NIC

National Investment Center for Seniors Housing & Care

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NEWSLETTER

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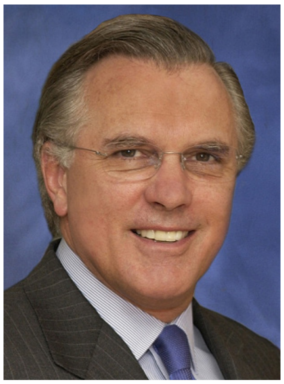
In the Insider February 2016 Issue

Consumers, Commodities, and Corrections

Richard Fisher Previews His Keynote on Current Economic Trends



After nearly a decade of historic lows, the Federal Reserve raised short-term interest rates in December. This move, along with volatility in the domestic and global financial markets, has left investors in all sectors wondering how the economy will be affected—and what the Fed might do next.

But overreactions and misunderstandings can lead to bad monetary policy, indicates Richard W. Fisher, a keynote speaker for the upcoming 2016 NIC Spring Investment Forum, March 9–11 in Dallas. The Federal Reserve Bank of Dallas' former president from 2005 to 2015, Fisher currently is on the board of directors for PepsiCo and AT&T, and serves as a senior advisor for Barclays Bank.

Fisher recently previewed his keynote for the Conference Luncheon during an interview with Beth Burnham Mace, NIC's chief economist, where they discussed future moves by the Fed, the economic outlook, and China's role in the global economy.

"Don't Go Wobbly"
Quoting former British Prime Minister Margaret Thatcher, Fisher pointed out the need for Federal Reserve Chair Janet Yellen and the Fed to keep a steady hand going forward in reaction to volatility in the financial markets.

While serving with the Fed, Fisher had warned of a significant correction in the financial markets, he said, because of the effects of an extensive period of zero-cost money and the third round of quantitative easing (QE3) in 2012. But he noted that historically, stock market corrections do not always have a negative effect on the economy.

"We had a correction in 1987 [that] was substantial and had no impact on the economy," he told Mace. "And we've had periods, on the other hand, where we've had significant corrections—1907, the Rich Man's Panic, 1929, 1937—and you did have a real impact on the economy."

For now, he advises the Fed to take steps to separate the real economy from movements in the financial markets. "A stock market correction is not necessarily a bad thing, as long as it doesn't overshoot and misalign with underlying values . . . Don't necessarily react to market activity unless it means that there's an underlying weakness in the economy. And stick to your guns."

Bifurcation in the Economy

Comparing positive unemployment rates to less favorable news from the manufacturing and goods-producing sectors, Mace asked Fisher how he thinks the real economy is faring. "It's a mixed view," he said.

Unemployment remains low, especially for the key working-age demographic of those aged 25 to 54, and a surplus of unfilled jobs exists. Low inflation has factored into higher after-tax incomes for consumers. Decreases in energy costs and an abundance of crops have benefited consumers with lower prices for food, heating, gasoline, and utilities. And early indicators suggest that consumers are pocketing some of the savings.

"Our savings rate has gone up, which is good. We've been under-savers," said Fisher. "We'll see as time progresses if their increased after-tax income as a result of relatively low inflation and these great tax cuts they've received on energy and food translates into greater consumption or just more savings."

On the industry side, however, the news is not as positive. Fisher pointed to energy and transportation as sectors that have been affected negatively. "There's a lot of uncertainty there."

Fisher also highlighted the growing separation between goods and services. "One statistic that most people don't realize is that goods prices have depreciated by 0.3% per annum since 1963, and services prices have gone up," he said. "We have tugging and pulling here between the service sector, which is inflating well above 3%, while the durable goods manufacturing sector is deflating in terms of price of product. So we have a bifurcated economy."

The economy, Fisher stated, is driven by services and consumers, and they're benefiting from it. Manufacturing, however, currently makes up only 12% of the economy. "So we have a mix of an economy," he said. "It's a slow growth picture. It's a bit of a crawl. But it's positive. It's going forward." And the volatility in the markets has not played a great role in decreasing consumer confidence thus far, he explained.

A Coming Correction for Construction?

Construction remains a major concern for those in seniors housing and care. Mace asked Fisher if he sees a correction in the future for construction for commercial real estate in general.

