NIC

National Investment Center for Seniors Housing & Care

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Lender and Industry Leader Dan Biron Discusses the Mortgage Market and Growing Housing Demand

With more than 25 years of experience in the seniors housing industry, Dan Biron has been an active participant in the evolution of the sector. Overseeing health care finance at several high-profile firms, Biron is currently Senior Managing Director—Seniors Housing at Berkadia Commercial Mortgage LLC, New York. He is co-head of the seniors housing and health care group providing loans through HUD/FHA, Fannie Mae and Freddie Mac, as well as bridge loans from Berkadia. Biron's group only finances seniors housing properties, and expects to close loans in 2015 totaling in excess of $1.1 billion.

Biron recently spoke with NIC about the mortgage market and what's next for the sector.

NIC: Berkadia has recently financed some very large portfolio sales, such as the $648 million purchase by NorthStar Realty Finance Corp. Do you have other big portfolio deals in the works?

Biron: We've done a number of portfolio deals in 2013 and 2014. We were very pleased to do the NorthStar deal, which was an acquisition of 32 independent living buildings. We expect to see more acquisitions, and not just of portfolios. We were just engaged on an assisted living building in Texas for $8 million. Our minimum transaction size is about $5 million, though we'll finance properties below that value if they're in a group of 2-3 buildings.

We are now in the midst of completing financing for two pools of seniors housing properties for publicly-traded companies that have a combined value of about $400 million. The properties are being refinanced now because of concerns about interest rate hikes. Borrowers are worried that interest rates will go up. If interest rates climb, we do expect refinancings to decline.

NIC: Do you think interest rates will rise?

Biron: People have been saying interest rates were going to go up for the last five years. No one has a crystal ball. Many observers expect a rate hike this fall, but time will tell. Many borrowers have already taken advantage of low rates and have refinanced their loans. That said, acquisitions will still need to be financed.

NIC: How would you describe today's lending climate?

Biron: The lending climate has changed in the last four to five years. During the recession a lot of lenders sat on the sidelines, but now banks are back in the space and the lending climate is very strong. We have our fair share of competition. We do our best possible job to execute loans and that's why many clients select us. From the moment we are engaged on a transaction, we work to get it underwritten, present it to the agencies, secure a full commitment, and close the loan. We have a team behind the process which is both thorough and timely.

NIC: Berkadia is one of the top agency lenders. How would you characterize the health of Fannie Mae and Freddie Mac?

Biron: They're still in business. Seniors housing is a line of business that does well for Fannie Mae and Freddie Mac, and they're willing to quote deals and get them done. There were concerns about them reaching their lending caps a few months ago, but they navigated through that issue. At the moment, we don't see any concerns of them hitting the caps for 2015.

NIC: What's the biggest change you've seen in the sector over the last 25 years?

Biron: Nursing homes are changing the way they look at care. The Centers for Medicare & Medicaid Services (CMS) is shifting its focus to compensate operators based on the quality of care. Hospitals are being penalized for patients who are readmitted soon after being discharged. So nursing homes have to change their approach and provide the kind of care that will keep their residents out of the hospital.

Another change is that many independent living operators are re-licensing their entire buildings as assisted living facilities so the resident doesn't have to move when he or she needs more care. Residents of independent living buildings naturally age in place and often eventually need more care. By re-licensing the building, the operator can provide more care to residents in their original apartments.

We're also seeing more use of Medicaid waivers to help pay for assisted living. Many seniors cannot afford the price of private-pay assisted living. More states are experimenting with how to use the waivers to reduce costs. And the GSE's will allow 20-25 percent of assisted living units to be Medicaid eligible. It's a way to make seniors housing more affordable and keep residents in assisted living who might otherwise have to move to a more expensive nursing home.

NIC: What's the biggest challenge facing the industry?

Biron: How do we meet the housing demands of seniors over the next 20-30 years? Today the caregiver ratio of seniors to family members is seven to one. But in 15 years, it will be four to one. The senior population is growing in number and we have to figure out how to meet its needs and create affordable seniors housing. That's a big challenge.

NIC: What's your outlook for the industry?

Biron: I'm glad I'm in this industry. We have growing demand and seniors housing is here to stay for a long time. During the recession, other commercial real estate sectors, such as office and retail, struggled. But seniors housing held its own. There was some decline on the independent living side because the product is less need-driven when compared to assisted living. But occupancy in independent living is growing now in places where the residential housing market has improved.

I have some concerns about overbuilding. I get phone calls every week from people who've decided to get into the seniors housing business without much experience. Before we work with a developer or operator, we make sure they are experienced and have selected an appropriate location based on a strong market study that shows true unmet demand for seniors housing. We pay close attention to those details. But hopefully, seniors housing won't experience the overbuilding we had in the 1990s.

