THE OUTLOOK

Marcus & Millichap

SENIORS HOUSING

MIDYEAR 2021

Mass Vaccination Efforts Quell Fear-Induced Headwinds; Prolonged Recovery Not Detrimental to Long-Term Outlook

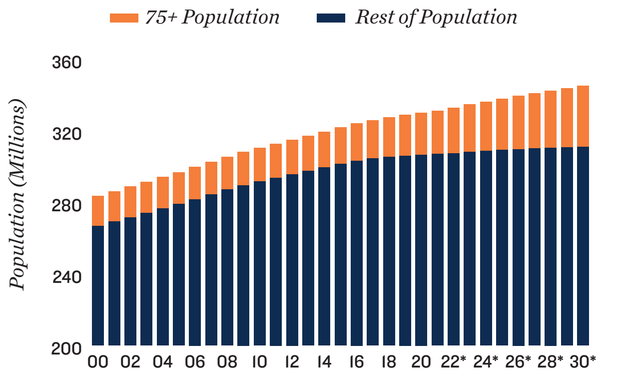
Unique disruption dislodged historically stable sector. Seniors housing has been resistant to economic downturns in the past, as there are few alternatives to the care-based services. The pandemic, however, put the sector in the eye of the storm as vulnerable population groups comprise virtually all of the resident pool. Early outbreaks at several facilities led to a surge in move-outs and stalled move-ins. Headwinds lingered into the early months of this year, prior to the widespread vaccine rollout. According to NIC MAP® Data Service, year-over-year occupancy declines as of March spanned from 730 basis points for CCRC/LPC to 960 basis points for memory care. There is light at the end of the tunnel, however, with two-thirds of U.S. adults at least partially inoculated and few outbreaks at seniors housing communities in recent months. A demand tailwind may emerge as more people return to offices and are unable to provide in-home care. Still, occupancy will likely take beyond this year to recover, with intense competition for residents as many facilities are competing to fill units simultaneously.

Industry grapples with oversight and workforce dynamics. Influenced by the pandemic and political transition, the seniors housing sector faces heightened regulations. Adapting to these ordinances may be costly for operators, especially as many wrestle with significant revenue declines. It was estimated that seniors housing providers had incurred financial losses of $22.5 billion in the 12 months following the onset of the pandemic. Contributing to this was an uptick in operational expenses and insurance premiums. Many buildings had to upgrade infrastructure or implement systems to combat the spread of the virus, while insurance coverage became historically stringent. Underlying costs could remain elevated as a labor shortage, which was already a concern before the health-crisis exacerbation, requires operators to utilize aggressive compensation to lure workers.

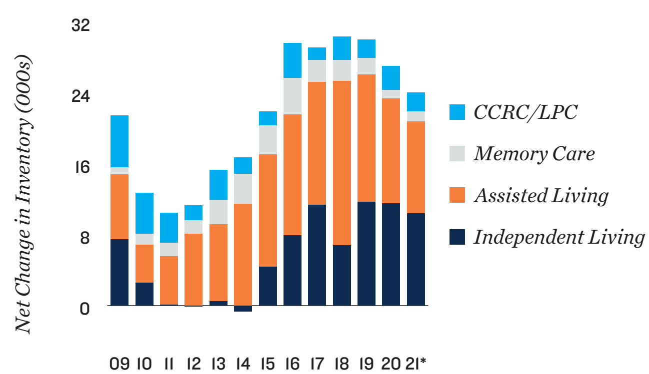
Strained assets face inflection point; buyers coming off the sidelines. Many operators were able to stay afloat over the past 15 months, buoyed by government assistance. As the economy recovers, the likelihood of additional support will dwindle. The second half of this year will be a crucial point for some facilities. Generally, assets that were in good financial standing prior to the pandemic are in a position to overcome challenges and move toward recovery. Struggling properties, however, could come to market and some may be redeveloped. Removal of this stock, alongside a construction pipeline that has contracted 25 percent since March of last year, could support occupancy. Listings of quality assets should improve as well, with many who were waiting on the sidelines for the most difficult stretch to pass now more confident in the investment landscape. Meanwhile, capital has accumulated and both private investors and institutions are eager to acquire seniors housing assets as many view the current dynamic as a short-term interruption rather than a long-term fracture.

Robust demand will materialize in the Sunbelt. An accelerated expansion of the older adult population driven by the aging baby boomer generation and longer life expectancies will buoy demand for seniors housing over the long term. Sunbelt markets will lure a heavy share of this subset as retirees frequently prioritize quality-of-life considerations such as cost of living and climate when relocating. The 65-plus cohorts in the 10 most populous markets in Florida and Texas are each projected to grow by at least 35 percent over the next decade. Combined, these 10 metros will add 2.1 million residents over the age of 65 by 2030, accounting for one-eighth of national growth. The older adult populations of Phoenix and Las Vegas are poised to expand even more, swelling by an estimated 45 percent or more this decade.

