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In the Insider January Issue

Freddie Mac: We're There When You Need Us

Steve Schmidt

Set to celebrate its twentieth year in the seniors housing market with a record-breaking 2018 lending volume, Freddie Mac is growing production as it continues to lead the nation in financing for the sector. NIC chief economist Beth Mace recently talked with Steve Schmidt, national director of senior housing at the Federal Home Loan Mortgage Corporation (Freddie Mac). They discussed what Freddie Mac has to offer, how the organization approaches lending and where it fits into the market, both today and in the near future.

Mace: Steve, can you tell us about yourself and your role at Freddie Mac? How long have you been at Freddie?

Schmidt: I manage our national seniors housing production team for Freddie Mac. In that role, I manage a staff of seniors housing loan producers and analysts. Together, we originate new seniors housing loans throughout our network of 17 seniors housing mortgage sellers and servicers. I've been with Freddie Mac a little over ten years; before that I was with Merrill Lynch healthcare real estate, GE Capital, and Heller Real Estate Finance. I have over 30 years of experience in commercial real estate mortgage financing.

Mace: How long has Freddie Mac been involved in the seniors housing and care sector?

Schmidt: We've been in seniors housing lending since 1998.

Mace: Why did Freddie Mac enter the space?

Schmidt: Our charter is to provide mortgage financing to the housing markets that is affordable, dependable, and liquid, which means readily available during both up and down cycles or dislocations of the market. Seniors housing fits that well. I think it was evident even in 1998 that the growing seniors housing market was attractive for Freddie Mac to enter.

Mace: What share of your overall book of business is seniors housing?

Schmidt: It's generally around 4-5% of our multifamily business.

Mace: How much business did you underwrite last year?

Schmidt: In 2017, we executed $3.6 billion of seniors housing financing. It was a record year for us. 2018 will exceed what we did last year.

Mace: Do you have a reason for that?

Schmidt: Yes, we're really good at what we do, but beside that, the more macro reason, which has been true for the last three years or more, is that the big three REITs rarely use mortgage financing. They use unsecured debt. With them becoming

really net sellers rather than net buyers of seniors housing real estate during the past few years, the need for seniors housing mortgage financing has greatly increased. Also, there's obviously been a lot of building going on over the last four to five years. A lot of those buildings need to be refinanced out of construction loans and we've seen a lot of that. In general, there's been continued strong acquisition activity driven by all the new equity capital that's been coming into the seniors housing space over the last four to five years as well.

Mace: You don't do construction financing, is that right?

Schmidt: We don't in the traditional sense. We provide floating and fixed-rate debt for both acquisitions and financing, and those loans can either be stabilized or have value creation potential, as we term it. Value creation potential can come from properties that are leasing up, new unit additions, changing the acuity mix, from independent living to assisted living units, for example, and there are other avenues of value creation as well. So, while we don't provide construction financing in the classic sense, we have several loan programs that work well with renovation and new unit and common area additions that are being made in existing seniors housing properties. Our charter does not allow us to do ground-up senior housing construction loans.

Mace: What do you like about the seniors housing and care sectors?

Schmidt: Speaking more from the heart than the pocket book, I like that we're fulfilling a crucial need. Our low-cost, accessible financing helps our borrowers provide quality seniors housing, care, and socialization for our nation's elderly. We are laser-focused on working with experienced and successful operators. That not only makes our job rewarding, but results in what I think is probably the best loan performance in the seniors housing sector.

Mace: Is your delinquency and default rate close to zero?

Schmidt: We have zero delinquencies and zero defaults.

Mace: How does that compare to multifamily?

Schmidt: I can't speak to the exact numbers, but our multifamily loan performance is stellar also. It is in the single basis point range, which is low compared to the banking and CMBS sectors, which are in the double-digits.

Mace: Is there anything about the seniors housing sector that makes you worried?

Schmidt: What worries me most in the near-term is the overbuilding of seniors housing properties. Roughly a quarter of the markets are over-built. Our thesis all along has been that, by sticking with strong owners and operators, eventually the coming wave of new seniors will take care of that. The thing that worries me the most in the medium- and long-term is whether the industry can hire and develop enough quality operators and staff to meet that demand over the next two decades. Those weren't top-of-mind worries five or ten years ago.

Mace: Do you provide debt financing to all seniors housing segments?

Schmidt: Yes, but to be clear, as with Fannie, our charter prohibits us from financing any property that derives more than 20% of its NOI from skilled nursing. That's sort of a cut-off point between Fannie and Freddie on one side and HUD and the FHA on the other. We're not chartered to do that kind of business. We do provide financing for for-profits, not-for-profits, entry fee and rental CCRCs, and single properties as well. There's no property type we favor over another. Each loan is evaluated on its own merits.

Mace: Can you tell us how you work with your seller and servicer network?

Schmidt: We originate, underwrite, and close all of our loans through seventeen seniors housing mortgage seller servicers. Depending on need, we either underwrite sequentially or in parallel with them. We don't delegate underwriting to seller servicers and then fund the loan without taking a very careful look at it. I would argue that's one of our strengths. Underwriting every deal helps us understand each deal's particular needs and challenges. That usually leads to the customized terms and loan structures that meet the borrower's needs. Our stellar loan performance is, in my opinion, a function of us getting to know our deals so well.

Mace: Does your group ever disagree with your mortgage sellers and servicers, on assumptions, or pro forma, for example?

Schmidt: Yes, there are occasionally differences of opinion, but we generally work to get the right numbers, whether that's proceeds, or rate so long as they know how we look at things.

Mace: Do you offer different types of financing options?

