NIC

National Investment Center for Seniors Housing & Care

2015

INSIDER

NEWSLETTER

December Issue

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Genesis Aims for Critical Mass in Key Markets

Ray Thivierge Explains the Giant Post-Acute Care Provider's Strategy

As the chief strategy officer at Genesis HealthCare, Ray Thivierge is focused on "geographic density." The idea is to create a substantial presence in markets to become a viable provider across the continuum of care as the health system transitions from a fee-for-service to a pay-for-performance model.

With extensive experience in the post-acute care sector, Thivierge was previously chief development officer at Sun Healthcare Group, which was acquired three years ago by Genesis. NIC recently spoke to Thivierge about recent acquisitions and future plans at the Kennett Square, PA-based company.

NIC: Genesis completed a large merger earlier this year. What is the status of the integration of the two companies? Why is scale important today?

Thivierge: Genesis HealthCare completed a reverse merger with Skilled Healthcare in February 2015, and previously completed the large-scale acquisition of Sun Healthcare in 2012. Genesis is now the largest skilled nursing provider in the United States. The integration with Skilled Healthcare is running smoothly. We have been able to use the experience and lessons of our integration of Sun Healthcare, and we already had support infrastructure in place in the West where much of Skilled Healthcare's portfolio is located.

Given today's reimbursement environment and value-based purchasing initiatives, scale is very important. With Genesis, we are able to leverage our corporate and regional infrastructure to support our 500+ facilities across the country. We have the benefits that small mom-and-pop operators don't have, and can't afford to have. This includes geographic density, which makes Genesis a viable solution in any given market. We can manage patient flow and take advantage of value-based purchasing because we control a certain percentage of beds.

We also offer clinical specialization and training along with Genesis Physician Services (GPS), a group practice which specializes in the holistic care of sub-acute, skilled nursing and long-term care patients. In addition, we have Genesis Rehab Services—the leading provider of physical therapy, occupational therapy, speech therapy, respiratory therapy, and wellness services for older adults. Also, Genesis Care Transitions offers a new care management solution for patients returning home after rehabilitation in select Genesis skilled nursing facilities. Our goal is to provide patients with the confidence they need to manage their care at home utilizing the healthcare support in their own community.

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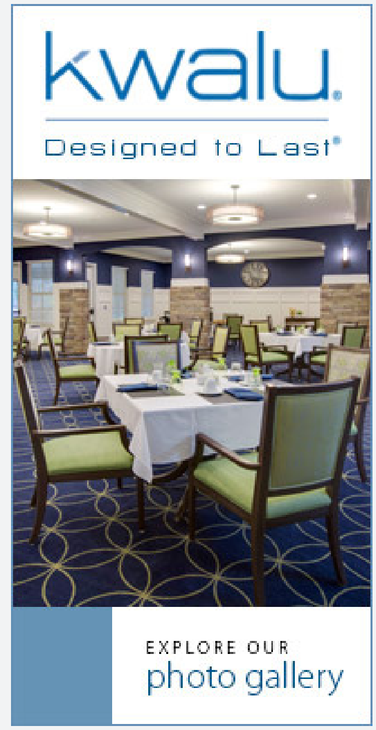

NIC: What is the company's strategy with skilled care/rehabilitation? Where are the best opportunities?

Thivierge: Skilled nursing and rehabilitation is our area of expertise. We had our 30th anniversary this year and we are now one of the largest post-acute providers in the country. Our main focus has been on our bifurcation strategy—creating stand-alone long-term and short-stay buildings.

In fact, we introduced our PowerBack Rehabilitation brand in 2011.

PowerBack is cutting edge—all 100% short-stay buildings that focus on getting patients back home as quickly as possible. We plan to grow the PowerBack brand. We currently have 11 stand-alone PowerBack locations, and five others in the planning stages.

We are also focused on small-scale acquisitions in our core markets and positioning ourselves for success in the new world of value-based pricing.

NIC: How is quality measurement factoring into your strategy?

