United States | Spring 2020

JLL Research Report

Seniors Housing & Care

Investor Survey and Trends COVID-19 Update

The Delaney at Georgetown Village, Georgetown, TX
Provided by LCS

Contents

Now in its third month, the COVID-19 pandemic is manifesting a new set of changes and challenges to commercial real estate. Across the seniors housing and care sector, owners and operators have faced these unprecedented challenges head-on, and are quickly and increasingly adapting to apply learned best practices that insure the health and wellbeing of their residents.

To shed more light on the full impact of COVID-19 on market valuations, current and future, JLL Valuation Advisory has updated our Spring 2020 Investor Survey (conducted pre-COVID-19) to reflect the sentiment and underwriting practices of market professionals.

Executive summary

The COVID-19 pandemic interrupted a nearly twelve-year growth cycle for seniors housing. Prior to the pandemic, capitalization rates compressed to all-time lows as market valuations continued to climb.

Eight weeks into the COVID-19 pandemic, the seniors housing sector is showing signs of rejuvenation, once again proving its resiliency despite some early concerns.

Stabilized occupancy is down only 110 basis points for seniors housing and down 220 basis points for nursing care. Seniors housing, including the more lifestyle focused active adult and independent living segments have outperformed initial expectations, mainly attributed to the favorable housing market, unlike the 2008 2009 financial crisis.

Rent collections remain stable with little to no change in loss-to-lease.

Operating expenses have increased by 3% to 10% year-to-date. Revised operator budgets are projecting an annual increase of 4.4% to 11.6% for seniors housing and 8.1% to 12% for nursing care properties, with means towards the lower end of the range, respectively.

Operators expect expenses to stabilize at 20% of the current COVID-19 premiums, or 1% to 2% above pre-COVID-19 levels and are already beginning to report declines as conditions normalize.

While survey participants indicate an increase in capitalization rates from prior to the pandemic, this increase is largely attributed to the uncertainty of the current COVID-19 environment rather than underlying capital market conditions, and they expect capitalization rates to normalize post COVID-19. Already, capital is starting to free up and deals are getting done.

On the bright side, the pandemic has accelerated the development of new innovations within technology, infrastructure and design.

Long-term investor sentiment remains cautiously bullish as experts prepare for the “silver tsunami” with the leading-edge baby boomer now within a ten-year investment cycle of occupancy.

Market snapshot pre-COVID-19

The rolling four-quarter seniors housing transaction volume totaled $12.5 billion as of the first quarter of 2020, the highest level reported since Q1 2016. Capitalization rates for seniors housing declined to an all-time low of 5.9%, only 60 bps above the average for apartments. Seniors housing valuations flattened, with the price per unit averaging $170,000.

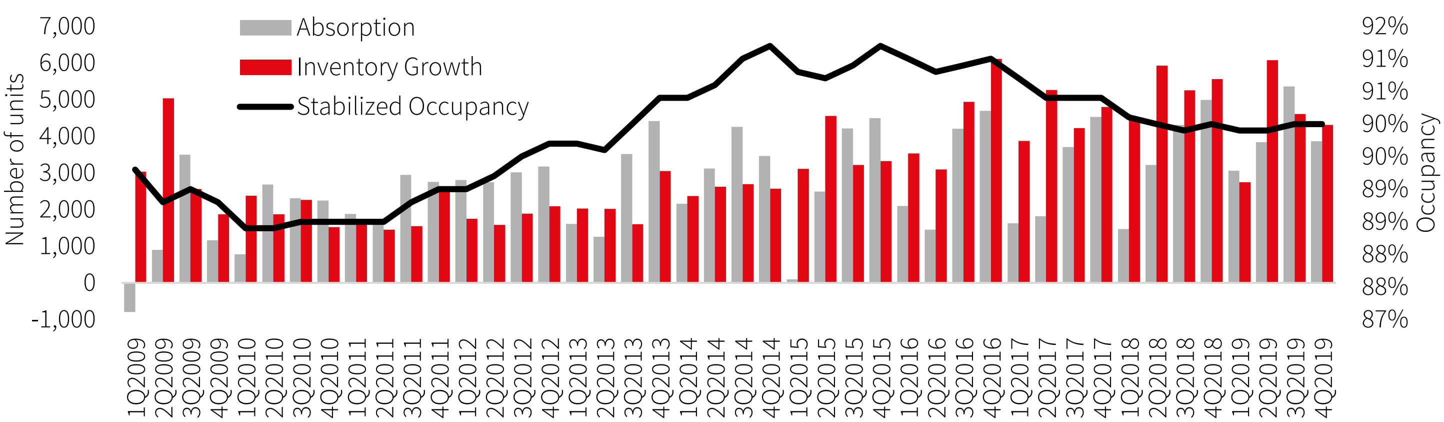
Conversely, the rolling four-quarter nursing home volume was reported at $4.4 billion, the lowest volume reported since 2014. The price per bed for nursing homes increased slightly to $75,250, as capitalization rates pushed upward to 12.5%.