Thoughts from NIC's Chief Economist

Beth Mace, Chief Economist, NIC

I often get asked about key trends in the seniors housing and care space. While there are many, I've highlighted eight notable trends I'm tracking below in this commentary.

1. Capital Markets. Seniors housing and care has become a more mainstream asset class in which to invest. This is evident by the high volumes of transaction activity in both the number of deals and the dollar value of transactions closed. Additionally, pricing is near record highs based on a per unit and cap rate basis. A host of factors are drawing investors into the sector, including:

- Enticing demographics
- Compelling investment returns
- Greater transaction volumes and liquidity in the sector
- Rising transparency and understanding of the sector

- Emerging post-acute care coordination opportunities
- Governmental and social policy changes impacting health care and its costs
- Mounting understanding of the positive social and psychological benefits for residents

2. Real Estate Cycles. Seniors housing, like all commercial real estate sectors, is cyclical, with periods of expansion, contraction and recovery. Today's market cycle can be characterized as expansionary, with construction activity rising in response to the growing economy, low interest rates, promising investment returns and generally rising occupancy rates. The question now is if both developers and the capital markets will have the required insight and discipline to slow capital flows in time to prevent excessive development and overbuilding.

3. Market Fundamentals. Market fundamentals for seniors housing are generally sound and are projected to remain so. NIC projections for the next 12 months show occupancy rates edging higher for both independent living and assisted living property types. At this time, there are probably at least a few property types in a few markets that are approaching hyper-supply, however. For developers, operators and capital providers, it's advisable during this expansion phase of the construction cycle to carefully monitor competitive trade areas for prospective new supply and to adjust, when necessary, business planning and underwriting assumptions regarding rent growth, occupancy and lease-up rates.

4. Bubble Pricing. Market participants are increasingly discussing today's pricing, with concerns that we may be approaching perfection pricing and a bubble may be developing. Some argue that seniors housing has become a core real estate asset type and a steady flow of capital into the sector will support today's prices, while others argue that the sector is becoming overbuilt and a bust is inevitable. In a rising interest rate environment, it is wise to be particularly diligent in gathering market intelligence in underwriting new opportunities and formulating upcoming property business plans.

5. Synergies and Coordination in Health Care. The combination of an aging population and subsequent rising health care needs, social and governmental changes in health care delivery and payment policy, and the need for cost containment is presenting opportunities for post-acute care coordination between hospitals, skilled nursing properties, assisted living properties, independent living properties and ancillary service providers. Because of Medicare provider payment reform, Medicare outlays are shifting from fee-for-service to outcome/value-based alternative payment programs, such as bundled payments, pay for performance and accountable care organizations (ACOs). As a result, opportunities are being created for those businesses that can align themselves in the ACO environment, where costs can be optimized between the post-acute care and acute care worlds of hospitals, physician groups, skilled nursing facilities, seniors housing properties and ancillary service providers. Moreover, those operators that can effectively and efficiently integrate systems and big data that measure outcomes and reduce costs stand to benefit.

6. Opportunity of Technology. Technological innovation is emerging as a great influencer in seniors housing and is affecting all aspects of the sector. From an operations perspective, lead generation is being delivered over the internet, IT systems and big data are allowing senior management to observe real-time changes in their day-to-day performance and operating systems, and remote monitoring of residents is generating staff efficiencies. From a health and wellness perspective, tele-health and virtual care systems have the potential to reduce health care costs and improve health care coverage, for example, by allowing instant video conferencing at call centers with live doctors. Smart phones and appliances, remote sensors, hand-held devices with medical applications, and mobile personalized connectivity applications and software systems have the potential to better allow aging in place, independence and virtual socialization. As these technologies get tested and winners and losers emerge, the operations, real estate, social and medical aspects of the sector will be forever changed.

7. Challenge of Affordability. Today's seniors housing products generally serve the nation's middle to higher income households. Yet, the need for housing for America's elders extends to all income thresholds. Moreover, the need for care outside the home will swell as the caregiver support ratio shrinks from 7:1 in 2010 to 4:1 by 2030. Innovative entrepreneurs and operators are increasingly recognizing this challenge and seeking ways to create a residential community option for seniors that offers housing, care, safety, social engagement and lifestyle. With labor costs accounting for 50% to 60% of a typical operators expense load, and with rising pressures on wages due to an increasingly tight labor market, the challenge is not trivial.

8. Wage Pressures Starting to Mount. Indeed, upward wage pressure is starting to occur in many industries and locations across the nation. This is due partly to tighter labor market conditions as evidenced by the falling unemployment rate (5.3% as of July at the national level and down from 9.9% in late 2009) as well as partly to the recent and planned increases in the minimum wage rate in many cities and states. This will filter through to the bottom line of many operators in the months and years ahead.

