New Studies Focus on Seniors' Housing Needs And Possible Investment Opportunities

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Seniors housing continues to rank high as a desirable property type in which to invest. In the most recent 2019 ULI Emerging Trends Report, it ranked second and third among 24 commercial/multifamily sectors for best investment and development prospects, respectively (behind fulfillment and warehouse). In the IREI/Kingsley 2019 survey, seniors housing ranked among the top five most attractive property types for US investors. And increasingly, pension funds are allocating investment dollars to seniors housing.

Traditionally, institutional investors have invested in the seniors housing properties that serve higher-income households. But recent research sponsored by the National Investment Center for Seniors Housing & Care (NIC) and conducted by NORC at the University of Chicago shines a light on the opportunity to serve middle-income seniors as well. This article presents key findings of this new study but initially highlights some of the reasons seniors housing has been attractive to institutional investors in the past several years, while also discussing its challenges.

Five Favorable Considerations

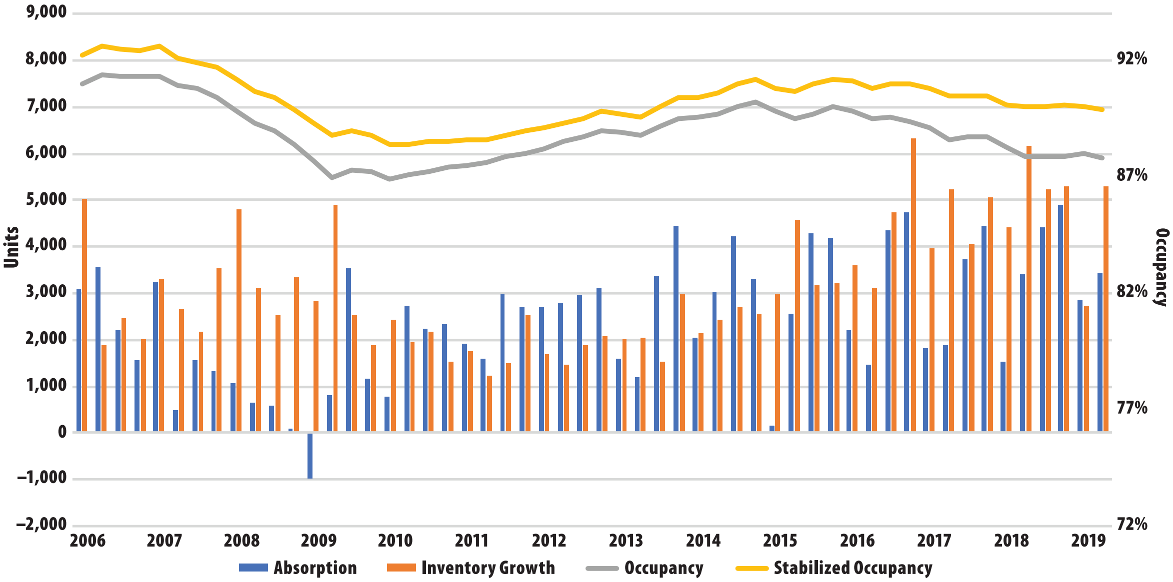
1. Private equity returns for seniors housing properties have outpaced those of other commercial real estate for the past ten years on both appreciation and income return performance. According to first-quarter 2019 NCREIF Property Index (NPI) results, the total investment return for the NCREIF-reported seniors housing properties on a ten-year basis was 11.7%—outpacing the overall NPI of 8.5% and apartment returns of 8.6%. On a one-year basis, seniors housing clocked in at an 8.5% return, besting the 6.8% NPI return and the 5.9% multifamily sector return.
2. Investment in seniors housing provides portfolio diversification because the sector is not as cyclical as other property types and was shown to be "recession resilient" during the global financial crisis. Its "needs-based" demand characteristics allowed assisted living to withstand many of the downwind recession pressures faced by other commercial real estate sectors.
3. With nearly two of every three properties built before 2002 (more than 17 years old), the inventory of seniors housing properties is relatively old, and often a property refresh and an institutional capital infusion are needed for design, functionality, and efficiency.
4. Seniors housing is increasingly recognized as a critical part of the solution for population health efficiencies and health-care cost containment—a growing social, economic, and political reality. Care coordination and collaboration across the spectrum of health-care providers is making seniors housing a practical solution for the growing housing and care needs of the aging US population.
5. Transparency and understanding of the sector are rising, which supports a more knowledgeable and disciplined capital market. Information about market fundamentals and capital market conditions is readily available from sources such as the NIC MAP Data Service and Real Capital Analytics, as well as Wall Street analysts' reports on health-care REITs. And lastly, as transaction volumes increase, investors have become more comfortable knowing that multiple exit strategies are likely.

What About Demographics?

Anecdotally, today's typical seniors housing resident is 83 years of age or older. And based on the demographic birth patterns of the US, this cohort is starting to grow at an accelerating rate. Indeed, the nadir of births that occurred in the mid-1930s, the years in which today's 83-year-olds were born, has now passed.