Occupancy and rent growth for seniors housing continued to trend upwards due to a favorable supply-demand balance; construction reported the ninth-straight quarter of declining starts with the rolling first quarter 2020 starts down 40% from the 2018 peak. The most significant challenges facing the industry were labor shortages and other rising costs.

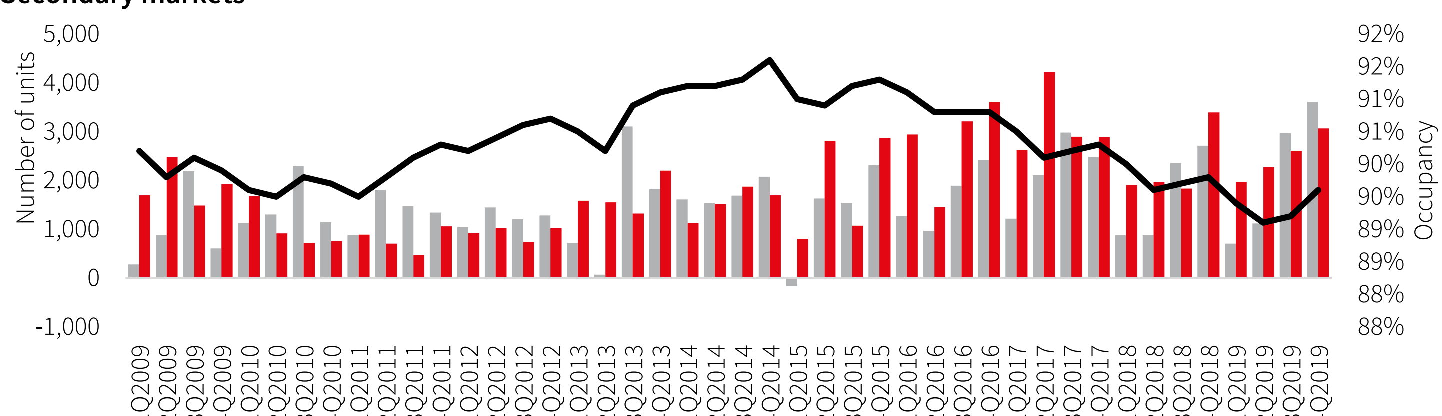
The occupancy rate for skilled nursing continued to stabilize as inventory growth decelerated. Skilled mix increased 41 basis points to 25.0% in the first quarter of 2020, while Medicare revenue per patient day increased by 4.6%, ending Q1 2020 at $544, primarily given the implementation of the patient driven payment model (PDPM).

Pre-COVID-19 Market trends market fundamentals – Seniors Housing

Primary markets



Secondary markets



Source: National Investment Center for Seniors Housing & Care, NIC MAP Q1 2020

COVID-19 impact on Seniors Housing & Care operations

Revenue
Declining occupancy has made the greatest impact on revenue. However, occupancy levels are segmented by market, with some properties being more affected than others; this makes it challenging to state a baseline.