Schmidt: We've got fixed and floating rate loans, obviously. We do loan terms of 5, 7, 10, 12, and 15 years, and variations of that. We have our standard loan for stabilized properties; we have a lease-up loan program. We have a float to fixed loan program where the loan floats for a couple of years and then converts to a pre-determined fixed rate, for properties that are creating value. Typically, those would be used when somebody is doing something to a property, such as adding units or doing a conversion. We also have green advantage loans. A big part of our volume comes from our structured pool transaction program. We can customize terms to meet what the borrower's trying to do with that pool. There can be fixed and floating rate debt components and customized pre-payment and release terms. By customizing them we can balance them off how they might be priced. By working with the borrower and the seller servicer, we can get to the best place, that provides the most flexibility at the best price. Those are our main programs.

A very important differentiator for FMAC is that all of our loans enable the borrower to hold the spread for 75 days upon signing of the loan application. Combining that with, at the borrower's option, our ability to lock the Treasury rate enables a borrower to eliminate interest rate risk during the underwriting and closing process. With today's volatile Treasury rates and credit spreads, this is a feature our borrowers have found immensely valuable.

Mace: Recourse or non-recourse?

Schmidt: They're non-recourse except for standard borrower carve-out provisions or standard bad boy acts. So as long as you behave in a legal and ethical manner, the loan is basically non-recourse.

Mace: Is there anything else you'd like our readers to know and understand about using debt finance through Freddie, particularly for anyone new to the industry?

Schmidt: Something we're known for, and that we take pride in, is our ability to structure our transactions to achieve the best results. We have a long history of doing that successfully. Also, we take the time to get to know our borrowers, operators, and their deals. We go outside the box when necessary to make a good transaction happen.

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

Schmidt: We typically look for a minimum of 10 years of experience. We've often financed the very first transaction for a new borrower group, but what's important is that the individuals within that group had that experience and a successful track record. We're very operationally focused because we want to be promoting the best care out there. That leads to the best outcomes because the best operators' properties are rarely not full.

Mace: When do you turn down an opportunity? Are there any immediate red flags?

Schmidt: The most immediate red flag is when the operator or borrower has had regulatory issues. If they were cited for something critical in their operations that really causes us to take pause.

Mace: What is your outstanding balance?

Schmidt: Freddie Mac has been securitizing our seniors housing loans since 2009. Because we basically sell the loans into the securities market, we guarantee a senior portion of those loan pools. We might do a pool of, say, 70 loans for a billion dollars. The first maybe 85-90% would be guaranteed by Freddie Mac. The first loss position of 10-15% is purchased by third party private equity capital. You have to paint a very draconian economic scenario for Freddie Mac to ever suffer a loan loss given we're selling off the vast majority of the risk to 3rd party private capital. We're providing very affordable liquid financing to the market, and yet we're not exposing the tax payer to the kind of risk they were exposed to prior to the conservatorship that took over Freddie Mac and Fannie Mae. In terms of what we have on our balance sheet, it's just the legacy loans from 1998-2009.

A different way of answering your question is to say we've financed well over $20 billion of seniors housing loans since inception of the program in 1998. Before I joined in 2008, the annual volume was never over $1 billion, so it's very back-ended, if you will.

Mace: Where is pricing headed? Will valuations be affected by a higher interest rate environment?

Schmidt: I'm not an economist, but from what I'm reading, I believe interest rate hikes are going to be modest. I think the Fed is starting to recognize that there are

some things happening in the economy that might make it less wise to continue quarterly increases. Spreads, however, have been widening in this market, which is true of all fixed-income where equities are being bashed.

Mace: Is there further room for cap rate compression? Where will cap rates be in 12 months?

Schmidt: In terms of cap rates, I would think there's much more bias for increases than for compression, but I don't anticipate a huge increase. There's still a lot of equity capital chasing the returns. When you look at returns in other commercial real estate, seniors housing is still very, very good on a total return basis. That continues to bring more capital into the market, not less. In general, real estate doesn't move in lock-step, increase for increase between interest rates and cap rates. There's an inflation hedge to real estate and all kinds of economic reasons why you shouldn't expect a 1% increase in cap rates when interest rates rise 1%. To me, it seems cap rates are going to range into a fairly narrow band for the next year or two, looking ahead.

Mace: Any worries that keep you up at night?

Schmidt: No, I love the business. We're growing. We've hired a lot of new production, underwriting, and legal staff. We're open for business. We are here for thick and thin. I mean, during the recession, we were financing every day through enormous economic strife. Freddie Mac was there every day, in the market, lending; not just putting out quotes that couldn't be executed, but quotes that were marketable and attractive. We're there when you need us.

Underwriting Healthcare in Private Pay Seniors Housing

Joel Mendes

The 2019 NIC Spring Conference will feature a number of breakout sessions designed to help attendees navigate the sector's changing dynamics, including a panel discussion titled "Underwriting Healthcare in Private Pay Seniors Housing." Joel Mendes, Senior Vice President, Seniors Housing Capital Markets at JLL, was a chief architect of the session, and will moderate the panel, which will be the opening breakout session at the conference. NIC recently talked with Mendes about the topic, the breakout session's panel assembled to tackle it, and what conference attendees can expect from the discussion.

NIC: Why don't we start with a little bit about yourself?

Mendes: I work in JLL's Seniors Housing Capital Markets team. We provide debt, equity, and investment sales services to seniors housing owners, operators, and developers nationally. An area of focus for me within the team is providing joint venture or preferred equity. We are engaged on a number of projects currently, several of which are large equity raises for high-end private-pay urban developments.

NIC: Tell us about the focus of this NIC Spring Conference breakout session and how it came to be.

Mendes: I'm on the Planning Committee for the upcoming NIC Spring Conference. We got together and brainstormed about the educational content we think would be most beneficial to attendees. The committee wanted to communicate how healthcare is being delivered within the private-pay space currently, and how that may change over time as the broader healthcare system and the traditional private-pay arena begin to speak with one another. Those dialogues are going to end up having an economic impact, and we wanted to convey how that economic impact will unfold, where it is at today, and where it might be in the future.

