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KeyBank's Steady Hand: A Conversation with Matthew Ruark


Matthew Ruark

Matthew Ruark takes things in stride. As a long-time commercial bank lender, he's seen interest rates rise and fall, hot markets and not-so-hot markets. Despite the recent run up in interest rates slowing transactions, he remains bullish on senior housing and care. He knows firsthand that the sector has performed well, even in choppy markets.

NIC Senior Principal Bill Kauffman recently talked with Ruark, Senior Vice President & Head of Commercial & Healthcare Mortgage Production, at KeyBank Real Estate Capital. Here's a recap of their discussion on recent trends.

Kauffman: Can you give us some background on your professional career and your role at KeyBank?

Ruark: I started 12 years ago in January at KeyBank. I am part of KeyBank's commercial mortgage group, focused on off-balance sheet lending. I was recruited to start our investor placement group to connect our sponsors with insurance companies. After a few years, I picked up the commercial mortgage banking team, and then six years ago, I added the senior housing team. My role today at KeyBank is to lead a group of mortgage bankers to drive off-balance sheet production to benefit our bank clients. I also source capital, so we have a broad-based off-balance sheet originations platform to complement our on-balance sheet financing.

Kauffman: How long has KeyBank been lending to the senior housing and care sector? How large is your group?

Ruark: KeyBank has been in the senior housing and care business for 30 years. Our on-balance sheet financing is led by Jim McLaughlin and Kevin Murray, and as I mentioned, I lead the off-balance sheet financing team. Between our two teams we have more than 30 senior housing and care specialists focused on originations, and portfolio management. Also, a few years ago we acquired Cain Brothers, a boutique investment banking firm focused on the healthcare sector, including senior living. We have a broad platform to serve the needs of senior housing and care.

Kauffman: What is the size of KeyBank's portfolio of loans to senior housing and skilled nursing?

Ruark: In total, we have a little over $3 billion in commitments to senior housing and care on KeyBank's balance sheet. About $500-$600 million of that total, or 15-20%, is in the skilled nursing segment We also service more than $6 billion in loans we originated for FHA, Fannie Mae, and Freddie Mac.

Kauffman: There has been much discussion that the lending markets are tightening. Is that the case for KeyBank?

Ruark: From a macro perspective, the Federal Reserve is pulling liquidity out of the financial system. They have already removed about $1 trillion. The tightening

is working. Interest rates have moved up so quickly that investment sales have slowed. There are fewer refinancings. We are still open for business, but the pace of originations has slowed. We are focused on serving the needs of our customers. It can be a really challenging time for those who don't have a relationship with a bank.

Kauffman: Are debt funds still active?

Ruark: Early on in the tightening cycle, banks put a pause on credit lines that provided leverage to debt funds. They get a higher spread than the bank market does and are able to offer higher leverage, non-recourse lending. But pricing has shot up with the rise in interest rates. So, the pace of originations in the debt fund market has slowed even more than in the traditional financing market. It can be hard for debt funds to find leverage right now, which further slows originations.

Kauffman: How has the rapid rise in interest rates impacted business in 2022?

Ruark: We've seen a rapid run from near zero to 400+ basis points for 1 Month SOFR Term rates, a broad measure of the cost of borrowing on floating rate loans. A big challenge is the inverted yield curve, the difference between yields on 10-year U.S. treasuries and 3-month bills which has accurately predicted every U.S. recession since 1955. Many investors would like to hold a short position to stay flexible. But long-term money is cheaper than short-term money. There's a lot of volatility in the market. The benchmark 10-year U.S. treasury yield fell 32 basis points after the October consumer price index report--a key inflation measure--came in weaker than expected, signaling that price increases have possibly peaked. That volatility causes transactions to come to a grinding halt. Borrowers wonder if the environment is changing. It creates a situation where investors and borrowers don't want to make a move. A lot of capital has moved to the sidelines until we get into calmer waters. Also, at this time of year, investors and lenders have already filled their annual allocations.

Kauffman: Has the regulatory environment changed for the bank? Have the reserve requirements changed?

Ruark: Others are closer to that issue than I am. But from what I've seen, the banks are in a better position than they were heading into the Great Recession. Controls were put in place to help us deal with the next recession. From the lender's perspective, more discipline has been exercised than prior to the Great Recession. Early in pandemic, regulators handled the situation really well. They let us breathe and figure out how to get from one month to the next.

Kauffman: How are the owner/operators (your borrowers) in your portfolio being impacted by rising rates and rising credit spreads?

Ruark: Borrowers with a floating rate loan have seen their cost of borrowing rise significantly. That puts pressure on the debt service coverage ratio. A sponsor may be performing better than it was in July 2020, but because of the run up in rates, the sponsor may start to trip covenants. The senior housing sector has been improving and getting closer to stabilized occupancy, though it is still dealing with higher expenses due to inflation and labor issues. But a run up in interest rates puts more pressure on cash flow for borrowers with floating rate debt. It's a double whammy.

Kauffman: Is there a lot of floating rate debt out there?

Ruark: With rates declining and operations not fully stabilized, many borrowers were focused on floating and flexible capital. Due to the substantial liquidity in the markets from the Fed's intervention during the pandemic, between the banks, debt funds, and some permanent lenders, there was no shortage of floating rate options available to match the demand for short-term, floating rate debt.