Thivierge: Quality measurement has always been a main focus. But in working with hospital partners and with the migration to value-based purchasing, the need for quality measurement has become increasingly important. We have developed scorecards to help us communicate our results to our partners who are increasingly focused on measuring outcomes after patients leave their environment. As the largest, most sophisticated provider of post-acute care, we are very well-positioned to provide the measurements, but also quality outcomes. For example, we utilize the Modified Barthel Index (MBI) to measure patient success and outcomes.

NIC: What about value-based initiatives?

Thivierge: We are participating in a number of pilot programs to deliver better models of care, and to become a more data- and outcomes-driven organization. Some of the pilots include:

Bundled Payments for Care Improvement

In April 2015, Genesis HealthCare entered the BPCI initiative Model 3, the only Medicare alternative payment model that allows post-acute providers to lead care delivery redesign and share in cost savings achieved. By October 2015, Genesis managed nearly 6,000 episodes annually with total Medicare claims of approximately $128 million, favorably positioning the company to leverage its skills and capabilities in Medicare alternative payment models. The 32 participating Genesis facilities are located in Connecticut, Delaware, Maryland, New Jersey, North Carolina, Pennsylvania, and Kentucky.

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Medicare Shared Savings Program

Genesis HealthCare applied to CMS for its Genesis Physicians Services ("GPS") physicians in select states to begin participating in the Medicare Shared Savings Program ("MSSP") effective January 2016. GPS providers make nearly half a million visits annually to both short-stay and long-term patients, helping to reduce unnecessary hospital readmissions by providing after-hours and weekend coverage supplemented by the use of state-of-the-art telemedicine technology.

Their services help to create both healthcare efficiencies and better quality outcomes.

GPS providers in Pennsylvania, New Jersey, Maryland and West Virginia are expected to oversee approximately 16,000 beneficiaries, primarily long-term care residents, in 2016. The cost of care per beneficiary is risk-adjusted based on each beneficiary's acuity.

Comprehensive Care for Joint Replacement

The Center for Medicare and Medicaid Innovation ("CMMI") has proposed an episode-based payment model for major joint replacements with mandatory participation for hospitals in 67 markets throughout the United States. This program, Comprehensive Care for Joint Replacement, puts hospitals at risk for all Medicare Part A and Part B costs associated with acute care, post-acute care, physician services, durable medical equipment, home health and hospice services, and other Part B service costs for a period of 90 days for Medicare beneficiaries following joint replacement surgery.

Genesis operates about 100 facilities across several of the 67 markets proposed for this initiative and is partnering with hospitals to help mitigate the risk they assume. In addition, a number of proposed markets overlap with those in which Genesis centers are participating in the BPCI Model 3 initiative. In these markets, Genesis is already assuming the risk for major lower joint replacements, which takes precedence relative to the proposed rule for the Comprehensive Care for Joint Replacement model.

NIC: Genesis recently announced the acquisition of 24 skilled centers from Revera. How would you characterize the property market today?

Thivierge: We are finding that it is becoming increasingly difficult for small mom and pops, and in some cases regional players, to compete in this new world order. That creates some opportunities for Genesis, which is one of the only large operators continuing to consolidate in the space.

NIC: What's the outlook for the skilled care/rehabilitation segment?

Thivierge: We are very excited about the segment. There are a lot of opportunities out there for Genesis to grow through smaller-scale acquisitions, through the development of new state-of-the-art products, and of course, the aging population will only increase demand as the baby

