BRIDGE INVESTMENT GROUP

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ASSESSING THE VALUE PARADIGM FOR SENIORS HOUSING

After nearly three years of pandemic-induced operational challenges, a rising cost environment, and uncertainty and a general lack of conviction in debt capital markets, the Seniors Housing sector appears to be transitioning to an expansionary cycle that could last several years due to projected tailwinds. Expectations tilt to the upside. An upswing in occupancies and rents has taken root, and the key age demographic is on the precipice of what is anticipated to be unprecedented growth, even as construction activity has ratcheted back to a decade low.[1]

THE SENIORS HOUSING VALUE PROPOSITION

Before delving into the driving forces powering the sector's recovery, let's first explore the diverse range of Housing options available to seniors.

While the spectrum of long-term care options ranges from active adult communities through skilled nursing facilities, where patients require particular medical attention, Seniors Housing—for the purposes of this article—comprises independent living, assisted living, and memory care. These communities offer service- and care-enriched housing that allows residents to age in place and are for-rent and private pay, rather than government subsidized and large upfront buy-in fees.

While Seniors Housing offers substantial cost savings relative to in-home care,[2] affordability is a crucial consideration in gauging the potential uplift to the sector overall. With monthly rents that typically range from $3,200 to $6,700,[3] Seniors Housing tends to attract what we have termed the "mass affluent demographic cohort," with personal assets between $350,000 and $500,000. Private-pay Seniors Housing residents typically rely on a combination of income sources such as retirement accounts, pensions, Social Security, and the liquidation of non-financial assets (i.e., financial asset spenddown) to access high-quality housing, which limits government reimbursement and rent collection risk.

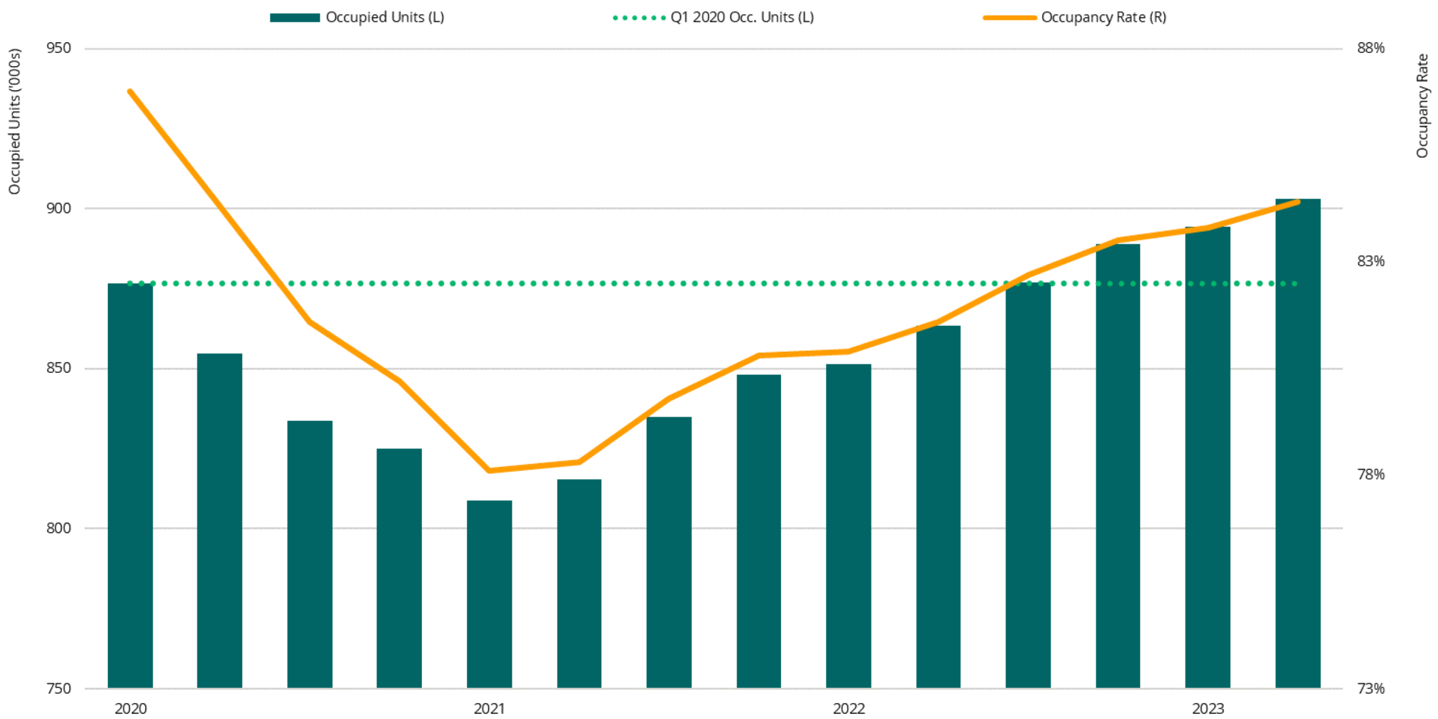
Seniors Housing living offers residents the advantages of vibrant social engagement and round-the-clock support for self-care, medication management, wellness, meals, transportation, and housekeeping. Given that the asset class combines elements of community-based living, hospitality services, and healthcare, we see a direct link between resident satisfaction and asset performance. This means Seniors Housing is an operationally intensive business where specialized operators who can fully meet nuanced individual resident needs are best positioned to deliver exceptional results.