A number of these options required interest rate caps. These caps were often for periods less than the loan term. So escrows were set up for the future cap purchases. These escrows are rising rapidly, as you might expect, with the dramatic increase in rates. Consequently, these increased escrows are now becoming an additional strain on cash flows. As a result, there is now a lot of demand for short term fixed options with prepayment flexibility. However, the supply of this capital is harder to find.

Borrowers who locked-in fixed rate loans in the high 2% or 3% range are feeling good about that decision today. By the way, that can be accretive debt if borrowers wanted to sell a property with the debt in-place today. That type of debt sets you up to get through a cycle where rates peak and then come back down over the next few years and then to be lower than where they are today.

Kauffman: Has the bank's interest and operating reserve requirements for your borrowers changed? Covenants? Loan-to-value ratios?

Ruark: The leverage in the system has changed because of the run up in rates. Instead of leverage at 70%-plus for a typical off-balance sheet loan, just about every deal is debt service constrained today. We are seeing low to mid 60% leverage because of constraints from debt-service-coverage ratios. Lenders are not tightening leverage, but cap rates have not adjusted as quickly as rates have run up. From an acquisition perspective, it's difficult to get the leverage many have been accustomed to getting over the last several years.

Floating rate borrowers are bumping into covenants. But it's not just because of occupancy or net operating income. It's because of the debt service constraints. There will have to be some calibration in price down the road. We have seen it time and time again. Cap rates and sellers don't react as quickly as rates run up. Sellers are conditioned that rates will come down. The slowdown will continue until buyers and sellers find a middle ground.

Kauffman: Are you lending for development deals? For acquisitions?

Ruark: We have taken a selective approach to development deals. We have been more focused on bridge loans to permanent financing, and acquisition loans.

Kauffman: What is your outlook for the lending environment in 2023?

Ruark: We're hopeful that inflation has peaked. The Federal Reserve has indicated that we can expect one or two more rate hikes, followed by a pause. A holding pattern at higher rates will continue to slow the investment sales market. The elective refinancing market will not be active. We want to be there for our clients. It can be a good time to make loans because liquidity has been pulled out of the

system and capital has moved to the sidelines. While the first half of the year will be slow, many expect the Federal Reserve could overshoot and then start to cut rates. The second half of the year could be interesting.

Kauffman: In early November, the Senior Living Diversity, Equity, Inclusion & Belonging (DEIB) Coalition released the results of the industry's first DEIB survey conducted by Ferguson Partners and launched the **Senior Living DEIB Toolkit** developed by The Axela Group. KeyBank has a tradition addressing DEI. Could you give us some insight into KeyBank's approach?

Ruark: I've internally represented Keys' Commercial Bank's DEI efforts for the last four years and served on NIC's DEI subcommittee. Our CEO at KeyBank talks about DEI as being foundational to our bank culture. We have a 20-year history of being active on DEI. DiversityInc has named Key one of the top 50 DEI companies 12 times. We are trying to create an environment where people can come to work and be themselves. We can recruit, develop, and retain diverse talent and be reflective of the communities we serve. It is great to see the industry step up with a survey to create a benchmark to show where we can improve and where we are making progress.

Kauffman: Where do you see the greatest opportunity for senior housing and care to address DEI?

Ruark: I co-led the environmental, social and governance (ESG) panel at NIC's Fall Conference with Michelle Kelly at NHI. As part of our preparation, we spent a lot of time discussing this point. The DEIB survey notes that 17% of senior living employees are male, but 51% percent of the senior managers are white males. We have a lot of diversity in the industry, but we need to develop talent for the C-suite. It's a great opportunity for the industry to leverage our natural demographics to create more diversification at the senior level.

Kauffman: Is there anything else you'd like to add?

Ruark: Senior housing and care has a robust and growing population of customers. We saw the industry's strength by how well we came through the Great Recession. We are a needs-based business, and the demographics are still moving in our direction. Healthcare is one of the four pillars that KeyBank has established for its business broadly in recognition of these trends and our leaders such as Angela Mago, the president of our commercial bank, are very supportive of the senior care sector specifically. KeyBank is also looking at opportunities to bring together our senior housing and care group with our affordable housing expertise to address the needs of lower income and middle market residents as identified by NIC. We are going to see huge demand across the income spectrum, and we need to figure out solutions for the entire senior care market.

Uncovering Trends: A Conversation with NORC's Caroline Pearson

Caroline Pearson

NIC's Beth Mace recently spoke with Caroline Pearson, Senior Vice President, Health Care Strategy at NORC at the University of Chicago. What follows is a recap of their conversation.

Mace: Caroline, you and your team at NORC at the University of Chicago have worked on two seminal research projects for NIC in the past few years. First was the Forgotten Middle Study released in 2019 that showed there is a sizeable number of older adults in the United States that cannot afford today's senior living options and this cohort will be expanding rapidly as the baby boomers age. The release of that study initiated many conversations including those in the boardrooms of many operators, investment and credit committees for equity and lender groups and policy discussions on Capitol Hill as well. It also has been a topic for NIC in many of its conferences and has been the focus of myriad blogs and articles.

Your team has recently updated that analysis with funding from The SCAN Foundation and West Health, and your team has also conducted a state level-study for California. Was there anything surprising in your findings in these two recent studies.

Pearson: The update largely confirms our findings from the original study that the number of middle-income seniors will grow significantly in the coming decade and that most will not have sufficient financial resources to pay for private senior housing. Our updated analysis predicts that there will be 16 million middle-income seniors age 75 and older in 2033—an 89% increase over 2018. By 2033, we will also see more baby boomers who have turned 85 years old, driving a doubling of that group of seniors.