"I live in Dallas," Fisher answered, "and there are more building cranes here than you can shake a stick at." Construction remains high throughout much of the country, including San Francisco, Boston, and New York. The high construction activity has the potential to be overdone.

"It's in the DNA of commercial developers to overdo it, to be overactive," he said, pointing to the availability of capital. "And there's probably a correction out there somewhere, but right now, it's not just crawling, it's booming along."

Labor and Monetary Policy

From executive directors of individual properties, down to the front lines of the actual caregivers, seniors housing and care providers increasingly are challenged in finding qualified candidates to fill open positions. Mace asked Fisher to weigh in on potentially growing labor shortages and rising wage pressures.

"This is no longer a matter of monetary policy," Fisher answered. "It's a matter of fiscal policy, educational policy, and regulatory policy—particularly educational policy."

Using an example from the transportation sector, Fisher pointed out the growing shortage of truck drivers in a profession that requires specific educational skills and health status. Current reports predict the shortage increasing from 30,000 to 200,000 in a couple years. "This is a matter of skills," Fisher said, "and it's not just in truck-driving."

The current educational system, along with fiscal and regulatory policies, is making it harder for employers in the United States to find qualified candidates with the right skill sets. It's a problem, he said, but "I don't think it's an issue monetary policy should try to solve or can solve."

Overreactions to China

Having completed over 50 trips to China during his career—including for the opening of the U.S. embassy in 1979—Fisher brings a deep understanding of the world's second largest economy and the role it plays in the global marketplace.

"I think we should be interested in China," Fisher told Mace, "but we overreact to China."

The focus on China by the press and by pundits is often caused by a misunderstanding of the country's history and economic policy. China suffers from a "misallocation of resources," Fisher explained, with 80% of bank loans going to state-owned enterprises, which make up 20% of the operating business in the country. That "80% is equivalent to 115% of GDP," he said.

Chinese Premier Xi Jinping has appointed economist Liu He to guide the country through a transition from producing output to achieving profitable efficiency. It's a transition that "will lead to a bit of a slowdown," he said.

Despite the challenges China faces as its economy becomes more sophisticated, Fisher said he doesn't lose sleep over it. "I don't believe for one nanosecond that when the Shenzhen and Shanghai markets sell off, or they move the currency 4%, that it's a reason for a selloff here."

Predictions for Future Interest Rate Hikes

There has been a lot of speculation on whether or not the Fed will raise interest rates again in 2016. Mace asked Fisher to share his perspectives on what the futures markets presently are predicting for the Fed's next move—that fewer rate hikes are projected for the rest of 2016 than were predicted at the beginning of the year.

"Markets come and go. Who knows?" Fisher stated. "It will depend on developments in the real economy."

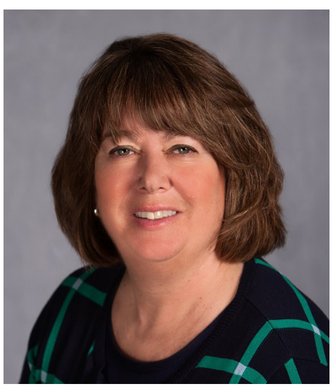
Fisher believes investors should be more interested in the reinvestment of Treasuries maturing between 2016 and 2019, which could reduce the number of sales in the Treasury market and affect bond market liquidity. It's a factor Fisher believes is more critical to focus upon than attempting to predict what the Fed may be contemplating for interest rates.

"You can never look too far down the road," he said, "because these are humans trying to make judgements."

Richard Fisher will speak at the Conference Luncheon on March 10 from 12:30 to 1:45 PM. For more information about the 2016 NIC Spring Investment Forum, or to register, go to the Forum website.

Thoughts from NIC's Chief Economist

By Beth Mace, Chief Economist, NIC



Recession, expansion, slowdown, correction, growth, gains, losses, best since . . . All of these words have been used in the press by either skeptics or optimists in recent weeks to comment on the economy. The strong dollar, coupled with weak oil prices, is hurting the goods-producing sectors of the economy, while a volatile stock market is spooking investors and consumers alike.

Against this backdrop is the job market, which continues to be strong. As of January 2016, the U.S. economy had 4.9 million more jobs than it did at the onset of the recession in December 2007 and 13.6 million more jobs than at the nadir—the lowest point—of the recession in early 2010. Additionally, the jobless rate was less than half the 10% peak reached in October 2009.