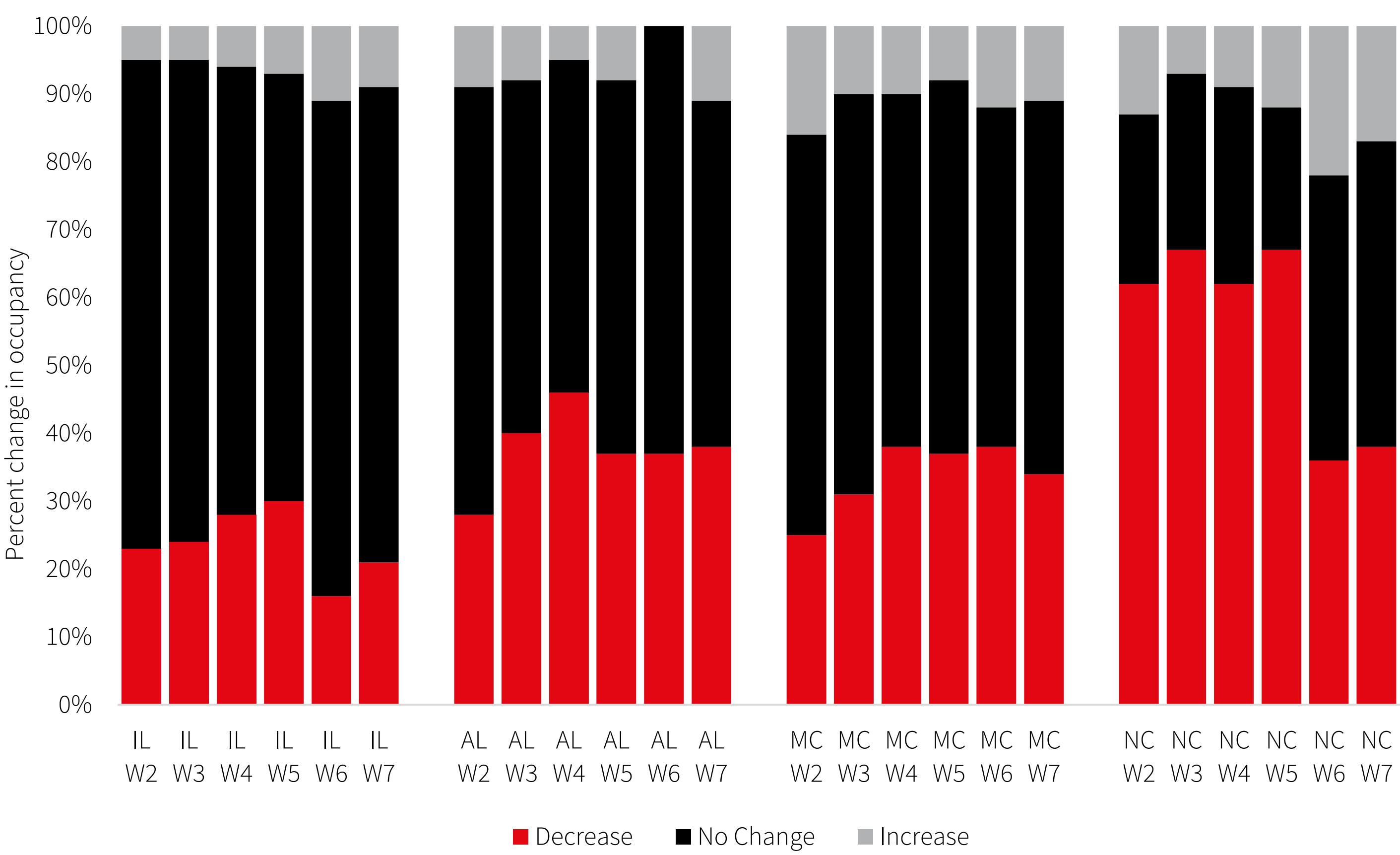
However, according to a survey of 155 operators conducted May 24, 2020 by the National Investment Center of the Seniors Housing & Care Industry, the weekly decline in occupancy has stabilized.

Stabilized occupancy is down 110 basis points to 88.7% for seniors housing and down 220 basis points to 84.7% for nursing care from pre-COVID-19 levels. According to the same survey, the reason for decelerating occupancy was reported as an organization-imposed ban or government-imposed ban by most respondents.

Rent collections remain stable with little to no change in loss-to-lease. JLL valuations have identified a 1% to 7% decline in effective gross revenue, with an average close to 2%.

For nursing care, elective surgeries were put on hold resulting in a significant impact on the Medicare census.