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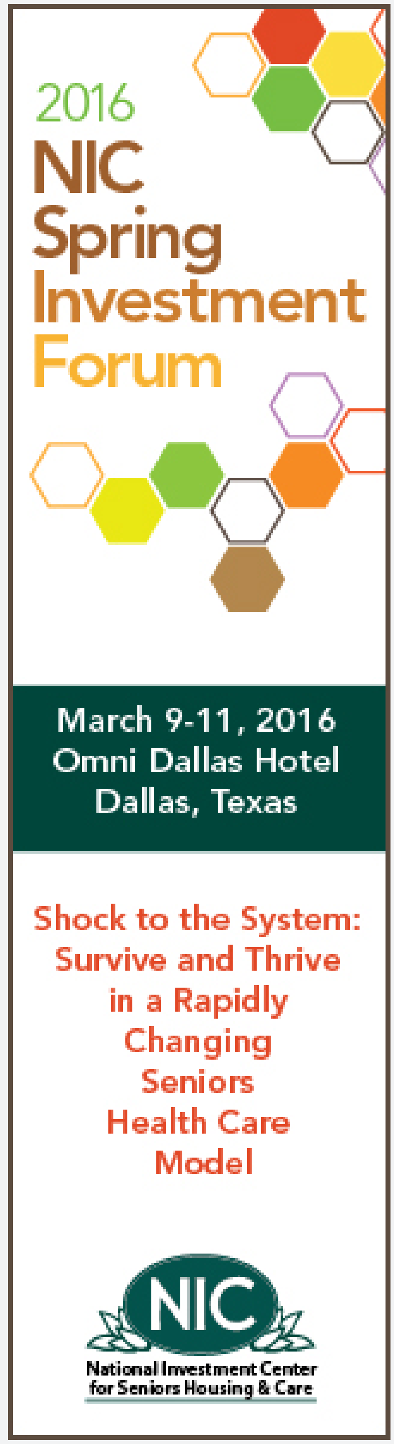

boomers start to utilize the system.

Thoughts from NIC's Chief Economist

Beth Mace, Chief Economist, NIC

We may encounter some bumps in the road as we begin a new year. Labor pressures are likely to mount in 2016, forcing many operators and investors to "roll up their sleeves" as they maintain margins and grow revenues. The unemployment rate stood at 5% in November, average hourly earnings rose 2.3% from year-earlier levels, and unit labor costs, as measured by the BLS's productivity reports, increased by 1.8% on an annualized basis in the third quarter. Over the past 12 months, unit labor costs are up by 3.0%, while hourly compensation are up by 3.6%.

While deflationary effects from the slump in commodity prices and the stronger dollar are keeping inflation low for now, this may not be the case in coming months. If inflation and labor cost pressures do unfold more quickly than anticipated, the Fed may have to abandon its expected "gradualist strategy" of raising interest rates and instead push interest rates up next year at a faster pace than the markets currently anticipate. If this were to happen, it would have implications for the cost of capital, pricing of deals, and valuation of properties.

A Tale of Many Cities

Seniors housing occupancy rates vary considerably across the nation, with Lancaster, PA, ranking as the strongest occupied market among the NIC 99 in the third quarter at 96.9%, followed by Charleston, SC (at 94.9%), and San Jose, CA (at 94.8%). Four metro areas with the lowest occupancy rates share one thing in common—Texas. These include McAllen, San Antonio, El Paso, and Houston, and all had occupancy rates below 85% in the third quarter. The NIC 99 metro average was 90.1% by comparison.

Houston has suffered from quick supply delivery with a 15% increase in inventory since early 2013 (compared with 5% for the NIC 99 markets), while San Antonio has suffered from generally weak demand and only moderate supply pressures. El Paso has been suffering from weak demand for a long while, and McAllen is a small and somewhat volatile market.

Lancaster, PA, is an interesting market with the highest occupancy and penetration rates in the nation (37.2%). Seniors housing is a long-established property type and lifestyle choice in

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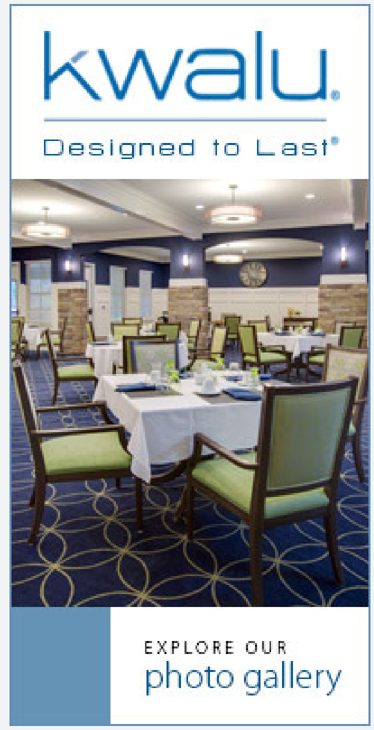

this market. Occupancy rates have remained above 92% since NIC began collecting data in 2008. Charleston, SC, has experienced rising occupancy rates since early 2012, but this, too, is a rather small market.

