Seniors Housing Investment Opportunities

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Pricing in the seniors housing and care sector is setting records.

INVESTOR INTEREST IN the seniors housing and care sector is strong. Transaction volumes reached near-record highs in the second quarter of 2015, with more than $23.4 billion of deals closing on a rolling four-quarter basis, the strongest pace since 2011. Moreover, over these same four quarters, 554 deals closed, nearly a peak. Strong acquisition demand for seniors housing and care properties is pushing prices higher, with many active bidders. In the second quarter, per-unit pricing averaged $173,000 for seniors housing and $73,000 for skilled nursing facilities on a four-quarter moving average basis. Prices for seniors housing have never been so high.

A host of factors are drawing investors into the sector. These include the following:

**Enticing Demographics.** While the oldest baby boomers will not reach age 80 until 2026, demographic tailwinds are quickly advancing. By 2017, growth in the 82-86 cohort (the age group that dominates assisted living and independent living properties) will start to accelerate and will generally continue to do so until 2025, providing a nice demographic driver for seniors housing. Between 2017 and 2025, this cohort will increase in size by 1.5 million persons, or 29 percent, from 5.1 million to 6.6 million.

**Compelling Investment Returns.** Institutional-quality private-pay seniors housing has consistently produced both strong income and strong appreciation returns for more than 10 years. Indeed, since 2002, the National Council of Real Estate Investment Fiduciaries (NCREIF) has been collecting return performance data from tax-exempt institutions such as pension funds that have invested in the seniors housing sector. While these still include a relatively small number of properties, the 10-year annualized average return was 14.2 percent as of the second quarter of 2015, outpacing the overall NCREIF Property Index (NPI) return of 8.2 percent and beating returns for any other single property type, including apartments, retail, office, industrial and hotels. They have outperformed for both the income and the appreciation components of return, by 7.1 percent and 6.8 percent, respectively, on a 10-year basis.

**Greater Transaction Volumes and Liquidity.** Investor interest in the sector continues to grow, as evidenced by the sheer volume of deals and dollars. Additionally, balance sheet lenders such as life companies, debt providers such as commercial mortgage-backed securities (CMBS) lenders and growing numbers of pension funds are investing in the sector today.

**Rising Transparency and Understanding.** Information about market fundamentals and capital market conditions from sources such as NIC MAP and Real Capital Analytics (RCA), as well as active REIT participation in the sector and Wall Street analyst coverage, allows lenders and borrowers to better understand current conditions and provides a more disciplined capital market.
Solid Market Fundamentals. Occupancy has generally recovered since the Great Recession. The sector has also shown itself to be “recession resilient,” with the need-based component of the business — housing for seniors who require help with activities of daily living — holding up relatively well. Rent growth has also been stronger and less volatile than it has for other core property types.

Emerging Post-acute Care Coordination Opportunities. The implementation of the Affordable Care Act and the changes that are currently underway in Medicare’s payments structure are dramatically changing the payer landscape. Alternative payment plans and networks such as accountable care organizations (ACOs), managed care organizations (MCOs) and bundled payments are quickly displacing fee-for-service payment plans in both Medicare and private health insurance. This rapid shift to a risk- and value-based environment is here to stay: By 2018, alternative payment plans will account for 50 percent of Medicare payments, up from 20 percent in 2015. Seniors housing operators, as well as skilled nursing and post-acute care providers, risk being left behind unless they move quickly to adjust to the new payer landscape.
Mounting Recognition of Benefits. Anecdotal evidence suggests that the hospitality and social aspects of living in a seniors housing setting offer physical and psychological benefits that can extend and expand a person’s quality and length of life.

Current capital market conditions — where capital is relatively inexpensive and readily available — are also contributing to increased investment in seniors housing. Indeed, today’s low interest-rate environment has led to a proliferation of lenders and a very competitive lending environment. Both large and small commercial banks, the government-sponsored enterprises Freddie Mac and Fannie Mae, the U.S. Department of Housing and Urban Development (HUD), life companies and a number of other nonbank lenders, including CMBS lenders, are active in the debt market. This has “greased the wheels” for deal activity.

The investor makeup is broad, but the large public companies and the REITS dominate activity in terms of total transaction volume. Typically, deals for these groups are relatively large and consist of several properties wrapped up into portfolio sales. Yet single-property sales dominate activity in terms of the number of deals executed (as opposed to total transaction volume), and these deals tend to be relatively small, at $10 million or less. Hence, the $23 billion volume of the past 12 months has been driven by portfolio deals, while the 554 deal count has been driven by single-property sales.

Some notable large deals closed in the second quarter of 2015, including the following:

- Seniors Housing Property Trust’s acquisition from CNL Lifestyle Properties for $719 million, which included 34 properties and 3,022 units at a price per unit of $237,900.
- NorthStar Healthcare’s acquisition from Arcapita for $640 million, which included 15 properties and 3,840 units at a price per unit of $166,600.
- The $1.7 billion Omega Healthcare Investors/Aviv REIT merger, which included 332 properties and 32,073 units at a price per unit of $53,000.
- NorthStar Realty Finance’s acquisition from Fortress Investment Group for $875 million, which included 32 properties and 3,912 units at a price per unit of $223,600.
- Finally, the HCP/Brookdale Senior Living acquisition from Chartwell Retirement Residences for $847 million, including 35 properties and 5,025 units for a price per unit of $168,500.
Looking ahead, the transaction landscape will be altered once interest rates start to edge higher, a likely phenomenon as the Federal Reserve normalizes its accommodative monetary policy and raises its base rate or the federal funds rate. In addition to increasing the cost of capital for private borrowers, public borrowers and REITs, this will alter property valuations and cap rates. The question is, how quickly and by how much? And will the risk premium associated with commercial real estate adjust to the same degree for all property types (office, industrial, retail, multifamily and seniors housing)?

Today, the risk premium — the difference between the average cap rate and the risk-free 10-year Treasury rate — is highest for seniors housing, at roughly 500 basis points. Will this premium remain when interest rates rise, or will the flood of capital moving into the sector, as well as the other factors contributing to its compelling investment thesis, allow the premium to narrow and properties to largely hold their values?