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In the Insider November Issue

A Dose of Perspective: Ally Bank's Steve Anderson Talks With NIC

Steve Anderson

A longtime healthcare lender, Steve Anderson has experienced the industry's highs and its lows.

As managing director at Ally Bank Healthcare Capital, he's concerned lately about the flood of new capital, product oversupply in some markets, and the availability of labor. But in the long run, he's optimistic about technological changes that can improve building performance and resident satisfaction.

NIC's chief economist Beth Mace recently talked with Anderson about Ally's offerings and where the seniors housing market is headed. Here's a recap of their conversation.

Mace: Ally Bank is an online-only bank. What does that mean and what are the differences between that and a traditional brick-and-mortar bank?

Anderson: Ally Bank's offerings are online via our website and app. We have no brick-and-mortar locations. Ally made that choice when the bank was launched in 2009. In 2014, we became a public company (Ally Financial, NYSE: ALLY), which is based in Detroit. The bank's goal was put the money that would have been spent on brick-and-mortar locations toward excellent customer services available 24/7, competitive rates, and low fees.

Mace: Do you think Ally has lost anything without brick-and-mortar locations?

Anderson: We've actually had 39 quarters of record breaking growth and double-digit growth annually in deposits and customers. We just hit 10 years and it has been a phenomenal story.

Mace: Where does healthcare fit into your corporate structure?

Anderson: The healthcare group is a balance sheet lender that is part of Ally's Corporate Finance division that focuses on senior secured lending to middle market companies. I'm based in Chicago, and we have approximately 20 professionals dedicated to healthcare real estate and asset-based lending located in Maryland and New York.

Mace: How long have you been lending to the seniors housing and care sector?

Anderson: I personally have been actively lending in healthcare for more than 25 years and seniors housing for the past seven. Our team, which has largely been lending in healthcare together since 2002, joined Ally in 2017 to 2018 and making our first loan in July 2017. We made our first seniors housing loan in August 2017.

Mace: Are you a domestic lender or do you lend outside the U.S.?

Anderson: We are a domestic lender. We have the capability to lend in Canada, but everything we have done so far has been within the U.S.

Mace: Are there any markets you prefer?

Anderson: Naturally, there's more stress in some markets than in others. But there's no one market we stay away from in seniors housing unless it is obviously overbuilt. Skilled nursing is very different with state specific reimbursement, budget, and labor topics being very important to our decisions

Mace: Do you prefer urban or rural markets?

Anderson: It really doesn't matter as long as the asset can be supported by the market it's in. We recently closed on a $176 million financing supporting a publicly traded investment

firm's acquisition of a portfolio of 17 assisted living and memory care properties along the East Coast operated by a local company. Some of the properties are close to large metropolitan statistical areas (MSAs), while others were in more rural markets.

Mace: Do you offer construction loans?

Anderson: We do not have a development or construction financing product but can participate in large construction loans led by other lenders. Everything we've closed to date has been acquisitions, refinancings, or recapitalizations of stabilized or mostly stabilized assets.

Mace: Do you work with the debt agencies, Fannie Mae & Freddie Mac?

Anderson: We do not, and that was a strategic choice by us to only do balance sheet lending. We work with a lot of lenders that work with the agencies, and we can provide bridge financings for acquisitions that might transition to agency loans over time.

Mace: Do you finance all types of seniors housing?

Anderson: We lend on everything from independent living and assisted living to skilled nursing, CCRCs, and medical office.

Mace: Any property type you prefer?

Anderson: We like medical office, although it's currently a very competitive asset class with stable risk dynamics that attract many banks as well as life insurance companies. As a team, we've done more skilled nursing over the last 15 years than any other property type. We understand the reimbursement environment very well; so we're comfortable lending there.

We like seniors housing a lot. We understand the industry dynamics, and we're watching equity pour into the sector, some of it from investors who may not understand seniors housing as well as others. When a deal hits my desk, the first thing we do is open the NIC MAP data base to understand the market. We also want to find the best sponsors and operators. Not everything goes perfectly all the time, so we want to pick the right partners who can work with us through situations when they arise.

Mace: Do you lend to operations?

Anderson: We don't provide operating company cash flow loans but, specific to skilled nursing and other reimbursed sectors of healthcare, we provide working capital asset-based loans secured by third-party accounts receivables.

Mace: Does the working capital loan originate with your group?

Anderson: Yes.

Mace: What terms and rates do you offer? What's your loan limit?

Anderson: All our loans are variable rate and terms are mostly three to seven years. We don't have a size limit on the upper end, but our loans range from about $25-$30 million to $250 million. Our average deal size right now is about $50 million or so, but we have a capital markets team in New York that supports us on larger deals to provide syndication strategies.

