Marcus & Millichap

National Report

Seniors Housing Research

First Half 2017

Elevated Home Prices Invigorate Seniors Housing Demand But Prospects of Healthcare Reform Raise New Questions

The aging U.S. population is a major driver in today's seniors housing segment. A weakened housing market as a result of the Great Recession encouraged many older Americans to extend stays in residences, and the homeownership rate of those older than age 75 peaked in the years that followed. A strengthened housing market, however, is prompting many seniors to sell homes and move into seniors housing communities, where broader access to care is available. While this has increased demand for seniors housing properties today, the segment is also preparing to receive an influx of residents over the next several years as baby boomers head into retirement and require the services of seniors housing communities, prompting a rise of new units. Majority assisted and independent living facilities are set to receive the bulk of deliveries for the foreseeable future, though the construction of memory care units is on the rise to meet increased demand that supports the care of seniors with dementia.

Senior-care providers must balance industry changes. In an effort to reduce resident turnover, seniors-care operators are striving to attract and service a wider range of residents. Advances in medical technology and the integration of third-party ancillary service providers are aiding in the convergence of independent living, assisted living, and memory care units. Meanwhile, healthcare reform, specifically related to reductions in Medicare and Medicaid reimbursements, are causing a shift in the skilled nursing segment. Some facilities are choosing to focus on short-term, post-acute care patients instead of serving long-stay, custodial-care residents in an effort to improve profit margins.

Investment Highlights

- REITs are focused on assisted and independent living properties, while restructuring portfolios by selling off skilled nursing centers. Rising interest rates, however, could put upward pressure on cap rates, which average in the 7 percent to mid-8 percent range.
- Memory care facilities are generating significant interest from private buyers, and initial yields for these assets range from 7 percent to 8 percent.
- Private capital accounts for the largest share of skilled nursing transaction velocity. Unleveraged returns for skilled nursing properties average near 12 percent.

2017 Seniors Housing Market Highlights

Occupancy up
10 basis points

Independent Living (IL):

Occupancy at IL centers will rise 10 basis points this year to 91.8 percent as healthy demand for units persists in the wake of elevated construction. In addition, rent growth remains steady, rising 3.0 percent annually to $3,109 per month.

Occupancy down
40 basis points

Assisted Living (AL):

Mounting completions put additional downward pressure on stabilized occupancy this year despite healthy demand, and the occupancy rate falls 40 basis points to 89.3 percent by year-end. The average monthly rent will climb at a healthy clip, rising 3.1 percent to $4,601 per month.

Occupancy down
40 basis points

Skilled Nursing (SN):

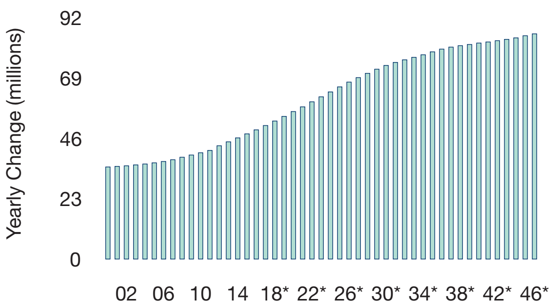
Occupancy at skilled nursing facilities will continue to dip despite units coming out of service, reaching 86.4 percent by year-end, a decline of 40 basis points. This dip will have little effect on rent growth and the average daily rate will rise 2.0 percent to $308 per bed per day.

Occupancy up
30 basis points

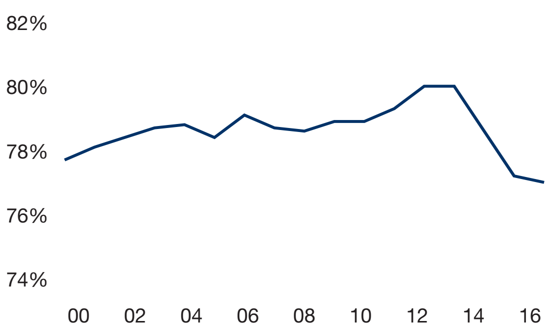
Continuing Care Retirement Communities (CCRCs):

The national stabilized occupancy rate at CCRC centers continues to rise this year, reaching 91.1 percent by year-end on a 20-basis-point annual increase. The average monthly rent will also advance, climbing 2.7 percent year over year to $3,189 per month in 2017.