The stand out is San Jose, which has had an occupancy rate of 94% or more since mid-2014 as fluctuations in demand and supply have largely offset each other. San Jose also ranks as the fastest growing job market in the nation; as of September (most recent data available), it posted a 4.7% gain in jobs from year-earlier levels (compared with 2% for the nation). The metro area's high concentration of technology jobs have served it well since the recession ended.

The reverse can be said for Houston, where the drop in energy prices has taken a toll on job growth. In September, Houston's economy expanded at a slower rate than the nation, a sharp contrast from the 2010-to-2014 period, when growth in the metro area dwarfed that of the nation. Going forward and for the near future, this slowdown is likely to influence the ability of the market to absorb new product being delivered.

Drain Versus Strain with an Aging Labor Force: Lessons to Be Learned?

A lengthy front page article in the November 30 edition of the *Wall Street Journal* explored Japan's rapidly aging population. Efforts are underway there to change the nature of the conversation about aging—from a negative and "unproductive" experience that drains resources from the economy to a positive event that generates economic growth and better overall well-being and quality of life. It was an interesting article and can serve as a catalyst for conversations about similar trends in the United States.

Japan's population is among the oldest and fastest aging in the world, with 25% of the population older than 65 (versus 15% in the U.S.). By 2050, there will be only one working age Japanese resident for every senior or child under 15. In the rapid growth of the 1980s, this ratio was two (similar to the U.S. today). Japan's demographics foreshadow some of those of the United States and much of the world. The United Nations projects that by 2050, for example, 32 countries will have a greater share of seniors than Japan currently has.

Most immediately, these demographic changes affect the labor force—both the quantity of workers and their productivity. Issues about caregivers are also paramount. In the United States, for example, the caregiver support ratio—that is, the share of 45- to 64-year-olds relative to those over 80—is projected to shrink from 7:1 in 2015 to 5:1 by 2026 (when the first baby boomer turns 80) to 4:1 by 2031, according to the U.S. Census Bureau's latest population estimates. An aging labor force raises questions about the economy, since workers traditionally retire at age 65, thereby draining a critical source of economic growth.

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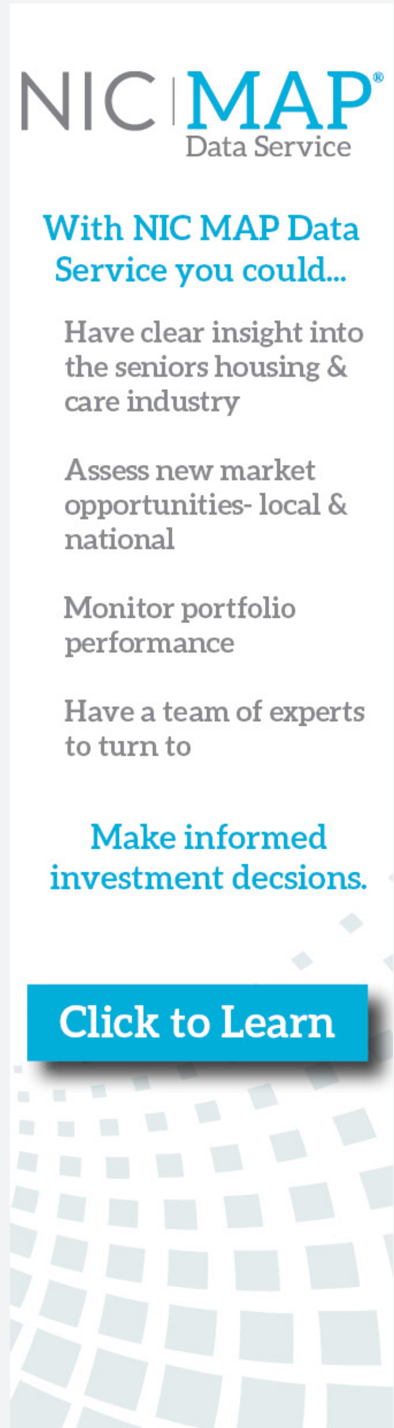