Seniors Housing Spectrum
Source: Bridge Investment Group

SERVICE FEATURES	INDEPENDENT LIVING	ASSISTED LIVING	MEMORY CARE
HOUSING	✓	✓	✓
SOCIAL ACTIVITIES & TRANSPORTATION	✓	✓	✓
HOUSEKEEPING	✓	✓	✓
MEALS	✓	✓	✓
SELF-CARE SUPPORT	✗	✓	✓
DEMENTIA & ALZHEIMER'S CARE	✗	✗	✓

EVOLUTION OF AN INDUSTRY: SENIORS HOUSING ON THE UPSWING

Seniors Housing Occupancies[9]
Source: NIC MAP, as of Q2 2023.



Because Seniors Housing is needs-based, it has historically served as a counter-cyclical asset class by offering resilient performance through macro-cycles. The specific challenges of the recent pandemic, however, disproportionately affected the sector in terms of both demand and operations.

As safety concerns prompted strict regulations and moratoriums that clamped down on resident move-ins, the industry shed 9.2 percentage points in occupancies,[4] undercutting financial results even as front-line employees admirably worked to protect vulnerable resident populations.

As of mid-2023, however, the sector has staged a remarkable turnaround. Market observers may look to a meaningful recovery in fundamentals that has taken root as the pace of resident move-ins has substantially stepped up compared to 2020's subdued levels, while net absorption has carried into positive territory for eight consecutive quarters at double the pre-pandemic average.[5] Occupancy rates are up 6.3 percentage points since 2021 and now stand only 2.6 percentage points short of full recovery.[6] On an absolute basis, the number of occupied units has already rebounded past the previous peak and continues to climb.[7]

These incremental demand gains appear to be poised to accelerate revenue creation and accretive rent growth. Seniors Housing rents experienced challenges throughout the pandemic, but we have observed steady gains over the past several quarters, more recently establishing a new high of 5.7% YOY with regard to effective rent growth as of Q2 2023.[8]

