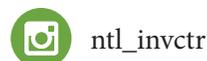


# NIC INSIDER

## Newsletter

December 2019



## In the Insider December Issue

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An Interview with MidCap's Kevin McMeen**

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## Experienced Middle Market Lender Carefully Balances Risk and Reward: An Interview with MidCap's Kevin McMeen



Kevin McMeen

Context counts. That's the big takeaway from a conversation with Kevin McMeen, president of Healthcare Real Estate Lending, MidCap Financial Services, LLC, a middle market debt provider. His deep experience in healthcare real estate finance provides the foundation of his nuanced insights into the dynamics of today's market.

NIC Senior Principal Bill Kauffman recently asked McMeen about MidCap's market position and his outlook, especially for the skilled nursing segment. What follows is a recap of their conversation.

**Kauffman:** Tell us about your professional background and how you became president of Healthcare Real Estate Lending at MidCap.

**McMeen:** I have been in the real estate finance business since 1993. I focused on seniors housing and healthcare properties in the late '90s and led teams at three different companies: Heller Financial, GE Capital, and Merrill Lynch Capital. In 2008, Merrill Lynch Capital was sold to GE, and shortly thereafter, myself and five other senior managers from Merrill Lynch Capital launched an effort to start MidCap. We were fortunate to have equity investors that were able to see the potential for the business despite a very challenging environment, and we closed on the equity raise for the platform in September of 2008. The business started as a finance company focused on lending to companies/investors in the healthcare industry. We have since evolved, and we are now a diversified middle market lender covering a variety of industries including commercial real estate, which is part of my team. We continue to have a significant presence in the healthcare and seniors housing and care industries. Throughout our 11 years of operations, I have had the pleasure of leading the real estate team at MidCap.

**Kauffman:** Can you give us an overview of MidCap? What are your growth plans?

**McMeen:** MidCap is a middle market finance company providing debt to companies operating in a wide array of industries. We are not a debt fund. We have a permanent equity capital base and a board of directors comprised of those investors. We are affiliated with Apollo Global Management, which manages MidCap on behalf of our equity investors. We have approximately \$8.5 billion of assets on our balance sheet, and we manage or service over \$22 billion of assets as of June 2019, of which \$3.44 billion are managed by MidCap Financial Services Capital Management LLC, a registered investment adviser. Our goal is to continue to grow our business in a prudent manner. We have a considerable amount of capacity to continue to grow but will do so only if we believe we originate new business without taking undue credit risk. As a private company that originates, underwrites, and manages our loans, we are highly focused not only on ensuring that we originate loans with an acceptable risk/reward balance, but that we have minimal downside risk.

**Kauffman:** What is your current target market for lending in the skilled nursing sector?

**McMeen:** We provide both real estate debt and working capital debt in the skilled nursing sector. With respect to working capital, we are one of the largest providers of working capital to operators of all sizes. With respect to real estate, we provide bridge loans for acquisitions, recapitalizations, refinancing and re-positioning. We also provide HUD loans for stabilized skilled nursing properties. Our focus in the skilled sector is to leverage our extensive experience to provide debt solutions to good owners, operators, and investors that value the variety of products we offer, and the ability to craft transactions that meet the specific needs of their business plan.

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**Kauffman:** What other services does MidCap provide?

**McMeen:** As a finance company, we don't offer a variety of services. Rather, we offer different debt products and the ability to meet the needs of clients that other lenders can't due to a lack of holistic product offerings, regulatory constraints, or lack of industry experience to deliver certainty of execution.

**Kauffman:** How is your current portfolio allocated, as far as debt in the skilled nursing sector—construction loans, bridge loans, etc.?

**McMeen:** We don't provide construction debt. Our portfolio is split pretty evenly between skilled nursing and senior housing. In the past, we had been more heavily weighted toward skilled nursing, but saw that weighting decline over the past couple of years as we took a step back to assess the challenges the industry had been facing regarding length of stay, reimbursement, and staffing costs. Our outlook is more positive today than it has been for a couple of years, and we anticipate seeing our skilled nursing portfolio grow in the future.

**Kauffman:** How do you measure risk as it relates to skilled nursing financing?

**McMeen:** I don't know that there is a single or simple answer to this question. Risk can be measured in a variety of ways from trends in operating metrics, to regulatory environment in a given state, to alignment of interests between debt and equity. The real question, however, is how you interpret, view or perceive those measures of risk. Obviously, there are a multitude of variables that drive people's perception of risk. We try to focus on trend lines, track records, sponsor integrity and alignment with regard to operations, and basic real estate fundamentals with regard to the hard asset. All those factors are considered in the context of our experience to assess risk and determine how best to structure a transaction.

**Kauffman:** Have you seen more demand from investors when it comes to skilled nursing debt, especially considering the continual reach for yield by some investors?

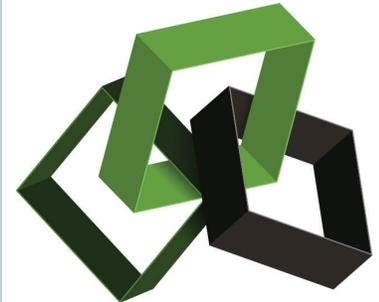
**McMeen:** I would say that there continues to be good demand for skilled nursing debt. The appetite in many cases over the past couple years has been surprisingly aggressive, but again, that is often a function of appetite for risk and experience in the sector. I do believe that there are many investors, whether on the debt or equity side of the investment, who recognize skilled nursing is a highly regulated and very challenging operating business and choose not to get involved, regardless of how attractive the potential returns may appear to be.

**Kauffman:** The skilled nursing sector, in general, has seen many challenges over the past few years, but NIC data shows occupancy stabilizing. What are you seeing in terms of that?

**McMeen:** We are seeing some signs of improvement in occupancy being reported by a number of operators. While it is too early to state definitively that the industry is on a positive trend line, it does appear that the occupancy may be bouncing around a flat trend line and potentially moving up as demographics start to improve for the sector.

**Kauffman:** Do you think skilled nursing valuations are fair right now?

**McMeen:** I think that skilled nursing valuations are relatively aggressive. We are seeing large operators divesting of underperforming assets at prices above both our valuations and that of recent appraisals. Certainly, there are unique opportunities for acquiring operators to perform at a higher level than the seller, but the level of expectations for future revenue and expenses can be very aggressive. We've seen some operators achieve those expectations and justify the purchase price, but if they fail, they would certainly be hard pressed to say that they made a good investment. In either case, you could argue that the buyer is paying the investor for the upside they have to create relative to recent performance. We do wonder at times how much of the equity in those



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acquisitions is syndicated and how much is from the sponsors, which, if not properly balanced, can drive aggressive behavior.

