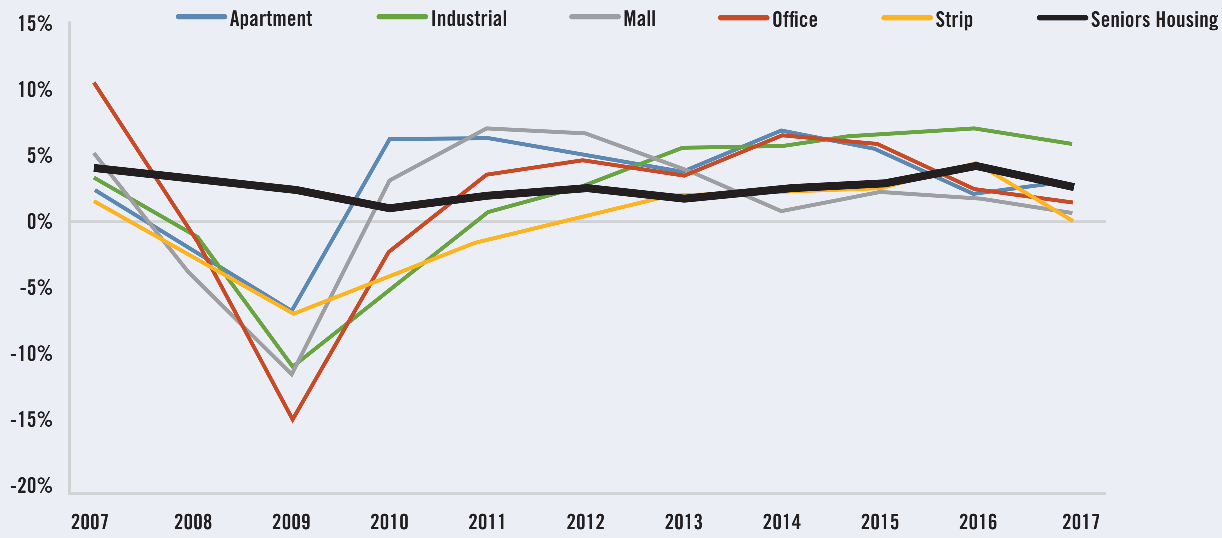
Exhibits 1.l, 1.m, and 1.n list the largest operators of seniors housing (majority independent living and assisted living properties), nursing care properties, and CCRCs. The 10 seniors housing operators in Exhibit 1.l control 26.5% of units within seniors housing properties in the 99 Primary and Secondary Markets tracked by NIC MAP®. In many cases, seniors housing and care properties are owned by an entity other than the operator. These ownership entities include publicly traded health care REITs and institutional investors. The structures of the relationships often vary by ownership, with institutional investors often entering into a joint venture ownership structure with an operator, while REITs engage in either a triple net lease (NNN) structure or a structure associated with the REIT Investment Diversification and Empowerment Act (RIDEA) of 2007. The latter provides exposure for REITs to the financial performance and health care operations of the properties they acquire, while NNN structures essentially make the REIT a landlord that receives previously negotiated rent checks at a specified interval.[1]

Exhibit 1.h
Annualized Total Equity Returns
Across Select REIT Types and the S&P 500 | As of 12/31/2017



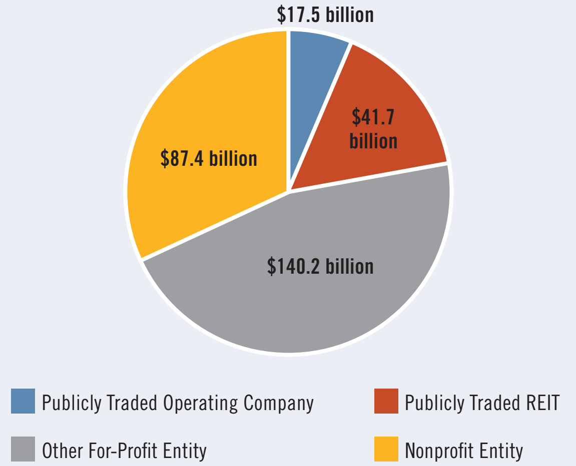
Source: FactSet, NAREIT, S&P

Exhibit 1.i
Commercial Real Estate Year-Over-Year Asking Rent Growth Trends
As of 12/31/2017