NIC: Why is understanding healthcare important?

Mendes: There is a thesis which is growing in popularity that the traditional private-pay independent living, assisted living, and memory care space is going to need to understand the healthcare payment system, at least more so than they do currently. Some folks feel that, in the extreme, this understanding will be required for an operator to survive. A less extreme view is that the understanding will be important in order to thrive. Private equity, REITs, and individual investors who deploy capital into independent living, assisted living, and memory care properties will increasingly be looking to their operating partners for this understanding to drive additional value.

NIC: Can you point to any signs that things are changing right now?

Mendes: Well, the landscape appears to be changing already. Historically the private pay sector, from a profit and loss perspective, was relatively straight forward. You had rent, level of care fees, and various other income sources coming in as revenue, and you had expenses coming out. The care being provided at the property level was not heavily integrated with the broader healthcare system because it didn't appear to be economically necessary or advantageous. Right now, there are operators that have already started putting wheels in motion to try to capitalize on what they believe to be an economic opportunity within the broader healthcare space. They will be able to provide some of the services within their properties that either they're already providing or that they'd like to provide going forward and be paid from new sources. That new revenue may soon be augmenting their traditional private-pay revenue.

NIC: Please say more about these new sources of revenue.

Mendes: The most obvious one is Medicare Advantage. But when you say Medicare Advantage to a private-pay investor, they view it as something only applicable to skilled nursing. But there are large operators, with Sunrise Senior Living being perhaps the best example, that are creating their own Medicare Advantage plans. They see an economic opportunity, as well as an opportunity to provide better healthcare to residents in their properties.

NIC: How will the breakout session help conference attendees to understand this issue?

Mendes: The session's concept is to follow the path of a fictional resident, an 86-year-old woman we named Mary. She'll start off living at home but will have an accident and go to the hospital. She's discharged, has a brief stay in a skilled nursing property, and ends up in assisted living. We'll utilize Mary's journey to describe how the healthcare system functions currently, from both a practical and an economic perspective, and, of course, how the assisted living property plays into that system. She'll live there for several years, and will have typical healthcare requirements during that time, before she eventually moves into hospice. We're going to show how each event along Mary's path affects the bottom line of the property itself. We're going to do that in 2019, and then in 2025, and compare the two scenarios.

NIC: Who can we expect to see on the breakout session's panel?

Mendes: We have an all-star lineup that includes John Rijos, Chris Winkle, and Jerry Taylor.

John Rijos is the co-founder of private equity firm Chicago Pacific Founders and the CEO of their seniors housing operating subsidiary CPF Living Communities. John is also the former Co-President and COO of Brookdale. He helped grow Brookdale from 20 or so properties to over 600. John is somewhat of an industry sage and is at the forefront of a lot of the Medicare Advantage activity within private-pay senior housing.

Jerry Taylor, Executive Vice President at Solera Senior Living, was formerly an Executive Director, and then a Regional Director, with Senior Lifestyles Corporation. Most of his seniors housing experience is at the onsite property level. He was also the Director of Business Development at the REIT NHI, so he has significant investment experience. He's going to walk us through the 2019 scenario. Within the investor world, most folks just haven't experienced what exactly goes on at the property level when healthcare events occur. Jerry will guide us through the logistics of it all, as well as the economics.

Chris Winkle, the CEO of Sunrise Senior Living, will take us through 2025. Sunrise, one of the largest private pay operators in the country, has already created their own Medicare Advantage plan, so they clearly buy into the thesis. Chris is going to help us understand what might be going on, from an investor's perspective, in the private-pay arena in 2025. He's a respected, authoritative voice who can speak to the economic opportunity with specificity.

NIC: That panel sounds fascinating, in and of itself. Can you tell us how far along the NIC Spring Conference Planning Committee believes we are already, regarding this central thesis?

Mendes: The answer to that question varies from individual to individual. In fact, there was significant discussion about whether 2025 was the right date for our speculative resident journey. Some felt that 2022, or 2020, or now would be the right time, while others felt that 2030 was more appropriate. 2025 was right in the middle.

NIC: Will your breakout session's panel reflect this difference of opinion?

Mendes: Clearly Chris Winkle and John Rios have bought into the care coordination thesis today. They are ahead of the curve, if there is a curve. Hopefully they'll be able to describe what they're doing now and that others, more widely, will be doing in the future. They will also be asked to address the dissenters of the idea.

NIC: To what extent are investors looking into healthcare in independent living, assisted living, and memory care today?

Mendes: I'm at the center of literally hundreds of investor questions on the projects that we're working on. These are some of the smartest people I've ever met, but healthcare in assisted living is just not top of mind. They never ask about it. Picture a Venn diagram: on the left, you have the investor's circle, and on the right, the operator's circle. In the middle the two areas of expertise overlap. On the investor side, where the operators are not involved, there are things like: where are they in their investment period; what internal rate of return hurdles are they targeting; how much capital do they have left to deploy into various types of opportunities. On the operator's side there are issues like making sure employee benefit plans are marketable and that vendor contracts are properly negotiated. In the middle, top of mind to investors and operators alike, there's a big area that includes the proposed rental rates, the level of care fee structure, the proposed margins, and how these metrics compare to the market. New supply is certainly in the middle area as well. Right now, to the extent that healthcare is in the private-pay discussion, it is on the operator's side of the diagram, on the far right.

I think, as we approach 2025, and as investors look for ways to maximize their returns, healthcare will start to move towards the middle of that Venn diagram along with rents, market analysis, and margins. At some point, questions about healthcare and tracking outcomes may be ubiquitous in the private-pay space.

NIC: From the investors' point of view, what are going to be the key challenges and opportunities relevant to healthcare in the next several years?

