

Senior Housing Facing Uneven Recovery; Demand Drivers Sustain Positive Outlook

Seniors living industry being reshaped by the health crisis.

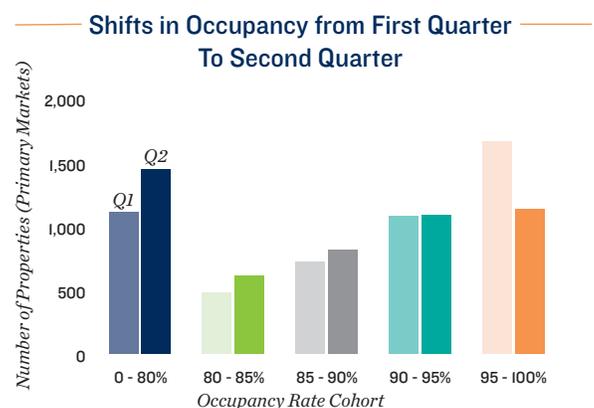
As the coronavirus pandemic drags on, the seniors housing sector continues to face unprecedented challenges that are altering operations. With the nation awaiting a vaccine, a health solution does not spell a return to normalcy for care providers. The pandemic will leave a lasting impact on daily operations, safety protocols and community design. The well-being of residents and front-line staff remain the top priority of operators, many of which are fatigued by budgetary pressures, workforce shortages and limitations to social interactions. The impacts have been uneven across markets and care segments, which will lead to an uneven recovery for the industry over the coming years. Long-term prospects for the sector remain positive though, driven by the growing care needs of an aging population.

Consolidation is on the horizon. Increased expenses and a hit to revenue streams shrunk margins for many care providers, which has been particularly challenging for smaller communities. The financial stress of the pandemic will create opportunities for seasoned operators to acquire troubled assets over the coming months and drive management efficiencies and boost occupancy. Industry consolidation will bring greater incorporation of technology and implementation of telehealth to facilities, among other safety and care improvements that will be essential in attracting new residents.

Restricted move-ins weigh on occupancy levels. The pandemic rapidly brought occupancy levels to record lows in the second quarter as move-ins slowed considerably. The skilled nursing sector posted the steepest decline from the prior quarter as seniors are particularly vulnerable to the virus and the care segment faces complex challenges. Occupancy has likely bottomed out in recent months and will slowly trend upwards as more facilities open up their doors to new residents, though risks remain as the recovery will be uneven across markets and properties. Approximately 28 percent of properties in primary markets registered an occupancy rate of 80 percent or less at midyear, a strong increase from the first quarter that challenges operators currently struggling with increased expenses. Post-pandemic, an increased emphasis on infection control and safety will be needed to build trust with potential residents.

Investment Highlights

- Senior housing transaction activity slowed considerably in alignment with other asset classes as challenges in closing sales increased. Deal volume this year through the second quarter totaled roughly \$4.4 billion.
- On a per unit basis, Assisted Living and Independent Living assets have been trading in the mid-\$100,000 range, while skilled nursing properties have recorded an average price of approximately \$80,000 per bed.
- Assisted Living and Independent Living cap rates are flattening with the pandemic impacting sales activity, averaging in the low-6 to low-7 percent band over the past 12 months.
- An abundance of capital is ready to be deployed into the sector. As visitor restrictions are lifted and greater clarity on long term occupancy trends emerge, transaction velocity will build momentum.



Abundance of Sidelined Capital Ready to Target Seniors Housing

Strong investment characteristics grow investor appetite. Sales activity was limited during the third quarter with many hurdles remaining in getting deals across the finish line. Visitor restrictions are still in place at many properties, adding to the challenges in underwriting assets in an uncertain environment. In an encouraging sign, several large portfolio deals closed recently to build momentum for transaction velocity. Pricing and cap rates have held relatively steady this year, with the average initial yield for seniors housing assets in the low-6 to low-7 percent territory. Investor confidence remains strong with favorable demand drivers for the sector and rising penetration rates. A large inventory of older properties in need of increased capital expenditures, in addition to a sizable yield premium create compelling opportunities for investors as an abundance of capital is sitting on the sidelines ready to be deployed. The elevated care needs of the elderly population bolsters demand for the sector and overshadows short-term challenges. By 2038, approximately 17.5 million U.S. head of households will be 80 years and greater, more than double the 2018 total to pressure demand for the senior living industry.