Change in occupancy by care segment: Current vs. One-week prior



Source: National Investment Center for Seniors Housing & Care, COVID-19 Resource Center, May 24, 2020

Operating expenses

The increase in operating expenses is the primary driver of changes in valuations. Personal Protective Equipment (PPE) and increased staffing costs represent the lion's share of operating expenses increases. Insurance premiums are also being requoted. Market valuations completed by JLL have identified an overall operating expense increase of 3% to 10% year-to-date.

Revised operator budgets project an annual increase of 4.4% to 11.6% for seniors housing and 8.1% to 12% for nursing care properties, with a mean towards the lower end of each range.

Most of these expense premiums are short-term and are expected to normalize post pandemic. Some long-term impact on staffing expenses is likely, as a result of increased regulatory requirements and PPE reserve requirements.

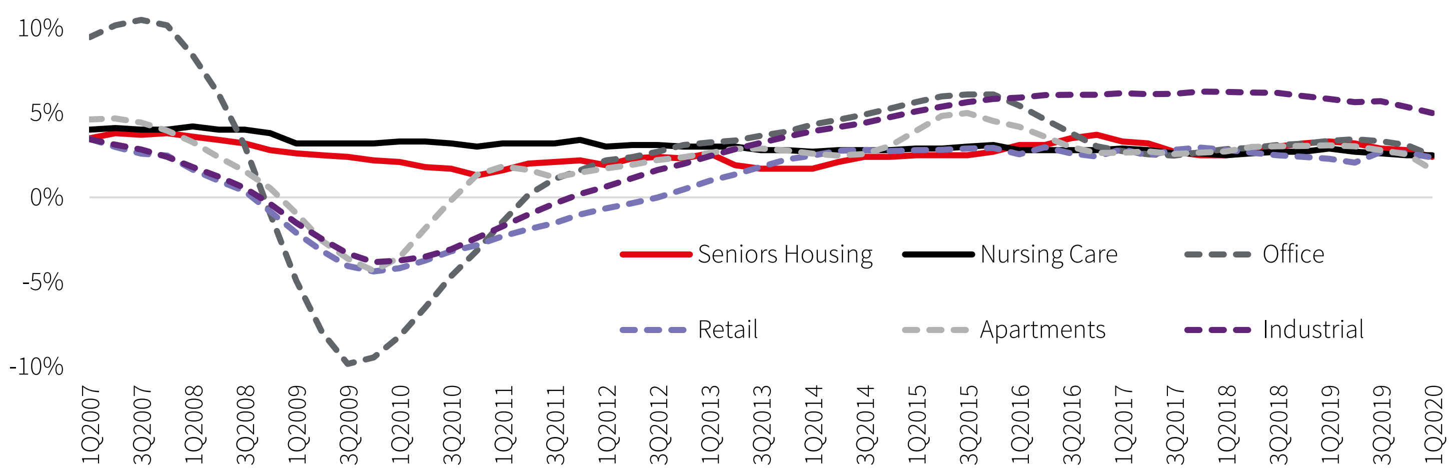
Market valuations

Operators expect expenses to normalize at 20% of the current COVID-19 premiums and are already beginning to report declines in actual operating expenses. Market valuations are being reported at an approximate 5% discount to pre-covid-19 pricing.

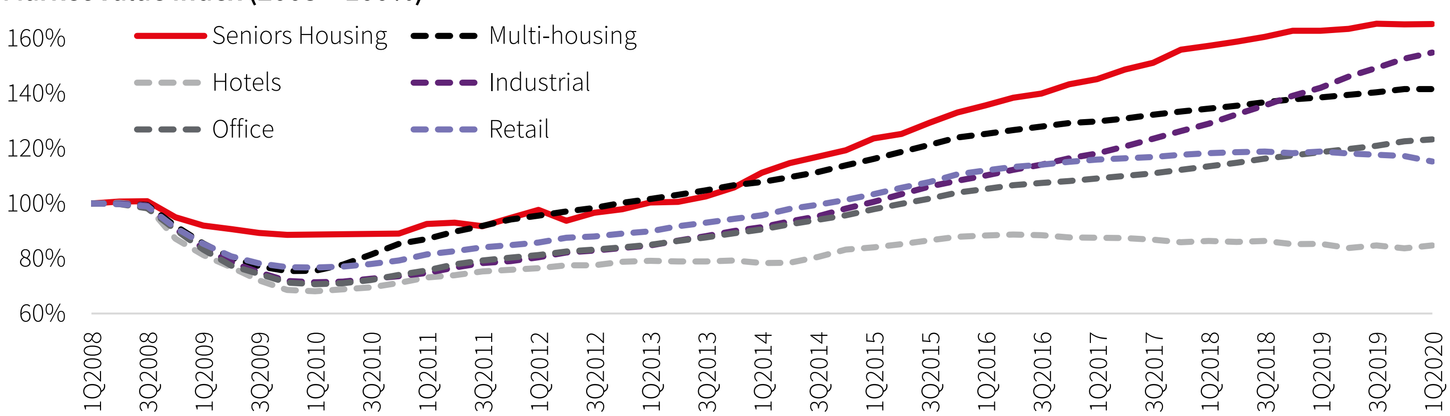
Looking at the global financial crisis of 2008 and 2009, seniors housing and nursing care year-over-year rent growth never went negative; in fact, levered IRRs in this sector outperformed other commercial real estate asset classes by 500 to 700 basis points , attributed to the need-driven demand component and overall cycle resilience.