Mendes: The biggest challenge is just becoming educated. The broader healthcare system is exceedingly complex. It will require a deliberate focus to extract, from all the resources available, the information that applies to the sector. This session will try to direct folks to seek out the most relevant information. That should help what might otherwise be an overwhelming challenge.

NIC: Speaking of information, what kinds of data do you think will be important to investors as they begin to look at healthcare and outcomes?

Mendes: Data has a huge role now, but it's a different type of data. Right now, we review market demand, demographic growth, occupancy, margins, etc. The data we'll be reviewing in the future will include tracking outcomes within an individual operator's portfolio. We'll look at how their rehospitalization rates compare to their peer group. Most of that data doesn't even exist right now within the private-pay arena. The prevailing opinion is that it's not all that important in the current market, despite some strong opinions to the contrary. I think that over time, it will become increasingly more important, and that those folks who are at the forefront of it will stand to benefit.

NIC: Is the thesis we're discussing a real opportunity right now?

Mendes: You have to think about how it affects your revenue and expenses at the property level. Right now, in the private-pay space, outside of a few notable exceptions, it doesn't really tangibly affect the bottom line of a property in a way that can be easily quantified. That's why it hasn't been a focus. When there are Medicare Advantage plans that direct, or even potentially incentivize, their enrollees to go to a certain subset of assisted living facilities that provide better outcomes, then those questions will start being asked more regularly. If you are an operator, and you start tracking these outcomes now, if and when that time comes, you will be able to empirically demonstrate to Medicare Advantage plans, or whomever it might be, that you are focused on providing those outcomes. You might therefore see higher census and longer lengths of stay. Those things absolutely affect the bottom line. There are also other potential revenue sources that might then come into the picture. Things that right now are being paid for at the private-pay rate might, in the future, be paid for by Medicare Advantage. Things like medication management and palliative care, for example.

NIC: Do you have a goal for the breakout session?

Mendes: The primary goal is to inspire investors to want to understand the relationship between their investments and the broader healthcare system. It might not be an opportunity they want to pursue, but I think it will be. Even if it's not, it should be an informed, educated decision that they make.

The "Underwriting Healthcare in Private Pay Seniors Housing" session will take place at the upcoming NIC Spring Conference in San Diego, at 2:30 on Wednesday, February 20. Further information can be found here.

M&A Activity Reveals a Wave of Innovative Partnerships

Recent months have seen a spate of headlines announcing novel merger and acquisition (M&A) deals that blend capabilities and services in an effort to better serve America's elders. Underlying much of this activity is an awareness both that the expectations and behaviors of aging boomers are very different from former generations and that the businesses, which will serve their needs, must adapt and develop new collaborative partnerships across the spectrum of care in order to succeed.

Several recent M&A deals appear to be designed to deliver better outcomes at lower cost, as healthcare organizations seek to expand care beyond traditional boundaries. A good example of this is the recent merger of Louisville, Kentucky-based BrightSpring Health Services and PharMerica, the nation's second-largest institutional pharmacy operator.

As quoted in a December 12, 2018 McKnight's article, titled "BrightSpring, PharMerica to Merge," Jon B. Rousseau, president and CEO of BrightSpring explains: "Together, we will have an unmatched platform and opportunity to drive improved patient outcomes and reduced costs through integrated care models–combining our community-based health services and pharmacy capabilities. Our complementary

services will have new and valuable benefits to our clients, patients and customers." When Welltower, a major healthcare REIT, and ProMedica, a regional health system, acquired the real estate of HCR/ManorCare in an 80/20 joint venture, and ProMedica acquired the operator, the $4.4 billion deal spawned many headlines. A Modern Healthcare article announcing the move, "ProMedica to Acquire HCR ManorCare" shed some light on the vision driving it: "When you look at the trends in inpatient care and how care is shifting to those settings, either you continue to fight it or you say, 'We've got to get all in,'" said ProMedica CEO Randy Oostra. "It's a little bit of a leap."

Major drugstore chains also hit newsstands with unexpected vertical integration. In a mega-deal that is still creating news, CVS is acquiring the insurer Aetna. As this Fortune headline says, "CVS's Aetna Acquisition Will Be This Year's Biggest Deal." Walgreens, another major drugstore retailer, announced partnerships with two senior health clinics in Kansas City. A Forbes piece on the news, titled "Walgreens: Humana Senior Clinics May Be Primary Care 'Template' In Many Stores" opens with the statement that "Walgreens Boots Alliance seems more convinced every day that its partnership with Humana developing senior health clinics is critical to the drugstore chain's future growth as a medical care provider in the U.S."

Giant online retailer, Amazon, recently increased the pressure on its brick and mortar competitors by gaining the ability to enter the prescription drug business in all 50 states through its acquisition of Pill Pack. As this CNBC headline declares, the unusual acquisition may be a sign of a major disruption: "Amazon shakes up drugstore business with deal to buy online pharmacy PillPack."

Numerous recent articles point to another form of partnership that is developing across the senior care landscape. As this piece in Senior Housing News: "Maplewood Teams With Connecticut Hospital on $100 Million Health Center," points out, "Collaborations between senior living providers and hospital networks is an emerging industry trend. For example, a planned $400 million life plan community in Utah will include a relationship with Intermountain Healthcare, a Utah-based health system that has 22 hospitals, more than 180 clinics and its own health insurance plan."

In August, headlines announced another hospital system's merger with a skilled nursing company. In an August 17 article in *Skilled Nursing News*, titled "Good Samaritan-Sanford Merger Clears Regulatory Review, On Pace to Close in 2018," Kelby Krabbenhoft, president and CEO of Sanford, states, "We feel strongly that this visionary plan will be modeled throughout the United States to offer a continuum of care throughout one's life. Having no objections during the government's regulatory review confirms our beliefs. We're excited to move forward."