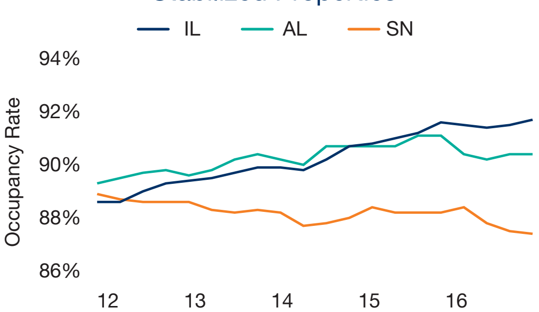
65+ Population (millions)



75+ Homeownership Rate



Seniors Housing Occupancy Rates
Stabilized Properties



* Forecast
Sources: Marcus & Millichap Research Services; NIC MAP® Data Service; CoStar Group, Inc.

Independent Living Facilities

- After rising consistently for five straight years, stabilized occupancy held firm in 2016, resting at 91.7 percent in the fourth quarter and remaining near its previous peak of 92 percent set in early 2008. Demand for IL units is strong with absorption rising from 2015 as more than 7,500 units were filled.
- Majority IL inventory growth reached a seven-year peak during 2016 as developers brought nearly 9,400 units online. Completions during the year were well above the average annual deliveries during the span but remained below pre-recession levels. More than 19,000 IL units were under construction at the end of last year, suggesting that deliveries will remain elevated.
- Rent growth at IL units strengthened last year as occupancy continued to remain near peak levels. A 3.4 percent advance pushed up the average to $3,017 per month. Strong demand for units in spite of rising deliveries over the past few years has facilitated a healthy pace of rent growth across the IL segment, a trend that will persist through the remainder of this year.
- IL property sales declined by nearly half during the last year, largely due to a reduction in the number of portfolio deals occurring compared with the prior year. The average price per unit held relatively firm, however, at $188,900, and first-year returns normalized in the low-7 percent area.

Outlook: Strong demand persists, though construction remains elevated in the IL sector this year, and the stabilized occupancy rate will end the year at 91.8 percent, up 10 basis points from 2016. This will encourage a healthy pace of rent growth in the months to come, and the average will rise 3.0 percent year over year to $3,109 per month.

Assisted Living Facilities

- Supply additions outweighed demand over the past year as 11,050 AL units were filled, and occupancy fell below 90 percent for the first time since 2011. In 2016, occupancy declined 70 basis points year over year to 89.7 percent. With construction remaining elevated, occupancy is likely to retreat further this year.
- The completion of nearly 17,700 majority AL units during 2016 reached the highest level of deliveries in seven years. Approximately 30,300 units were underway at the beginning of 2017, down slightly from the previous year. AL development makes up the bulk of seniors housing construction.
- Rent growth for AL units continued to strengthen last year, advancing 3.5 percent annually to $4,464 per month. The gain in the average was the healthiest in the last eight years.
- AL properties built since 1990 remain in the highest demand, accounting for approximately 65 percent of trades during 2016. While investors continue to heavily target Southern and coastal markets, Midwestern states such as Kansas and Wisconsin are capturing a larger share of buyers. Last year, AL properties changed hands for an average $158,600 per unit, with initial yields in the low-8 percent area.

Outlook: Occupancy will stay relatively in line with levels over the previous 10 years, though supply-side pressure remains a concern for AL operators. This year, the rate will fall 40 basis points to 89.3 percent, and strong absorption trends will encourage rent growth to remain healthy, pushing up the average 3.1 percent to $4,601 per month.