However, other indicators of the economy have recently been coming in less sanguine. The Federal Reserve reported that December's industrial production index fell 0.4%, the third monthly decline in as many months, while durable goods orders retreated for the fourth time in the past five months. In addition, the fourth-quarter preliminary GDP estimate is a mere 0.7%.

The Fed's Delicate Work

The Federal Reserve needs to weigh and balance these mixed signals as it formulates its next steps for monetary policy and interest rates. The strong dollar, instability in global stock markets, falling oil and commodity prices, benign inflation indicators, weakening emerging market growth, global debt strains, and policy decisions in Europe, China, Japan and Russia also need to be taken into account.

At this point, the status of U.S. Treasury market as a safe haven against these threats makes it difficult to execute and maintain the intentions of the Federal Reserve's policy makers. Indeed in January, interest rates reversed course and fell back after having risen in the immediate aftermath of the Fed's first rate hike in eight years in mid-December. The 10-year Treasury rate, for example, slipped back to 1.66% in mid-February after having been as high as 2.30% on December 16, the day the Fed increased rates.

As a result, the path forward for interest rates is murky at best. The March Federal Open Market Committee (FOMC) meeting will be the next time the Fed could make a move. But many analysts are projecting no increase at that time, with a rapidly declining probability for a further increase in the Fed's benchmark rate in the spring—or, for that matter, anytime in 2016. For seniors housing financiers and operators, this is both good and bad: bad, because the Fed's reticence to raise rates means that there are storm clouds on the economic horizon; good, because the cost of debt will remain relatively low, deal structure and financing may remain competitively priced, and valuations are likely to be reasonably stable.

The Ripples through Real Estate

The threat of higher interest rates last year and the stock market's rout so far this year have played havoc with the market capitalizations of many publicly-traded REITs. This in turn has changed the financing environment for many REITs and has increased on their cost of capital on both the debt and equity side. In combination with near-record high transaction pricing on both a per-unit basis and a cap-rate basis, a change in the financial environment has caused a series of responses. Among them was a marked slowdown in acquisition activity and volume in the second half of 2015 by publicly-traded companies, which include REITs.

Acquisitions of senior housing and care properties by public, private, and institutional real estate investors totaled $19.3 billion in 2015 (revised up from $18.7 billion at the time of the Q4 2015 NIC MAP® webinar), which was up from $17.9 billion in 2014. Combined third- and fourth-quarter volume totaled $6.5 billion, however, which was down significantly from $12.8 billion in the first half of the year. The slowdown largely was due to the drop off in acquisitions activity by the publicly-traded companies which accounted for nearly $8.1 billion of the $12.8 billion in the first half of the year, and less than $2.9 billion for the second half of the year.

For the biggest health care REITs, large transactions are often needed to move the needle on earnings, and there were fewer large transactions in the market in the second half of the year. Indeed, of the 514 deals that closed during 2015 transactions, there were only two that exceeded $1 billion (the Omega/Aviv deal and the Senior Housing Properties Trust/CNL deal). The NIC/RCA data shows that as the year evolved, fewer large deals over $500 million occurred, and more portfolio deals in the smaller $10 to $50 million range took place. The private buyer type, which includes private REITs, accounted for $1.5 billion in the fourth quarter, a pace that is consistent with the past couple of years; however, in the fourth quarter, that $1.5 billion represented 47% of all transaction activity, up from the 21% in the second quarter. The institutional buyer represented 15% of deal volume in the fourth quarter, up from 2% a year ago. Note that these numbers do not include the large 97-property Trilogy deal that closed in early December. As of this writing, the real estate portion of the $1.1 billion deal was still being determined.

The average price per unit for seniors housing properties remained near record highs. As of the fourth quarter of 2015, the rolling four-quarter average price per unit for seniors housing properties was $174,000, up 9% from year-earlier levels and just 1.3% shy of its record reached in late 2011. The rolling four-quarter average price per bed for nursing care properties was $72,000 in the fourth quarter, down 12% from a year ago.

The Lift for the Labor Markets

The jobless rate fell to an eight-year low of 4.9% in January from 5.0% in December. The unemployment rate has not been this low since February 2008, just before the Great Financial Crisis began. For perspective, the lowest the unemployment rate has been since 2000 was 4.4% in May 2007. The wider measure of unemployment—the U-6 measure—was 9.9%, unchanged from December. Moody's Analytics estimates that this latter measure needs to fall to 9% for the economy to be considered at a "full employment" level.