**Kauffman:** How do you assess the operator and how do you define a successful operator? What quality metrics are important to MidCap?

**McMeen:** Often times, we assess the operator based on the track record, quality and depth of the management/operating team, financial alignment, and geographic experience. These are very important factors in assessing whether the operator has the ability to execute, whether it is on an acquisition we are financing, growing their business outside of any transaction we may be involved in, or managing the day-to-day complexities of this business. Financial and operational reporting is also critical. We need to be confident that our borrower will be able to deliver accurate and thorough reporting in a timely fashion. Too often, we have seen situations where the inability to deliver basic reporting is a signal of greater stress within the company. Obviously, quality of care is absolutely critical. We look to survey history and the ability to deliver quality care and deal with quality of care issues promptly when flagged in a survey. Lastly, for most every operator, it is critically important to deliver and track quality patient outcomes.

**Kauffman:** What do you see as the main risks and the main opportunities for the skilled nursing sector over the long-term?

**McMeen:** This is an excellent question, and risks will ebb and flow as the sector evolves, demographic trends play out, payment plans change, etc. I do believe that the industry has a strong place in providing both short-term and long-term care. However, I believe that there is risk in both types of care. On the short-term side, there is risk around the ability to capture demand, which could be a function of relationships with referral sources, the ability to deliver consistently good quality of care, as well as tracking and demonstrating that patients have good outcomes and low hospital readmissions. For both short- and long-term care, there is margin risk, whether from reimbursement challenges, further compression in length of stay, and the cost of labor to staff effectively with qualified and dedicated employees. Lastly, I believe that there is risk in building obsolescence. So much of the skilled nursing stock was designed for long-term care and is simply no longer suited for delivering care for today's resident population without major capital investment. In addition, many buildings are located in markets that are no longer ideally suited to capture demand as a result of real estate market dynamics that have changed over time.

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## Key Takeaways from NIC MAP's Third-Quarter 2019 Data Release

NIC MAP® Data Service clients attended a webinar in mid-October on the key seniors housing data trends during the third quarter of 2019. Some notable takeaways included:

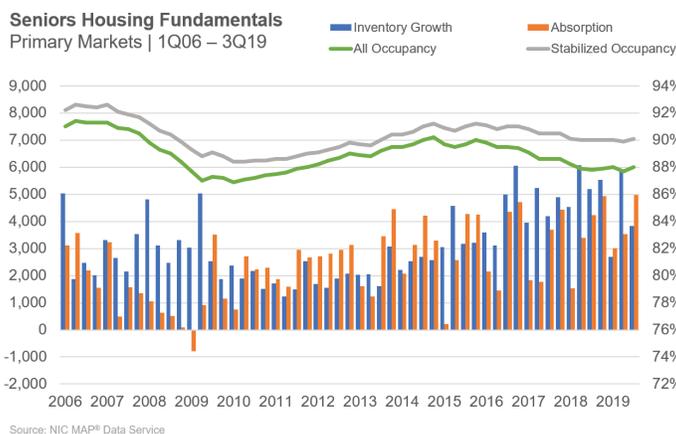
- Seniors housing occupancy increased from an 8-year low to 88.0% in the third quarter.
- Assisted living properties' occupancy edged up during the third quarter from a record low.
- Units under construction in assisted living properties slowed.
- Wage growth continued to exceed rent growth.
- There exists a wide distribution in transaction prices on a per unit basis.

Let's take a closer look at some of these observations.

### Seniors housing occupancy increased from an 8-year low.

- During the third quarter, seniors housing net absorption totaled 4,977 units for the NIC MAP® 31 Primary Markets, the greatest number of units absorbed on a net basis in a single quarter since NIC began reporting the data in 2006.
- At the same time, the quarterly change in the number of units added to inventory slowed to 3,832 units, the second fewest units added to the stock since mid-2016.
- Combined, these factors supported a 30-basis point increase in the seniors housing occupancy to 88.0% in the third quarter from 87.7% in the second quarter when it had fallen to its lowest level in 8 years.
- This placed occupancy 1.1 percentage points above its cyclical low (of 86.9%) reached during the first quarter of 2010 and 2.2 percentage point below its most recent high (of 90.2%) in the fourth quarter of 2014.

#### Seniors Housing Occupancy Up From 8-Year Low



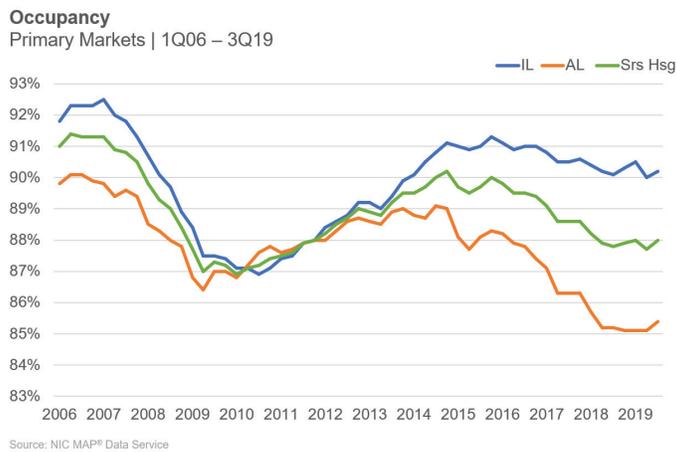
### Assisted living properties' occupancy edged up during the third quarter from record low.

- During the third quarter, assisted living properties' occupancy moved off its record low rate of 85.1% for the past three quarters to 85.4%, as relatively robust demand outpaced new inventory growth. Indeed, net absorption totaled 3,128 units in the third quarter, the most of any quarter except the Q4 2018.
- The occupancy rate for independent living properties inched up 20 basis points to 90.2% in the third quarter, 10 basis points higher than year-earlier levels, but below its rate earlier in 2019.

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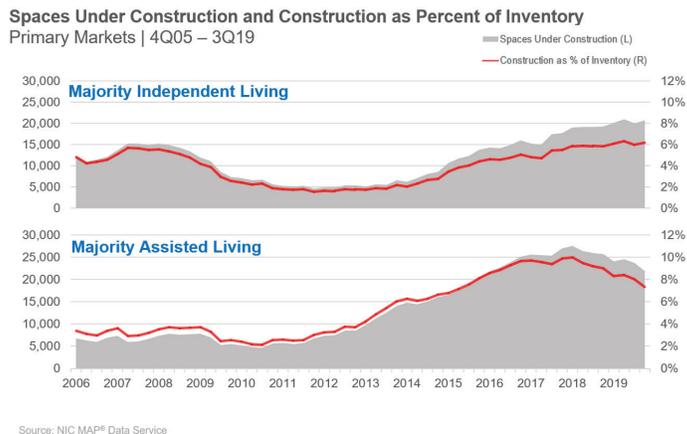
### Assisted Living Occupancy Edged Up



### Units under construction in assisted living properties slowed.

- Construction as a share of inventory for majority assisted living properties decelerated in the third quarter and equaled 7.3% or 22,000 units. This includes all properties under construction from start to completion. This was the lowest rate of construction since 2015 and down from a peak of 10% in late 2017.
- The same pattern is not yet evident in independent living properties as the following exhibit shows. In the third quarter, construction as a share of the independent living inventory totaled 6.2%, where it has been hovering for the past year.