Silo-breaking activity is occurring in other new partnerships, as well. An August 15, 2018 Reuters article, "Best Buy to acquire health services company GreatCall for $800 million" sheds light on the underlying strategy: "The health space is a large, growing market in which technology can address the needs of aging consumers, their caregivers and payers. There are approximately 50 million Americans over age 65, a number that is expected to increase by more than 50 percent within the next 20 years, Best Buy said."

Walmart recently partnered with health insurance giant, Anthem. Articles such as this Healthcare Dive piece, "Anthem, Walmart partner on MA program aimed at improving OTC access" feature senior executives explaining their vision: "We believe that programs like this can make a tremendous difference for healthcare consumers who often live on a fixed income or are managing chronic medical conditions," said Felicia Norwood, Anthem's executive VP and president of its government business division."

Look for more headlines, and more innovative partnerships, as the value-based world drives healthcare players, and payors, to seek new ways to improve outcomes while reducing costs. While the scale of healthcare and seniors housing and care collaborations is still relatively small, these headlines reveal that it is no longer something that happens only in the future. The news of the day is that, when it comes to seniors housing and healthcare collaborations, the future is now.

The upcoming NIC Spring Conference, to be held in San Diego, California, February 20-22, focuses on the seniors housing & care sector's emerging need to collaborate with healthcare. Further information can be found here.

Welcome to seniorcare.nic.org

Since its founding in 1991, NIC has seen numerous market changes, recessions, regulatory upheavals, and policy shifts. Today, the seniors housing and care sector is facing another major disruption, brought about by several factors at once. Our healthcare system is moving from a fee-for-service payment and delivery model to a value-based system. Policy is shifting to place risk on providers and reward improved outcomes achieved at lower total cost of care. A new generation of seniors is living longer, will need and demand more effective and coordinated care delivery, and has a different view of what it means to live well as they age.

Players in various healthcare silos and payors, many of whom would have had no interest in sitting down with our sector previously, are beginning to take an active interest in settings that are home to several million frail seniors with multiple chronic conditions and functional needs each day. As we recently argued in the October Insider, it will be necessary in this new environment for the seniors housing and care sector to develop new partnerships, as it collaborates with healthcare organizations, both upstream and downstream, to meet the needs of our residents in a value-based world. There is a lot to consider for anyone who hopes to navigate the challenges and opportunities presented by these changes today. Traditional seniors housing and care providers, as well as upstream and downstream healthcare organizations and payors, have a lot to learn about each other, if they are to collaborate. That is why NIC is launching the seniorcare.nic.org microsite.

This new microsite is an important part of NIC's response to the need for collaboration between seniors housing and care and new healthcare partners across the spectrum of care. Through the curation of relevant headlines, op-eds, case studies, white papers, videos, and other materials, this unique microsite will offer a wealth of thought-leadership, news, data, analysis and commentary relevant to this emerging shift in the market. It is designed to inform, and to encourage contributions

from leaders across both healthcare and seniors housing and care, particularly on the new "Housing and Healthcare" blog, which is a central component of the site.

The "Housing and Healthcare" blog will feature interviews, original articles and analysis, along with commentary on news items and trends. It is a platform both for NIC to distribute analysis and for contributors to voice their perspectives. NIC's intent is to encourage an open exchange of ideas, strategies, solutions, and commentary that could help decision makers to navigate the exploration of collaborative partnerships. The more perspectives and voices the blog reflects, the more it will become an essential – and unique – resource.

Recent headlines have announced an accelerating spate of merger and acquisition activity, much of which reflects new partnerships across old silos. Leading journals are already publishing news and analysis on the emerging need to deliver healthcare services to seniors beyond traditional retail and healthcare venues, while news is increasingly breaking of corporate efforts to capture the promise of added value and cost-savings through new value-based partnerships. Every headline to be found on seniorcare.nic.org links to a story that is relevant to our sector.

Some organizations are blazing new trails already. The microsite includes case studies that provide for more in-depth and detailed analysis of partnerships that are being tested in today's markets. Relevant research and analysis will be found on the site for download or will link to host-sites. The site also links to a variety of NIC resources relevant to our central thesis that, in the future, seniors will increasingly demand, technology will increasingly enable, and payors will increasingly pay for healthcare services to be delivered where they live. Current partnerships promise to be only the beginning of a great opportunity for all seniors housing and care providers that are currently home to between 2.5 and 3.0 million seniors.

NIC conferences feature a host of educational sessions and presentations, many of which are highly relevant to the concept of collaboration across housing and healthcare. The 2019 NIC Spring Conference, in particular, will focus on the thesis, and has attracted a small but growing cadre of leaders from the healthcare industry. In service to our mission, NIC made its relevant conference content available on this microsite as well, to help encourage education and the sharing of ideas. Anyone interested in the seniors housing and care industry's thought-leadership, ideas, and analysis of healthcare collaboration and partnership will value the content now available to them.

The new site is now live and can be explored at seniorcare.nic.org. NIC also encourages those interested in learning more to consider the upcoming 2019 NIC Spring Conference, which focuses on this topic.

Thoughts from NIC's Chief Economist

Beth Mace

A new year is once again upon us. And what will 2019 bring for the economy and the capital markets, seniors housing, and skilled nursing sectors? Here are some thoughts on these topics.

The Economy Slows But Grows

By most accounts, 2019 should prove to be another relatively strong year for the U.S. economy, although growth will likely be slower compared with 2018. GDP projections range from 2.2% to 2.8% (after growing by an estimated 2.9% in 2018), monthly job growth is expected to average between 110,000 and 150,000 positions (195,000 in 2018), and the unemployment rate will likely continue to decline further to historic lows of less than 3.5% (3.7% in late 2018). Inflation is projected to remain mostly benign, averaging between 2.1% and 2.5% (2.5% in 2018), while average hourly earnings are projected to accelerate toward 3.4% during the year (3.0% in 2018). For assisted living, wage pressures may be even stronger, after having increased by 4.3% from year-earlier levels in the second quarter.