Unfortunately, the affordability problem remains a huge issue in the updated model. Three out of four middle-income seniors will have insufficient resources to pay for the average cost of assisted living and medical expenses without selling their homes.

Education continues to play an essential role in predicting the financial resources of older adults. Future seniors will be more well educated than today's seniors, resulting in greater prosperity. By 2033, we estimate far fewer seniors will be low-income, with most growth in the middle- and high-income groups. However, rising inflation and a downturn in the economy could significantly impact these estimates to reduce the savings and buying power of older adults' savings. If economic challenges persist, our estimates may be too rosy, and the problem of the Forgotten Middle could be even larger than we predict, as some high-income seniors will see losses in their financial assets that shift them into the middle-income cohort.

It was also exciting to complete our first-ever state analysis. California is such a different market than the rest of the country. When I have traveled there and talked with senior housing groups, they have highlighted that population differences and higher costs may significantly change the outcomes.

Future middle-income seniors in California will be much more racially and ethnically diverse than the rest of the country (47% people of color in California compared to 22% nationwide). The state also has more polarized educational attainment, with more people who haven't completed a high school degree and more who have a college degree. Importantly, California seniors are less likely to have children nearby, which limits their familial caregiving options. But the most important difference in California is cost. Average assisted living costs there are 17% higher than the national average, with costs in some urban geographies being much higher than that. As a result, in 2033, a staggering 89% of middle-income California seniors will not have enough savings to pay for assisted living and medical costs in the state. Even if they sell their homes, half still are unlikely to be able to afford assisted living if they need and want it.

Mace: Why are these studies important? From a policy and societal point of view? And, from the point of view of senior housing operators and capital providers?

Pearson: The reason these studies are important is because they have shined a spotlight on a huge unmet need for senior housing and long-term services and supports. By measuring and characterizing the needs of middle-income seniors, we have brought awareness and focus on this group of older adults. The response to the studies has been staggering. Many audiences are surprised to realize the magnitude of the gap in our existing system, and they are urgent in their demands for solutions.

Unfortunately, the problem of the Forgotten Middle is not easily solved, which is why we must begin work across both public and private sectors to address solutions. Since the first NIC study launched in 2019, we have seen senior housing operators creating new, innovative solutions to offer middle-income assisted living products at lower rent costs. These models need to expand and have the potential to serve the top end of the middle market where people still have significant resources to spend on their housing and care. The public policy discussion has started more slowly but is gaining speed. Policymakers in both states and the federal government have begun to look at solutions that include Medicaid expansion or buy-in, changes to property tax and housing policies, lower cost access to debt and equity, and new financing models. We have much more work to do, but we simply cannot leave middle-income seniors without affordable, dignified options for their housing and care, nor can we burden our entitlement programs by allowing millions of additional seniors to spend down to Medicaid.

Mace: The second seminal study you undertook through a grant from NIC was two parts. First distinguishing the disparate impact of COVID-19 on mortality rates in senior housing, nursing care settings and their surrounding geographic areas. And second, examining the excess mortality rates of persons of similar demographic and health characteristics. The **first part of this study** showed that mortality rates increase by complexity of care, but in lower acuity settings such as independent living communities, they are comparable to surrounding populations. As part of the second study, you were able to better understand the healthcare needs and associated spending of residents of senior housing communities and nursing homes. The **study's findings** indicate that residents of senior housing and nursing homes average over a dozen chronic conditions and that behavioral health

conditions are common. Why is this important? How could these findings influence the senior housing and nursing care sectors?

Pearson: The data underscored the ongoing need to break down silos between housing and healthcare. Senior housing residents have many serious physical and mental health needs, and they accumulate significant annual healthcare costs. The senior housing industry is, by default, a part of the healthcare system due to the complex needs of their residents. As such, it is imperative that operators continue to understand the health needs of their residents in order to better support them with onsite medical care and wrap-around services.

The results also made me hopeful about the significant potential to expand partnerships between senior housing and risk-based healthcare providers, including Medicare Advantage. Assisted living residents incur about $31,000 per year in Medicare costs and more than a third of assisted living residents have an ER visit that results in hospitalization annually. We also found that 44% of assisted living residents had an ER visit that did not result in an inpatient stay. These represent real opportunities for senior housing to partner with healthcare providers to help reduce emergency room use and avoid hospitalizations, which will result in lower costs.

Mace: The final portion of the analysis of this study on excess mortality rates will be released sometime in 2023. We are really looking forward to that.

Congratulations on recently accepting a position to head the Peterson Center on Healthcare. Can you tell our readers about the Peterson Center on Healthcare and your role there?

Pearson: The Peterson Center on Healthcare is a non-profit working to make U.S. healthcare more affordable and higher value by lowering costs and improving quality. I will be the executive director working closely with the team there to implement a strategy that drives change in the system.

Mace: What are you most looking forward to in your new position?

Pearson: As a lifelong consultant, I am excited to become more active in setting the agenda for which issues we should tackle. But, just like my consulting days, I still believe that creating system change requires clear communication and compelling data to generate impact.

Mace: Do you think a focus on older American's health and access to health care will be an area you in which you will focus?

Pearson: Given the huge and growing role that older adults play in driving healthcare costs, I am sure this will be a central facet of our work across multiple program areas.

Mace: And finally, for those in our industry balancing busy lives, tell us your secret. You've an incredibly active person, raising a family and working professionally. What is your secret to balancing it all?