### AL Units Under Construction Still High, But Trending Lower



### Wage growth continued to exceed rent growth.

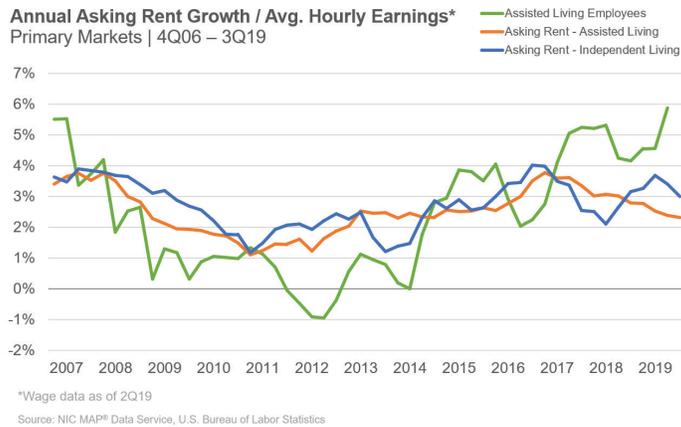
- Since 2017, same store asking rent growth for assisted living has been decelerating, and this pattern continued in the third quarter when annual rent growth slipped back to 2.3% from 3.8% in late 2016 and 2.8% one year ago.
- For independent living, the pattern is not as consistent; during the third quarter, its annual asking rent growth was 3.0%.
- Compared with the growth of average hourly earnings for assisted living in the second quarter, which increased by a very strong 5.9% from year earlier levels, asking rent growth has been lagging.

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### Wage Growth Continued to Exceed Rent Growth



### There exists a wide distribution in transaction prices on a per unit basis.

- The following exhibit represents a snapshot of the pricing distribution of seniors housing and skilled nursing properties as of the third quarter of 2019.
- The average price per unit for seniors housing was \$184,000, which represents an increase of 9.2% from the second quarter when it came in at \$168,500. Compared to a year ago, the price per unit increased 17%.
- There is a wide range of pricing, however, as this chart shows, with the upper decile at \$324,000.
- For skilled nursing, the upper decile is \$200,000 lower at \$134,000.

### Wide Distribution in Price Per Unit (PPU)

**Seniors Housing & Care Transactions Price Per Unit Distribution<sup>1</sup>**  
U.S. | Rolling 4-Quarter as of 3Q19

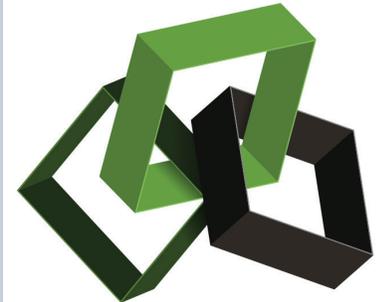
PPU Summary - Seniors Housing					
Average	Lower Decile	Lower Quartile	Median	Upper Quartile	Upper Decile
\$184,000	\$54,000	\$83,000	\$130,000	\$226,000	\$324,000

PPU Summary - Nursing Care					
Average	Lower Decile	Lower Quartile	Median	Upper Quartile	Upper Decile
\$80,000	\$32,000	\$46,000	\$68,000	\$94,000	\$134,000

<sup>\*</sup>Deciles/Quartiles are rounded to nearest \$1,000

<sup>1</sup> Preliminary Data

Source: NIC MAP® Data Service, Real Capital Analytics



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## How to Develop Innovative Solutions for the Post-Acute Industry: A Conversation with Marc Zimmet



Marc Zimmet

Managing change is difficult. When an organization adjusts to new circumstances, it often results in unexpected consequences.

The skilled nursing sector is undergoing such a transformation. The shift to value-based care can benefit a facility's performance in one respect, but hurt it at the same time in another.

Marc Zimmet understands the dynamic. He is president and CEO of Zimmet Healthcare Services Group, a New Jersey-based consulting firm that advises skilled nursing facilities and other stakeholders on all aspects of the reimbursement-compliance

ecosystem. NIC's chief economist Beth Mace recently talked with Zimmet about the skilled nursing market and what providers can expect. What follows is a recap of their conversation.

**Mace:** What is Zimmet Healthcare Services Group? And who are your clients?

**Zimmet:** Zimmet Healthcare Services Group, LLC is a full-service consulting firm dedicated to providing comprehensive reimbursement, regulatory, and strategic solutions to the post-acute care industry. We started by preparing Medicare cost reports for skilled nursing facilities in 1993. Since then, we've grown to about 60 full-time professionals, and service more than 3,000 providers and related stakeholders nationwide. Our services include reimbursement and compliance support, auditing, strategic planning, market reform analysis, analytics, litigation support, quality reporting, and financial modeling.

**Mace:** Your firm works with Greystone & Co., a leading real estate lending, investment, and advisory company headquartered in New York. What is your relationship with them?

**Zimmet:** About five years ago, we started getting calls from clients expanding into new areas across the country. They wanted to understand the market dynamics, regulations, and reimbursement systems unique to each state. We were also getting calls from lenders asking similar questions regarding increasingly complex deals. Reimbursement has become so nuanced with new payment models and fragmented coverage guidelines—what I call the reimbursement ecosystem.

A mutual client kept telling me that I "had to meet Steve Rosenberg from Greystone;" so, one rainy day I made it into Midtown, and we hit it off right away. Since then, we have an exclusive relationship where my firm's consulting services along with Greystone's capital offerings help to add client value and mitigate risk for everyone involved in a transaction.

**Mace:** How does that work?

**Zimmet:** We distill the proposition down to three factors (in order of importance): position, performance, potential. If a provider is not well-positioned in its market, that may tell us all we need to know.

To understand the position factor, we have to reconcile Federal mandates superimposed on the highly uneven regulatory and market reforms that shape each state (and county). Hospital discharge patterns, demographics, health system politics, survey bias, successor liability, ancillary opportunities, and a dozen other variables can make or break a deal.