Mace: Was the East Coast portfolio a syndicated loan?

Anderson: Yes, our capital markets team was involved in that from the beginning.

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

Anderson: We look for someone with experience investing in healthcare real estate, and experience in a downside scenario. We want to know borrowers have patient strategies and good operating partnerships—people who have been there and done that. We like funds-based investors that can invest further into an opportunity, alongside of us,

if a problem comes up. Operators are the other part of the equation. It's important for sponsors to have good relationships with operators with good outcomes.

Mace: When do you turn a lending opportunity down? What are some red flags?

Anderson: As I mentioned, the first thing we do is look at NIC MAP. A market with a lot of stress—overbuilding or properties having trouble reaching stabilization—is a big red flag. We do not turn it down immediately necessarily, but, if the sponsor doesn't have a good story as to how they're going to compete in that market, it's tough for us to get excited about a situation like that.

We look at the capital structure. It can be a challenge if the structure is light on equity or has a lot of mezzanine debt and not enough institutional capital. We want all the interests to be aligned.

We don't like older properties as much as newer ones. There's so much new product out there, we've had the luxury to invest in properties 5 to 15 years old rather than 20 to 30 years old. But there's nothing wrong with older properties as long as they've been kept up.

Mace: What do you think the opportunities and challenges are for seniors housing today and in the long term?

Anderson: The biggest challenges are the oversupply of product and labor shortages. Technology represents an opportunity. Innovative technology should benefit seniors over the next three to seven years and improve their experience in senior living.

Mace: Do you ever turn down opportunities because of the labor market?

Anderson: There have been situations where labor made a difference. For example, we looked at a deal in a popular retirement area on the Gulf Coast of Florida. The building was gorgeous and moving toward stabilization, but it was starting to run into labor issues. Laborers were finding work closer to where they lived. That created a challenge. We were conservative and offered a low loan-to-value ratio. We didn't do the deal.

Mace: What else concerns you?

Anderson: There are a lot of distressed construction loans out there. A building might be at 55% occupancy after being open for three years and need to be refinanced. If we can figure out how they're going to get to stabilization, we have an open mind and willingness to consider creative structures and credit enhancements that help keep incentives aligned and share the risk of achieving stabilization.

Mace: Any other comments?

Anderson: It's an exciting time. Many call aging baby boomers a silver tsunami. But it's more like waves lapping up on the beach. The seniors are coming, but it's a slow sale process to get families to make these decisions. I was around in the 1990s when a lot of investors lost money because they thought 75-year olds were going to move into assisted living. There is so much money chasing the industry, and we want it to grow, but you have to tiptoe occasionally. We don't want to get ahead of ourselves.

Thoughts From NIC's Chief Economist

By Beth Burnham Mace

Beth Burnham Mace

While recently attending the 2019 National Association of Business Economists (NABE) Annual meeting, several ideas were discussed that are relevant to our sector and interesting to consider. First, have you ever wondered why interest rates are relatively low compared with historical norms? Well, it may in part be related to our aging society.

Lower Long-term Interest Rates. At the conference, there was a discussion about the impact of an aging society (a result of falling fertility rates and rising longevity across much of the globe) and its effects on interest rates. The theory is two-fold. First, an aging population influences interest rates through the savings rate. Because older adults tend to spend less and save more, a higher savings rate increases the supply of loanable funds that banks can lend out and thereby lowers interest rates. Further, increased longevity, fewer defined benefit plans, uncertainty related to the solvency of Social Security, and anticipation of longer periods of retirement may be drivers of even higher savings as prospective retirees want to be prepared for a potentially longer retirement period.

Second, an aging population and slowing population growth limit the supply of available workers in an economy which leads to slower, overall economic growth, provided there is no change in the productivity growth rate. As the economy's capacity declines, the natural rate of interest rates also potentially declines.

In addition, in the U.S. as well as in Japan and Western Europe, other effects of an aging population may include higher health care costs, potentially unsustainable pension commitments, and changing demand drivers within the economy.

Demographic Tail Winds? Interesting, and not always a topic of discussion in seniors housing circles was a demographic discussion about millennials (Gen Y) and post-millennials (Gen Z), those born between 1981 and 1996 (currently age 23 to 38) and 1997 to 2012 (age 7 to 22), respectively.

Based on these cohort definitions, millennials now outsize the baby boomers (73 million in 2019 versus 72 million), while Gen Z are not far behind (67 million). The growth of these two cohorts is important because of the potentially offsetting impact they may have on:

- slowing labor force growth,
- declining working age populations (those aged 15–64),
- rising old-age dependency ratios, and
- the slowing economic growth generally associated with the aging of the baby boomers.