Looming 75+ Population Expansion



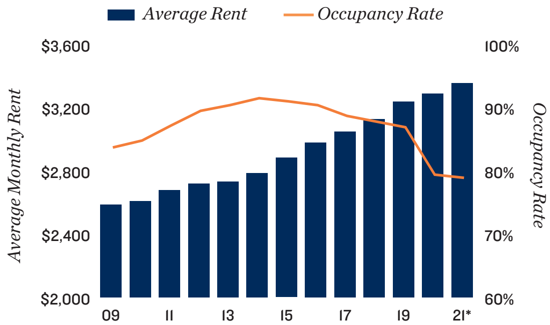
Supply Growth Will Subside



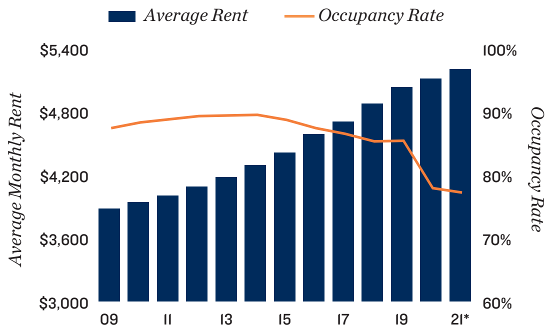
* Forecast

Sources: U.S. Census Bureau; Moody's Analytics; NIC Map® Data and Analysis Service (www.nicmap.org); Argentum

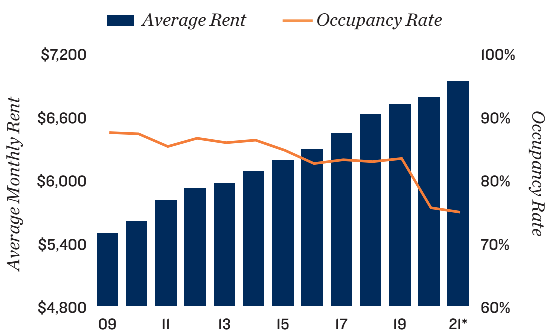
Independent Living Occupancy and Rent Trends



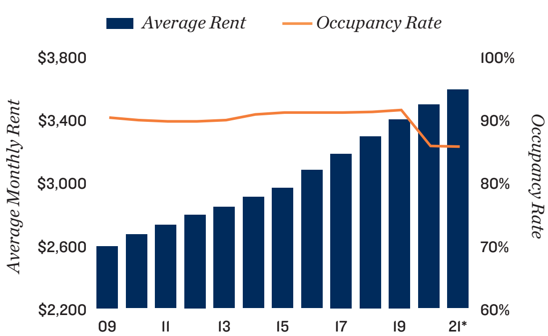
Assisted Living Occupancy and Rent Trends



Memory Care Occupancy and Rent Trends



CCRC/LPC Occupancy and Rent Trends



** Forecast*
Source: NIC Map® Data and Analysis Service (www.nicmap.org)

Independent Living

Unbalanced conditions will produce an uneven recovery. Independent living facilities fared better than some other levels of care during the health crisis, with lockdown provisions less disruptive to operations. Still, negative net absorption of at least 2,500 units in each of the past four quarters, combined with 10,250 new units, led to a 70 percent increase in total vacant stock. As such, the occupancy rate in the U.S. fell 850 basis points year over year to 77.7 percent in March. Declines ranged from more than 1,000 basis points in high-density primary markets like Los Angeles and New York City to under 500 basis points in fast-growing Sunbelt markets such as Nashville and Raleigh. Despite lower occupancy nationally, the average rent grew 1.3 percent to $3,315 per month. Incoming supply could impede recovery momentum in 2021 as 21,680 units, or 8.3 percent of inventory, was under construction in March.

Assisted Living

Construction slowdown welcomed after widespread disruption. Assisted living was one of the most impacted levels of care during the health crisis. Negative net absorption of 28,000 units during the past four quarters compounded a national stock expansion of 3.2 percent, or 12,600 units. This curtailed occupancy by 950 basis points to 75.5 percent in March. Every U.S. market with an inventory larger than 2,000 units posted a decline of at least 400 basis points. Nevertheless, rent sustained a positive trajectory, growing 1.0 percent to $5,144 per month. Recuperating occupancy and returning to the pre-crisis pace of rent growth will take multiple years, though waning supply-side pressure should aid the recovery. As of the first quarter 18,490 units were under construction, the lowest total since 2014.