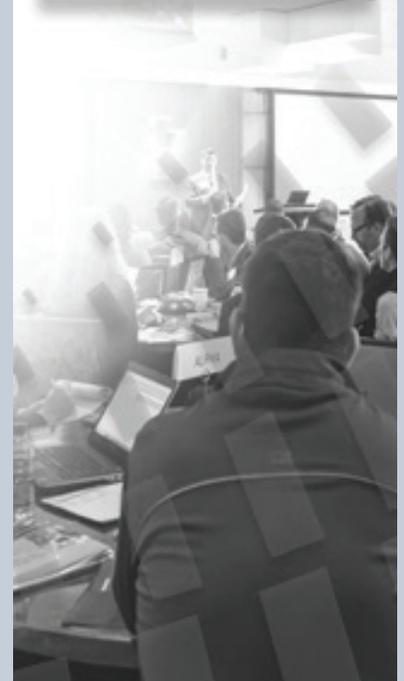
Quality reporting has also become a financial hot button, and we were fortunate to add Steven Littlehale last June as chief innovation officer. With so much investment interest in turnaround projects, Steven's insight into clinical metrics is invaluable.

**Mace:** The skilled nursing sector is going through a significant transitional period. How would you summarize the dominant trends?



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**Zimmet:** Financial success is being tied to quality. It's very difficult to be financially successful without meeting quality standards. At the same time, a much more complex system has emerged with so many players, payors and vested interests: ACOs, bundled payment conveners, Medicare Advantage / I-SNPs, payment demonstration projects, etc. All these players are concerned about quality care in the skilled nursing facility.

But meeting increasingly stringent value-targets often results in counterproductive strategies that may improve one revenue source but hurt another. "It's all connected," as we say. Zimmet-Healthcare helps arbitrage strategies for different payors to determine the best net result for the facility.

**Mace:** How long has this shift been underway?

**Zimmet:** The big shift started around 2014 as hospitals started getting penalized for readmissions. The trend has accelerated over the last several years with payors monitoring their skilled nursing partners and tightening their provider networks.

**Mace:** Is this a good change from viewpoint of operator or patient?

**Zimmet:** Rewarding quality is the right thing to do. The issue is that everyone measures quality and rewards quality differently. Many operators struggle to manage all these moving parts, and the result is lost reimbursement. For example, Medicare Advantage contracts often have exclusions for certain items that are reimbursable separately, but they must first be identified, captured and authorized by the plan's case management. Things like that fall through the cracks; we try to make sure that doesn't happen.

**Mace:** Where are we in this transformation process? How long do operators need to remain nimble?

**Zimmet:** We are being pushed towards a quality-based system. Will we get there? Does the skilled facility ever become a post-acute care manager that assumes risk and follows the patient through care transitions? That's a huge challenge that few operators could handle at the moment, but I believe some industry players will evolve into a new class of provider. A lot has to happen before that's a mainstream reality.

**Mace:** Is this driven by the federal government, which only has so many dollars for the coming wave of baby boomers who will need care?

**Zimmet:** Medicare Advantage is chipping away at fee-for-service Medicare. We just hit 35% penetration of Medicare Advantage.

We have analyzed the fee-for-service attrition rate. About 65% of new Medicare recipients are opting for Advantage plans. This depresses episodic treatment revenue from fee-for-service Medicare.

The Medicaid equation is different depending on the state. But the goal is to keep people out of an institutional setting. This may result in a low census and facility closures. But few new facilities are being built and the baby boomers are coming. We will reach supply and demand equilibrium at some point. But with the Alzheimer's epidemic, some markets could have a shortage of beds.

**Mace:** What do you see in the near future?

**Zimmet:** The industry's health is fundamentally predicated on occupancy. Skilled nursing facilities have high fixed costs. So, when occupancy declines are distributed across a fixed number of providers, everyone's operating costs on a per-day-basis go up – and the "Medicaid shortfall" grows even if the Medicaid rate remains the same. Revenues should improve as the market moves toward equilibrium and occupancies rise. Our goal is to identify that exact inflection point – because that moment in time represents the greatest opportunity.

**Mace:** Let's shift the conversation to I-SNPs. What are the benefits of an Institutional Special Needs Plan or I-SNP?



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**Zimmet:** I-SNPs fall into two classes: skilled facilities that contract with an I-SNP; and a provider-owned I-SNP.

The idea of an I-SNP is to treat the resident in place. By contracting with an I-SNP, a skilled nursing facility can share in the savings generated by reducing the overall “Medicare spend” (specifically avoiding unnecessary hospitalizations).

Facilities may also partner with a particular I-SNP associated with a strategic Medicare Advantage plan to gain favor in its skilled nursing property network.

**Mace:** Is an I-SNP better for the resident?

**Zimmet:** If I am a patient or have a family member in a skilled facility, I would prefer membership in an I-SNP. It’s better to be treated in place.

**Mace:** What else should facilities know?

**Zimmet:** I-SNP may be a balancing act for the facility. It has to consider how all the pieces fit together, including the dynamics of contracted services, such as physical therapy, the impact of capitated payments, and the new Patient Driven Payment Model (PDP). It’s all connected. I-SNP may be the right move for a provider, but they should understand that introducing any new model will have ripple effects on other areas of operations.

**Mace:** What’s the best approach?

**Zimmet:** The answer is different for every facility depending on how they are positioned in the local market. Positioning relates to all facets of operations and planning to determine the best net benefit. Nothing can be analyzed in a vacuum. It’s a value paradox where it’s all connected, or said another way, it’s our “Theory of Reimbursementity.”

**Mace:** What are the opportunities and risks for a facility to manage its own I-SNP?

**Zimmet:** I-SNPs are like a shiny new toy. Everyone wants to try it, but many can’t use it. In my estimation, up to a third of facilities in the country may not be appropriate for I-SNP participation.

**Mace:** Why?

**Zimmet:** So many variables go into the ISNP-Equation. Scale, clinical competencies, culture, market politics, partners in care, and even the ability to measure performance play roles. Medicaid, in particular, is a factor; facilities in states with higher Medicaid rates are better positioned to benefit from I-SNP engagement. That’s because long-term care Medicaid patients are not going to be sent to the hospital. So they won’t be returning and placed on Medicare. The result is fewer Medicare days and more Medicaid days.

At the end of the day, skilled nursing properties are holding tight to the “fee-for-service” mentality –the I-SNP proposition involves forgoing traditional Medicare revenue but generating more Medicare “replacement revenue” driven by quality. There are many moving parts to that equation, and providers must closely monitor performance or risk missing the opportunity altogether.