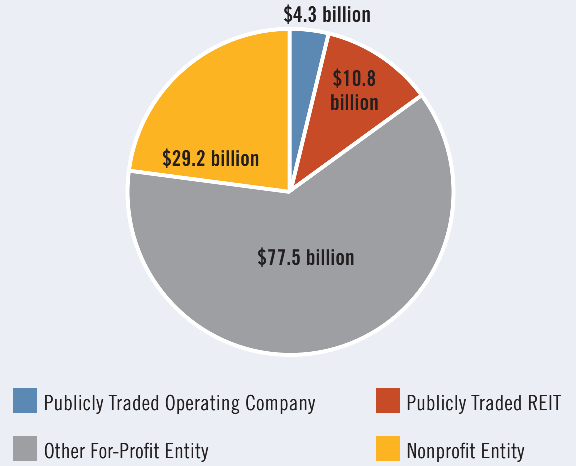
Source: NIC MAP® Data Service; Green Street Advisors

Exhibit 1.j
Implied Market Value of Seniors Housing Properties
As of 4Q17



Source: NIC MAP® Data Service; NIC

Exhibit 1.k
Implied Market Value of Majority Nursing Care Properties
As of 4Q17



Source: NIC MAP® Data Service; NIC

The 10 nursing care operators in Exhibit 1.m control 15.2% of units within majority nursing care properties in the 99 Primary and Secondary Markets.[1]

The 10 CCRC operators in Exhibit 1.n control 22.9% of units within CCRC properties in the 99 Primary and Secondary Markets.[1]

Exhibit 1.l
Largest Seniors Housing Operators in the 99 Primary and Secondary Markets
As of 4Q17

	Number of Properties Operated*	Number of Units Operated**
Brookdale Senior Living	647	63,351
Holiday Retirement	185	22,914
Sunrise Senior Living	248	20,439
Atria Senior Living	155	18,722
Five Star Senior Living	131	13,495
Senior Lifestyle Corporation	104	12,304
Life Care Services	55	8,033
Capital Senior Living Corp	71	7,769
Integral Senior Living	46	5,377
Senior Resource Group	29	5,065
10 Largest Operator's Share of Total Units		**26.5%**

*Includes independent living, assisted living, and memory care communities.
**Includes all units within the property. May also contain nursing beds.

Source: NIC MAP® Data Service

Exhibit 1.m
Largest Nursing Care Operators in the 99 Primary and Secondary Markets
As of 4Q17

	Number of Properties Operated*	Number of Units Operated**
Genesis HealthCare	281	35,904
HCR ManorCare	165	22,917
Sava Senior Care	98	12,376
Life Care Centers of America	87	10,640
Consulate Health Care	78	9,296
Ensign Group	80	8,906
CommuniCare Health Services	60	8,013
National HealthCare Corporation	43	6,453
Kindred Healthcare	48	6,024
Diversicare	43	4,516
10 Largest Operator's Share of Total Units		**15.2%**

*Includes nursing care properties.
**May include independent living units, assisted living units, or memory care units in addition to nursing care beds.

Source: NIC MAP® Data Service

Exhibit 1.n
Largest CCRC/Life Plan Community Operators in the 99 Primary and Secondary Markets
As of 4Q17

	Number of Properties Operated*	Number of Units Operated**
Erickson Living	18	23,308
Life Care Services	49	19,578
Brookdale Senior Living	34	12,546
Five Star Senior Living	26	7,243
ACTS Retirement-Life Communities	13	5,085
Covenant Retirement Communities	11	4,258
Lifespace Communities	11	4,240
Vi Senior Living	8	3,065
Presbyterian Homes & Services	8	2,643
Sunrise Senior Living	6	2,604
10 Largest Operator's Share of Total Units		**22.9%**

*Includes CCRCs/Life plan communities.
**Includes all units within the property, including nursing beds.

Source: NIC MAP® Data Service

Brightview West End
Rockville, MD

In this section

Section 2: Emerging Trends and Observations

Throughout most of this document, NIC relies on data-driven observations to inform investors about the seniors housing and care industry. This section is different because it draws upon the judgment of industry participants to make observations and discuss trends that presently are emerging, for which reliable empirical data may not be available. The observations are presented in the spirit of contributing to a timely and forward-looking document. The observations and trends fall into five broad areas: supply and demand, operating strategies, capital markets, the labor market, and regulation.