The Federal Reserve is expected (by many, but not all prognosticators) to continue to increase the Fed funds rates toward 2.75% or higher by year-end 2019 from an estimated 2.25% at year-end 2018, and the yield curve may flatten out further, with the 10-year Treasury yield closing out 2019 close to 3.5% from 3.2% at year-end 2018. The impact of this will be higher borrowing costs but also higher rates of returns for consumers and savers.

However, there are many risks that could derail this generally positive outlook for 2019. First, as the fiscal stimulus associated with tax cuts and federal spending fades and the lagged impact of monetary tightening intensifies, the economy could slow more quickly than anticipated, decelerating in 2019 toward 2% before a deeper deceleration in 2020 occurs, with many economists calling for an outright recession. Second, with the House controlled by the Democrats and the Senate and the White House controlled by Republicans, general gridlock in Washington could undermine business and market confidence. Third, escalating protectionist trade policies could disrupt global supply chains, reduce economic growth world-wide and raise consumer and producer prices. Fourth, as the Fed shifts its policies from years of being accommodative to more restrictive policy; higher interest rates, and the value of riskier assets such as equities, high yield bonds, and commercial real estate could change, causing a significant market correction.

Seniors Housing Remains Challenged

The big challenge for the seniors housing sector anticipated for 2019, as it was during 2018, will continue to be a squeeze on NOI from both the revenue and expense side. On the revenue side, despite strong absorption, even stronger new supply has put downward pressure on occupancy in many markets, with the NIC MAP 31 Primary Market occupancy rate averaging 87.9% in the third quarter, the lowest occupancy rate in seven years. On the expense side, historic low unemployment rates are

helping to drive higher labor costs, which generally comprise approximately two-thirds of an operators' expenses. These downward pressures on NOI growth are happening at a time when valuations may also be pressured from higher interest rates.

Continued labor shortages for the entire spectrum of employees from front line staff to executive directors will mean increased competition for quality staff among new and existing communities. Construction projects started in 2017 and 2018 will open in many markets, adding pressure to occupancy and rate growth. However, as has been stated many times, not all areas of the country are facing the same development pressures, and some markets will continue to see occupancy rates in the low 90% range. There also will be emerging, and growing opportunities associated with value-based care for seniors housing operators.

Skilled Nursing Confronts Policy Changes

The skilled nursing sector faces a myriad of challenges associated with policy changes related to reimbursements and a shift to a value-based health care system and shorter lengths of patient stays. But savvy operators also face a myriad of promising opportunities, as operational bed counts continue to decline and as the industry responds to another change in Medicare reimbursements in October 2019: PDPM. As a result of PDPM, there may be a spike in M&A activity if smaller operators opt not to undergo the changes, bowed by the complexity and cost of adjusting to this new system. Meanwhile, other operators will use scale to more efficiently adjust to these changes.

As always, I welcome your feedback, thoughts, and comments. Let's keep the conversation going.

Beth

NIC Skilled Nursing Data Initiative: The Latest Trends from Third Quarter 2018 Release

Bill Kauffman

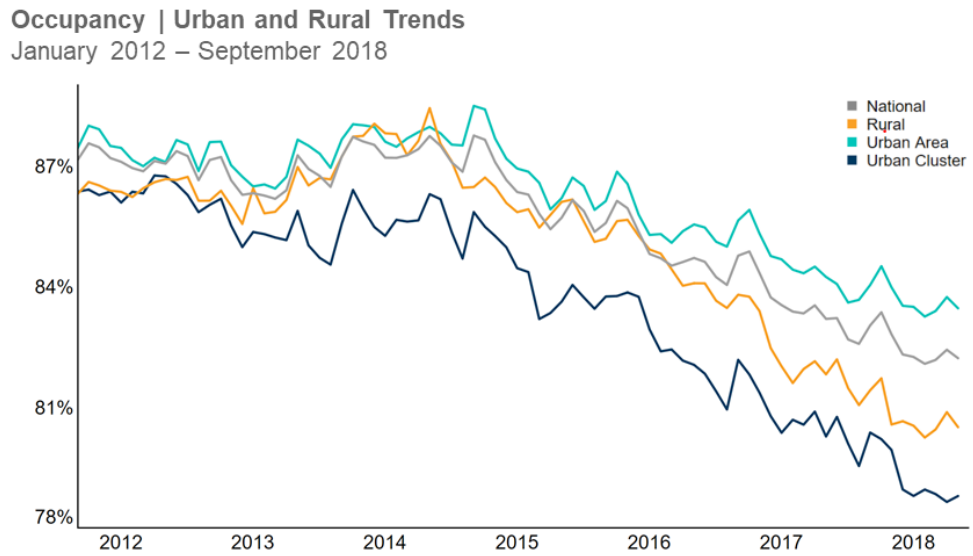
NIC has worked to increase the quality of data in the skilled nursing sector over the past few years. During the past year, NIC added additional metrics to the Skilled Nursing Data Report which is released every quarter. The additional metrics added were revenue mix trends by payer type, including managed Medicare, and urban vs. rural trends.

NIC continues to add additional contributors to the report's data collection which now stands at 27 operators. The operators submit data to NIC every month and receive a complimentary benchmark report for doing so. The data represents national, aggregate figures. NIC plans to grow the data set, adding more operators and properties to produce state-level reports. NIC welcomes the participation of operators nationwide in this confidential data collection process.

The latest quarterly Skilled Nursing Data Report was released last month (i.e., December 2018) with the most recent trends in the sector. Let's look at some of the key takeaways from that report.