**Mace:** It’s a very complex business. Do you expect further evolution in the environment?

**Zimmet:** I think it will change, though there are pockets in the country where nothing has changed yet and managed care has not arrived. It is market specific. Healthcare reform isn’t always defined by systemic change – but a significant iterative step we’re seeing is skilled facilities accepting episodic payments from Medicare Advantage plans. For example, instead of being paid \$400 a day, the facility will be paid \$6,000 for an episode of treatment. That represents real risk – the financial impact is subtle, but the psychological aspect is a big jump.

**Mace:** What are the I-SNP issues that no one is talking about and why are they important?

**Zimmet:** Compliance is a big issue that gets overlooked. Operators must adhere to certain rules around qualifying for Medicare coverage which can be impacted by whether

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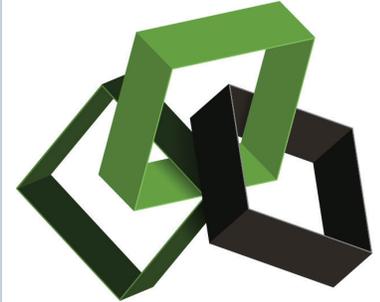
or not the resident is enrolled in the I-SNP or traditional fee-for-service. Facilities must have consistent policies, as regulators could question why certain residents returning from the hospital receive Medicare coverage and others don't. This issue is complicated further when I-SNPs waive the three-midnight hospital eligibility requirement.

**Mace:** How do you figure that out?

**Zimmet:** It's not easy. The equation is getting more complex. We just have to consider the nuances of every market. There is no shortage of opportunity, especially with all the change happening in post-acute care. But success requires innovation and pursuing new services as reimbursement systems evolve.

**Mace:** Will small operators still have a chance to succeed?

**Zimmet:** The small operator that is already well positioned and established in a market can still do well. But the days of a new entry as a "one-off" facility in a market and expecting to succeed are behind us.



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## The Forgotten Middle – Fall Conference Sessions Recap

In a ground-breaking study, sponsored by NIC and published in Health Affairs, researchers at Harvard University, University of Maryland, NIC, and NORC at the University of Chicago, an independent non-partisan research institution, quantified the belief that “Many middle-income seniors will have insufficient resources for housing and healthcare.” The study is the first of its kind to analyze the household assets of America’s aging baby boomers and compare them to their projected needs as they age. The 2019 NIC Fall Conference wasted no time in both disseminating the study’s key findings to leaders in the seniors housing and care industry, and challenging attendees to begin to discuss solutions to this emerging – and highly important – challenge.

In the first of two sessions dedicated to the topic, NIC chief economist Beth Mace presented the study’s findings after NIC founder and strategic advisor Bob Kramer highlighted the importance of addressing the challenges and opportunities it has brought to light. The session was designed both to draw attention to the broader issues raised by the study, and then pivot to begin generating new ideas. After the study review and a brief question and answer period, attendees were treated to a presentation of new ideas from participants in a NIC-orchestrated “hackathon.”

In his opening remarks, Kramer highlighted both the challenges and the opportunities revealed by the study. In his view, a key challenge is to avoid doing nothing. “To do so would risk governmental interventions.” On the positive side, Kramer said, “It’s an opportunity. This is a huge underserved market. But it’s going to grow enormously in the future. It will be the single largest market in terms of income that will be out there.”

Eventual solutions will involve public-private sector involvement, according to Kramer, “It’s not going to be an all government solution. Nor is it going to be an all private sector solution. It’s going to be some types of combinations, and even within that middle market, there are obviously—as you would expect—gradations. Some that are going to be able to afford more. Some that are going to be very close already to qualifying for Medicaid, and be able to afford much, much less.” Kramer concluded his remarks with the summary that, “Bottom line, this is a huge growth opportunity for our sector. But at the same time, it’s also an imperative that we be part of the solution, not be seen as part of the problem because we have no interest in it.”

In her review of the study, Mace provided insight on how the study was structured, and outlined its key findings. While more affluent seniors will be able to afford a range of private-pay options, and lower income seniors will qualify for government assistance, a large cohort will neither qualify for assistance nor be able to afford current private-pay options. The resulting challenge is likely to spur policy changes, drive public-private partnerships, and inspire entrepreneurial investment and innovation.

### Executive Summary

- ▷ Innovative financial structures and operating models are needed to provide care and housing options for America’s middle-income seniors cohort.
- ▷ The investment opportunity is large and growing— over 14 million middle income seniors by 2029, 6 million more than today.
- ▷ Of these future seniors, 6.6 million (46%) are projected to have the financial means to meet the estimated \$60,000 annual costs of living in seniors housing and paying out of pocket medical costs.
- ▷ An additional 2.3 million middle income seniors could meet the yearly costs of rent and other costs if they were cut by \$10,000 from \$60,000 to \$50,000.
- ▷ At today’s utilization rates, more than 700,000 units of seniors housing will be needed to satisfy potential demand from middle market seniors by 2029.

### Executive Summary

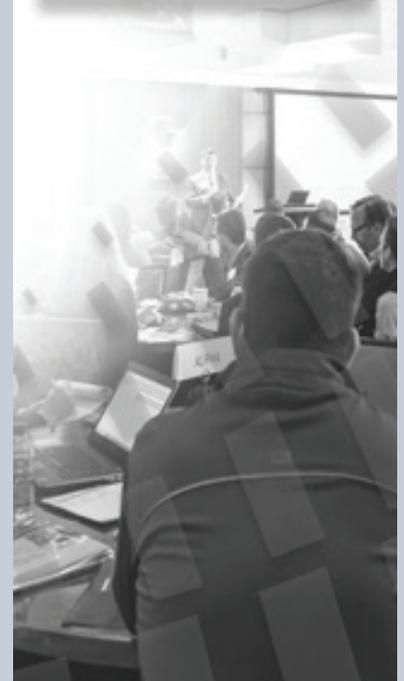
- ▷ The middle income seniors cohort includes today’s retiring workforce housing cohort -- teachers, firefighters, government workers and nurses -- individuals with financial resources between \$24,000 and \$95,000 annually.
- ▷ Future seniors will be more racially and ethnically diverse and more educated than today, potentially altering the care needs and preferences of this burgeoning cohort.
- ▷ Many middle income seniors may have health and mobility needs that cause them to leave their homes for additional care
- ▷ Lower marriage rates, fewer children, and less access to caregivers may increase the need for paid, private seniors housing solutions

Mace pointed out that there will be more than 14 million middle-income seniors in 2029. She went on to explain that these numbers are conservative, and will actually continue to grow dramatically beyond 2029 as the baby boomers age and to point out



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that at today's penetration rate of 11.2% and today's construction rates, it would take 17 years to open the 700,000 new units it would take to meet this demand in 2029. After reviewing other key data points, Mace said that, "to put it in context, when we're talking about middle-income, you can think about workforce housing residents aging in the multifamily world. This includes teachers and firefighters, government workers, and nurses. We're looking at the housing and care needs of that workforce group now and then out to the year 2029."