2.1 Supply and Demand

- **High Construction Activity.** The historically strong operational and investment performance of seniors housing, expectations for strengthening demand due to demographic growth, and availability of capital have helped fuel investment activity in the seniors housing market in recent years. Demand for existing high-quality seniors housing properties has generally outpaced supply in recent years, which has driven average transaction prices higher. Subsequently, these conditions have caused some investors to turn to new development opportunities to grow their seniors housing portfolios in the pursuit of higher investment returns. As a result, some metropolitan markets have experienced significant amounts of new construction, with much of the new development focused on private pay assisted living and memory care. As a result, supply has outpaced demand in a number of markets, resulting in downward pressure on occupancy. Some investors speculate that the best return opportunities may shift in the coming years toward acquiring failed development projects or repositioning older properties through investment in capital improvement projects. The rising costs of construction and borrowing may prove to be mitigating factors going forward.

- **Addressing Affordability.** Industry participants are exploring ways to make seniors housing more affordable and serve a less affluent resident. Among these efforts, NIC awarded a research grant to the non-partisan and objective research organization NORC at the University of Chicago in 2017, with published results anticipated for mid-2019. The grant is intended to help define and quantify the “middle market” seniors population through 2029. As many baby boomers (born between 1946 and 1964) have not saved sufficiently, it is generally believed that there will be an increasing need for lower-cost seniors housing and care options and/or a greater availability of subsidies for care costs as the U.S. population ages. While the majority of new construction activity has been focused on private-pay, market-rate projects, some developers and operators have been innovating to address demand for more affordable seniors housing. New development approaches have been pursued to reduce costs, including redeveloping existing real estate rather than ground-up new construction.

- **Residents’ Entry Age and Acuity Continue to Increase.** On average, seniors are older and frailer at the time of moving into a seniors housing community today than they were in the past. Following the Great Recession, many seniors delayed moving into seniors housing due to economic uncertainty and weakness in the single-family resale market, as proceeds from the sale of a home are often accessed to pay for seniors housing rents and services. However, the average age of entry into seniors housing reportedly continues to rise even though home prices have recovered. The trend implies a current shift in consumer decision-making for seniors housing toward more needs-driven factors that arise with age and declining health rather than lifestyle-driven factors. This has investment implications for seniors housing, since rising average age and increasing frailty of residents affect length of stay, turnover rates, occupancy, and, ultimately, operating income. However, there are some investors and operators looking at lower-acuity, hospitality-oriented independent living and "active adult" products as promising opportunities.

- **New Interest in Age-Restricted Housing Development.** Age-restricted housing, also referred to as "active adult" or "55+" housing, is not a new concept but has attracted renewed interest from developers and investors in the seniors housing industry. Age-restricted communities do not directly provide care services but rather offer lifestyle housing options for older adults, often centered on socialization and recreational activities. Historically, since personal care services are not provided, age-restricted properties were traditionally distinct from the seniors housing continuum and considered to be a variation of multifamily housing or other residential real estate products. However, some investors who are active in the seniors housing industry or the multifamily housing sector are directing capital toward the development of these communities. Rationale for their investment interest includes a view that age-restricted housing will be in greater demand from the baby boomer generation based on the trend of seniors delaying entry into higher-service communities until they are older and have greater care needs. There is also a view that age-restricted housing may provide a referral source for prospective residents seeking higher levels of care over time. And while there is a wide variety of development models for this type of housing, it remains to be seen what role these types of communities will play as they attract new investors and potentially become more closely aligned with the seniors housing continuum.

2.2 Operating Strategies

- **Growth of Provider Partnerships.** Health care reform, the growing number of seniors using managed care plans, and various demonstration programs are driving the integration of acute care/post-acute care and long-term care. As the lines blur across the continuum of care, seniors housing and nursing care operators are identifying ways to partner with acute care hospitals, managed care companies, and other health care providers up and down the care continuum. For nursing care providers, the need for such partnerships is becoming clear. Financial incentives increasingly are being tied to producing better health outcomes and opportunities to improve payer mix and margins through relationships with hospitals and insurers. While seniors housing operators may also find a need for partnerships in the health care continuum as value-based payment models evolve and resident acuity increases, there are currently diverging strategies among operators, with some focusing on care and ancillary service offerings and others focusing on housing and hospitality services.

