# NIC INSIDER

## Newsletter

## December 2017

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# In the Insider December Issue

## A Veteran Lender Takes on a New Role: A Conversation with Imran Javaid

**Imran Javaid**

Imran Javaid has known lots of success as a prominent banker in the healthcare sector, including 15 years focused on seniors housing and care. So it came as little surprise when he was recently tapped to launch a new healthcare lending platform for BMO Harris Bank. The Chicago-based bank is a part of BMO Financial Group.

NIC's Chief Economist Beth Mace recently spoke with Javaid about the industry and his goal to make BMO Harris Bank one of the top five lenders in the healthcare sector. What follows is an edited version of their conversation.

**Mace**: How long has BMO Harris Bank been lending to the seniors housing and care sector?

**Javaid**: BMO Capital Markets, the investment banking arm of BMO Financial Group, has been serving the healthcare industry for decades. Through BMO Capital Markets, the bank has been lending to healthcare REITs for quite some time. I joined BMO Harris about 18 months ago when the bank decided to enter the lending market for owners and operators of senior living and care properties. Now we have a dedicated senior housing team that lives and breathes the sector.

**Mace**: Have you had success over the last 18 months?

**Javaid**: Absolutely, we've been growing our platform and book of business. We're a relatively new entrant to the market, but we've had a good reception.

**Mace**: Do you lend to all sectors? Independent living? Assisted living? Skilled nursing?

**Javaid**: We are national in scope and lend to all sectors of the market. But we prefer a project that offers a continuum of care instead of a stand-alone project. Our ideal property is a rental continuing care model.

**Mace**: Why?

**Javaid:** We think projects that offer a continuum of care present a more compelling value proposition for seniors than a stand-alone property that, for example, only serves those with memory problems or those who need assisted living. We like the continuum of care because independent living gets people through the door, and then they can age in place. A husband and wife can be on the same campus even if their needs differ.

**Mace:** What is your focus? Development, acquisitions or expansions?

**Javaid:** All three. We would like to find more acquisition opportunities, but development is our most active area. It's also the area in which we turn down the most deals. We believe we add the most value in the expansions sector.  A good example might be a 90-pecent occupied independent living property that is adding assisted living or memory care. We do not offer a direct-to-agency product because we can't compete with the government sponsored agencies on rates and structure. Also, we offer new development loans to sponsors we like as a way to build a relationship that leads to other services such as treasury and derivative management.

**Mace**: Do you look at the operator's motivations for an expansion?

**Javaid**: The scenarios vary quite a bit. Some operators have always had it in their plans to expand and are following through on those plans. Or, an operator may have reached a maximum lending limit and may need a larger institution like BMO Harris to step in with a loan package. In other cases, the original owners have space for an expansion, but figure it's a good time to sell a property and let the next owner build out the independent or assisted living units.

**Mace**: Is your reviewing process the same for expansions as for new development?

**Javaid**: We're always very deliberate. Our analysis does not change, though deals for new developments have an extra hurdle because there is no rent history. That's the biggest disconnect and why we turn down a lot of development deals. The process is easier for acquisitions and expansions because they're already performing.

**Mace**: Do you conduct your own market analysis, or do you rely on the sponsor's analysis?

**Javaid**: We look for market studies from a third party. It may be ordered by a client but we would engage with the author of the study as part of our analysis. Everyone has a secret sauce they think they've discovered and we analyze the details of how they determined those numbers.

**Mace**: Your loan collateral is the real estate. Do you make loans to the operations of the business as well?

**Javaid**: We make working capital loans to our client base with our treasury and other working capital solutions. But we will be rolling out an asset-based lending product and revolving line of credit. There is a real need in the market that we want to address.

**Mace**: What types of terms and rates are you offering as interest rates have moved up?

**Javaid**: We are constantly adapting to the market. Spreads were widening, and now they have compressed. We are always trying to find that sweet spot to be competitive on every deal. Our rates vary between 225 and 350 basis points on most seniors housing deals, and a bit higher on skilled nursing. On new construction, our general rule is to offer a recourse loan to a credit-worthy facility. On acquisitions, we offer a maximum of 65 percent loan-to-value (LTV) on non-recourse loans, and 75 percent LTV with recourse.