Memory Care

Steep occupancy hurdles fail to impede rent growth. The initial impact during the pandemic was weighty, a result of memory care communities' shorter lengths of stay and usually rapid turnover. More than 40 percent of the 3,750 units that returned to market in the past year transpired in just the second quarter of 2020. Meanwhile national inventory expanded by 2.3 percent annually as 1,100 units opened. Occupancy fell 960 basis points to 73.2 percent in March, though declines were less dramatic in areas experiencing strong retiree in-migration like the Mountain and Gulf Coast regions. Despite the segment's occupancy hurdles, rent grew by 2.2 percent to $6,850 per month, beating the previous year's 0.4 percent rise. As of March, roughly 1,570 units were under construction, the lowest quarter-ending volume in almost a decade.

CCRC/LPC

Occupancy less disrupted in CCRC/LPC communities. In the past 12 months negative net absorption totaled 25,000 units, though 17,200 of those were released during the strenuous second and third quarters of last year. The occupancy rate was 84.3 percent in the first quarter of 2021, down 730 basis points annually, assisted by national stock growing by less than 1 percent. The average rent moved up 1.9 percent to $3,527 per month and a handful of secondary and tertiary markets, which have been garnering a larger share of household growth, had notable jumps. Louisville, Milwaukee, Phoenix and Charlotte posted year-over-year gains larger than 7 percent. Limited construction should help accelerate the recovery with only 6,650 units under construction as of March, a seven-year low for the segment.

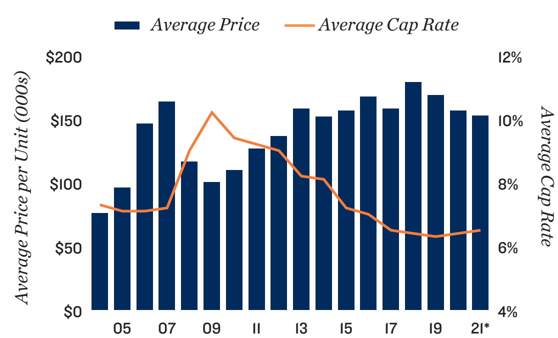
2021 Forecast

	Construction:		Occupancy:		Rent:	
INDEPENDENT LIVING	4.0% *of stock*	10,380 units *will be completed*	78.9%	50 basis point *decrease in occupancy*	$3,355 *per month*	2.0% increase *in average rent*
ASSISTED LIVING	2.6% *of stock*	10,390 units *will be completed*	77.2%	70 basis point *decrease in occupancy*	$5,205 *per month*	1.8% increase *in average rent*
MEMORY CARE	2.4% *of stock*	1,130 units *will be completed*	74.8%	70 basis point *decrease in occupancy*	$6,935 *per month*	2.3% increase *in average rent*
CCRC/LPC	0.6% *of stock*	2,170 units *will be completed*	85.6%	10 basis point *decrease in occupancy*	$3,585 *per month*	2.7% increase *in average rent*

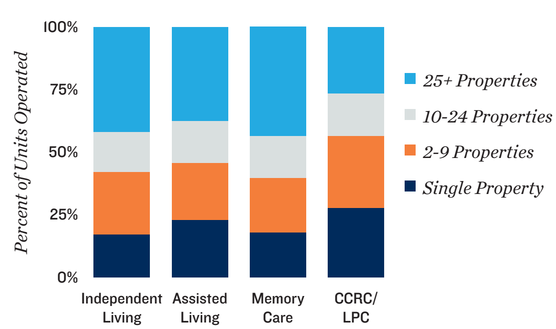
2021 Investment Outlook

- **Private buyers find opportunities as REITs await clarity.** Over the past four quarters ending in March, trading activity was nearly cut in half compared with the previous yearlong period. Public entities such as REITs stepped on the brakes. Acquisitions within this segment were down more than 60 percent year over year. Some private investors with longer-term objectives seized the window to obtain assets in a less-competitive bidding environment. Preliminary data shows that REITs are steadily coming off the sidelines as conditions improve, though, which will expand competition for quality-assets in the second half of this year.
- **Average pricing dipped as cap rates inched up**. Seniors housing properties that changed hands during the past 12 months ending in the first quarter had a five-year-low average sale price of $153,000 per unit, a result of lower-quality assets comprising a bigger share of overall deal flow. The average initial yield was 6.5 percent, up 20 basis points from the trough recorded in 2019. Reduced NOI as a result of higher vacancy and greater expenses is a factor behind the uptick in cap rates.
- **Deal flow down in most of the country, with a few scattered exceptions.** Within the continental U.S. all but six states recorded year-over-year contractions in trading activity. Among the outliers, Washington and Montana posted the most notable improvements. Conversely, a handful of East Coast states including Connecticut, Massachusetts, Maryland and Pennsylvania recorded transaction velocity moderations of at least two-thirds. The three most prominent states for seniors housing activity — Florida, Texas and California — each recorded slower deal flow annually but combined for 32 percent of trades that took place in the U.S. over the past year.