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

Beth

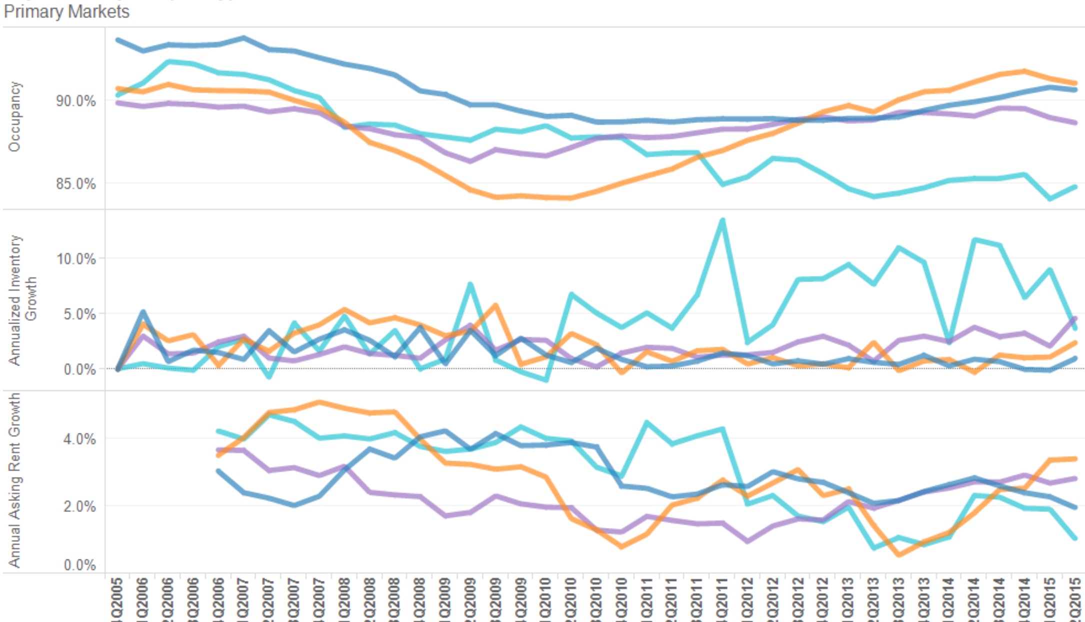
Market Fundamental Snapshots by Campus Type

Chris McGraw, Senior Research Analyst, NIC

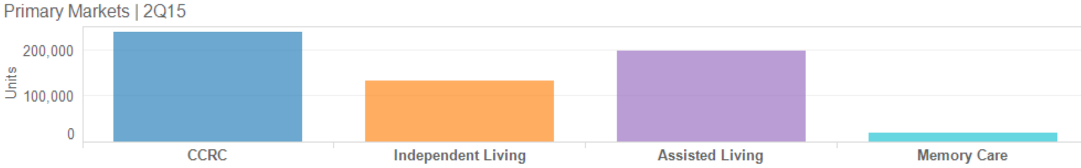
The campus types that constitute the broader seniors housing universe have their own unique set of market fundamentals. Some campus types, e.g. assisted living, are further along their respective market cycles and nearing the point in the cycle that traditionally is highlighted by over-supply. Other campus types like CCRCs were slow to recover initially and, as a result, have significantly less supply risk in the near-term.

Memory care properties continued to see the highest rate of construction, with the number of units under construction representing more than 9% of its existing inventory during the second quarter of 2015. Its annual rate of inventory growth has remained near double-digits for the last two years, which has pushed its occupancy nearly 400 basis points below that of any other campus type. Stabilized properties have fared better than the overall figure would suggest, with their occupancy rate 88.9% as of the second quarter. Asking rent growth has slowed to 1% year-over-year, which may be a byproduct of the amount of supply coming into the market.

Key Metrics by Campus Type
Primary Markets



Inventory by Campus Type
Primary Markets | 2Q15



The rate of construction in assisted living properties cannot be dismissed as easily as memory care, as it has a sizeable inventory base. As of the second quarter, construction represented 6.1% of existing inventory, more than 200 basis points above prior market cycle's peak. Between annual rates of inventory growth accelerating to nearly 5% and the flu season, occupancy has declined by 90 basis points since the fourth quarter of 2014 and is down 40 basis points from a year ago. Despite accelerating supply growth, asking rents have been holding around 2.8% on a year-over-basis for the past year.