**Mace:** What opportunities and challenges do you see in the sector in the next 12 months and in the long term?

**Javaid**: In the short term, I sense there is a mentality that "if you build it they will come." I am concerned that slow fill-ups in some markets will cause an overreaction among lenders throughout the sector. In the long term, the biggest concern is that the seniors of tomorrow have not saved enough money to pay the rents required at some of these high-end seniors housing properties. Baby Boomers were not big savers like the Silent Generation. That's a concern.

**Mace**: There are a lot of newcomers to the industry. What financing challenges do they face?

**Javaid**: Developers new to the sector need to partner with an operator that is an existing player in the market that can provide local insights. But partnering with a great operator as a fee-based manager is not a compelling story for us. The operator has to have skin in the game. However, we do work with experienced owners and private equity groups that partner with fee-based managers.

**Mace**: What do you look for in a good sponsor?

**Javaid**: We like to have a relationship with a sponsor so we can have an honest discussion and ask what lending needs of theirs are not being fulfilled. That's the starting point. Our borrowers can achieve their goals, but we also can address our risk appetite.

**Mace**: What is your outlook for interest rates and the economy? How does that impact your lending strategies?

**Javaid**: We are very diligent analyzing interest rate sensitivity on various projects. This has not changed. It's a good metric to look at and if the projects don't pencil out, you can look at hedge products which are growing in popularity. With respect to my prognosis on interest rates, long-term rates are not trending up yet; though we may see that as quantitative easing declines. But until that happens, interest rates have only a small impact on most of the projects we are financing.

**Mace**: Any other thoughts?

**Javaid**: BMO has been around for 200 years. It's a very deliberate institution, and doesn't take lightly the decision to enter the seniors housing and care space. We have made a meaningful entrance into the market and look to grow our relationships. As a lender to owners and operators, our goal was to become one of the top five names that come to mind. We are not there yet, but that is our vision.

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

Beth

## The Biology of Aging and the Intersection of Science, Setting and Compassion

by Joel Mendes, NIC Future Leaders Council

**Joel Mendes**

Seniors housing and care has a role to play in the emerging science of aging. Such environments that encourage a healthy lifestyle and new learning may actually slow the aging process and help extend a purposeful and joyful life.

Though there is much we still do not know, the mysteries of aging are gradually being revealed by scientific progress. These advances described below can help guide the design of senior living properties and the programming they provide to residents seeking a high quality of longer life.

**Aging and Evolution**

The large number of people living well into old age worldwide is a new phenomenon. Just 100 years ago, a 20-year-old in the U.S. could expect to live on average to about age 63, compared to age 80 today. This 17-year increase in life expectancy in 100 years is extraordinary, perhaps even greater than the aggregate increase over the last 200,000 years of modern human evolution. The introduction of agricultural food production is also relatively new, with the first crops appearing around 10,000 years ago. The vast majority of ancestral humans were nomadic hunter-gatherers, and our bodies were shaped largely in these conditions. An adaptive premium was placed on beneficial traits that materialize early in life, frequently at the expense of those traits that surface in old age. For instance, while cellular death becomes increasingly problematic in older age, it likely protected our early ancestors from dying of cancer before procreating (see below).

Why, then, does aging and death in humans not occur sharply after reproductive success (at, say, age 50)? Women, both ancestrally and today, can live for decades after the body becomes infertile. This is unique in nature. By contrast, the female chimpanzee can reproduce well into old age. The human species appears to have benefited over the millennia from the presence and contributions of older adults.

**Aging at the Cellular Level**

In 1961, American microbiologist Leonard Hayflick demonstrated that human cells can only divide a certain number of times before they die or deactivate (a process called cellular senescence). This maximum number, referred to as the Hayflick Limit, varies by cell type but is approximately 50. More recent research indicates that the Hayflick Limit is largely due to the erosion of telomeres at the ends of genes. Telomeres are surplus portions of DNA designed to be a buffer to protect the vital genetic code in genes from damage resulting from cellular division. These “time bombs” help to kill the cell before it produces cancerous mutations. Cancer cells actually have an enzyme, telomerase, that stops telomere erosion and allows cancer cells to divide indefinitely, to the detriment of the organism in which they reside.

While adult stem cells produce new cells to replace the older ones, eventually the stem cells themselves become damaged. Senescent cells then begin to accumulate, contributing to aging. While environmental factors can have dramatic effects on aging, the body is nonetheless designed to age, and die, on its own.