Furthermore, during this period seniors housing values experienced relatively mild pricing impact. Given these strong numbers, many are remaining hopeful for a stronger future as we head toward re-entry. Why? Because of cycle resistance?

Rolling four-quarter rent growth by sector



Market value index (2008 = 100%)



Source: JLL Research, NCREIF; based on equal weighted Market Value Indicator Index

Rebuilding for a better future

Although the sector faces meaningful challenges in the present, many are looking to what the future holds. Medium and long-term investment sentiment is still bullish as experts prepare for the “silver tsunami”, with the leading-edge baby boomer now within a ten-year investment cycle of occupancy.

In the short-term

Federal stimulus programs have provided much needed relief. The $2.2 trillion CARES Act included $100 billion for qualified healthcare providers. The Department of Health & Human Services (HHS) announced nearly $4.9 billion distribution to nursing homes impacted by COVID-19. Coronavirus Stimulus Bill includes $200 million for nursing homes infection-control efforts, with industry lobbyists working for additional government relief.

In the long term

Safety is key. Buildings across the United States are applying safety guidelines and protocols to ensure the safety of staff and residents. Curtailed construction caused by this pandemic only magnifies the long-term supply shortage. Considering global economic impact of COVID-19, the need to serve the middle-income population will continue to grow.

In a sector already poised for disruption, we are seeing an acceleration of existing trends and innovations with the emergence of new innovations such as technology, infrastructure and design. Healthcare leaders are hyper focused on the health and safety of their residents, as they reopen to meet the demands of this burgeoning population.

Investor survey results

The JLL Spring 2020 Investor Survey focused on transactional professionals who specialize in the seniors housing and care space and includes 109 respondents. These professionals represent the most influential leaders in our sector. When updating this survey to reflect investor sentiment during COVID-19, this survey was extended to the same 109 respondents.

The information presented in the following table and charts represent the results of our Spring 2020 investor survey juxtaposed with the recent COVID-19 survey. The intention of this survey is to garner insights into market sentiment during these challenging and unprecedented times.

Capitalization rates by investment class

Respondents were asked to select the most appropriate capitalization rate range, applied to year 1 stabilized net operating income, inclusive of market level management fees and replacement reserves, for core or primary market locations and by class.

Core Capitalization Rates (%)	Class A					Class B					Class C				
	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)
Active Adult	4.0	6.0	4.8	5.5	64.7	4.5	7.0	5.8	6.4	60.7	5.5	8.0	7.0	7.2	16.8
Independent Living	4.0	6.5	5.4	6.0	59.2	5.0	8.0	6.5	6.9	38.0	6.0	9.5	7.7	7.7	2.2
Assisted Living	5.0	7.0	5.9	6.4	46.1	5.5	8.5	7.0	7.3	35.4	6.0	10.0	8.2	8.3	8.5
Memory Care	6.0	9.0	7.3	7.8	48.2	6.0	10.0	8.1	8.5	41.6	7.0	11.0	9.1	9.3	20.4
Nursing Care	9.0	12.0	11.0	11.7	74.6	10.0	13.0	12.0	12.6	63.8	11.0	15.0	13.1	13.5	33.3
CCRC/LPC	5.0	10.0	7.4	7.9	48.2	6.0	10.5	8.2	8.5	32.6	7.5	10.5	8.9	9.1	23.8