Independent living construction has been accelerating recently, but hasn't begun to pressure occupancy yet. Inventory growth has remained relatively tempered to this point, with annualized rates oscillating around 1% for several years, however, it may begin to accelerate as the rate of construction has begun to creep upwards. As of the second quarter, construction represented 4.0% of existing supply, up 70 basis points from a year ago, but still more than 200 basis points below its prior market cycle peak. Occupancy is essentially back to pre-recession levels, and given the uptick in construction and an older resident base, there likely isn't a lot of upside left. Asking rents have accelerated to 3.4% on a year-over-year basis, which may suggest operators are beginning to raise rates now that occupancy has recovered.

Construction in CCRCs continues to oscillate near cyclical lows, representing less than 2% of existing inventory. While it was the last campus type to begin its recovery, the dearth of new supply has benefited fundamentals during the first half of the year. Annual rates of inventory growth have run below 1% since 2010, and based on construction data, inventory growth rates should remain tempered in the near-term. While occupancy dipped 20 basis points during the second quarter, it is the only campus type with net positive occupancy during the first half of 2015 and year-over-year. As its occupancy recovery is still in early stages, asking rent growth hasn't begun to accelerate materially, although still maintaining growth rates above inflation.

Strategic Networking Boosts Results

Paul Nevala and his team have spent the last three weeks talking mostly about the upcoming NIC National Conference. "We know that's where the people we want to connect with will be," said Nevala, principal at American Capital Real Estate Finance, Bethesda, Md. "We're mapping out a meeting strategy," Nevala noted, adding that the NIC Conference this year is a "can't miss event."

Nevala, along with two colleagues, recently left GE Capital to open the newly formed health care finance arm at American Capital. The NIC Conference is a way for Nevala's team to re-establish

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their previous industry connections, but in a different role at a capital provider new to the sector. "The Conference is a super cost-effective way to have a lot of meetings with a lot of people in a short period of time," he said.

Networking opportunities are among the top reasons why industry executives attend the NIC National Conference. It is known as the one yearly industry event that brings together hundreds of seniors housing operators, capital providers and developers.

Attendees will have a variety of opportunities to network at the 25th NIC National Conference, Sept. 30 – Oct. 2, at the Gaylord National, National Harbor. The NIC Conference celebrates its 25th anniversary this year, focusing on the forward-looking theme of "The Next 25."

While the seniors housing industry has attracted interest lately from those new to the sector, veteran attendees of the Conference offer some practical advice on how to network strategically. Sheryl Marcet suggests conducting some upfront homework and taking advantage of NIC's resources. "As much pre-planning as you can do, the more you will get out of the Conference," said Marcet, managing director at Omega Healthcare Investors, Inc., a Maryland-based REIT with over 900 properties, primarily skilled nursing properties.

Prior to the Conference, Marcet searches the attendee list which NIC publishes in advance of the meeting. She reaches out to many contacts and keeps a short list of those she wants to meet with at the Conference.

In addition to the attendee list, NIC hosts an online community where participants can post messages, meet virtually and schedule appointments. The online community goes live August 26.

In addition, attendees will receive a checklist to help them prepare for meetings with prospects and customers. The checklist, "How to Click @ NIC," provides a handy roadmap of successful networking strategies for capital providers, developers and operators.

NIC also provides a variety of networking events and venues at the Conference itself. "NIC has the most amazing networking lounge," said Marcet. "People should totally take advantage of it." She advises attendees to introduce themselves to others. "Have your one-minute elevator pitch ready," she said. "Time is precious."

A number of networking breaks and receptions are scheduled during the Conference. Those new to the industry should consider attending the "First-Time Attendee Mixer," according to Paul Mullin, vice president of development at Silverado, Irvine, Calif. Mullin is an alumnus of NIC's Future Leadership Council and always attends the Mixer, which will be held this year at 4 p.m. on Wednesday, Sept. 4. "It's a really valuable way for new attendees to get to know the leaders of NIC," he said.

Of course, the purpose of networking is to eventually make deals. "The NIC Conference is one of the more meaningful deal-making opportunities," said Mullin. "We've developed and purchased several properties because of relationships we have started at NIC."

Others agree. Omega's Marcet said that the NIC Conference was a good opportunity to talk about deals, get deals started and shop specific deals. "If an operator or provider has a deal, the NIC Conference provides an audience to present that deal to competitors," said Marcet. "It's the perfect opportunity to hit everyone in a two-day time period.

Seniors Housing & Care Industry Calendar

September 2015:

30-2 25th NIC National Conference, Gaylord National, National Harbor

October 2015:

4-7 AHCA/NCAL Convention & Expo, San Antonio, TX

19-21 2015 CALA Fall Conference & Trade Show, Westin Mission Hills Resort and Spa, Rancho Mirage

October 2015:

1-4 LeadingAge Annual Meeting, Boston, MA

11-13 NCREIF Fall Conference 2015, Orlando, FL

17-19 REITWorld: NAREIT's Annual Convention Las Vegas, NV

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