**Aging in the Brain: The Anatomy of Wisdom**

As we age, the brain shrinks, neurons die, and extracellular debris begins to build. These changes take their toll. Indeed, there is ample scientific evidence for the superiority of younger adults in completing discrete mental functions, such as mental math or short-term memory retention. This body of evidence exists in part due to the ease with which it is measured as compared to a more integrative function, like intuition.

However, recent analysis indicates that degeneration in certain areas of an older brain leads to increased, compensating activity in other areas. This concept, referred to as compensatory scaffolding, allows older adults to maintain cognitive function despite damage to the local brain regions that govern these functions in younger adults (Reuter-Lorentz and Park, 2014). The result is not improved performance in said functions, but rather the creation of new connections within the brain, and enhancements of specific areas that have been linked to traits associated with wisdom. These traits include sound judgment in the face of uncertainty, emotional stability, and empathy. While these findings have yet to definitively verify the hypothesis, research in this space continues to advance and is led by pioneering neuropsychiatrist Dr. Dilip Jeste of UCSD.

**Aging and Memory: The Power of Learning**

The primary biological markers of Alzheimer's disease in the brain are the presence of disruptive protein masses that effectively wedge themselves in between nerve cells and prevent information from being transmitted. Once the disease becomes symptomatic, research indicates that the damage is irreversible. The disease will continue to progress and eventually cause death. Lisa Genova, neuroscientist and author of Still Alice, refers to development of symptoms as the "tipping point," past which there is no return. Many of us will never reach it, but of course, some of us will.

Fortunately, there are proactive ways for individuals to literally change the cellular make-up of their brains to push the tipping point further out into the future. Diet, exercise, and good sleep habits all have marked effects, but less well-known is the positive effects of continued, unique learning. When we learn something new, our brains create new nerve connections, a concept referred to as neuroplasticity. The capacity for neuroplasticity endures through late life, and the more new connections we add, the more connections there are for plaques to have to fill before the tipping point. Examples of activities that might create new connections include learning another language, playing a new instrument, reading history, or studying physics.

**Science and Seniors Housing**

Operators and developers have been increasingly integrating neuroscience into building design, with program planning and space planning occurring side-by-side. Examples include: window placement and lighting software to support the body's natural daily cycles, music and language rooms to foster dynamic learning, touchscreen program integration to make education more accessible and enjoyable, and door placement as well as carpet patterns to discourage wandering in memory care settings. We've also seen operators partner with local schools and universities to promote intergenerational socialization, thereby allowing the broader community to benefit from their residents' biological and experiential wisdom.

The intersection of science, setting, and compassion makes seniors housing an ideal laboratory of healthy aging. Understanding how and why our bodies and brains age has had a tangible influence on seniors housing, and the influence appears to be growing in lockstep with the research.

## Thoughts from NIC's Chief Economist
## A New Fed Head: What Does it Mean?

**Beth Mace**

President Trump recently nominated Jerome H. Powell to be the next chair of the Federal Reserve. If confirmed by the Senate, Powell would begin serving as chair in February 2018, replacing Janet L. Yellen. Most prognosticators believe he will be approved. It is expected that Powell will largely continue the Fed's current policy of gradually normalizing interest rates in 2018 and beyond. In addition, he'll likely continue to slowly unwind the Fed's $4.5 trillion balance sheet of bonds and other asset holdings from the bloated levels created under Quantitative Easing (QE). The Fed began the process of unwinding almost a decade's worth of stimulus investments in September.

Powell has made it clear that he supports the process of reversing the effects of QE. In a speech in June, he suggested that the Fed balance sheet probably would fall below $2.9 trillion. Powell is also expected to be less aggressive toward financial regulation, especially as it pertains to the Volcker Rule, which restricts banks with taxpayer-backed deposits from making certain types of speculative "proprietary" trades. Indeed, Powell has defended some of the Fed's tighter oversight of the financial market but also pointed to areas where he thinks regulation may be inappropriate.

With regard to interest rates, it is likely that there will still be one more rate increase in the Fed Funds rate to 1.4% by year-end 2017, under Janet Yellen's jurisdiction, and then several more in 2018, under Jerome Powell's leadership. The Fed has raised rates by a quarter percentage point four times since late 2015, and most recently to a range between 1.0% and 1.25% in June of this year, after keeping them near zero for seven years.