A Morgan Stanley study released in January of this year carefully examined this emerging demographic bulge and asserts that labor force growth may in fact be stronger than currently estimated by the Congressional Budget Office (CBO) beyond 2024. "Powered by the economic machine of the Gens Y and Z, the prime working-age population is projected to accelerate into the 2030s," according to the research. If this is indeed the case, stronger labor force growth could power stronger GDP growth between the 2020s and 2040s, and thereby create a less dire outlook for Social Security and Medicare solvency. In theory, faster growth in the pool of workers covered by Social Security and Medicare should help support the programs' sustainability.

Further, the study asserts that the slowdown in labor force growth associated with the aging of the baby boomers can be more than offset by the "youth jolt" of Gen Y and Z, and thereby allow the U.S. economy to grow well beyond that of its G10 peers.

While no one's crystal ball is perfect, the Morgan Stanley report does cause a pause for thought.

Chairman Powell. On the last day of the conference, Federal Reserve Chairman Jay Powell gave a presentation to the group and responded to inquiries from the audience. Naturally, the topic of inflation and disinflation came up, and Chairman Powell responded by talking about the Fed's dual mandate given to the Fed in 1977 by Congress of "promoting effectively the goals of maximum employment, stable prices and moderate long-term interest rates". To meet the price stability objective, Federal Reserve policy makers are currently targeting an inflation rate of 2%. For people and businesses to plan, Powell explained, they need to be relatively confident that prices will remain relatively constant over time. He also briefly mentioned the role and influence of an aging population on inflation.

Further research that I conducted concludes that economists disagree on whether population aging is inherently inflationary or deflationary. A November 2016 study from Societe Generale concludes aging populations generally lead to greater spending on pensions and health care, while simultaneously causing the labor force and the broader economy to slow. Combined, these factors increase expenditures, reduce the tax base, and add stress to federal budgets and deficits. If the response to these conditions is fiscal consolidation, slower economic growth may result and put downward pressure on inflation or even lead to disinflation. If the response to these conditions is printing money, however, inflation may result.

So, the answer to the inflation/disinflation question is "it depends," and it depends largely on the response of the government to the situation. In Japan, where the aging population situation has existed for longer than anywhere else, the result is significant disinflation. Time will tell how U.S. policy makers respond.

Market Fundamentals Show Signs of Improvement. Third quarter data from the NIC MAP® Data Service showed improvement in market fundamentals for both assisted living and independent living. The assisted living occupancy rate increased to 85.4% from its record low of 85.1% during the past three quarters, as relatively robust demand outpaced new inventory growth. Meanwhile, the occupancy rate for independent living 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.

Construction within the 31 Primary Markets as a share of inventory for majority assisted living properties also decelerated and equaled 7.3% or 22,000 units in the third quarter. This includes all properties under construction from start until completion and was the lowest rate since 2015 and down from a peak of 10.0% in late 2017. At 21,000 units, construction of independent living was almost the same as for assisted living but accounted for a lesser share of overall inventory at 6.2%.

Since 2017, annual growth in the average same store asking rents 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 was not as consistent, and annual asking rent growth was 3.0% in the third quarter. 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. Based on anecdotal comments from operators, the Bureau of Labor Statistics (BLS) estimate of 5.9% seems to be a more accurate reflection than past readings of the upward pressure operators have been experiencing for wage growth. For many operators, labor expenses amount to roughly 60% of their expenses, so rising wage growth is taking a toll on their ability to maintain and grow NOI.

As always, I welcome your comments and feedback. Beth

2019 Fall NIC Talks Recap

NIC Talks returned to the 2019 NIC Fall Conference, offering fresh ideas that inform, challenge, and inspire thinking about aging and longevity. Eight speakers, most from outside of the seniors housing and care industry, offered innovative ideas in response to the question: "How Am I Changing the Future of Aging?"

We recapped each of these inspiring NIC Talks, and encourage you to view the talks in their entirety on NIC.org.

Age-Friendly Health System on the Horizon


Terry Fulmer

One of the greatest success stories of our time is the increase in life expectancy. The opportunity now is to celebrate longevity by creating an age-friendly health system.

Terry Fulmer, president, The John A. Hartford Foundation, noted that we can't have age-friendly cities unless we have an age-friendly health system. The framework for an age-friendly health system consists of the 4Ms: What Matters, Medication, Mobility and Mentation.

An age-friendly health system starts with what matters. Healthcare providers should ask their patients what matters to them instead of what's the matter. The answer will provide the best approach for care. For example, a very sick woman with multiple conditions wanted to be able to garden again. "That was the goal," said Fulmer.