As the labor markets tighten, we would expect to see upward pressure on wages. However, this has not been readily apparent in the official statistics, although evidence is beginning to show up in the some of the wage measurements. Unit labor costs, a measure of expenses per worker, increased 2.4% in 2015, up from 2.0% in 2014 and the most since 2007. And the U.S. Bureau of Labor Statistics' measure of average hourly earnings was up 2.5% from year-earlier levels in January, while December's growth rate was revised up to 2.7% from 2.5%.

Moreover, for the first time in more than a decade, nearly half (49%) of respondents to the most recent National Association of Business Economists (NABE) Business Conditions survey report their firms' wages and salaries rose in the latest quarter. The net rising index {NRI) for wages and salaries rose sharply to 45 in the January survey from 28 in the October survey—the highest NRI since at least January 2005. Wage increases were more prevalent in the services sector (50%) and finance and insurance sectors (61%) than in the goods-producing sectors (35%). Wages are also being pressured higher by a number of states and localities that are mandating higher minimum wages; in January, 14 states increased their minimum wages.

As always, I welcome your thoughts, comments, and feedback.

Beth

Looking to the Future of Data

New Operational Benchmark Metrics for Strategic Planning in 2016 and Beyond

As operators progressively need to demonstrate the quality of their operations, and capital providers evaluate properties for operational success, having timely and relevant benchmarking data is increasingly a top priority among the industry's data requirements.

Reporting data that increases transparency into the seniors housing and care property market is a top NIC priority, as well.

"NIC is incubating a number of new data initiatives designed to give operators and investors insight into the operational performance of properties," said Chuck Harry, NIC's managing director and director of Research & Analytics. "The better and more actionable the data that's being reported is, the better equipped the industry will be to meet the aging population's needs now and in the future."

Initiatives underway at NIC include collecting and reporting on skilled nursing financial metrics, actual rents for private pay properties, and loan volumes from banks and other debt providers. The initiatives will be highlighted at the NIC MAP® Data Service Hub during the upcoming 2016 NIC Spring Investment Forum in Dallas, March 9–11. Forum attendees can stop by the hub for additional information.

Timely and Deeper Skilled Nursing Market Data

The inaugural NIC Skilled Nursing Data Report will be released on March 10, 2016, at the 2016 NIC Spring Investment Forum. The quarterly report, which will be publicly available at no cost, publishes select skilled nursing metrics, including data on managed Medicare census and rates. The Skilled Nursing Data Report is designed to provide operators and investors with relevant and timely data.

“Operators and investors have been relying on government reports with data that is at least 12 to 18 months old,” said Bill Kauffman, NIC’s senior principal, Research & Analytics. “The NIC Skilled Nursing Data Report will provide data that is only 60 to 90 days old, which is crucial for them to have the information they need about a sector that is changing so rapidly.”

The inaugural report will be available at no cost. Attendees of the 2016 NIC Spring Investment Forum will receive an email with a link to download the report and can stop by the NIC MAP Data Service Hub for more information.

Mobile-Friendly Data Portal and Expanded Market Coverage

Increasing the ease of accessing data is the goal of the MAP 2.0 initiative, which will provide NIC MAP Data Service clients with new functionality within the client portal to view, download, and interact with data. In addition, MAP 2.0 will make the website mobile-friendly, so NIC MAP clients can access it on the go. The new interface is scheduled to launch in June 2016.

Also in 2016, NIC is expanding coverage of the markets it tracks from 99 to 140 U.S. metropolitan markets. New markets being added were chosen to fill existing coverage gaps between existing markets, especially in North Carolina, California, and Florida. The expansion also will include Hawaii, which will increase NIC MAP coverage beyond the 48 continental U.S. states for the first time.

Actual Rents and Leasing Activity

NIC’s Actual Rents initiative is designed to report on actual rents (in-place and move-in rents), which can vary at differing stages of the market cycle from the asking rents that NIC MAP currently reports. Also included are leasing activity velocities, which are measured by move-in and move-out rates.

NIC is the first to collect these metrics for the seniors housing property market and report them in market aggregates.