Sales Trends



Ownership Structure



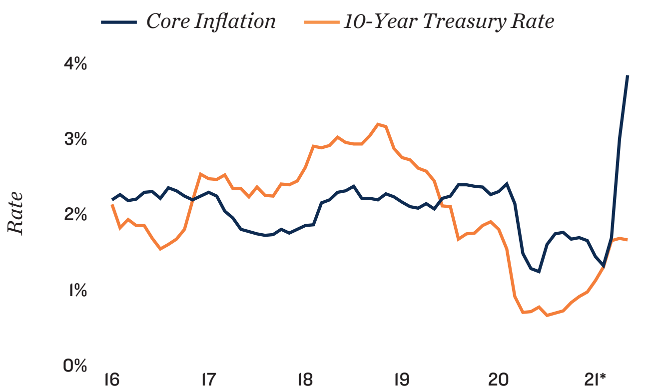
** Through 1Q*
Ownership structure as of 2019
Source: NIC Map® Data and Analysis Service (www.nicmap.org)

Capital Market Operations Largely Resume; Inflation Concerns Becoming More Apparent

Fed positions for temporary higher inflation period. Applying lessons learned from the global financial crisis, Congress and the Federal Reserve acted swiftly to preserve market liquidity and support borrowers amid the pandemic last year. As U.S. infections recede and the economy reopens, attention is shifting to the potential longer-term ramifications of these actions. The rapid increase in money supply from multiple stimulus provisions paired with low interest rates and disrupted supply chains has led to higher inflation, with core CPI climbing 3.8 percent annually in May. While above earlier expectations, the Federal Open Market Committee (FOMC) still considers this a transitory concern and intends to allow inflation to stay above the traditional 2 percent growth target for longer than it has in the past. The Fed also expects to keep the overnight lending rate low for the near future, citing still-high unemployment as one reason to hold off. More committee members are now open to the prospect of raising rates in 2023, however. Current quantitative easing practices will also remain in effect for the time being. The FOMC will wait for more substantial economic progress before tapering asset purchases, although some pandemic period programs have already expired.

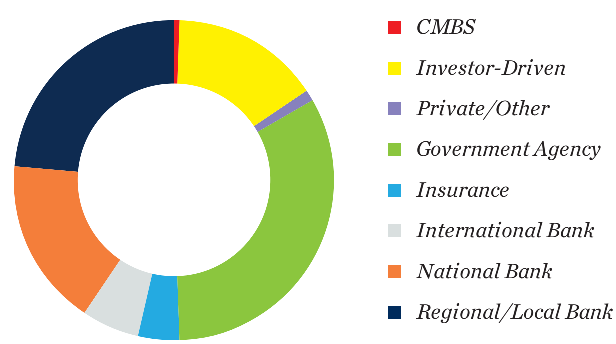
Capital available for well-performing seniors housing assets as marketplace reopens. Following significant disruptions last year, the majority of lenders are now active and anticipating larger volume after 2020's slowdown. Sentiment is improving, aided by greater population mobility that will help properties in commercial and travel hubs that were disproportionately affected by lockdowns. Lenders are nevertheless favoring borrowers with whom they have an established and positive relationship. A borrower's credit worthiness and track record bear considerable weight when accessing capital, as does recent property performance. The acute health threat poised by COVID-19 challenged numerous seniors housing facilities. Properties that have stabilized operations and are well positioned to capture future demand from changing demographics can obtain financing. Government-sponsored agencies are the primary lenders to seniors housing assets in the current marketplace. Other financiers, including banks and debt funds, may provide capital on a case-by-case basis. Overall, while lending volume is not anticipated to recover to 2019 levels, the impact of the health crisis on capital availability is expected to be less severe than that of the global financial crisis. The external nature of the health problem and critical efforts taken by Congress and the Federal Reserve have maintained and are improving liquidity in the market.

Inflation and Interest Rate Trends



* Through May
Sources: BLS; Federal Reserve; Real Capital Analytics

2020 Seniors Housing Lender Composition



Healthcare Real Estate Division

Seniors Housing

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