Banks cautious as they assess the new climate. Lenders quickly adjusted underwriting criteria, closely examining occupancy trends and operators ability to cover debt service should occupancy rates continue to deteriorate. Freddie Mac is requiring borrowers to align with its pandemic-related criteria in addition to the facility being open to new residents. Cautious lending despite ample liquidity has kept loan-to-value ratios typically in the 50 to 70 percent range, dependent on the borrower, asset and location. The current low interest rate climate is exceptionally attractive and has reopened the yield spread to create a unique window of opportunity for investors. The stability and long term demand of the seniors housing sector should keep buyer-seller expectations better aligned, though assumptions surrounding operating expenses and occupancy are likely to weigh on net operating income for more challenged properties.

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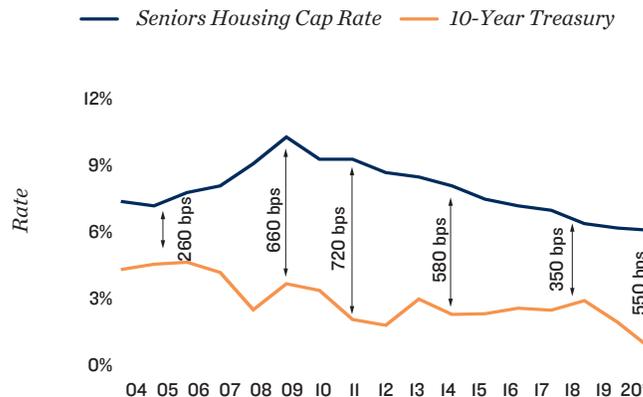
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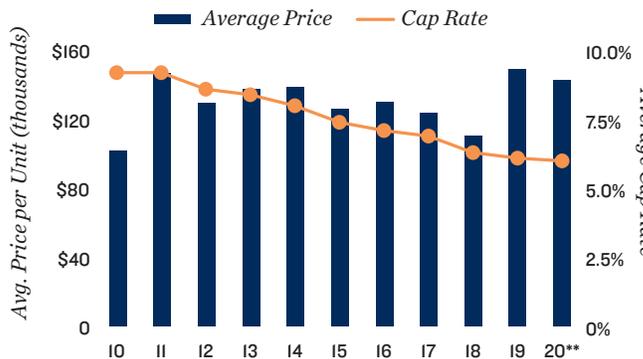
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Sources: Marcus & Millichap Research Services; NIC Map® Data and Analysis Service (www.nicmap.org)

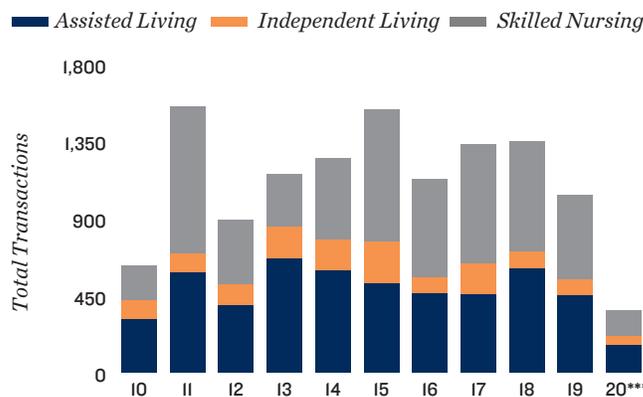
Yield Spread Reopens



Favorable Pricing and Cap Rates Sustains Investor Sentiment



Transaction Activity by Facility Type



* Through second quarter
** Trailing 12 months through second quarter
*** Through October 11, 2020

Sources: Marcus & Millichap Research Services; NIC Map® Data and Analysis Service (www.nicmap.org)

Price: \$1,000

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