Medications should be monitored with a watchful eye on side effects. Mobility is often the first concern of elders. They want to be able to move about freely. Clinicians should work toward that goal.

Mentation or cognition is key in elderly adults. Depression is not a part of normal aging. It can be treated. Cognitive changes could indicate a need for hearing aids or new glasses.

Fulmer ended with a challenge to the audience. "What will you do differently to create an age-friendly health system?"

What Do Baby Boomers Want?

Senior living owners and operators are trying to figure out exactly what type of community will appeal to the coming wave of aging baby boomers. Jody Holtzman has some ideas. He is senior managing partner at Longevity Venture Advisors, and an expert on branding.


Jody Holtzman

"It's a myth that baby boomers are locked into brands," said Holtzman. They have always been interested in new things. Boomers are not all the same, but they do share certain qualities. They question authority, prize self-sufficiency, and are aspirational.

What baby boomers are seeking stands in contrast to how they view senior living, said Holtzman. Boomers think of nursing homes when someone mentions senior living. "We need brands that lift the spirit," he said.

Senior living companies tend to brand themselves with terms like "quality care" or "the best in senior living." Holtzman said a brand should be a differentiator and sell the product. He pointed to the example of Latitude Margaritaville, a 55-plus community with a Jimmy Buffett-inspired lifestyle. "The challenge is to create a place that becomes a metaphor for living," said Holtzman.

A New Era of Transportation

Tim Woods

Self-driving vehicles provide a big opportunity to the senior living industry. No longer do elders need to drive to get where they want to go.

Caregivers are also freed from having to drive the elder to the store or appointments. "We are enabling independence," said Tim Woods, general manager, Autonomous Vehicle Alliance. Woods spotlighted a vehicle he called, "The Box on Wheels." It is a barrier-free vehicle with a no-step entry that can accommodate any type of passenger, including those in wheelchairs. The vehicle can park itself. It measures the sidewalk height and can drop to that level so the passengers do not have to navigate any steps. "The technology exists today," said Woods.

Hospital systems are interested in the vehicle. It could be used to take patients to the doctor's office for follow-up visits in order to avoid a hospital readmission. The vehicle could be equipped with other technologies that weigh the passengers or take their blood pressures.

Woods noted that other industries are interested in autonomous vehicles. Imagine Disney World with barrier-free vehicles to transport guests. "If you design a vehicle for those with disabilities, you have created a vehicle for everyone," said Woods.

Telehealth: The New House Call

Modern technology is making old-fashioned house calls possible again—a return to a time when the doctor traveled to see the patient.

"Health care delivery will be virtualized," said Yulun Wang, chairman, founder & chief innovation officer at InTouch Health. Seniors will be able to receive care in their own homes via digital platforms. Frail elders who can't travel will benefit most. Telehealth will connect seniors to the specialists who treat complex conditions. "Large tech companies are moving into health care," said Wang. "We are in the midst of a transformation."

Yulan Wang

Telehealth could also help curb rising healthcare costs. Simple issues can be treated early before becoming a big problem that results in a hospital visit.

Wang doesn't foresee the end of traditional doctor office visits but envisions a telehealth system that complements office care. Another innovation will be the telemedicine kiosk, a station to check the vital signs of residents at a senior living facility. "We can greatly improve the health care delivery system," said Wang.

Elevating Human Connection

Thomas Grape

After years of growth at Benchmark Senior Living, Thomas Grape, Benchmark chairman and CEO, began to see slowing results across the company. At the same time, he noticed that company culture was suffering.

Grape prioritized a rewrite of the company's purpose and values statements, inspired by the writings of Jim Collins. He reflected on the letters he'd received from happy customers and realized that none mentioned the buildings, food, or physical properties of their communities. Instead,

the letters were all about connections that customers and their families made with the staff. Benchmark's purpose became "elevating human connection."

The staff, Grape said, no longer think of Benchmark as a senior living operating company but as a human connection company—a truly disruptive concept. The renewed focus on the company's purpose has allowed Benchmark to improve experiences for customers and improve employee satisfaction.

"I think all of us need to be asking: what business are we in?" said Grape.

Predictive Analytics for Better Outcomes

How to provide better care at a lower cost is a challenge faced by virtually all senior care providers.


Davin Inns

David Inns, CEO of GreatCall, Inc., believes predictive analytics offers a solution. According to Inns, predictive analytics can be used to improve the well-being of seniors, reduce their health care costs, and provide new revenue stream opportunities for the senior living industry.

"Predictive analytics is the future of senior care," he said.

In general terms, predictive analytics means collecting large sets of data, analyzing the data over time, and using it to predict outcomes. Inns described the "activities of daily living monitoring" used by Best Buy Health that has and will provide a vast amount of data. Tying the data to outcomes allows modeling to predict high cost health episodes and prevent them with lower cost interventions.