Pearson: Balance is a fallacy. Lean into the juggling act and be gracious with yourself when you can't do it all at the same time. Ruthlessly prioritize your energy and let go of emotional baggage for things you have deprioritized. I do not worry about not providing themed snacks for the school Valentine's Day party. So far, my kids seem to be surviving ok! My life is pretty busy, but boy is it fun.

Mace: Anything else that you would like to share with our readership?

Pearson: It has been such a pleasure to get to know the NIC community over the past five years. You are all doing essential work caring for our older adults and evolving to meet the changing needs of our country. To the NIC staff, you are amazing! Thanks for being wonderful thought partners across this important body of research. I know your work will continue to challenge the industry and drive focus. I'll be reading it eagerly.

Mace: Finally, thank you Caroline. On behalf of NIC, we wish you the very best as you embark on a new professional path. Best of luck!

Thoughts from NIC's Chief Economist—Inflation, Rising Interest Rates and Lending Challenges

by Beth Burnham Mace, NIC Chief Economist

Beth Mace

The holidays often bring a time of anticipation, hope, and excitement, and with this holiday season fast upon us, perhaps we can anticipate and hope that the worst of inflation may be behind us. At a still very high 7.7%, the October measure of consumer prices surprised most analysts as being weaker than expected and as an indicator that the year-over-year change in prices may be decelerating. There were hopeful signs in the measure, including a slowdown in goods inflation with prices for clothing and used cars falling markedly and declines in health inflation occurring as well.

Nevertheless, one indicator is not sufficient evidence of a trend, nor is the actual rate of price growth sufficiently weak to cause a change in policy by the Federal Reserve. Since March, the Fed has been tightening monetary policy through a few levers. First among these has been raising the overnight fed funds borrowing rate six times from a level of near zero to a range of 3.75% to 4.0% in November. Second, the Fed has been selling mortgage backed securities (MBS) and treasury bonds, as it shrinks its voluminous balance sheet and course corrects from Quantitative Easing (QE) to Quantitative Tightening (QT). And third, the Fed has tried to be transparent about its efforts and intended actions by providing forward guidance to the market. These and other efforts have all been done to take liquidity out of the financial system, shrink demand, slow the economy, and cause inflation to move back toward the Fed's preferred and targeted 2% range. These endeavors seem to be working in at least a few regards; foremost among these is the screeching halt of lending in the residential and commercial real estate markets.

Indeed, there has been a sharp slowdown in the most interest-rate sensitive sectors of the economy, namely residential and commercial real estate lending activity. Residential mortgage applications were at their lowest level since 1997 in October as 30-year mortgage rates have more than doubled since the beginning of the year to an average rate of more than 7.0%. Based on the median existing home price and a 20% down payment, housing affordability has fallen sharply—the typical monthly mortgage payment had risen nearly 70% between the first quarter of 2021 and the second quarter of 2022. Refinancing volume has also tumbled and was 86% below year-earlier levels in October. Further, Moody's Analytics projects a drop of 10.5% in the Case-Shiller home price index from its second quarter 2022 peak. Finally, these trends are likely to translate into a slowdown in residential construction activity as builders pause new projects until they are sure that the units already under construction will be able to sell.

Higher costs of borrowing and more conservative underwriting practices are also affecting the pace of ground breakings for commercial real estate, including

housing developments for older adults. Indeed, NIC MAP Vision quarterly starts data for assisted living for the third quarter of 2022 fell to levels not seen in over a decade, while units under construction for senior living overall were at their lowest levels since 2015.

While higher rates are dampening demand and reducing affordability, lenders are also taking a more cautious look at borrowers and their ability to repay their loans with some debt providers "putting their foot on the brake," as one lender recently said. Even reliable commercial real estate borrowers with long-term relationships with lenders are being turned away for some requests, as many lending institutions begin to "ration loans." Construction borrowing is the most challenged, but stricter underwriting standards, lower loan-to-value ratios, and higher debt service coverage and reserve requirements are making it more difficult to refinance existing debt obligations, as well as obtaining new debt commitments for acquisitions. Flexible-rate, short-term bridge loans are supplanting permanent debt. Loans already on the books are being shifted to different FDIC risk-rating categories, as stressed operator margins and the ability to adhere to more stringent operating and interest reserve requirements often cannot be met.

It's likely the lending environment will continue to be challenged until the Federal Reserve has a change of heart, and that is not expected to occur until clear signs of slower inflation appear. And the risk of over-doing it by the Fed and keeping interest rates too high for too long is elevated, given the size of the task at hand. There is often a significant lag between the time monetary policy is executed and the time the economy fully responds. The labor markets are just now beginning to show nascent signs of softening. The ability of the Fed to steer the economy into a so-called "soft landing" to avoid a recession is difficult if history is any indicator. Most mainstream economists are upwardly adjusting the probability of at least a mild recession in 2023.

For senior housing, the timing of this economic cycle comes at an especially poor moment as the sector continues to recover from the health-related pandemic-created economic cycle of 2020. By many measures, demand for senior housing is at all-time highs—the number of occupied units for assisted living in the 31 NIC MAP Primary Markets hit a record high in the third quarter, as did the number of units of occupied inventory for senior housing in the 68 NIC MAP Secondary Markets. But while occupied units are at high levels, the overall occupancy rate, which takes inventory growth into account, remains well below pre-pandemic levels. For the Primary Markets, the occupancy rate in the third quarter was 82.2%, which was still 5.0 percentage points below its first quarter 2020 level, although up 4.3 percentage points from its nadir of 77.9% in the second quarter of 2021.