Mace continued to explain and detail how the demographics, finances, marital status, lack of caregivers, and healthcare needs, among other factors, point to an increased need for seniors housing in the middle market – but with a varying capability within this cohort to pay for it. After walking through detailed slides and carefully explaining their significance, Mace underlined what this will mean on a grander scale, "Maybe we'll never be able to address the needs for all the middle-income cohort, but we need to come up with a solution for at least some of those individuals. Because if we don't, the result could be that people will draw down on their assets, become eligible for Medicaid, and there's not enough money in Medicaid for today's recipients, much less for this huge group that could require those funds."

Following a short "Town Hall" question and answer session, Mace introduced Lisa Spinali, who facilitated the concurrent Hackathon session. Spinali explained that, working in five groups of five individuals, each selected for diversity of experience and perspective, the hackathon had worked on ideas to address the "Forgotten Middle" challenge. An individual from each group then presented the ideas that they'd worked on.

Several ideas appeared in more than one presentation. These included looking at ways that municipalities, states, and the federal government can help lower costs through tax incentives, abatements, and credits. Another concept that was raised by multiple hacking groups was the idea that developers could lower costs by repurposing existing facilities, such as malls and shopping strips. Conference attendees may access the full audio recording and transcript, which includes all five hackathon presentations, at the [2019 NIC Fall Conference Recap Website](#).

Beyond these ideas, the groups outlined some different approaches to the seniors housing model itself. In one case, a group suggested a multi-generational mixed-use development that incorporates tenants that align with residents' needs, such as physicians' offices and restaurants. In such a model, it might be possible to cut out construction and operating costs by "decoupling" certain services from the facility, and removing, for example, an expensive commercial kitchen that would otherwise be required. One group eliminated the kitchen by suggesting a model that relied on a la carte food delivery. The same group also cut transportation costs by utilizing Uber, Lyft, and ride-sharing alternatives.

One group looked at "the overall care paradigm" and suggested a model in which the operator partners with local healthcare providers. Collaborating on healthcare and investing in telemedicine and other technological innovations may enable the provider to share in the savings they are helping to generate, while improving the quality of life, raising satisfaction scores, and creating greater length-of-stay numbers.

As Mace responded to one of the questions in the "town hall" component of the session, it was NIC's intention not to provide all the answers, but to begin the discussion of solutions amongst industry decision-makers. As the session concluded, with five sets of ideas on display, it was clear both that there will be multiple avenues to successfully provide for this cohort, and that further discussion and strategic development would likely be warranted. Perhaps the key takeaway was that this issue is very real, and will have a huge impact, not only on the seniors housing and care industry – but on America as a whole.

The logo for NIC MAP Data Service is displayed on a dark blue background with a grid of light blue dots. The text "NIC MAP" is in a large, white, sans-serif font, with "Data Service" in a smaller, white, sans-serif font below it.

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The ideas generated by the hackathon provided the foundation for a substantive discussion during - and after - a town hall-style session hosted by NIC on the last day of the conference. Focused on exploring practical solutions to the challenges and opportunities presented by this cohort of middle market seniors, the session proved inspiring. Numerous attendees and panelists engaged in a real-time brainstorm, from which more ideas emerged.

Host Lori Coombs, managing director, Wells Fargo, described the session as “an open forum to discuss the results of the hackathon.” She was joined by a panel of industry experts, and a very attentive audience of industry leaders. She started by presenting an overview of the study’s findings, and the results of the hackathon, which she summarized by highlighting several key themes that hackers focused on. These included physical structure (real estate), operational improvements, return on debt and equity, and purpose and choices.

When asked to address the structure piece of the challenge, panelist David Watkins, partner, SHA Capital Partners, took the position that it would take a multi-faceted approach for the industry to successfully address the challenges of serving the middle market. “It would be great if it were just a real estate solution...but it’s not. It has to be a multi-faceted approach that includes operations, technology...finance, etc.” His company focuses on Class B real estate, often “in need of some love” as a means of reducing costs. He went on to mention some new construction approaches to achieving lower real estate costs, such as opportunity zone locations, modular construction techniques, building smaller communities with shared facilities, such as bathrooms and kitchens, leveraging mixed-use construction for another potential stream of revenue, and repurposing existing real estate, such as malls, schools, etc.

In response to an audience question on achieving economies of scale, panelist Gaurie Rodman, director, Development Services, Direct Supply/Aptura, responded, “Whatever solution we come up with has to be a transformational change...a lot of the ideas that came out of the hackathon had to do with unbundling {today’s model}. As operators, keep the piece that is essential for the regulatory environment, for the care component, but find ways to partner with hospitals, home health agencies and others.”

Rodman went on to discuss changes in consumer expectations, “They’re going to want a quality of life that keeps them purposeful, keeps them engaged, keeps them younger. They want intergenerational. They want to continue to travel...the entire travel business that takes cruises down the Amazon and the Nile have grown exponentially, because there are frail elders who can do that. Our business has to start thinking about that.”

She provided an outline of the operational ideas raised by the hackathon, including unbundling services in a concierge model, eliminating commercial kitchens, and implementing technologies such as wearables, improving real-time data collection, advanced lighting systems, and telemedicine. Other ideas she outlined included improving alignment with payors and healthcare providers, and working on refining government services such as Medicare and Medicaid.

Panelist Rodney Harrell, interim vice president, Livable Communities and LTSS Director, Livability Thought Leadership, AARP Public Policy Institute, addressed some of the issues raised dealing with social isolation and community. He mentioned some issues that had been raised during the hackathon, including transportation, such as relying on Uber or volunteer ridesharing, outsourcing food, such as collaborating with a Starbucks. He explained that tying services to outside institutions within the community could both reduce operating expenses and deliver what residents want, particularly connection to the community; “community institutions might be able to provide some of the services that you want inside, and that helps you tie the residents who are living with you into the community as well.”

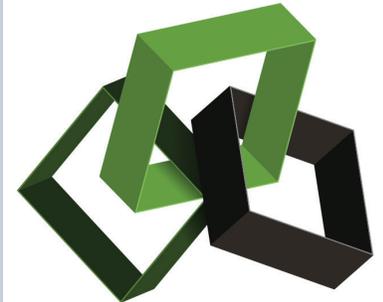
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Harrell discussed some of the public policy aspects of the issue, from the perspective of the AARP. "If there are community assets of one sort or another that can be explained by this development, that might, at minimum, expedite some permitting. It might qualify for bond financing, or other funds that are available but not traditionally used for this kind of work. So, the idea is that if you're providing things that communities need, you can actually become part of the community, not just within the building, but without."