Inns expects the use of predictive analytics in senior care will keep seniors healthier and allow them to stay in place longer. He also sees revenue opportunities for providers to get involved with managed care.

Slowing Cognitive Decline

By the time we're in our 80s, nearly all of us will have visible pathology in our brains. But, only some of us will experience evident cognitive decline because of it.


Patricia Boyle

Patricia Boyle, professor, Alzheimer's Disease Center at Rush University Medical Center, described the cause for that difference in terms of resilience. "Increasing resilience is the best way we have right now to guard against dementia," she said.

As part of the Rush Memory and Aging Project, Boyle and her team sought to identify what drives cognitive decline and the factors that can contribute to better cognition as we age. In addition to exercise, healthy eating, and mental stimulation, the team identified a more powerful factor. "We found that purpose in life is one of the most robust predictors of health and wellness in old age," she said.

Boyle found that purpose in life reduces the effects of pathology in the brain, such as Alzheimer's, on cognitive function. "Somehow, purpose in life provides a buffer that actually counters the harmful effects of Alzheimer's disease in the brain."

Boyle recommends senior living providers engage in guided conversations with residents to help them seek out their purposes. And she shared the advice of 88-year-old Ron Miller, "Be open to new people, new ideas, take risks."

Bringing the Generations Together

Marc Freedman

Age integration has fallen out of favor in recent history. "We ended the 20th century as the most age segregated society in the world," according to Marc Freedman, CEO, Encore.org.

And studies show that the trend toward separating generations is detrimental to both the younger and the older generations.

Freedman thinks it's time to reverse the age segregation trend and to recognize the benefits of age integration. "Older people who bond with younger people are 3 times more likely to be happy," Freedman noted.

"2019 is the first year we have more people over 60 than under 18," he said, noting that the older adults have a lot to offer younger generations.

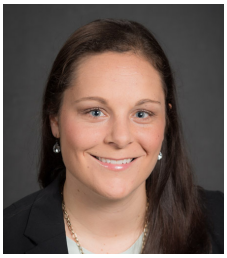
He called upon the NIC Talks audience to think creatively about ways to bring the generations together, rather than keep them apart. Freedman described senior living communities in Seattle and Cleveland that offer innovative strategies for integrating those of different ages. In one community, a day care center is commingled with a senior living community. "The day care waiting list has 500 children on it," he said. Another offers free housing to local college students.

"Rather than trying to be young, we need to be there for those that actually are," said Freedman.

To view these talks in their entirety, visit NIC.org.

Future Leaders Council 10-Year Anniversary Celebration

By Sara Veit, Managing Director, Acquisitions at Hana2.0 Property Group LP



Sara Veit

On the eve of the 2019 NIC Fall Conference, over 100 professionals gathered in downtown Chicago to celebrate the accomplishments of NIC's Future Leaders Council over the past decade. The group was welcomed by NIC's president and CEO, Brian Jurutka who provided an overview of the evening. The Future Leaders Council (FLC) was established in 2009 by a group of forward-thinking NIC leaders with the goal to provide its members with a unique opportunity to help advance NIC's mission and to develop leadership skills and meaningful professional relationships with the current industry leaders.

Allen Lynch, partner at Nixon Peabody and member of the FLC Oversight Committee, kicked off the event by enlightening the crowd to the rigorous selection process completed annually by the FLC Oversight Committee to select its members. FLC is comprised of 25 select professionals who each serve a three-year term. Each member was nominated in a highly competitive selection process given the depth of the talented pool and large number of qualified applicants for the limited spots.

During the celebration the newest FLC Class of 2022 was welcomed:

- Cameron Bell, National Health Investors
- Edward "Teddy" Hillard, Brookdale Senior Living, Inc.
- Ross Holland, Lancaster Pollard
- Kari Onweller, Invesque
- Kendra Roberts, HumanGood
- Adam Rybka, Longview Senior Housing Advisors
- Andrew Sfreddo, Birchwood Healthcare Partners, LLC
- Jason Zuccari, Hamilton Insurance Agency

This year FLC is led by a solid leadership team chaired by Sarah Peerson of Wells Fargo, and vice chairs Fritz Kieckhefer of CIBC and Dana Scheppmann of Capital One.

The work being done by FLC provides its members the unique chance to continue to develop their volunteer leadership skills while broadening their professional network. NIC's goal is to continue to attract emerging leaders with energy, drive and passion to benefit the seniors housing industry and assist NIC in delivering on its mission.