Based on recently updated estimates from the US Census Bureau, there were 8.7 million individuals aged 83 or more in 2018. In 2019, an additional 132,000 people are projected to age into the 83-plus cohort.

Exhibit 1: Seniors Housing Fundamentals—Primary Markets, 1Q06–2Q19
Seniors housing occupancy remains soft.



Source: NIC MAP Data Service

By 2025, the US Census Bureau estimates, this cohort will comprise 10.2 million people, with an increase of 1.5 million people over the seven-year period from 2018 to 2025. Using a penetration rate of 24%, this translates into more than 350,000 additional units of seniors housing needed to satisfy demographically driven demand over this period. (Note that this does not consider consumer preferences, which could increase or decrease this estimate.)

Challenges Exist

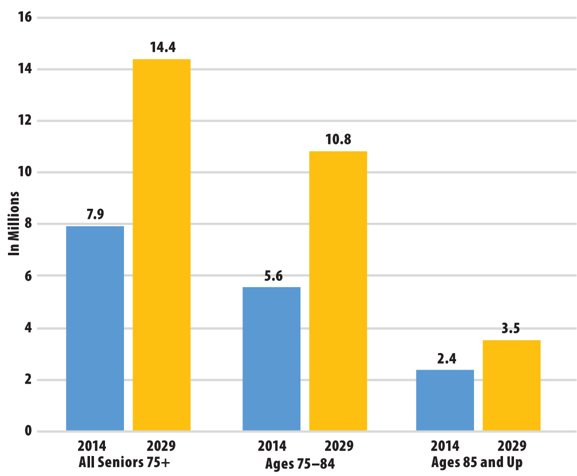
Rarely does an opportunity occur that has no challenges. For seniors housing, two challenges currently dominate: unit supply and labor shortages. First are supply-demand imbalances and occupancy challenges in some, but not all, markets. In the second quarter of 2019, the occupancy rate for seniors housing slipped to 87.8%, the lowest rate since 2011, as inventory growth outpaced net demand (Exhibit 1). However, a very wide 14-percentage-point difference exists between second-quarter 2019 occupancy rates for the most occupied senior housing market (San Jose, at 95.7%) and the least occupied (Houston, at 81.1%), according to the NIC MAP Data Service. Supply has been a more notable issue in many Sunbelt metropolitan markets and less remarkable in higher barrier-to-entry markets, such as Northern California.

The second challenge is the labor market. Increasingly, operators are reporting labor shortages in all occupations across their operating platforms, ranging from care managers to executive directors. With the national unemployment rate falling below 3.7%, the challenge of recruiting and retaining employees is expected to grow. Shortages in the health-care professions as well as in other industry sectors, such as the construction trades, are slowly putting upward pressure on wage rates. In the second quarter of 2019, average hourly earnings for assisted living employees grew 5.9% from year-earlier levels, considerably higher than the 3.1% increase incurred for private-sector employees in general.

Middle Market Study Highlights New Investment Opportunities

Delivering on its mission to enable access and choice for US elders, NIC provided a grant to NORC at the University of Chicago to conduct a demand study that quantifies and characterizes the US middle-

Exhibit 2: Middle-Income Population Size in 2014 and 2029, by Age
As baby boomers age, the total number of middle-income seniors aged 75 and up will grow by 82% between 2014 and 2029.



Source: NIC *Middle Market Seniors Housing Study*

income seniors cohort. The results of *The Forgotten Middle: Middle Market Seniors Housing Study* were initially presented at a Health Affairs policy briefing in Washington, DC, on April 24, 2019, and then at an investor summit in New York on May 21. More information can be found at nic.org/middlemarket.