The recent slowdown seen in senior housing construction activity should provide a tail wind for further gains in the occupancy rate, but the broader forces in the economy may limit that progress. History shows that demand for senior housing is affected by consumer attitudes, the ability to sell one's home, the stock

market, and general trends in the economy. And unfortunately, most of those measures are currently not moving in the positive direction.

The offset to this, however, is that senior housing, and assisted living in particular, has also shown itself to be "recession-resilient" in the past due to its need-based demand. This means that when family members believe a loved one needs more care than they can provide, the move to senior housing often occurs despite the state of the broader economy. This should provide operators and their financial partners some ballast in the upcoming storm.

In wrapping up and as always, I appreciate and welcome your comments, thoughts, and feedback.

Beth

How to Scale Operations Effectively

Scaling operations is a chicken-or-egg dilemma. Which comes first? Acquire assets? Or build services?

There's no right answer. Companies can scale up and succeed either way. But there is one essential requirement. "Companies need a plan to scale and grow," said Bryan Starnes, CFO at ALG Senior, an owner/operator with 153 communities in the Southeast.

Starnes moderated a panel discussion on how to effectively scale up operations at the 2022 NIC Fall Conference. He was joined on the panel by three senior level executives who have successfully grown their operations.

The chicken-or-egg question kicked off the well-attended session.

Trilogy Health Services takes a "services first" approach. "We built a service model," said Trilogy CEO Leigh Ann Barney. "It has allowed us to be leaders in the market and build census."

With 127 properties, Trilogy invests upfront in clinical, hospitality, and life enrichment services. Barney said it's difficult to sell consumers on a service-oriented model if the services are not actually being provided. "You have to invest ahead of time in a measured way," she noted.

ALG takes a similar route. Starnes said the service infrastructure has to be in place, even as a loss leader. "You need more people than buildings" to grow the portfolio, he said. "That's been our path."

Avista Senior Living owns and operates 16 properties in the West. The company started as an owner with two distressed assets and then launched a management arm, which took time to build. It's only in the last five years that Avista has added assets and operational staff. "We've been disciplined," said Kristopher Woolley, founder & CEO at Avista.

Jamie Cobb provided the investor's perspective. He is managing director at Columbia Pacific Management, an owner of 130 communities with 14 operating partners. He prefers to partner and grow with regional operators that understand their local markets.

The panel discussed buy-or-build growth strategies. Both approaches can work, though each presents its own challenges.

Trilogy has mostly grown by developing new properties. A typical Trilogy campus offers a continuum of care. "We would much rather develop a new community," said Barney. From an operational perspective, she prefers starting with a new team to establish Trilogy's corporate culture and performance expectations. With an acquisition, the existing staff may not be willing to accept Trilogy's approach.

Avista has grown by acquisition. Properties are typically acquired from local developers that were not committed to operations long-term and were ready to sell. "We welcomed their on-site teams into our organization," said Woolley.

ALG grows by both new development and acquisition. Regarding the staff at acquired properties, Starnes advised, "Be careful not to come in right away and make a lot of changes."

Have a Plan

The panel agreed that growth should be both strategic and opportunistic. But success depends on developing a plan.

Trilogy sticks to several tenets: the property must offer a continuum of care, it must be customer and hospitality focused, and situated in the Midwest.

Woolley started Avista with the goal of a tight geographic focus. Assets had to be within an hour's drive of Phoenix. "We wanted to stay in touch with our people," he said. Using a similar approach, the company now has a cluster of closely located properties in Utah. Plans are in the works to create more clusters by adding assets in Idaho, New Mexico, and Southern California.

Culture plays an important role. "Know what drives your success," said Barney. Trilogy has a culture of servant leadership. The goal of the leader is to serve others. All new leaders spend time at the home office to absorb the culture. Mentors steeped in the culture train others. "My number one job is to maintain the culture," said Barney.

The pandemic taught Cobb a lesson about ownership. Visiting owners sometimes lead team members to wonder who's in charge. Unable to visit buildings during the pandemic, Columbia Pacific managers rethought their role. "We looked at where we could add value," said Cobb.

Columbia Pacific transitioned 30 communities to new operators during the pandemic, including to Avista. A pipe broke in a building and Woolley and his team fixed it even though they had not yet taken over management of the property. Cobb said that approach demonstrated that Avista was living its culture day-to-day. "That's what we are looking for," he said.

Woolley explained that he started the company to provide a good customer experience. But he did not foresee how passionate he would be about his team members. "The focus needs to be on the team," he said. "That trickles down to the customer experience."

Centralize or Decentralize?

At ALG, the executive director's job is to take care of residents. The executive director hires the staff, but the human resources department at ALG's central office handles the details. Menu planning, and other administrative tasks are also managed by the central office. "We don't want the executive directors distracted from their main mission," said Starnes.

Operations at Avista are mostly decentralized. The properties all use the same software platforms, but executive directors have a lot of autonomy. That approach may have to be modified as the company grows, said Woolley.

Columbia Pacific employed five recruiters to hire workers for 15 buildings, cutting those responsibilities at the property level. Cobb noted that the recruiters put in 50 hours of work to typically screen 32 applicants just to fill one job. "We try to centralize those areas to help an operator scale up," he said.

The session wrapped up with a discussion on management fees. The panelists agreed that the typical 5-7% fee is too low. They expect management fees to rise, though capital partners need to be educated about the value of raising management fees. Capital investments in human resources and technology will result in higher valuations, according to Woolley, who added: "That's what capital really cares about."