However, in Japan, as the *Wall Street Journal* article reported, the labor force has not shrunk as fast as the demographics would suggest. Many workers remain in the labor force beyond age 65, either because of their vigorous health, financial needs, or a desire to stay productive. Indeed, one in five seniors continues to work, nearly two times as many as in other developed nations. These seniors work in many industries and perform many jobs, including caring for other elderly, effectively boosting the caregiver population. One-third of the homecare workers are now over 60, up from one-fifth a decade ago, according to the *WSJ* article.

Interestingly, technology also plays a role with exoskeleton suits used more commonly to give additional strength and heft to aging workers (think the *Iron Man* movies!). And robots are increasingly substituting for human workers in repetitive tasks as well as companionship. As the U.S. population continues to age and as the baby boomers move into traditional retirement years, it will be important to watch other innovative ideas and care solutions emerge, as well.

Data, Data, Data: NIC's Actual Rent Initiative and More

As part of NIC's mission to provide more transparency in the seniors housing and care sector, we currently are engaged in an effort to expand the seniors housing data we collect and report on to include data about:

- Actual rents (in-place rents as well as move-in rents, which are different than the asking rents currently being collected and reported by our NIC MAP® Data Service).
- Leasing activity (as measured by move-in and move-out velocities).

The data will be important for benchmarking, strategic planning efforts, and day-to-day business operations. Data from this initiative will be reported to the market during the second half of 2016.

Other notable NIC seniors housing and care data news includes:

- The October 2015 milestone, when the NIC MAP® Data Service's quarterly time series of market fundamentals data reached an entire 10 years—dating back to the fourth quarter of 2005.
- NIC's coming expansion of its coverage of metropolitan areas to 140 markets from the NIC 99 currently reported upon by NIC. This will go into effect for the data release of the second quarter in 2016.
- The NIC Skilled Nursing Initiative, which is discussed in more depth in other sections of this month's NIC Insider.

Investment Returns Continue Strong

The investment total return performance of the private seniors housing sector showed improvement in the third quarter, reversing a one-time blip in the second quarter, according to

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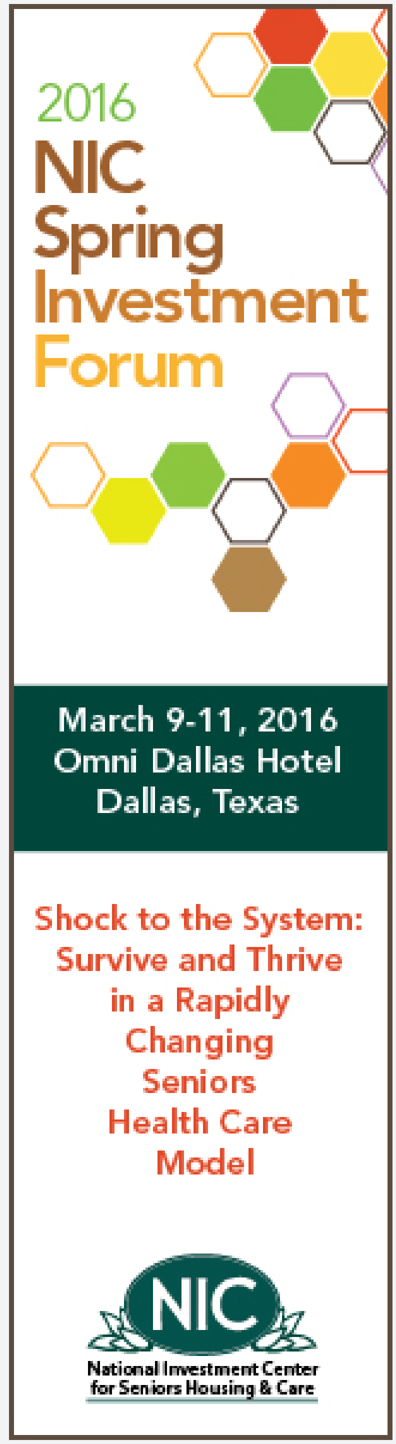