"This is a major undertaking that has received endorsement by most of the nation's largest health care REITs and major lenders," said Beth Mace, NIC's chief economist. "They, and the operators who are contributing the data, recognize that this is critical information operators and investors alike need for benchmarking property performance against market trends with actionable data."

The operators included in the sample data collection for the initial data release are larger, professionally managed, and investment-grade operators. The Actual Rents Initiative's initial national report is scheduled for release during the third quarter of 2016.

All of NIC's current data initiatives will further advance the transparency of the seniors housing and skilled nursing property markets with the goal of attracting more debt and equity capital and thereby lower the cost of that capital to better ensure the quality and the availability of housing and care needed for seniors.

Initiatives Seek Participation

To further its goal of increasing transparency across the seniors housing and care industry, NIC is seeking operators and investors to participate in its current data initiatives:

> **Actual Rents:** data on in-place rates, move-in rates, and leasing activity collected through monthly rent roll submissions with standard file formats and field definitions. Additional information about participating is available online: http://info.nic.org/actual-rents-participation.
>
> **Debt Metrics:** bank/debt providers to participate in a quarterly survey on loan volume for seniors housing and care properties. Contact Bill Kauffman at bkauffman@nic.org.
>
> **Skilled Nursing:** data on occupancy, skilled mix, quality mix, average daily rate by payor class, and patient day mix. For more information about participating, please visit http://www.nic.org/analytics/nic-initiatives/skilled-nursing-data-initiative.

How Assisted Living Providers Can Benefit from Health Care Reform

Harvard Researcher to Present Study Results at NIC Spring Investment Forum

Skilled nursing is already feeling the impact of health care reform. Next up: assisted living. In fact, forward-looking providers are already exploring ways to integrate and coordinate health care for their assisted living residents.

Harvard Medical School Professor David Grabowski will address the changing role of assisted living in the health care system at the NIC Spring Forum, and present the results of his research on the topic. He will be joined by Dr. Kevin O'Neil, chief medical officer at Brookdale Senior Living, who will discuss the results of a CMS initiative to improve care transitions in assisted living.

NIC CEO Bob Kramer will moderate the session, "Stepping Up to the Plate: Opportunities and Challenges for Assisted Living in the New Integrated Health Care Delivery Model." The session will be held Thursday, March 10, 11:30 AM – 12:30 PM. The 2016 NIC Spring Investment Forum is being held March 9–11, at the Omni Dallas Hotel, Dallas.

In advance of the session, Grabowski previewed his research findings during a recent conversation with NIC.

NIC: What was the purpose of your research?

Grabowski: Under health care reform, we are seeing a transformation away from Medicare buying health care services simply on a fee basis to Medicare seeking to incentivize high-value services. To date, assisted living has largely been excluded from the health care delivery system, but there may be real potential for assisted living to serve as a provider of high-value care. Thus, our research consisted of two parts. First, we wanted to profile individuals living in assisted living and determine their needs, and then look at their usage of health care services. The second step of our research was to see what infrastructure is in place at assisted living campuses to potentially coordinate care and encourage high-value services.

NIC: What did you find?

Grabowski: Assisted living residents had relatively high rates of chronic illness, and in some cases, it was nearly as high as the rates in nursing homes. The population receiving services in assisted living is chronically ill, and medically complex. But we also found that those in assisted living had fewer hospitalizations than seniors with similar health problems who lived in the community. That's where there's potential in assisted living to help coordinate services and encourage greater efficiency.

NIC: Your research also looked at assisted living infrastructure. What did you find?

Grabowski: We took two approaches here. First, we examined a national survey and found relatively little intensive investment in infrastructure to coordinate health services. For example, very few assisted living campuses have integrated electronic health records. Second, we also interviewed six of the largest senior living companies to get a sense of what they were doing to coordinate health care. All of them recognized they were caring for sicker and sicker residents. None had joined an accountable care organization or a demonstration program, but they recognized that it's an issue.

NIC: What are the opportunities for providers?

Grabowski: There's a real opportunity for providers to offer on-site services. Another opportunity is to build data infrastructure, integrating health records with hospitals, physician networks, and accountable care organizations. But providers have to start by tracking utilization, such as the rate of resident hospitalizations. You can't enter into a risk-bearing relationship without knowing your baseline data.

NIC: Are assisted living providers making any headway yet?