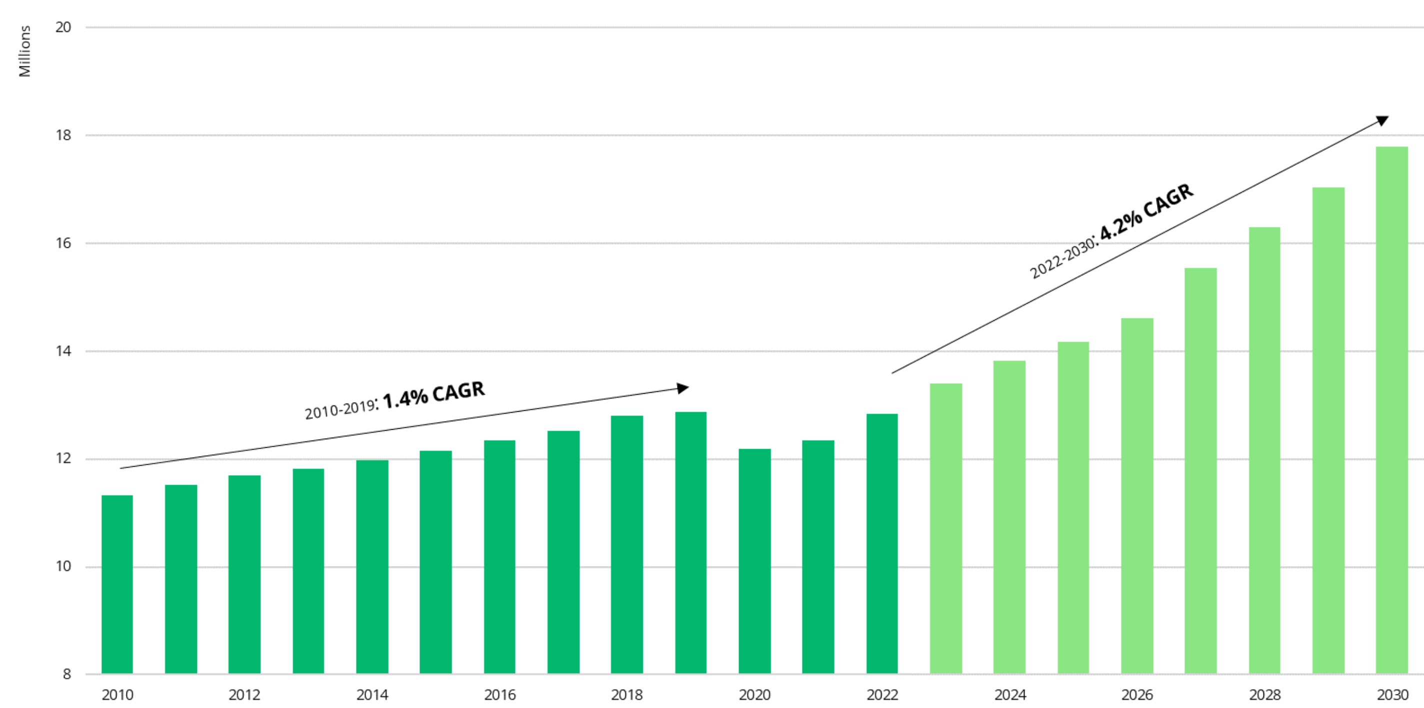
ACCELERATING TAILWINDS FUELING DEMAND

With pandemic disruptions in the rearview mirror, a leading headline in the sector's recovery is what we have termed the "Aging Avalanche," which is the incoming surge in the 80+ population cohort that is setting the table for what we believe will be protracted demand gains. The Aging Avalanche has been discussed at length, and as the crest of a demographic swell arrives, we see two distinct waves of population-driven demand providing meaningful tailwinds.[10]

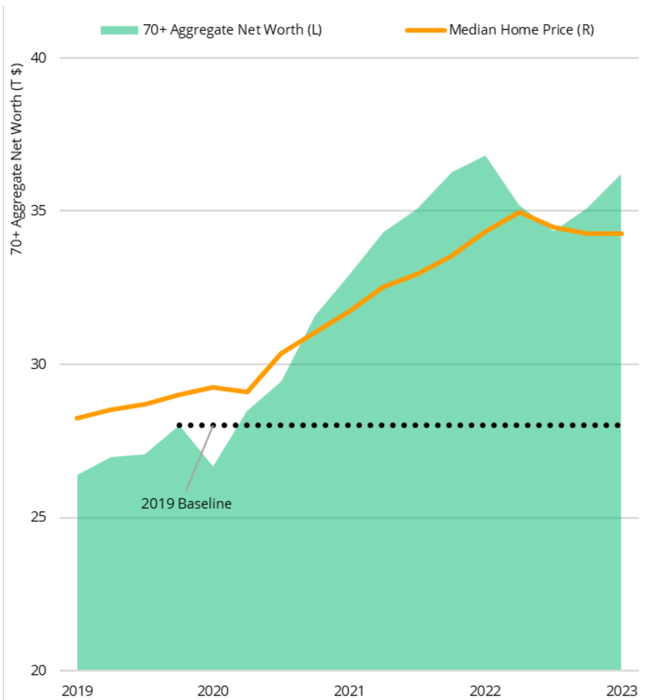
The first wave of the Aging Avalanche is already in motion as the 80+ population is projected to expand by a record-breaking 561,000 people in 2023—more than double the typical annual increase compared to the past ten years and well in excess of prior population growth rates.[11] A second, even larger cohort is projected to rise in 2027 when the 80+ ranks will begin to accelerate by 800,000 people per year, foreshadowing several years of pronounced demand growth potential, leading to a 39% increase in the prime Seniors Housing demographic.[12]

Another touchstone in the sector's outlook is the notable increase in purchasing power among seniors, who are wealthier than ever before, creating a broader potential pool of renters. Since 2019, seniors aged 70 years and older have witnessed a remarkable 29% increase in household net worth, representing an aggregate gain of $9.1 trillion[14] that was fueled in great part by a jump in home values during the pandemic. Additionally, a rise in both the number and the share of retirees with high incomes (i.e., $100,000+ annually) suggests a higher ceiling for pricing power along a longer time horizon.[15]