Behavioral Health in Senior Housing and Care

by Ryan Brooks, Senior Principal, NIC

Ryan Brooks

Not unlike the broader community, the senior housing and care industry finds itself entrenched in the learning curve associated with behavioral health among our resident populations. There is a lot to comprehend – and understanding what behavioral health really means and encompasses often involves confronting misunderstandings and challenging misconceptions.

Behavioral health is certainly a broad term. If you are involved in the senior housing and care sector, your mind may jump immediately to memory care as a care setting. Alzheimer's Disease and other related dementias may spring to mind as well. Memory care serves a population facing memory issues specifically, and those operators are equipped to handle the unique issues that often arise as a result – wandering for instance.

Memory care residents are prone to behavioral health challenges. We know that memory care residents struggled with **isolation and loneliness** during the COVID-19 pandemic, and **sufferers of dementia** were particularly prone to agitation or behavioral disturbances if they couldn't remember why they had to wear a mask or why they couldn't see their family members. Memory care residents, however, still represent only a portion of the population affected by behavioral health challenges.

Behavioral health generally refers to mental health and substance use disorders, life stressors and crises, and stress-related physical symptoms. Behavioral health care refers to the prevention, diagnosis, and treatment of those conditions. Behavioral health conditions can include anxiety, depression, obsessive-compulsive behaviors, insomnia, and even post-traumatic stress. These can be further complicated with alcohol and substance abuse factors. Behavioral health challenges can result in serious functional impairment that significantly interferes with or limits at least one major life activity.

When speaking to the rise in behavioral health challenges, we must not forget that resident populations in other settings for older adults – active adult (i.e., 55+ age eligible housing), independent living, assisted living, and skilled nursing – are far from immune to behavioral health challenges. Further, because positive mental health outcomes are essential to healthy aging, they must be addressed to truly improve the quality of life in older adults.

It is important to keep in mind that behavioral health issues did not begin with the COVID-19 pandemic – these issues have been around for a long time. Rather, the COVID-19 pandemic simultaneously exposed and exacerbated the behavioral health issues that are becoming a more routine part of the conversation. Isolation and loneliness challenges spurred by the COVID-19 pandemic combined with the emerging economic uncertainty – rising interest rates, inflation, the potential inability to sell one's home – have accentuated the challenges associated with behavioral health issues.

Behavioral health issues may be on the radar more these days as the COVID-19 pandemic helped to give focus to and bring behavioral health to our collective attention. Whether the focus on behavioral health issues should have come to the forefront sooner is beside the point. With behavioral health being talked about, now is the time to develop proactive strategies, treatments, and support services to assist individuals.

> ***"The best time to plant a tree is 20 years ago. The second-best time is now."***
> -Chinese Proverb

Integrating Behavioral Health

From an operator's perspective, developing and supporting interventions for behavioral health challenges can help not only residents, but can positively impact relevant key performance indicators. Behavioral health integration is the result of care teams and behavioral health clinicians working together with residents to provide patient-centered care using a systematic approach.

In an evidence-based resource guide published by the Substance Abuse and Mental Health Association (SAMSHA), outcomes of successful interventions included improved illness self-management, improved medication adherence and management, improved social and communication skills, more appropriate use of emergency services, reduced hospitalizations, and improved quality of life.

Services and supports for older adults with behavioral health challenges are often fragmented due to lack of coordination among care providers in different systems, as well as varying insurance and eligibility requirements for physical and behavioral health care. This fragmentation impedes access to effective care and limits the ability to share information, control costs, ensure continuity of care, avoid conflicting treatments, and improve outcomes. The rise in electronic health records (EHRs) and improved care coordination within senior housing and care settings, however, can mitigate many of these hampering factors.

Additionally, improvements in behavioral health access brought on by the Patient-Driven Payment Model (PDPM) are helping to solidify the business case for treating behavioral health issues. Take the issue of depression identification for example. With PDPM, operators are provided incentives for treating each resident's specific needs, with payments increasing in line with patient acuity.

In addition to the specific PDPM reimbursement gains, the proper treatment of depression can bring positive downstream effects to other high-visibility nursing care metrics as well. Residents with depression typically have longer lengths of stay, as they require more attention and recuperation time before they can return home. Treating this mental health issue thus becomes a potential safeguard against shortening lengths of stay, driven both by Medicare Advantage plans and other alternative payment models.

Interventions, practices, and programs to address behavioral health can take many different forms. They can also be tailored to demographic groups and can differ in typical setting, intensity, duration, and outcomes. Senior housing and care operators may look to and take lessons from some tailored implementation strategies intended to overcome barriers to successful program implementation, adoption, and sustainability:

- **Develop in-house expertise:** PDPM incentivizes depression identification and documentation. Offering frontline staff training and education on how to identify and treat depression yields benefits in staff satisfaction, resident outcomes, and a property's bottom line. An often-overlooked retention incentive is to invest in training and ongoing development. This strategy requires upfront investment, but can yield improved patient care, as well as improved billing and reimbursement.

- **Coordinate with mental health and older adult services partners:** Title III initiatives of the Older Americans Act, block grants, and ACA initiatives are available to support behavioral health initiatives. State agencies and local organizations (state units on aging, state mental health authorities, and charitable foundations) have resources to provide training and technical assistance related to the implementation of evidence-based practices.

- **Adapt the practice to better serve the target population:** When considering program implementation, understand the influence of culture on aging. Consider how to tailor psychosocial interventions to be compatible with race, ethnicity, cultural context, and values. Baby Boomers, for instance, grew up in an era when mental health issues were generally not discussed and often viewed as signs of weakness. As a result, they often view mental and behavioral health care as taboo.