analysis conducted by NIC with the NCREIF data. The total return performance of 4.2% was strong and compared favorably with the NCREIF Property Index (the NPI), which logged in a total return of 3.1% and apartments (at 2.9%). On a 10-year basis, the total returns for seniors housing was 13.3%, significantly outpacing the NPI (8.0%) and apartments (7.6%).

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

Beth

NIC's Skilled Nursing Data Initiative

Bill Kauffman, Senior Research Analyst, NIC

As part of NIC's continued commitment to transparency and data analytics, NIC has been incubating its Skilled Nursing Data Initiative for several years. The skilled nursing industry, along with the entire healthcare landscape, is undergoing a significant transformation, and the industry needs capital to transform and survive. Currently, there is a wealth of capital coming into the seniors housing and care space; however, a majority of this capital is allocated to independent living, assisted living, and memory care properties. There is less capital targeting skilled nursing communities, a property type that needs capital more than ever to support it—especially as the sector navigates through the policy and regulatory changes happening now and the changes still to come.

When looking at the data the skilled nursing sector currently produces from the investor perspective, it is no surprise that there often is a challenge to attract the interest of new investors to the sector. The reason, quite frankly, is that there is a lack of relevant data for investors. For one, the industry needs data that is timely. The current primary provider of data is CMS, and that data is typically at least 12 to 18 months old. Given the rapidly changing dynamics of the current marketplace, the CMS data in general is simply not good enough for investors seeking to make current investment decisions. In addition, the data required by investors needs to be reported on a consistent and reliable basis.

It is also critical for operators and investors to understand the fast-changing shift from traditional fee-for-service Medicare and Medicaid to the managed care payment system. NIC's skilled nursing data initiative tracks and breaks out Medicare managed care to help operators and investors identify the trends.

In order to meet this void of transparency, NIC currently is collecting monthly data from 18 skilled nursing operators with a total of 1,500 properties through our Skilled Nursing Data Initiative. We have commitments to participate from additional skilled nursing operators, which will add another 500 properties.

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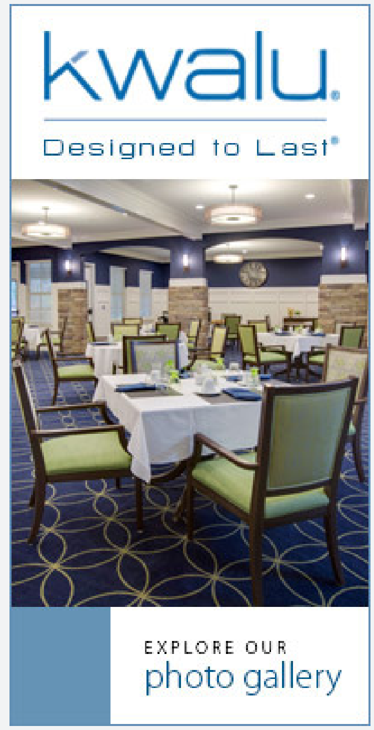

All of the individual property data collected is confidential, and no property or operator data is disclosed. As is NIC's practice with the data it collects, all of this data will be reported on an aggregate basis. NIC has numerous safeguards in place to protect the confidentiality and integrity of data including an internal SEC compliance policy and regular antitrust reviews.

We are asking each skilled nursing operator and/or owner participating in the initiative to submit monthly data to NIC, which enables us to compute the following metrics:

- Occupancy.
- Skilled mix.
- Quality mix.
- ADR by payor class.
- Patient day mix.
- Overall revenue trends.