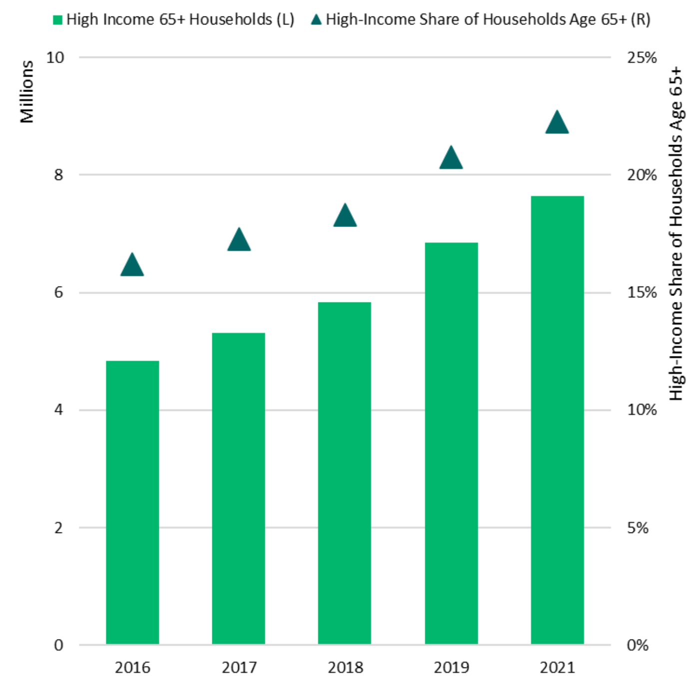
Chart: Accelerating 80+ Population Growth Fueling Seniors Housing Demand[13]
Source: Moody's Analytics, Baseline Scenario, as of June 2023.



Aggregate Net Worth of 70+ Cohort[16]
Source: Federal Reserve, as of Q1 2023.



High-Income ($100,000+) Households Over 65[17]
Source: U.S. Census Bureau, American Community Survey, 2016-2021.



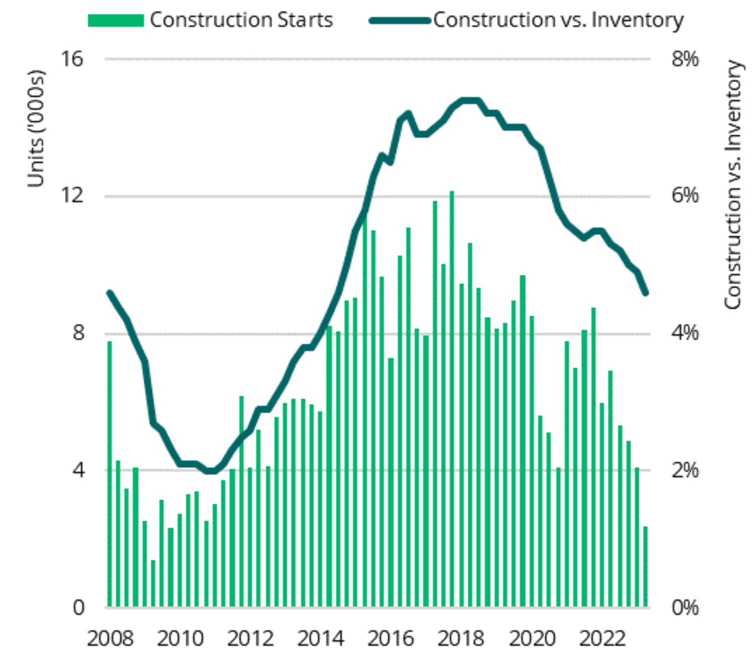
RATE HIKES LIKELY TO MUTE SUPPLY AND CATALYZE TRANSACTION ACTIVITY FOR HIGH-QUALITY ASSETS

Even as demand tailwinds accelerate, hardening debt markets have forced developers to throttle back, marking a stark reversal from the runup to the pandemic when deliveries overshot the market. Seniors Housing construction starts are down 80% since the 2017 peak, registering at a decade low of 2,400 units nationwide, and the number of units under construction as a share of existing inventory is now at the lowest level since 2014.[18] Taken together, these leading indicators are indicative of muted supply growth through at least the next 24 months, and potentially longer if conventional lenders remain largely sidelined for new construction.