Interested in learning more about the real estate and service perspectives to consider or about the opportunities in behavioral care afforded to senior housing and care owners and operators? Be sure to attend the 2023 NIC Spring Conference session focused on behavioral health to hear from experts on how to partner for the future.

"Active Adult is Blurring the Lines between Multifamily and Independent Living" A Conversation with Tod Petty and Michael Joseph

by Audrey Griffin, Vice President, Senior Housing Finance, Wells Fargo Bank

Audrey Griffin

Tod Petty

Michael Joseph

In September, NIC released a white paper, "Active Adult Rental Properties: Defining the Emerging Property Type," on this fast-growing segment. In this interview, Tod Petty, vice chairman of Lloyd Jones Senior Living with a background in traditional seniors housing and Michael Joseph, president and founder of Clover Communities with a background in conventional multifamily, share their active adult experiences and insights.

Tod Petty is the vice chairman of Lloyd Jones, a 40-year old real estate investment, development and management company based in Miami, Florida. The family office specializes in multifamily, senior living, and hospitality and has overseen over $1 billion of transactions. In 1992, Tod founded Augusta Respiratory Care which he subsequently sold to Lincare Holdings. From there, Tod joined various health-related organizations serving in executive-level positions in business development and operations. With over 30 years of experience in the industry, he has managed over 60 senior housing communities across the continuum of care. At Lloyd Jones, Tod is responsible for the operations of the senior living communities – existing and to-be -developed – as well as business development of the firm's third-party management services.

Michael Joseph is the founder and president of Clover Communities, a large real estate development and management company based in Buffalo, NY. Michael started his career as an investment banker on Wall Street before founding Clover Group in 1989. Clover Group initially began with value-add multifamily opportunities which grew the management company as they managed their own communities before eventually taking on third party management contracts. At one point, the group managed over 11,000 multifamily units. In 1992, Michael saw the growing senior's market and demographic trends and decided to develop age-restricted communities under the Clover Communities brand.

Griffin: Could you tell us about your company's experience within the active adult sector?

Petty: Lloyd Jones disposed of over 75% of our multifamily portfolio for the sole purpose of reinvesting in seniors housing. Today, we have approximately 20 assets with four that are age-restricted (55+). While we have a handful of new developments, the majority of our portfolio is 20-year-old vintage that desperately needed CapEx. Being vertically integrated, we are able to target opportunities

below replacement cost and reposition them for a middle market customer.

Joseph: For the past 30 years, Clover Communities has been building active adult communities for middle income seniors. Today, we have over 50 communities; 44 operating, 4 to 5 that are in lease up, and another 7 under construction.

Griffin: NIC's white paper defines active adult as "age-qualified, market-rate, multifamily rental properties that are lifestyle focused; general operations do not provide meals." Do you offer any sort of meal service?

Petty: I disagree with the current definition and think that you have to offer a meal in active adult communities. The residents that move into our communities are people who realize that they are declining, and while they don't need assistance or three meals a day, they do need some help. The middle market customer is willing to pay a premium over a multifamily to get a meal or two. Middle market customers only have so many dollars, and they look at the meal as a safety net. I've heard developers say, "if you have a kitchen, you're not active adult"; when asked "why do you have one," they say "well we're not using it," and to me, that doesn't make much sense unless down the road you think you're going to need it.

Joseph: I completely agree as soon as you start offering meals, you are not active adult. Unless you're really high-end and putting in a nice restaurant, but that's part of the packaging to live there, it's not active adult. We organize all kinds of activities, so there's a robust list of things residents can do, but bottom line is they are apartments that are age restricted where seniors can live with seniors. Our residents don't want to be by a family with teenagers or an apartment complex with mixed age-cohorts demographics. To me, our residents are truly independent—they feed and clothes themselves, they still drive, they take their meds and there isn't someone to help them. If they can no longer do all that by themselves, they're not active adult.

Griffin: NIC's active adult white paper noted that properties "require fewer employees to deliver great customer experience" when compared to traditional seniors housing. What's your strategy when staffing for active adult? How does it compare to seniors and multifamily?

Petty: I don't think you can just have one to two people because you're not offering many services, and it's a multifamily play. However, it is a little like the Hyatt Place concept in that the concierge who checks you in, may also get you a slice of pizza or beer, and may also pick people up at the airport. It's the type of design in that the employees wear different hats and provide services in different areas. We have five main positions – a general manager, a community relations director (sales), physical plant manager, the event planner, and a lifestyle engagement director. The most critical is the lifestyle engagement director, whose job is to function like a social worker or utilization review manager or discharge planner in a hospital; they facilitate the third-party health care continuum.

Joseph: We don't need any more staff than multifamily and could argue that you could get away with a little less. A conventional multifamily manager spends a lot of time chasing down rents and, with the higher turnover, in some cases you also need

a leasing specialist. The difference is that we target a manager who will be a good social director versus a manager who is good at leasing.

Griffin: How does the entitlement/zoning process compare?

Petty: Zoning is much more favorable to active adult than senior housing because there's still a lot of misunderstanding about what seniors housing is. It takes a lot of education to convince zoning it's not clinical or invasive, while they seem more open to active adult, having more knowledge of the 55+ single family neighborhoods. Active adult is not perceived as a threat because it's not seniors and don't have to worry about behavioral health issues.