Throughout the session, attendees posed questions and relayed their own experiences working with some of the ideas and models being discussed. At several points, attendees engaged with each other, as well as the panelists, on the realities involved. Representatives from some of the nation's leading capital providers, operators, and developers, among other leading voices and thought leaders from across the sector, jumped in to what became a substantive group discussion focused on real-world solutions. While the session began with hackathon concepts, it ended with an exchange of practical ideas that were both pragmatic and dramatic. It is likely that the discussion will continue, and bear fruit, in the years to come.



# NIC 2020 Spring Conference

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## 2019 NIC Fall Conference Session Recap: What Do Baby Boomers Want? New Active Adult Product Could be the Answer.



Scott Stewart, Zachary Crowe, Aron Will, Jared Bankos, Robert May (From left to right)

The industry's long quest for a baby boomer-friendly product may be within reach amid the recent emergence of active adult rental communities.

Targeted at young elders, the projects are light on services but big on amenities. The thinking is that baby boomers will trade their old homes for the hassle-free lifestyle that comes with a stylish apartment in an amenity-rich building.

"What do baby boomers want?" asked Aron Will, kicking off a well-attended panel discussion on the new active adult segment at the 2019 NIC Fall Conference. "Active adult developers may have the answer."

The session was later followed by a peer-to-peer exchange where participants networked and shared ideas on active adult projects.

Timing could make the active adult product a winner. About 76 million baby boomers are age 55 or older. Many will be seeking age-appropriate housing.

It should be noted that the active adult market is just starting to take shape. The industry hasn't even settled on a definition yet, according to Will, vice chairman, CBRE Capital Markets.

Until recently, the term was mostly used to describe retirement communities with for-sale homes.

Early adopters of the new rental product are mostly multifamily developers and investors that see an opening. Independent living has morphed into assisted living light, they believe. And there is no product just for younger seniors who want something new and different.

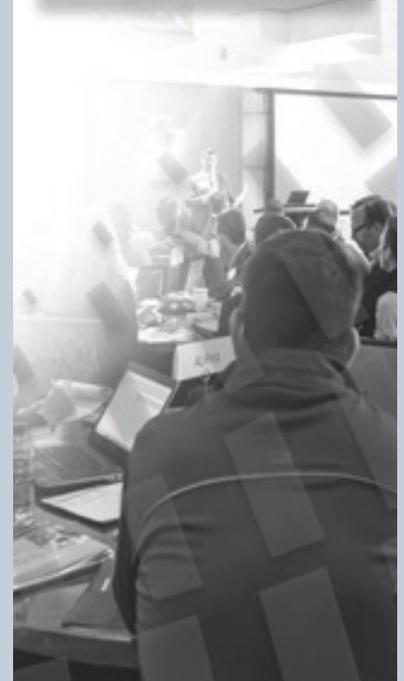
"Our product is different," said panelist Robert May, founder & CEO of Avenida Partners. The company is currently building its 11th active adult project. "We didn't see opportunities in acquisitions," he said.

May considers the active adult segment as the intersection between hospitality and residential. Active adult is different from the multifamily product and different from the medical model of senior living. "We are excited to be in this niche," he said. "We think it has a huge runway."

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Panelist Zachary Crowe agreed. He is a principal at The Carlyle Group, a big investment firm that jumped into the active adult market about five years ago and has partnered with Avenida. "We wanted to target baby boomers," he said.

Potential residents are vastly different from those who reside in other types of senior living properties, panelists noted. "Understanding the consumer is the whole ball game," said Scott Stewart, managing partner, Capitol Seniors Housing. "We still have a lot to figure out."

The challenge is to answer three basic questions, said May. What do these baby boomers want? What will they pay for it? And how much does it cost to operate? "We are all pioneers," he said.

### Early Lessons Learned

Panelists shared their general observations on active adult projects:

- The right project size is about 120-160 units, smaller than multifamily projects.
- The average age of residents is about 72, younger than those in independent living which has an average age of about 82.
- Most residents (65%) are single women.
- Seniors take longer to make a decision to move than renters of traditional multifamily properties.
- Rents are generally higher and grow more quickly than at multifamily buildings.
- Residents are "sticky." They tend to have a long length of stay, 6-10 years. Low turnover makes up for the long sales cycle.
- Services are minimal. Meals are generally not included, but a concierge is often on staff.
- Programming is key. Residents are looking for fun.
- Common areas need flexible designs to accommodate different activities.

May's strategy at Avenida is to pick off the best locations and tailor the product to the local market. He said 70% of residents come from within a seven-mile radius of a property. "They share a common culture," he said. "We have to speak their language."

Solid marketing plans are a must, and should include a personal approach, said Crowe. "Create a bond." The real competition is the person's own home. Sales pitches should include rent versus buy analyses, as well as an emphasis on the active adult lifestyle.

"It's a high-touch sales process," said May. "We do a lot of education." Marketing strategies include dinners and special events to build sales momentum.

Pre-leasing starts nine months prior to opening. Avenida also has a move-in coordinator on staff to help ease the transition for new residents.

The active adult segment doesn't necessarily compete with independent living properties, said Jarod Bankos, director of investments, Cortland Partners. The company has nine active adult projects under the Attiva brand.

A successful strategy is to share referrals with independent living communities, said Bankos. Younger seniors who tour a retirement community may be looking for an alternative.

The active adult segment is uncharted territory for the capital markets, panelists said. Lenders and equity investors still need to be educated about the product. Capital providers want experienced operators with marketing expertise, noted Crowe. He added that capital sources will appreciate the high rent growth rates compared to other residential sectors.

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### The Conversation Continues

The peer-to-peer salon began with a panelist Q&A, followed by roundtable discussions among participants. They included a mix of operators, developers and investors. Most work in the active adult segment.

Rental rates were discussed. Active adult rents are about 30% less than for independent living, but 30% more than for standard multifamily apartments. Operators justify the rent premium to consumers by noting the higher level of staffing and programming.

Participants observed that it's hard to judge the depth of the market. No statistics are available on the segment. The product is still in its infancy, they noted, and will require more time to mature.



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## Senior Housing and Care Integration: An Opportunity or a Threat? By Kate Nicholls, Director, Investments at Ventas, Inc.