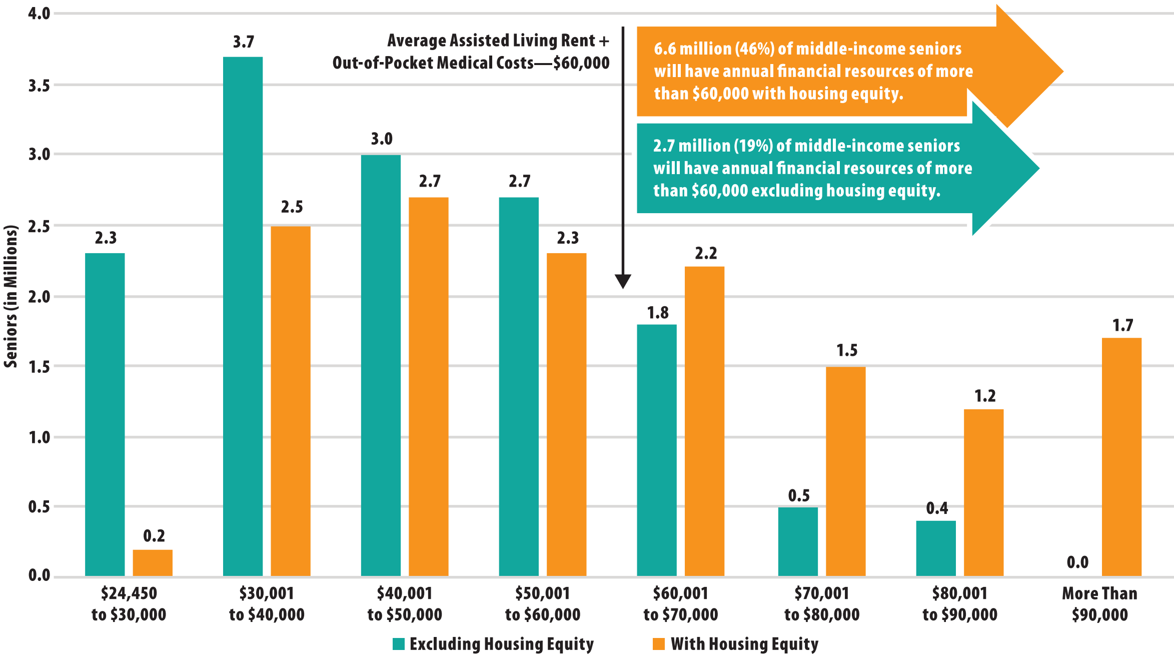
Some notable takeaways from the study include the following:

- The middle-income seniors cohort includes today's retiring workforce housing cohort—teachers, firefighters, government workers, and nurses—individuals with financial resources between $25,000 and $74,000 annually for those between the ages of 75 and 84, and $24,000 and $95,000 for those over 85. The middle-income cohort excludes those who may be eligible for Medicaid on one end of the income spectrum and those who can easily afford seniors housing on the other end of the income spectrum.
- The middle market investment opportunity is large and growing, with more than 14.4 million seniors over the age of 75 anticipated to be in this cohort by 2029—6 million more than today (Exhibit 2).
- By 2029, the middle-income cohort will be 43% of the total senior population. Future seniors are less likely to be married and will have fewer children, creating additional need for paid, private seniors housing solutions and outside-the-home caregivers.
- Future seniors will be more racially and ethnically diverse and more educated than seniors today, potentially altering the care needs and preferences of this cohort.
- Seniors will have more need requirements, so the appropriate physical plant and operating model must be developed/enhanced:
  - 60% will have mobility limitations
  - 20% will have high needs
  - 8% will have cognitive impairment
  - 6% will have cognitive impairment and mobility limitations
- More than half of these middle-income seniors (54%) will not have sufficient financial resources to cover projected average annual costs of about $55,000 for assisted living rent and other out-of-pocket medical costs ($5,000) a decade from now, even if they generate equity by selling their homes and committing all their annual financial resources.
- That said, 46% of seniors, or 6.6 million, will be able to cover the costs, highlighting a significant demand pool that is not being tapped into today (Exhibit 3).
- An additional 2.3 million middle-income seniors could meet the yearly costs of rent and other costs if these costs could be reduced by $10,000 to $50,000 from $60,000.

What's Next?

Innovative financial structures and operating models are needed to provide care and housing options for the US middle-income seniors cohort. Middle-market boomer consumers are likely to establish their own preferences for care and housing options, presenting opportunities for new and traditional entrepreneurs and innovators. With a steady stream of strong demand and the appropriate operating models, risk-adjusted returns may have the potential to compete with core or core-plus property returns. Pension funds may find the opportunity attractive as they provide housing and care options to their retirees at appropriate risk-adjusted returns. Moreover, there is a clear component of socially responsible investing with this opportunity.

Exhibit 3: Projected Financial Resources of Middle-Income Seniors Aged 75+ Compared to Assisted Living Costs, 2029
46% of middle-income seniors aged 75 and up may have sufficient financial resources for seniors housing with home equity.



Source: NIC *Middle Market Seniors Housing Study*
Note: Numbers depicted are in 2014 dollars.

Possible solutions to providing care and housing options to this group include these:

- Socially responsible investment opportunities for pension funds, other institutional investors, and consumers
- New investors, including pension funds, with different return expectations
- Adaptive reuse of older existing properties, including retail malls or obsolete seniors housing properties
- Tax credits or real estate tax abatements
- The creation of new public-private partnerships
- The creation of a lower cost basis through less-expensive land, materials, or labor
- Value-based engineering of the physical building and property
- New capital providers for different parts of the capital stack
- New debt instruments that merge construction and permanent debt structures
- Securitized mortgage debt pools
- Technology as a substitute for labor
- The lure for potential workers into the labor force, including young and old
- Opportunity Zone investing
- Tax-exempt bond financing
- Consumer Reinvestment Act credits
- Set-asides for select income cohorts

The study and its results pave the way for new conversations about how to address the needs of this growing group of seniors. We hope that pension funds, private and public equity funds and REITs, debt providers, and operators and developers will get together to think of innovative, practical solutions to serving this group of US seniors. ■

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