Joseph: When I was initially starting this business, there was a lot of resistance as the initial thought was that an active adult community would be more demanding on services. Zoning boards have come to learn that it's less demanding on schools and traffic with the only increase potentially EMT visits. We also get a lot of politician support because they have seniors living in their municipalities, and they want to keep them as voters.

Griffin: How does the sales cycle and occupancy compare to seniors housing and multifamily?

Petty: While it takes longer compared to both, I don't believe it's a lifestyle choice. There are some residents who are proactive and make the choice to move to be near their grandkids that are looking for active adult properties, but majority of our residents aren't deciding to leave their home to come be with like-minded seniors. There's an event or personal life change that exacerbates their situation. Once leased they stay full, even during the pandemic, our active adult communities were 100% with a waitlist.

Joseph: Lease up is way shorter compared to multifamily. We open our active adult buildings 40-50% preleased and are able to fully lease them up within a year, compared to a couple of years for multifamily. Our active adult properties run between 97-98% occupied across the portfolio.

Griffin: What types of amenities/spaces drive value?

Petty: Having IT and managed Wi-Fi in the building is critical. A solid low voltage plan allows you to switch out equipment as technology changes, and the baby boomers are much more acclimated to technology. Technology allows you to also offer some assistance. If you have a resident who just needs a little help with meds because they forget; instead of needing assisted living, you can put a machine on their wall that is similar to how WeMo controls your lights that will spit out the exact prescriptions three times a day. The cost of that is significantly less than assisted living. Technology and analytics provide data on who's in the building and what the psychosocial makeup is, which builds rapport and can create targeted activities that go beyond a 55+ community with some amenities, and we believe that's the future of active adult. Our Living with Confidence program incorporates aromatherapy, music, digital signage, and other senses that connects memories and mindset for quality of life.

Joseph: Our focus is on creating a sense of community. We could build a regular high-end apartment with a nice gym and nice apartments, and it will lease to anyone who walks in; you don't need activities. In active adult, you have to do something to make it feel like a community where seniors can take ownership and organize their activities. Most of our residents are looking for a place to stay for maybe the rest of their lives, and they aren't going to move out when a new better-looking project opens across town; they only move out if they need higher care or they pass. For active adult to work, you have to create an environment that's different than typical multifamily.

Griffin: The NIC white paper also discussed "age creep" and "aging out." An interesting example was that, by not offering services (such as transportation, care, meals), residents would naturally decide to move out. You mentioned that your active adult communities stay full so clearly you can lease-up and fill the buildings, but what does it look like in five to ten years. Does it then feel like assisted living? Do you help the residents move on?

Petty: I disagree with the assumption that if you offer less services then people will leave. If you used the same logic in independent living, you leave it up to the resident who will do everything that they can to stay – they don't want to write the higher check and may also be unaware of what they need. The Lifestyle Engagement Director is like a social worker in the sense that they are working with the family and resident to direct them to appropriate care. It's the same concept on if you left an independent building alone; pretty soon it's going to look like assisted living, and you're going to have big problems –you have to be proactive about helping people move on within the third-party health care continuum.

Joseph: Having done this for almost three decades, I find that the profile of our tenants stays very constant. The average age is late 70s, with average length of stay 6-10 years. In the old days, when a senior didn't want to cook, there was meals on wheels, or if you worried about your parents not taking their meds, you hired a visiting nurse. This is the same concept in our communities; these services allow you to still be independent. The fact that you don't care to cook is different than can't cook, you might need a cane but can still walk; once they cross the line, they self selectively move-out. We don't provide that service and have not had to tell our residents that they need to leave; it becomes evident that they need to leave. Our experience has been that this does happen naturally, but if you start providing services such as meals and make it easier for them to truly age in place, you will run into a problem.

Griffin: How does the return (IRR) compare to traditional seniors housing and multifamily? Do you expect it to be higher given the longer sales cycle/leasing? Do you target lower as residents stay for a longer period? Basically, as an investor, if you have two options – invest in a multifamily or an active adult building; why choose active adult?

Petty: I expect it to be higher than seniors housing given labor costs are lower. With no healthcare license, the life and safety code is easier, and cost of construction is also lower. When comparing to multifamily, I expect it to be lower.

Multifamily is such an efficient driven business, but we believe the demographics and runway of seniors is at the place multifamily was in 2008.

Joseph: Over the long term, I expect them to be about the same. With the majority of our portfolio 40-50% preleased at opening and a handful that have been 90% preleased, for a quick flip with the faster leasing, the IRR is better. However, when holding long term, I don't think there's any advantage given majority of our tenants income is from social security, we can't push rents. The reasons active adult is more attractive than multifamily is (1) you don't have the higher turnover and (2) you don't get impacted by the economy. We've operated through recessions, depressions, high inflation, no inflation, and our communities stay full and provide very consistent yields.

Senior Housing & Care Industry Calendar for December 2022

12/1.....Seniors Housing Business Interface Southeast (Atlanta, GA)
12/6-7.....GlobeSt. HEALTHCARE 2022 (Scottsdale, AZ)
12/4-6.....Assisted & Senior Living Facilities Summit 2022 (Phoenix, AZ)
12/6-8.....Milken Institute Future of Health Summit (Washington, DC)
12/6-7.....NYSHFA|NYSCAL 26th Annual Fall Education Conference (Albany, NY)
12/7-8.....AHCA/NCAL 2022 Population Health Management Summit (National Harbor, MD)
12/13-14.....Senior Housing News RISK Summit (Virtual)

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