- **Skilled Nursing Properties Position for Post-Acute Care.** The skilled nursing care sector is bifurcating, with many operators and facilities moving to provide more intensive therapy for short-stay post-acute care patients rather than serving traditional long-stay custodial-care residents. This move has the potential to improve rates and margins at skilled nursing properties that are able to deliver and document positive outcomes for such patients. However, challenges remain, such as shorter lengths of stay and getting access to health care dollar savings being generated. Operators may find the need to renovate or replace their real estate to effectively provide these services, and they may need to recruit and retain more highly trained staff and adjust their operating models for higher resident turnover. While skilled nursing properties may reposition themselves to attract more short-term, post-acute patients, long-term residents continue to make up the majority of skilled nursing patients.

- **Convergence of Independent Living and Assisted Living.** As independent living properties continue to experience a rising entry age for residents, there is less distinction in the services provided in assisted living and independent living. Some independent living operators increasingly are providing more of the services available in an assisted living property, either through third-party ancillary service providers or on their own. Other operators focus on ensuring residents can "age in place" by using flexible building design. It is important to recognize, however, that states often have building codes that specify standards for assisted living that are different than those for independent living.

- **Technology Innovations.** There has been a growing interest in both complementary and potentially disruptive technologies that will allow seniors housing providers to achieve greater operating efficiency. From an operations perspective, new leads are being generated over the internet. IT systems and big data are allowing senior management to observe real-time changes in their day-to-day performance and operations, and remote monitoring of residents is generating staff efficiencies. From a health and wellness perspective, telehealth and virtual care systems have the potential to reduce health care costs and improve health care coverage by allowing instant video conferencing at call centers with live doctors. Smart phones and appliances, remote sensors, handheld devices with medical applications, and mobile, personalized connectivity applications, and software systems have the potential to better allow aging in place, independence, and virtual socialization.

2.3 Capital Markets

- **Rising Interest Rates.** Seniors housing and care real estate experienced a declining cost of capital in recent years as cap rates and debt pricing were driven downward by competition among capital providers pursuing opportunities in the sector and a very low interest rate environment. However, after years of historically low levels, interest rates in the U.S. are beginning to increase. In this environment, investors may have higher return targets, and the rising cost of debt capital may dampen both acquisition and development volumes. An offset to rising interest rates could be strong growth in net operating income (NOI) driven by positive market fundamentals, such as rising occupancy rates. However, occupancy rates have generally been trending lower in the past few years. Another offset could be continued inflow of capital into the sector, which would put downward pressure on cap rates. However, higher interest rates could also affect valuations if NOI growth doesn't offset the effects of higher interest rates on cap rates.

- **Changing Acquisition Market.** Ongoing consolidation among seniors housing and care providers is expected to continue due to capital availability, industry fundamentals, and growing investor awareness of the sector. However, the composition of the investors that are driving transaction activity is again changing. For example, after several years of high acquisition volume, public REITs were not buying at the same pace and, in some instances, were selling assets through year-end 2017. More private equity funds have entered the space as active buyers, while existing private equity funds are expanding their footprint. Foreign capital sources, ranging from private investment funds to public institutions, have also entered the U.S. senior care sector as buyers. Chinese capital has been particularly strong, as of late. Additionally, some independent, non-institutional owners are aggregating assets as they find opportunities to strengthen their presence in their current markets or expand to new markets.

- **Joint Ventures Are Preferred.** Historically, REITs were exclusively real estate owners and sought triple net lease (NNN) structures with operators. However, certain REITs and operators have shifted away from NNN and are actively pursuing new structures for their relationships. Among those structures, REITs are pursuing more joint ventures through the REIT Investment Diversification and Empowerment Act of 2007 (RIDEA) for their seniors housing properties, which allow them to share in the operating income along with their operating partner. Also notable is anecdotal evidence that REITs are aligning more frequently with regional operators rather than operators that are national in scope. Reasons for these changes include the difficulty some operators experience in meeting rent escalators in their leases, a mutual interest in establishing strong partnerships, and a desire for a greater alignment of incentives.