Skilled Nursing Facilities

- Stabilized occupancy at majority SN centers fell 60 basis points during the last year to 86.8 percent, reaching an eight-year low. Occupancy is trending downward due to many factors, including changes in the care delivery model and reimbursements, though beds continue to be removed from inventory.
- Majority SN inventory declined again in 2016 as approximately 600 beds were removed from inventory. In the previous year, SN stock fell by more than 1,000 beds, continuing a trend that has persisted for the past few years. The construction pipeline thinned significantly over 2016, with 4,900 SN beds underway at the end of the fourth quarter, compared with 8,300 beds one year ago.
- The average daily rate at SN facilities continued to rise last year, largely due to the increasing cost of medical care. During 2016, the average topped $300 per bed per day for the first time after climbing 2.4 percent. This was a slowdown from 2014 and 2015 when the average advanced 2.9 percent and 3.1 percent, respectively.
- Price appreciation for SN facilities in many Southern, Northeastern and Midwestern states contributed to a healthy gain in the average price per bed last year, which reached $91,600, the highest level in five years. The average cap rate for SN assets hovered in the mid-9 percent area during 2016, remaining compressed when compared with prior years.

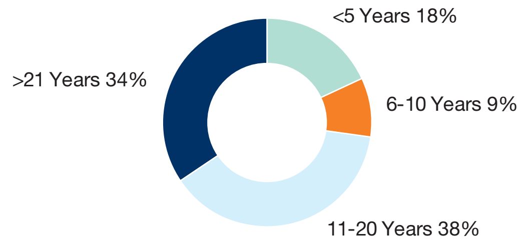
Outlook: In 2017, occupancy will fall 40 basis points to 86.4 percent despite the removal of additional units from service. Rent growth remains healthy, with the average rising 2.0 percent to $308 per bed per day this year.

Continuing Care Retirement Communities

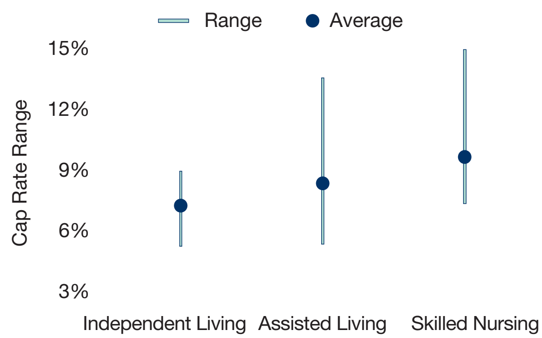
- CCRC occupancy has hovered between 90 percent and 91 percent for the past two years, ticking down 10 basis points in the last 12 months to 90.9 percent. As the number of units underway continues to diminish, occupancy should remain elevated through 2017.
- Inventory of CCRC units grew by nearly 3,900 during 2016, the highest level of completions since 2009. The construction pipeline has thinned over the last two years, with the number of units underway peaking at the end of 2015. Currently 5,800 units are underway, suggesting that deliveries will temper this year.
- After rising steadily for the past few years, rent growth for CCRC units strengthened. The average rent advanced 3.3 percent to $3,104 per month. Approximately half of all CCRCs require entrance fees, which averaged near $314,000 during 2016.
- Nearly 50 percent of all CCRC properties trading during the last 12 months were built before 1990, and the sale of older facilities is reflected in the average price per unit. In 2016, the price averaged $107,800 per unit, down 25 percent from the peak achieved in 2014 when the bulk of trades were newer construction properties. Cap rates averaged in the low- to mid-7 percent area last year.

Outlook: Occupancy at CCRCs will rise 20 basis points this year to 91.1 percent as demand remains strong and completions taper slightly. This encourages rent to grow at 2.7 percent to $3,189 per month by year-end.

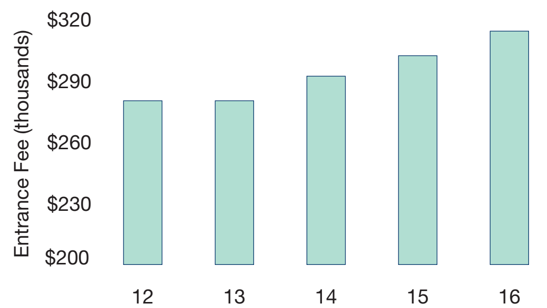
Age of IL and AL Properties Sold During 2016