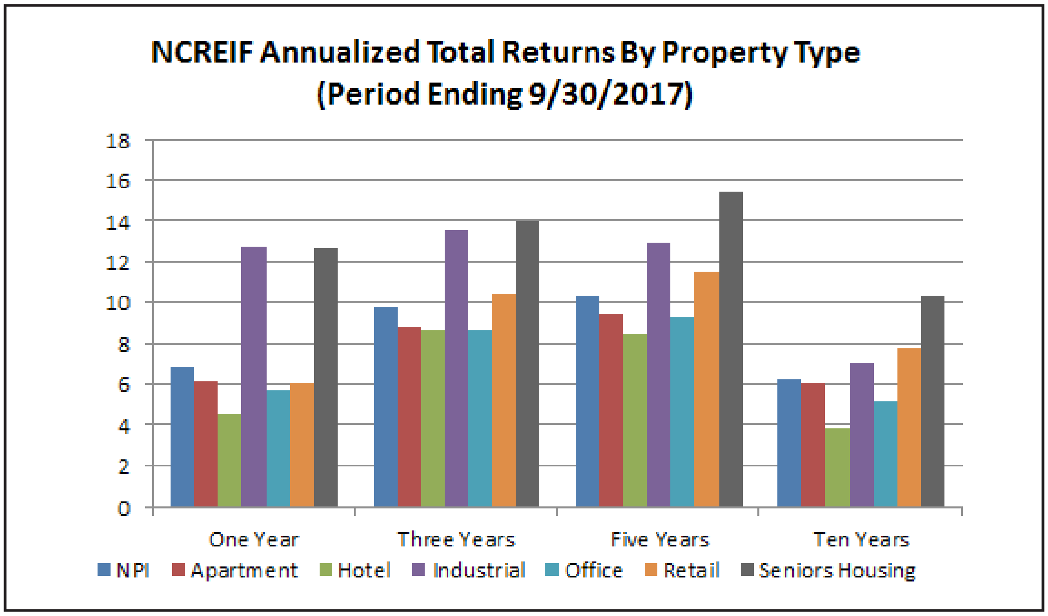
In addition to Powell, the composition of the Board of the Federal Reserve will continue to change further in 2018, as four more vacancies on the Federal Reserve Board, including the Vice Chair position, need to be filled by President Trump.

**A Tale of Many Markets**

For the past several quarters the disparity between relatively strong and relatively weak markets has become abundantly evident. Of the 31 metropolitan markets that comprise the NIC MAP® Primary Markets, San Jose ranked highest in the third quarter with an occupancy rate for seniors housing of 95.6%, while San Antonio has ranked lowest with an occupancy rate of 79.3%. This 16 percentage point differential is large and demonstrates the importance of drilling down into local market areas when looking at investment performance and opportunities. Factors shaping this differential include barriers to entry, which are significant in many of California's markets due to regulatory and physical constraints to growth; recent development activity, which has been robust for its market size in the case of San Antonio; and the strength of the economy and the subsequent effect of this on demand for seniors housing and the ability of the market to absorb new properties as they come on line. Even in physically large metropolitan areas, such as Houston or Dallas, the effect of new development in one area can affect the performance of another property many miles away. The takeaway from this is to thoroughly understand the market conditions in which your properties are located.

**Investment Returns for Seniors Housing: Still Strong**

For many institutional investors, seniors housing has been and continues to be a lucrative investment, offering both steady income and strong appreciation. As of the end of the third quarter 2017, the total annual return for seniors housing was 12.72%, according to NCREIF. This was comprised of a 5.89% income return and a 6.56% appreciation return. The total return overshadowed the broader NCREIF Property Index (NPI) return (of 6.89%) by nearly six percentage points. Despite the relatively strong showing, the total annual return for seniors housing has been trending down since mid-2014, when it peaked at 20.37%. This pattern can also be seen in the broader index. On a 10-year basis as of the end of the third quarter, total returns for seniors housing exceeded the NPI by more than 400 basis points.




The seniors housing investment performance measurements reflect the returns of 102 seniors housing stabilized properties, valued at $4.9 billion in the third quarter. This is highest market value for this property type since 2003, when NCREIF first started reporting data for seniors housing, and this marked the first quarter that the property count of the NCREIF universe of seniors housing exceeded 100 properties.