- **Divergence of Nursing Care Market.** Through year-end 2017, diversified health care REITs have increasingly separated their nursing care portfolios from their seniors housing portfolios to focus on private-pay seniors housing, and increasingly the buyers of nursing facilities are institutional private equity funds and independent owner/operators. The reasons for these changes are in part attributable to the diverging market fundamentals of nursing care properties from seniors housing, as evidenced in NIC data and elsewhere. Additionally, as many nursing care operators enhance their operating models with high acuity rehabilitation services, they are aligning further with the health care continuum, which could potentially affect the composition of the investor base.

2.4 Labor Market

- **Rising Cost of Labor.** Operators are experiencing rising labor costs nationally as a result of tighter labor markets and minimum wage legislation in various states and municipalities. NIC MAP and Bureau of Labor Statistics (BLS) data for 4Q2017 show wage growth, as measured by average hourly wages, exceeding asking rent growth for assisted living and independent living properties. Since labor costs are typically the largest expense of operating a seniors housing property, these changes can have a significant impact on operating margins.

- **Labor Shortages.** Shortages of labor are emerging across many industries in the U.S. Shortages of executive directors, nurses, and care assistants are becoming more common in the seniors housing and care sector due to low unemployment and uncertain immigration policy going forward. The recent period of high development activity in seniors housing has created greater need for labor in the industry. In addition, there has been growing competition among operators to hire experienced staff from incumbent operators in response to a shortage of qualified labor. The availability of labor in a local market is becoming a key investment criteria for operators considering the acquisition or development of a seniors housing property.

- **Recruitment and Retention.** Training programs and credentialing for positions such as executive directors are emerging in an effort to develop bench strength in the labor force. Such credentialing includes the Certified Director of Assisted Living (CDAL) from the Senior Living Certification Commission (SLCC). Employee retention is a key concern, because the labor market continues to be competitive and the cost of labor turnover can be high. As the demand for seniors housing increases with the anticipated demographic trends, the labor shortfall may be exacerbated. Projections from Argentum, University of California, and others estimate the need for 1 million to 2.5 million additional long-term care workers by 2030.

2.5 Regulation

- **CMS Strategies.** A characteristic of the nursing care industry is its exposure to extensive regulatory risks, since the majority of revenue is derived from federal and state funds through Medicare and Medicaid. The Centers for Medicare & Medicaid Services (CMS) continues to develop new strategies to adequately manage health care access and costs as the U.S. approaches a time of unprecedented growth in the population of older adults. Among the current initiatives, CMS is in the process of implementing a three-year phase-in of significant updates to the requirements for participation in its programs. Additionally, the Value-Based Purchasing Initiative, which intends to reduce costly hospital readmissions, will be implemented in fiscal year 2019. CMS has also proposed a replacement for the current RUG-IV Medicare payment system. The new Skilled Nursing Facility (SNF) Patient-Driven Payment Model (PDPM) is expected to be implemented in 2019.

- **Managed Care Is Increasing Market Share.** Medicare Advantage plans continue to increase their market share, with 33% of Medicare beneficiaries enrolled as of 2017, representing more than a tripling of market share since 2004. However, while Medicare Advantage penetration is increasing among post-acute skilled nursing patients, according to NIC's Skilled Nursing Data Initiative, only a small share of skilled nursing patient days is attributable to Medicare Advantage. Additionally, more states are moving toward managed care administration of their Medicaid programs for long-term care services. Nursing care properties will need to adapt to these changing payment systems, which may have leverage in determining reimbursement rates, as managed care companies begin to represent a greater share of their payer mix and potentially reduce their operating margins.

- **Fragmented Seniors Housing Regulation.** While the skilled nursing industry is highly regulated at the federal and state levels, regulation of assisted living and memory care facilities differs by state. Building design standards, licensure types, minimum staffing requirements, staff credentialing, and numerous other considerations that affect the development or operation of these properties are not uniform, and there are no apparent trends in the regulatory environment nationally. Investors should seek awareness of local regulatory requirements and understand how they affect the costs and underwriting of a seniors housing property.

Lakeshore
Duluth, MN

The complete NIC Investment Guide is available for purchase at www.store.nic.org/ig.

NIC

National Investment Center for Seniors Housing & Care
1997 Annapolis Exchange Parkway, Suite 480
Annapolis, MD 21401
Phone: (410) 267-0504
Fax: (410) 268-4620
www.nic.org

ISBN 978-0-692-16655-0

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