Occupancy

Although one quarter does not make a trend, the third quarter 2018 report brought some welcome news to the sector as overall occupancy increased 14 basis points to 82.2% in the third quarter. The quarterly increase is notable because occupancy has declined or been flat between the second and third quarters for the past three years. In addition, occupancy has been relatively flat over the past six months and oscillating around the 82% range. However, it was nearly a full percentage point below year-earlier levels.



Source: NIC Skilled Nursing Data Initiative

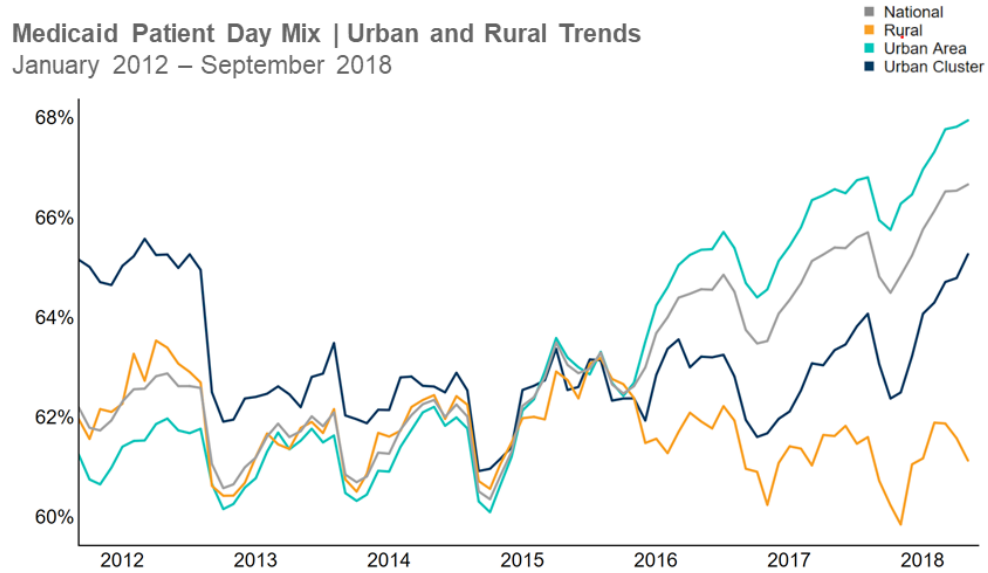
Occupancy has been challenged on many fronts over the last few years, including pressure on lengths of stay from Medicare Advantage insurance plans and competition from home health as more patients have been discharged directly home from the hospital instead of entering a skilled nursing facility. So why the relatively stable occupancy trend over the past six months? One answer might be the fact that supply and demand are coming into balance. However, it would be prudent to see if the trend continues into the spring of 2019 as the sector navigates the typical seasonal pattern with the flu season and winter months. This time period can make it challenging to see how the demand side is truly playing out.

Occupancy trended up quarter over quarter in both urban and rural areas, but it was down in urban clusters. Occupancy finished the third quarter at 83.5% and 80.5% in urban and rural areas, respectively.

Medicaid and Private Patient Day Mix

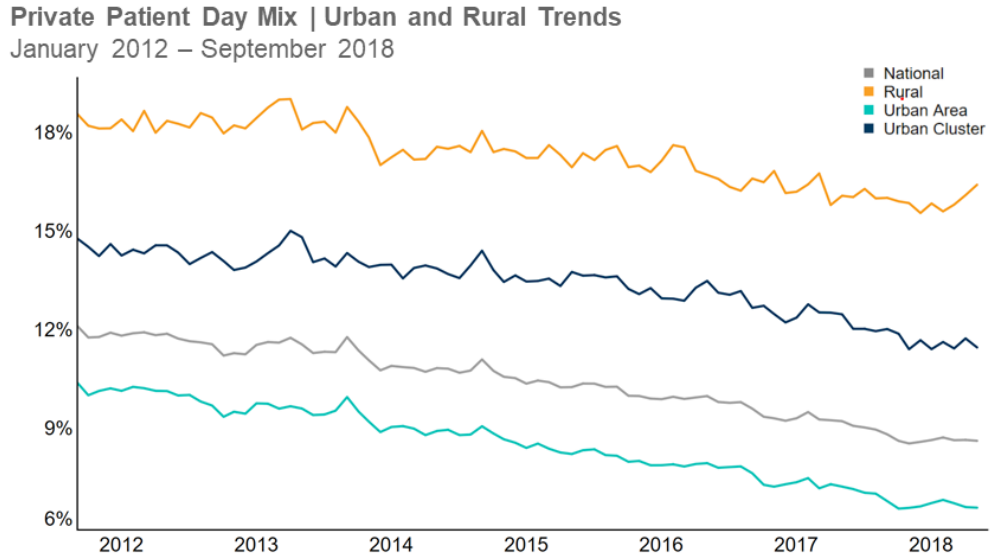
The data suggests that the steady occupancy performance in the third quarter was partly driven by consistent Medicaid demand. Medicaid patient day mix increased

to a time-series high of 66.7% in the third quarter. The combination of this and the relatively steady performance in private patient day mix help to explain the third quarter occupancy trend. The Medicaid patient day mix increase was driven by urban areas which rose to a time-series high of 67.9%. Medicaid patient day mix ended the third quarter at 61.1% in rural areas.