2016 Seniors Housing Cap Rates



Average CCRC Entrance Fee

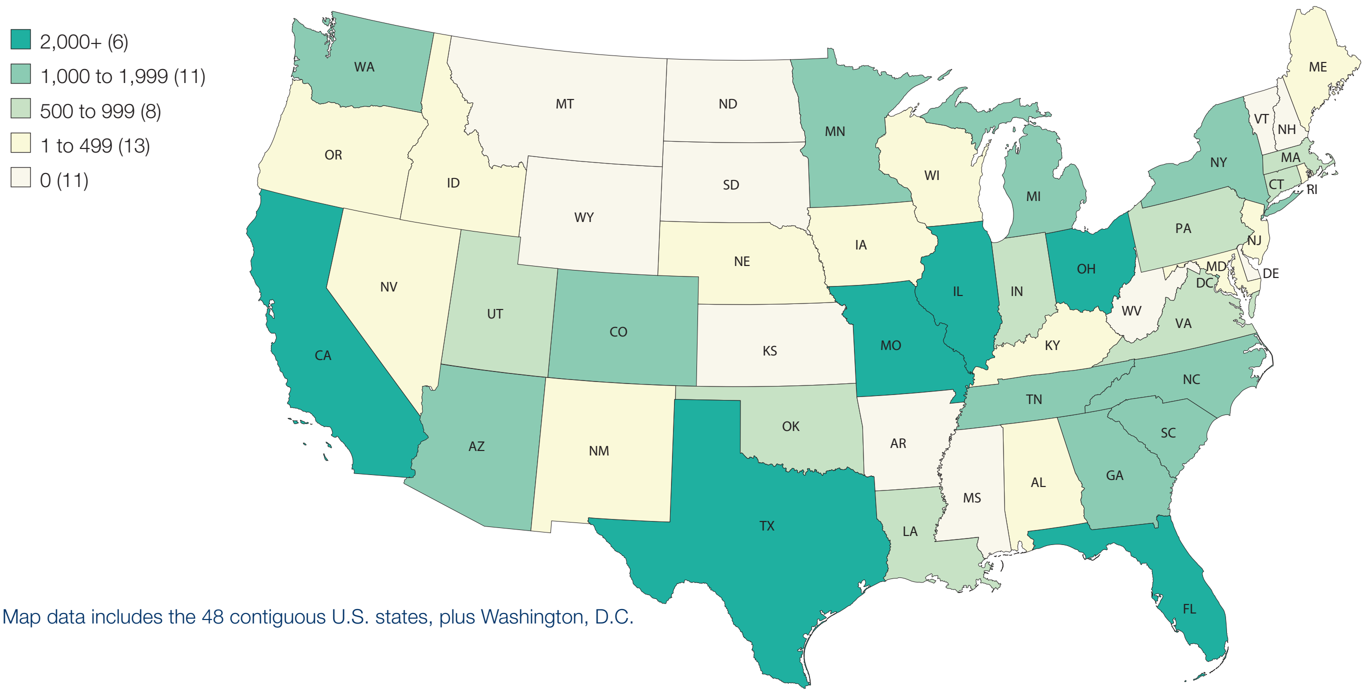


Sources: Marcus & Millichap Research Services; NIC MAP® Data Service; CoStar Group, Inc.

Seniors Housing Units Under Construction in 2017

Source: NIC MAP® Data Service

Number of Units (Number of States)



Map data includes the 48 contiguous U.S. states, plus Washington, D.C.

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Accelerating Home Prices Unlock Demand for Seniors Housing

Homeownership among the 75 and older age segment nears decade low. Following the Great Recession, single-family home prices fell nearly 30 percent, keeping many seniors from cashing out home equity and funding their transition into seniors housing. For those older than age 75, homeownership peaked at more than 80 percent in early 2013 as households extended stays and waited for the market to rebound. As single-family home prices have surpassed their prior peak over the last few years, the homeownership rate for this age segment has fallen closer to the long-term average of 75 percent, suggesting that many seniors are taking advantage of appreciated home values by selling and moving into seniors housing communities.

Sales of homes help seniors cover long-term-care costs. IL communities, in particular, are heavily reliant on private-pay residents, meaning seniors and their families must foot the bill to reside in the facility. Private pay is also the most common form of payment among long-term-care patients in all segments of seniors housing, and in many cases, it may be the only option available. The return of home prices to previous levels has allowed seniors to take advantage of untapped equity to help fund stays in senior care facilities, helping to mitigate the housing-related costs not covered by Medicare and Medicaid.