Each operator who contributes this data to NIC on a monthly basis receives, free of charge, an aggregate monthly summary of the latest national data along with a benchmark comparison of their data to the national aggregate statistics. The data reported includes occupancy, skilled mix, quality mix, ADR by payor class, patient day mix, and overall revenue trends. As the database grows with more contributors, NIC will provide each contributor with more enhanced geographic data.

NIC recognizes that its new skilled nursing database and the resultant products and services will provide invaluable market information not readily available from other sources, and is essential to attracting additional sources of capital for the skilled nursing sector, including both post-acute/short stay and chronic care/long stay products.

As the sector advances the transparency with more relevant data, such as the timely and pertinent metrics that will be reported as a result of this NIC initiative, the skilled nursing sector will be better positioned to gain the confidence and interest from real estate and private equity healthcare investors that will be necessary to fund the needed transformation of buildings and technologies. With the average age of skilled nursing properties within the top 99 metropolitan markets currently at 36 years, many of the buildings are on the verge of functional obsolescence. The need is here, and the time is now.

If your firm is interested in participating in NIC's Skilled Nursing Data Initiative, please contact Bill Kauffman at NIC for more information. Bill can be reached at bkauffman@nic.org or at (410) 267-0504.

Additional information about the Skilled Nursing Data Initiative is available at http://info.nic.org/nic-skilled-nursing-data-initiative.

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Capital Connections Returns with a New Format

If you're an operator or developer looking to access capital, *Capital Connections* is your chance to meet select capital providers and discuss the financing options available to address your specific capital requirements. This networking opportunity will be held on the first day of the 2016 NIC Spring Investment Forum, which is March 9–11 in Dallas, Texas.

Capital Connections will be a lively and interactive session that addresses multiple areas of capital and financing, including:

- Development and repositioning financing
- Mortgages and business loans
- Equity, leases, and other partnerships

Advisors will be on hand to help guide participating capital seekers to the types of capital providers they should meet with, based on needs. Other available resources at *Capital Connections* include capital provider profiles designed to maximize the productivity of the session.

You spoke, and we listened. Based on feedback we gathered from the 2015 Forum, in 2016 *Capital Connections* will be held on Wednesday, March 9, at 1:00 PM and will not run concurrently with other sessions. In addition, the new format will be more informal and conversational to faciliatate meaningful discussions between capital seekers and capital providers. We believe these changes will increase the value of the session for capital seekers and give attendees time to follow up on the new contacts they will make during *Capital Connections*.

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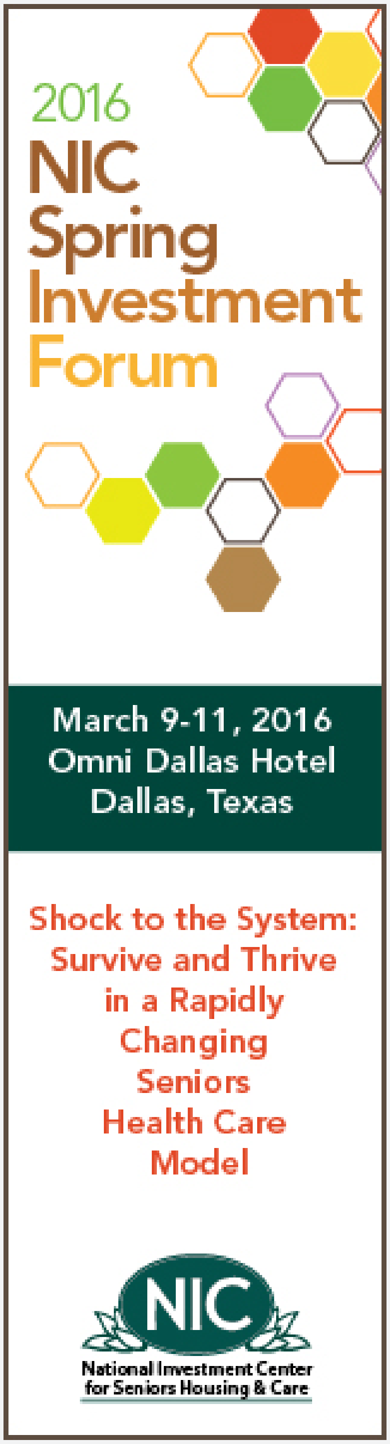