FLC alumni, Ben Firestone, managing partner at Blueprint Healthcare Real Estate Advisors, and Bre Grubbs, senior vice president of Leisure Care, highlighted the evolution of NIC's Boot Camp. Born from an FLC brainstorming idea that identified the need for an educational session for new professionals entering the industry, the Boot Camp evolved to one of the greatest accomplishments of FLC. This past spring, FLC designed, marketed and hosted a stand-alone all-day Boot Camp session in Charlotte for over 80 professionals—a sold-out event. FLC plans to continue to spearhead this event in the future through the leadership of Ryan Chase, Blueprint Healthcare (FLC Class of 2020). The next Boot Camp will take place January 16, 2020 in Austin, TX.

Susannah Myerson, FLC alumnus, and Sarah Peerson, both of Wells Fargo highlighted the accomplishments of FLC's University Outreach and Internship programs. Each year, one of FLC's goals is to expand the number of relationships with universities. The goal of this program is to share with students the growing career opportunities available in seniors housing and care. Additionally, FLC helped NIC launch a new website for companies to post internships and find applicants.

Before the celebration was complete, Paul Mullin, co-founder and principal of Flatiron Development Group and FLC alumnus, highlighted some of the most memorable moments from his FLC experience. In true roasting form, Paul emphasized the importance of developing lifelong relationships that go beyond the FLC's three-year commitment. There are numerous FLC alumni that continue to volunteer with NIC and use their talents to advance our industry.

Bob Kramer, NIC founder and strategic advisor, ended the night by applauding the group's efforts over the past ten years to get the FLC to where it is today. He emphasized that our work here is not done. He challenged the room full of industry leaders to use their unique skills to continue to improve this industry for the next generation of seniors.

The past ten years of FLC were a huge success and the collective is excited for the future evolution of the industry as guided by the new emerging leaders. Thanks both to NIC for your unwavering support and resources and to the FLC alumni community for paving the way for this one-of-a-kind opportunity to impact our industry.

To view the FLC alumni on NIC's website click here.

To view FLC current members in Classes 2020, 2021 and 2022 visit the NIC website.

Navigating Investments During a Period of Rising Wages

By Ryan Chase, Senior Managing Director and Head of Market Strategy at Blueprint

Ryan Chase

My colleagues and I often debate how changes in the market impact different participants in our industry. As market intermediaries, our lens tends to focus on valuation and investment strategy. There are changes to interest rates, occupancies, coverages, rents, regulations, etc. Occasionally, we entertain a debate on the impact of reimbursement shifts too. One trending topic is the impact of rising minimum wages.

Specifically, what is a reasonable investment strategy given minimum wage increases and the impact of rising costs to valuation?

Like our debates about reimbursement illustrate, answers in our industry are becoming more complex. The answer depends on a couple things. First, where is your asset located? There is a lot of variation in minimum wage reform from state to state. (2019 Minimum Wages by State) Second, are you a short-run or long-run holder of a given asset? Answers to both can help craft a strategy for navigating the wave of minimum wage increases continuing around the country.

Taking a step back, we're in unprecedented times with respect to minimum wages at both the state and federal level. Federally, the minimum wage has been $7.25 per hour since July 2009. At over ten years, it's the longest period elapsing between federal minimum wage hikes ever. At the state-level, the opposite is occurring. Legislatures have been busy passing new minimum wage laws. Never have so many states enacted legislation mandating minimum wages that surpass the federal level by so much as today. For example, in 2015 there was just one state with a minimum wage 30% above the federal level, Washington. Today, there are 18 states whose minimum wage surpass the federal's by more than 30%. That number is likely to go up too as 'planned' increases in numerous states are scheduled for the next several years. Soon some states will have a minimum wage that more than doubles the current federal level. Adding yet another wrinkle of complexity to all this, numerous states have (or will have) indexed-CPI bumps once their planned increases are implemented. In sum, this minimum wage thing is a real consideration that any prudent investor should understand when crafting their investment strategy over the next several years. The question is, 'what is the impact?'

To measure this, we need to understand how much labor there is at the community-level and what portion is likely to be affected by minimum wage increases. A sample of 30 seniors housing properties that my team and I recently underwrote indicates salaries & wages tend to range between 44% and 62% of total costs. The sample set includes properties in numerous states and all assets are either stabilized or approaching stabilization. Payroll taxes, employee benefits, and workers' compensation are not included in the percentages above; however, they would also be impacted by rising labor costs. Clearly, operating margin—and therefore valuation—will be sensitive to labor change. Next, as alluded to earlier, the specific minimum wage increase impacting the 44%-to-62% of costs made up by labor depends on an asset's location. In Texas, the minimum wage is $7.25/hour, and it's not set to change. In California though, it's $12/hour now and increasing to $13/hour in January 2020. That's an 8.3% increase. In a vacuum, this will reduce profit margin next year. By how much though?