Kate Nicholls

From care concierges and on-site specialty care to sharing electronic health records and offering Medicare Advantage plans, there is an abundance of options for senior housing and care integration, and senior living operators are considering the benefits of integrating their daily business with the healthcare ecosystem.

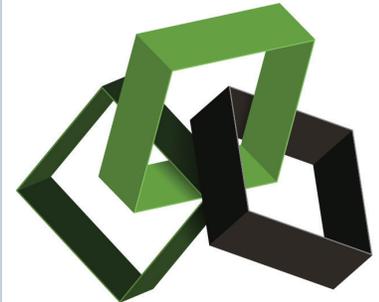
While today's senior housing value proposition does not regularly provide formal healthcare, it does offer support in the form of socialization, nutrition, and assistance with activities of daily living that can positively impact residents' overall health. Given

the general acceptance of these social determinants of health by the CDC as well as CMS's expansion of supplemental benefits under Medicare, the senior housing industry now has an opportunity to claim a real seat at the healthcare table. Future healthcare payment reform may align the interests of senior housing operators with other players on the healthcare continuum including upstream care providers and payors, with the dual aim of lowered cost and improved health.

That said, this alignment poses both opportunities and challenges for operators.

### Opportunities:

- **Improved care coordination may lead to better outcomes:** Care coordination is the deliberate organization of a patient's care and includes information sharing across care providers so a patient receives as safe and effective of care as possible. Involving the senior housing operator enhances care coordination and can lead to reduced hospitalizations and improved overall health because they are uniquely positioned to track senior health on a daily basis and implement care plans after a health episode.
- **Increased revenue:** Assuming care coordination is successful in extending senior health and independence, lengths of stay should increase, supporting a higher property occupancy for longer. If length of stay increases, resident acuity may increase over the longer term, generating higher care revenue. Operators can also realize revenue upside by offering their own Medicare Advantage plan, although this comes with downside risk if operated poorly.
- **Cost savings:** CMS's expansion of allowed supplemental benefits to include things like transportation, nutritional services, and personal care means that Medicare Advantage beneficiaries will see certain private pay services paid for by their plans. The broader promotion and coordination of Medicare Advantage plans in the senior housing industry could help offset the cost of senior housing for individual residents.
- **Healthcare industry is moving in this direction:** The Affordable Care Act (ACA) brought with it an emphasis on medical care delivery that lowers the costs of healthcare. Despite uncertainty of healthcare at the federal level, there remains a focus on improved outcomes and reducing cost. If the industry trends towards integrating senior housing with healthcare, regardless of federal mandate, an operator could eventually face a competitive disadvantage or even obsolescence if it doesn't participate.



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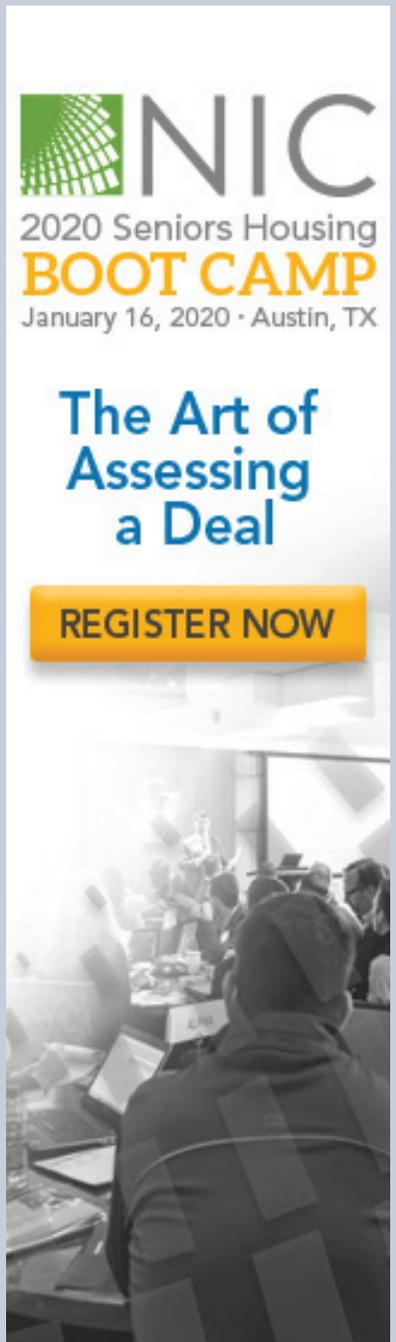
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**Threats:**

- **High cost to implement:** Whether it be the cost for electronic health record (EHR) technology or hiring and training of additional staff, integration may not be affordable. Costs may outweigh the benefits, especially if an operator or investor weighs it against other uses of capital and return on investment. When the ACA was passed in 2010, it included considerable incentives for acute care providers to adopt, implement, upgrade, or demonstrate meaningful use of EHR, but those incentives don't exist for senior housing operators today.
- **Increased regulatory risk:** Providing more care in-house as well as inviting Medicare as a payor means increased government regulations, which are subject to change and may be applied inconsistently. This drives more licensing and certification risk to a community than it has today. An operator is also at risk by association with key care partners, given their operations and reputation may be impacted by their partners as well.
- **Government reimbursement:** Some senior living operators exclusively provide private pay services to avoid the government as a payor. Providing onsite care covered by Medicare means an operator becomes subjected to (or increases its) "stroke of the pen" risk if reimbursement is cut. It also adds administrative costs and complexity associated with submitting for government payments.
- **Distraction to the core business:** The complexity of integrating with the healthcare ecosystem (e.g. new technology, more training, new partnership coordination, billing Medicare) will take resources away from providing assisted living care to seniors, which may be detrimental to the operator's reputation for its core senior housing product.
- **Many unanswered questions:** Will the building take on more of an institutional quality and feel less like home if more healthcare services are added? Will at-risk healthcare entities be able to influence where a beneficiary lives? How can integration be rolled out in a standard way given the industry is fragmented and each market is different? With turnover high at both communities and third-party providers, how will this impact sustainability of the local relationships that are necessary for successful coordination?

As healthcare payment reform hasn't yet been formally addressed, it is up to the senior housing, healthcare, and payor players to figure out if and how to work together. There is no one right answer, but operators and investors should avail themselves to all of the information available to decide what is best for their respective businesses.



## Seniors Housing & Care Industry Calendar

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12/9–10.....AHCA/NCAL Population Health Management Summit for Long Term and Post-Acute Care Leaders, Washington, D.C.

### January 2020

1/16.....NIC Seniors Housing Boot Camp, Austin, TX

1/22–24.....ASHA 2020 Annual Meeting, Palm Desert, CA

1/28–30.....IREI 2020 Visions, Insights, & Perspectives (VIP) Americas, Dana Point, CA

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