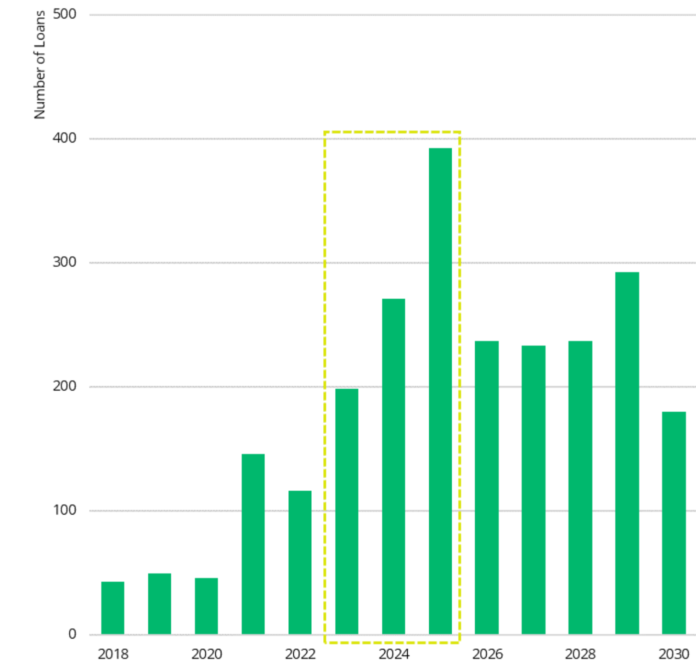
Elevated volatility in debt markets is also reshuffling the investment landscape and could open the door to forced sales of high-quality assets, potentially creating openings for opportunistic buyers with sharp pencils. Between 2023 and 2025, 860 Seniors Housing loans will come due,[20] and borrowers are likely to encounter capital stack stress amid a stricter lending environment that has seen loan-to-value (LTV) ratios retreat.

Further expanding the opportunity set of high-quality investments, private equity funds own ~$12 billion of Seniors Housing assets that are approaching the end of typical asset hold periods, which will likely lead asset managers to consider strategic sales of such assets.[21] At the other end of the investor spectrum, small-scale investors that represent 40% of sector deal flow[22] are often poorly capitalized, raise equity on a deal-by-deal basis, and may also be forced to exit investments upon loan maturity as the current debt capital environment is not accretive for short-term extensions.

Seniors Housing Construction Starts at an Eight-Year Low[19]
Source: NIC MAP, as of Q2 2023.



Seniors Housing to See a Wave of Loan Maturities in 2023-2025[23]
Source: MSCI Real Capital Analytics, as of June 30, 2023.



TANGIBLE TAILWINDS

Fundamentals are creating tangible tailwinds, and projections continue to trend upward just as the Aging Avalanche begins swelling the ranks of the prime Seniors Housing demographic cohort and boosting demand. At the same time, the recent central bank rate hike cycle is undercutting development activity to the lowest levels in years and is likely to result in an uptick in sales of assets with attractive operations but misaligned capital stacks.

With many of the challenges of the pandemic now in the rearview mirror, the Seniors Housing sector is primed for a new phase of expanded opportunity.

About the Authors

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Notes

1 NIC MAP, as of Q2 2023. Moody's Analytics, Baseline Scenario, as of June 2023.

2 Genworth, Cost of Care Survey.

3 NIC Investment Guide: Investing in Seniors Housing & Care Properties, 6th Edition.

4 NIC MAP, as of Q2 2023.

5 NIC MAP, as of Q2 2023.

6 NIC MAP, as of Q2 2023.

7 NIC MAP, as of Q2 2023.

8 NIC MAP, as of Q2 2023.

9 NIC MAP, as of Q2 2023.

10 Moody's Analytics, Baseline Scenario, as of June 2023.

11 Moody's Analytics, Baseline Scenario, as of June 2023.

12 Moody's Analytics, Baseline Scenario, as of June 2023.

13 Moody's Analytics, Baseline Scenario, as of June 2023.

14 Board of Governors of the Federal Reserve System, Distributional Financial Accounts, as of Q1 2023.

15 U.S. Census Bureau, American Community Survey One-Year Estimates: Table B19037, 2016-2021. 2020 data unavailable due to Census survey difficulties during the pandemic.

16 Board of Governors of the Federal Reserve System, Distributional Financial Accounts, as of Q4 2022.

17 U.S. Census Bureau, American Community Survey One-Year Estimates: Table B19037, 2016-2021. 2020 data unavailable due to Census survey difficulties during the pandemic.

18 NIC MAP, as of Q2 2023.

19 NIC MAP Data and Analysis Service, as of Q2 2023.

20 MSCI Real Capital Analytics, as of June 30, 2023. Includes assets and portfolios valued at $2.5 million and greater

21 Preqin, as of Q2 2023

22 MSCI Real Capital Analytics, as of June 30, 2023. Includes assets and portfolios valued at $2.5 million and greater.

23 MSCI Real Capital Analytics, as of June 30, 2023. Includes assets and portfolios valued at $2.5 million and greater.

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