Using an example from a property in California (see 'Figure 1' below), roughly 60% of the labor is at the minimum wage level (≈$1.18 million of ≈$1.95 million). Applying the 8.3% bump associated with the 2020 increase to all minimum wages at the community increases payroll expenses by a little over $130,000. To have a net neutral impact on EBITDAR in 2020 from minimum wage expense growth at this specific property, it would require an offsetting increase to total revenue of approximately 2.3%.

Figure 1: Example California Property – TTM vs TTM Net of Minimum Wage Increase

BLUEPRINT	TTM			TTM Adjusted for Minimum Wage Growth		
ASSISTED LIVING	83			83		
MEMORY CARE	22			22		
TOTAL AVAILABLE UNITS	**105**			**105**		
OCCUPANCY METRICS	**AMC**	**RevPOR**	**%-OCC**	**AMC**	**RevPOR**	**%-OCC**
Assisted Living	78.5	$4,731	94.6%	78.5	$4,888	94.6%
Memory Care	20.4	$5,921	92.8%	20.4	$6,117	92.8%
TOTAL OCCUPIED UNITS	**98.9**	**$4,731**	**94.2%**	**98.9**	**$4,888**	**94.2%**
REVENUE	**TTM**	**Per Unit**	**%-REV**	**TTM Adj.**	**Per Unit**	**%-REV**
Total Assisted Living	*$4,456,324*	*$4,731*	*75.5%*	*$4,603,778*	*$4,888*	*75.5%*
Memory Care						
Room & Board - Private Pay	$1,161,326	$4,742	19.7%	$1,161,326	$4,742	19.0%
Room & Board - State	$0	$0	0.0%	$0	$0	0.0%
Levels of Care - Private Pay	$288,629	$1,179	4.9%	$288,629	$1,179	4.7%
Levels of Care - State	$0	$0	0.0%	$0	$0	0.0%
Total Memory Care	*$1,449,956*	*$5,921*	*24.6%*	*$1,497,933*	*$6,117*	*24.6%*
Total Discounts	*-$154,482*	*-$130*	*-2.6%*	*-$159,594*	*-$134*	*-2.6%*
Total R&B and Levels of Care	*$5,751,798*	*$4,846*	*97.4%*	*$5,942,116*	*$5,007*	*97.4%*
Community Fee	$34,398	$29	0.6%	$35,536	$30	0.6%
Other Resident Revenue	$119,630	$101	2.0%	$123,589	$104	2.0%
TOTAL REVENUE	**$5,905,826**	**$4,976**	**100.0%**	**$6,101,241**	**$5,141**	**100.0%**
OPERATING EXPENSES	**TTM**	**Per Unit**	**%-REV**	**TTM Adj.**	**Per Unit**	**%-REV**
Payroll Expenses						
Salaries & Wages						
Minimum Wage Salaries	$1,177,408	$992	19.9%	$1,275,525	$1,075	20.9%
Non-Minimum Wage Salaries	$769,309	$648	13.0%	$788,541	$664	12.9%
Total Salaries & Wages	*$1,946,717*	*$1,640*	*33.0%*	*$2,064,067*	*$1,739*	*33.8%*
Payroll Taxes	$181,489	$153	3.1%	$192,429	$162	3.2%
Employee Benefits	$197,998	$167	3.4%	$209,934	$177	3.4%
Worker's Compensation	$280,470	$236	4.7%	$297,377	$251	4.9%
Total Payroll Expenses	**$2,606,673**	**$2,196**	**44.1%**	**$2,763,806**	**$2,329**	**45.3%**
Resident Care Supplies*	$49,382	$42	0.8%	$50,616	$43	0.8%
Food & Dietary Supplies	$203,077	$171	3.4%	$208,154	$175	3.4%
Activities	$61,873	$52	1.0%	$63,420	$53	1.0%
Housekeeping & Laundry	$18,490	$16	0.3%	$18,952	$16	0.3%
Marketing	$144,805	$122	2.5%	$148,425	$125	2.4%
General Administrative	$123,920	$104	2.1%	$127,018	$107	2.1%
Insurance	$31,303	$26	0.5%	$32,086	$27	0.5%
Real Estate Taxes	$152,922	$129	2.6%	$156,745	$132	2.6%
Property, Plant, & Maintenance	$149,109	$126	2.5%	$152,836	$129	2.5%
Utilities	$200,263	$169	3.4%	$205,269	$173	3.4%
Bad Debt	$4,012	$3	0.1%	$4,144	$3	0.1%
Management Fee	$295,291	$249	5.0%	$305,062	$257	5.0%
TOTAL OPERATING EXPENSES	**$4,041,118**	**$3,405**	**68.4%**	**$4,236,532**	**$3,570**	**69.4%**
EBITDAR	**$1,864,708**	**$1,571**	**31.6%**	**$1,864,708**	**$1,571**	**30.6%**

Keep in mind that minimum wage will be $15/hour in California by January 2022, which is a 25% increase from today. Using the example and same math from above, a 7.0% increase to revenue is needed to have a net neural impact to EBITDAR and offset the planned minimum wage bumps through 2022. Each state falls somewhere on the spectrum between Texas and California. Navigating the impact requires diligence at the state, and sometimes municipal level.