Source: NIC Skilled Nursing Data Initiative

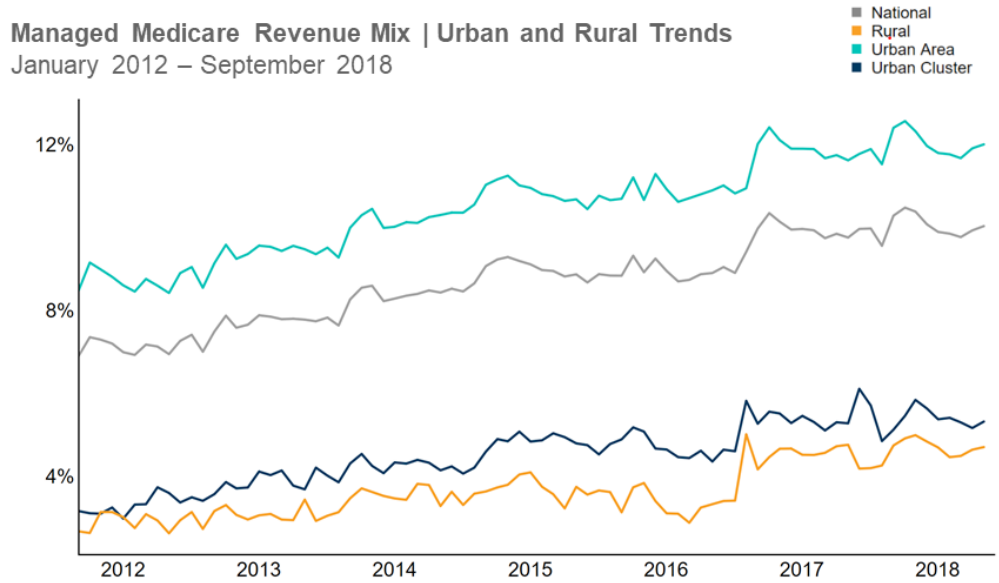
Private patient day mix held relatively steady overall now at 8.6% as of the third quarter 2018. Private mix in rural areas was up from the prior quarter and year-earlier levels but still down by 188 basis points over the last five years and is now at 16.4%. Urban areas showed a decrease from the prior quarter and from a year ago down to 6.6%. The large difference between urban and rural areas is most likely due to less options available for private pay in the rural areas, hence the private pay mix is significantly higher in rural areas.



Source: NIC Skilled Nursing Data Initiative

Managed Medicare

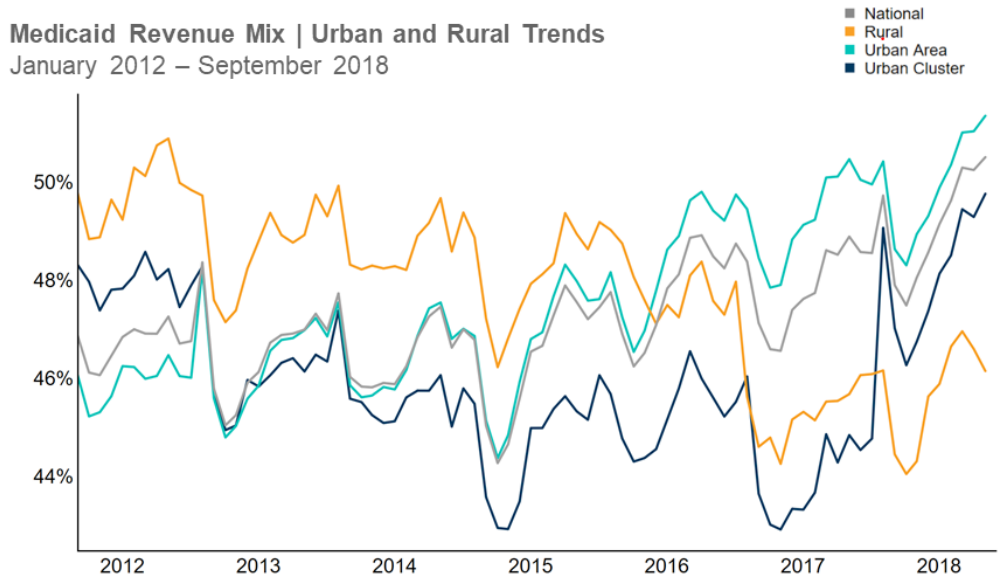
Managed Medicare has continued to play a growing role, as expected, over the past few years in the skilled nursing sector and it is likely to continue to play more of a role in the years ahead. The latest report shows its patient day mix increased 7 basis points from the second quarter of 2018 to 6.5%. However, the increase appears to be moderating because it was only up 13 basis points compared to one year ago.
The relatively small increase from last year was driven by urban areas, up 22 basis points, as rural areas were slightly down. At 10%, managed Medicare revenue mix was up quarter over quarter and year over year. Managed Medicare now represents 12% of revenue in urban areas but only 4.7% in rural areas. However, it has grown over the past few years in rural areas, albeit slowly.



Source: NIC Skilled Nursing Data Initiative

Medicaid Revenue Mix

As stated earlier, regarding the Medicaid patient day mix, Medicaid is an important part of the skilled nursing business. That is also evident when looking at the latest Medicaid revenue mix trends, as it reached a time-series high of 50.5% in the third quarter 2018, up 88 basis points from the second quarter of 2018 and up 162 basis points from a year ago. The quarterly revenue trend is driven by the urban areas, just like the Medicaid patient day mix, as rural area Medicaid revenue mix was down from the prior quarter. Although the lowest payor in terms of revenue per patient day (RPPD), Medicaid RPPD grew at the fastest pace over the past year relative to the other payor types in this data set, rising by 2.0%.



Source: NIC Skilled Nursing Data Initiative

For additional information and trends The NIC Skilled Nursing Data Report is available here. There is no charge for this report.

The report provides aggregate data at the national level from a sampling of skilled nursing operators with multiple properties in the United States. NIC continues to grow its database of participating operators in order to provide data at localized levels in the future. Operators who are interested in participating can complete a participation form. NIC maintains strict confidentiality of all data it receives.

Seniors Housing & Care Industry Calendar

January 2019

1/22-24	IREI 2019 Visions, Insights & Perspectives (VIP) Americas	Carlsbad, CA
1/30-2/1	ASHA Annual Meeting 2019	Ranchos Palos Verdes, CA

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