## How to Take on Healthcare Risk: Four Sessions Address the Possibilities at 2018 NIC Spring Investment Forum

Risk sharing is an emerging business model that seniors housing and care providers would be remiss to ignore. Insurers, managed care plans and government payors are gradually adopting programs to spread the financial risk associated with healthcare outcomes.

Senior living providers find themselves in a confusing situation. What's the best approach? How quickly must they adapt? Is risk-sharing even right for them? How can they prepare for the inevitable changes?

"The opportunities and challenges of taking on healthcare risk will impact providers," said Robert Kramer, founder & strategic advisor at NIC. "They need to get ahead of the curve because the changes could come rapidly."

The **Risk & Return** of taking on healthcare risk is one of three areas of focus at the upcoming 2018 NIC Spring Investment Forum. Four educational sessions at the Forum will explore healthcare risk-sharing models, along with the associated benefits and pitfalls. "The sessions will help providers sort out their path forward," said Kramer.

The 2018 NIC Spring Investment Forum will be held March 7-9 at the Omni Dallas Hotel. Other special focus areas to be explored at the Forum include: **Investing & Valuation; and Value Creation & Partnerships.**

**Deep dive into healthcare risk**

In recent remarks previewing the sessions on risk sharing, Kramer said the issue will impact all senior living providers. Skilled nursing owners and operators are already facing difficult situations where better healthcare outcomes do not necessarily result in better financial returns. Seniors housing companies need to understand how the changes also will affect them. “Providers could make good use of a roadmap,” said Kramer.

Each risk-sharing session at the Forum will explore a different aspect of the topic.

How to share in the value created by better healthcare outcomes will be detailed in the session titled, **“The Path to Healthcare Risk: Do You Have a Decent Map and Proper Footwear.”** The session will explore the various payment models, including Medicare Advantage plans, accountable care organizations and others. Every market is different. It’s crucial to understand local dynamics as well as the investor’s appetite for risk. Senior living providers will begin to learn how to navigate the changing environment. “It’s a big undertaking,” said Kramer.

A creative approach will be presented in the session titled, **“What Business Are We In? Senior Care CEOs Talk About Insuring Their Residents.”** Nursing homes and some seniors housing operators are selling Medicare managed care plans to residents. Panelists will share their experiences with taking on the full healthcare risk for frail seniors. What is it like to manage the plans? Will residents sign up?

Since Medicaid provides about 65 percent of skilled nursing revenues, operators and investors should be aware of managed Medicaid programs which many states have embraced. The session, **“Risk Based Long-Term Care Solutions for Providers and States”** will detail how providers can benefit from expanding their partnerships with states and health plans.

Risk-sharing isn’t for everyone, noted Kramer. This alternative concept will be discussed in the session titled, “**Sitting Out Healthcare Risk: Sink, Survive or Thrive?**” When is it best to not take on healthcare risk? How can a provider assess the options?

Three key takeaways from these four risk-sharing sessions apply to all providers, said Kramer.

Operators and investors must have good interpretive data. That means tracking outcomes and being able to share that data seamlessly in collaboration with insurers and payors.

Partnerships are critical. Seniors housing and care providers must align themselves with services such as hospice and home care, said Kramer. Even primary care can be provided in a seniors housing setting. This can lengthen the stay in private pay seniors

housing and also work to differentiate an operator from the competition, said Kramer. “There’s a lot of interest in bringing healthcare to where the seniors live.”

Lastly, providers need to scale at the local level to become a preferred provider by delivering better outcomes and having the data to back up performance.

The timing of the shift to take on healthcare risk is crucial, said Kramer. The penetration of managed care, bundled payments and accountable care organizations in markets such as California and Massachusetts is growing quickly. Other markets may still rely on fee-for-service arrangements, but the changes could eventually come to their markets too.

“Providers must understand risk-sharing and within the context of their local markets,” said Kramer. “Otherwise they are flying blind.”

***Registration is now open for the 2018 NIC Spring Investment Forum. [Click here to register.](#)***

## Seniors Housing & Care Industry Calendar

### December 2017

11-13 The BRG Healthcare Leadership Conference, Washington DC

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