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NIC Scholarship Program Encourages New Grads to Choose Senior Living as a Career

As America's senior population continues to grow at an unprecedented rate, the need for a larger, well-trained workforce is becoming imperative. And while the growth of the seniors housing and care industry offers exceptional career opportunities for those entering the workforce, the industry at large is still often overlooked.

To support its mission of leadership development, NIC has established graduate and undergraduate student scholarship programs for research support and conference attendance designed to increase the visibility and awareness of seniors housing and care. At the recent National Conference in Washington, D.C., Future Leaders Council (FLC) members met recent scholarship recipient, Vivien Wu, Wharton School MBA candidate, to discuss her impressions of the conference and the industry as a whole.

FLC: How did you become interested in the seniors housing industry and how did you first hear about NIC?

Wu: Initially, our school's career office had posted information on NIC's internship program. I logged on to the website and was impressed with the number of recognizable companies active in this space—Berkadia, Wells Fargo, Ventas, CBRE. I realized this was not a niche industry but a possible career path. Over the summer, I interned with CBRE and had the chance to learn more about the seniors housing industry. By working with developer/operator clients and equity placement opportunities, I began to understand the inner workings of clients' business models and their needs. When offered the scholarship to the National Conference, I was excited at the possibility of learning more about the industry as a whole.

FLC: What were your expectations prior to attending the NIC conference and how did those change after attending the conference?

Wu: I knew the NIC conference would be a great opportunity to expand my knowledge and meet people throughout the industry, but I was surprised by the amount of thought leadership about the business model itself—the emphasis on quality of care issues and resident/ family experiences, and the ability to hear about field-level perspectives and their effects. The session discussions were not limited to independent living and assisted living but expanded to the roles and impacts of skilled nursing/rehab, as well as the role home care plays within the industry. Overall, I was impressed by the friendship, collaboration, and desire to see the industry succeed as a whole.

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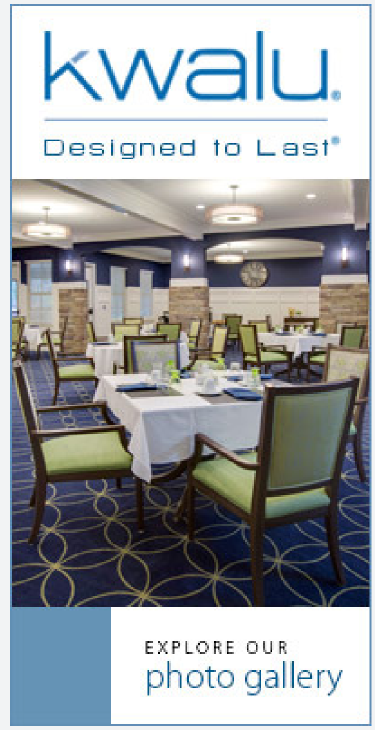

FLC: What presentations did you attend and what did you take away?

Wu: I was able to attend several of the NIC Talks presentations and was impressed with how they pushed the message of the senior living experience. As our population ages, the re-envisioning of retirement or senior living as a second-life experience similar to going away to college was intriguing and really resonated with me. In addition, the concept of older workers or the impact of second careers was also interesting.

FLC: Overall, do you feel attending the NIC conference changed your impression of the seniors housing industry, and if so, how?

Wu: Overall, I came away with a feeling of dedication and commitment to the industry at large shown by so many of those at the conference and the expanded possible career paths available to new graduates.

Seniors Housing & Care Industry Calendar

January 2016:

28-29 ASHA Annual Meeting, Phoenix AZ

March 2016:

9-11 2016 NIC Spring Investment Forum, Dallas, TX

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