The example above controls for the direct impact of minimum wage increases by holding other variables constant. We know the world doesn't operate in a vacuum though. A survey of operationally focused NIC Future Leaders Council ('FLC') members and alumni asking for their opinion on the indirect impact of minimum wage increases to non-minimum wage paying jobs demonstrates this point. While the results are inconclusive to the magnitude of wage growth for non-minimum paying wage jobs, one thing is conclusive: almost 90% of the survey respondents believe that minimum wage increases will increase non-minimum wage paying jobs in all departments of a community. In the California example from Figure 1, this implies that the 'Non-Minimum Wage Salaries' (≈$769,000) will be indirectly impacted by the minimum wage increase set to take place in the state. Also, don't forget about inflation. There may be inflationary increases to non-payroll expenses. Annual CPI increases in California have ranged from 1.3% to 3.7% since 2010.

The evidence is starting to show that the deck is stacked against revenue growth outpacing expense growth for states that have large, upcoming increases to minimum wage, in the short run. There are numerous states that fall into this group. Using the California example, we learned that revenues need to increase by 2.3% to offset just the minimum wage bump. Revenues likely need to increase further to offset the labor increases indirectly impacted by minimum wage growth and inflation. Growing both Non-Minimum Wage Salaries and non-payroll expenses by 2.5% would mean revenues must grow by 3.3% to offset expense growth in our example. Based on NIC MAP data, seniors housing rents in 3Q19 for all California NIC MAP markets grew by only 2.9%. Average profit margins in states like California have a real possibility to come down until the state-specific planned increases taper off and wages stabilize once again. Mentioned earlier, this happens in 2022 for California. In other states this happens later, such as Illinois in 2025.

In sum, valuations for property assets in states with large minimum wage increases are likely as high today as they will be for the next few years. This is for a couple of reasons. Key drivers of value are the returns supported by cash flow. The earlier example illustrates that it's possible for same-store cash flow to decrease because of minimum wage growth. If that happens, pricing would need to shift downward in order to allow for the same return on investment. Once these planned increases are complete, it is more likely that revenue growth can outpace expense growth as we've traditionally observed, and operating margins may widen once again. It may take a few extra years to get to get back to where we are today though, should the increases truly result in slightly lower operating margins in the interim. Also, from a macro standpoint, interest rates and returns demanded by investors (cap rates, etc.) are almost as low as they've ever been. It's hard to imagine an environment where they are materially lower. It actually is easier to imagine the opposite. Putting it all together, we may see a period in some states over the next several years where margins first narrow and then proceed to widen, while simultaneously, there's a risk of interest rates and returns creeping upwards.

This brings us back to the original question of finding a reasonable strategy for navigating these upcoming changes. If you're a long-run holder, this likely doesn't matter. Costs can go up; margins may decay in the short run and then expand again in the long run. Valuations may be as high, or higher, than they are today once we go through the full cycle. The downside is that the cycle may not be short, but volatility in price should be less of a concern for a long-run holder. As a short-run holder, knowing that valuations today may be as high as they will be over the next several years is noteworthy. It's reasonable to pursue ways to lock in today's value with debt, equity capital or to potentially consider an exit to a different long-run investor having less sensitivity to near-term price fluctuations that may or may not materialize.

Seniors Housing & Care Industry Calendar

11/5.....Middle Income Seniors in 2029: A Customer Profile, Senior Housing News Webinar

11/12–14.....REITworld: 2019 Annual Conference, Los Angeles, CA

11/13–14.....New York State Health Care Association, 24th Annual Fall Education Conference & Trade Show, Albany, NY

11/19.....Oregon Health Care Association Annual Convention (OHCA), Portland, OR

11/19–21.....2019 NCHCFA Financial Summit, Raleigh, NC

11/21.....Interface Seniors Housing Northeast, Philadelphia, PA

11/17-19.....US News & World Report Healthcare of Tomorrow Summit, Washington, D.C.

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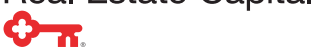

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