Grabowski: Most companies are beginning to make investments, but it's very early. They're talking to accountable care organizations and thinking through what new models of care coordination might look like. But some companies see themselves more as housing operators and don't want to go down the health care path. The sector could grow into two distinct segments: assisted living with some integrated health care, and traditional assisted living.

NIC: What are the challenges?

Grabowski: Assisted living operators don't want the regulation that nursing homes face. Assisted living providers are already frustrated with current regulations which vary from state to state, though they recognize they'll probably have to accept more regulation if they want to offer some onsite health services. The information technology component is another huge challenge. And who will pay for the services? Can Medicare be convinced these services offer a value?

NIC: What should attendees takeaway from your presentation?

Grabowski: Health care payment and delivery is moving in the direction of greater accountability and value-based purchasing. Given the high degree of chronic illness and avoidable Medicare spending in the assisted living population, there are real opportunities for providers that want to integrate health care services into their communities. However, we have to recognize that there will be some bumps in the road in getting there. If this were easy, everyone would have already been doing it.

Crucial Role of Ancillary Services in Focus at NIC Spring Investment Forum

The role of ancillary services in the care delivery system is rapidly changing. Once an afterthought, ancillary services are becoming a critical link to resident and patient outcomes now demanded by referral sources. Ancillary services are also emerging as an important source of revenue and cost containment.

So what's the best strategy? A panel of experts will detail how best to manage ancillary services at a session during the upcoming NIC Spring Investment Forum, March 9-11, Omni Dallas Hotel, Dallas. In a recent conversation with NIC, panelists previewed their remarks on what attendees can expect to learn during the session.

"The whole industry has changed," said panelist Jeff Barton, executive vice president, MobilexUSA, a provider of mobile imaging services. "What used to be acceptable is not acceptable any more."

As the health care system evolves from a fee-for-service to fee-for-outcome system, ancillary service providers have "stepped up their game," said Barton. They're becoming "trusted partners" rather than mere "vendors" in order to help communities attract and retain residents, and avoid costly rehospitalizations. "Expectations have changed," he added.

The session, "The Growing Role of Ancillary Service Providers," will be held from 2:00 to 3:15 PM Central Time on Thursday, March 10. Ann B. O'Shaughnessy, managing director, The PrivateBank, will moderate the session. Other panelists include Peter Longo, managing partner, Cantex Continuing Care Network; and Phil Fogg Jr., CEO, Marquis Companies & Consonus Healthcare.

Start with a Strategy

A solid strategy begins with an analysis of which services to outsource, and which to keep in house. Larger care providers tend to maintain internal therapy and pharmacy services because of the huge impact on costs and outcomes, said panelist Longo.

Sophisticated services are more likely to be outsourced if they require advanced technology such as mobile imaging and laboratory testing. Services that call for special expertise, such as dialysis, are outsourced too.

Small housing and care providers take a different approach. They typically outsource the majority of ancillary services because they lack the resources to invest in the new technologies needed to compete. "They don't have the critical mass to make the economics work," said Fogg of the Marquis Companies.

The challenge for all housing and care properties is to take the cost out of the post-acute care delivery system and achieve better outcomes for the patients. "How can ancillary services help the facility get better results?" asked Fogg. The first step is to make sure the ancillary service provider is aligned with the facility's goals, he noted, and held accountable to the same measures the facility must meet.

The panelists emphasized the importance of the role ancillary services now play in the selection of a community or provider by managed care companies, accountable care organizations, and other intermediaries. "We see more pressures on outcomes," said Longo. "They're using measures to narrow networks and pick providers."

While communities tend to take a hands-off approach once ancillary services are in place, the changed heath care landscape calls for more rigorous management of the process. Data must be collected and shared. "Time and attention is needed to build the relationship," said Longo. He added that the ancillary service provider and facility should work toward the comprehensive collection of cost data for different episodes of care. Though somewhat illusive, granular detail will help housing and care providers negotiate prices that allow them to generate positive returns and stay competitive. "It behooves everyone to provide more control over costs and outcomes," he said.

Seniors Housing & Care Industry Calendar

March 2016:

9-11 2016 NIC Spring Investment Forum, Dallas, TX

April 2016:

19–21 ULI Spring Meeting, Philadelphia, PA

May 2016:

9–12 Argentum Senior Living Executive Conference, Denver, CO

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