Non-Core Capitalization Rates (%)	Class A					Class B					Class C				
	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)
Active Adult	4.0	7.0	6.0	6.4	44.9	5.0	8.0	6.6	7.1	48.0	6.0	10.0	7.7	7.7	1.9
Independent Living	5.0	8.0	6.4	6.8	37.8	5.5	9.0	7.3	7.5	23.5	6.0	11.0	8.2	8.4	19.6
Assisted Living	5.5	8.0	7.0	7.3	35.6	6.0	9.0	7.7	8.0	28.9	6.5	11.0	8.8	8.9	8.3
Memory Care	6.0	10.0	7.8	8.5	65.2	6.5	10.5	8.5	9.1	53.3	7.5	11.5	9.4	9.8	45.1
Nursing Care	10.0	14.0	11.4	12.3	86.9	10.0	15.0	12.7	13.2	52.9	12.0	16.0	14.0	14.2	13.9
CCRC/LPC	6.0	10.0	8.0	8.6	57.2	7.0	11.0	8.7	9.2	48.4	8.0	11.5	9.7	9.8	12.4

The COVID-19 capitalization rate indications are on a short-term basis and do not account for any normalization of COVID-19 expenses. Capitalizing current cash flow in perpetuity would be overly punitive. Most market participants expect capitalization rates to compress post COVID-19.

Unleveraged yield rates by investment class

With little transactional data and short-term volatility of cashflows, investors are more often relying on the discounted cashflow analysis. The percentage of survey respondents relying on the discounted cashflow analysis increased from 46% to 58% during COVID-19.

Respondents were asked to indicate their minimum unlevered yield rate by both investment class and product type.

All Markets	Class A					Class B					Class C				
Unlevered Yield (%)	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)	Low	High	Avg.	CV-19 Avg.	Change (bps)
Active Adult	5.0	8.0	6.9	6.9	2.5	5.0	9.0	7.8	7.9	13.3	6.0	10.0	8.6	8.8	11.7
Independent Living	6.0	9.0	7.7	7.7	-4.0	6.0	10.0	8.5	8.6	5.0	7.0	11.0	9.3	9.5	15.1
Assisted Living	6.0	10.0	8.2	8.2	-1.0	6.0	11.0	9.0	8.9	-6.7	7.0	12.0	9.9	10.0	10.7
Memory Care	7.0	12.0	9.2	9.4	18.0	7.0	13.0	10.3	10.3	-5.1	7.0	13.0	11.1	11.2	12.1
Nursing Care	11.0	15.0	13.2	13.6	37.3	11.0	16.0	14.2	14.4	17.3	13.0	17.0	15.3	15.3	-1.8
CCRC/LPC	7.0	12.0	9.3	9.4	6.0	8.0	13.0	10.4	10.6	14.6	9.0	13.0	11.1	10.9	-19.2

Composition of respondents

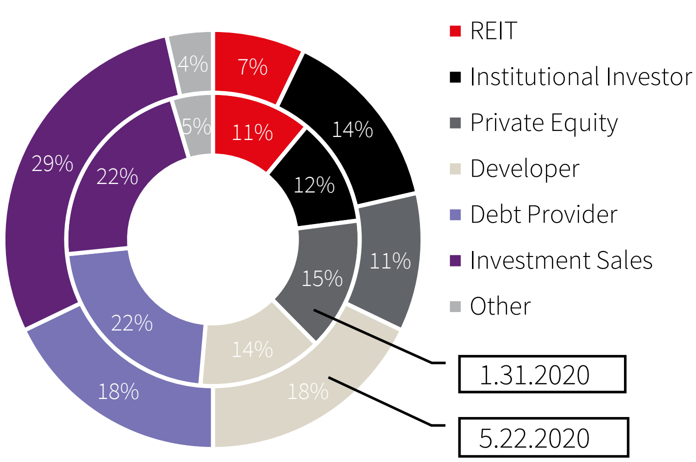
Most survey respondents were represented by investment sales professionals and debt providers, at 22% of total respondents each. Private equity and developers represented the next level of respondents at 15% and 14% of respondents respectively.

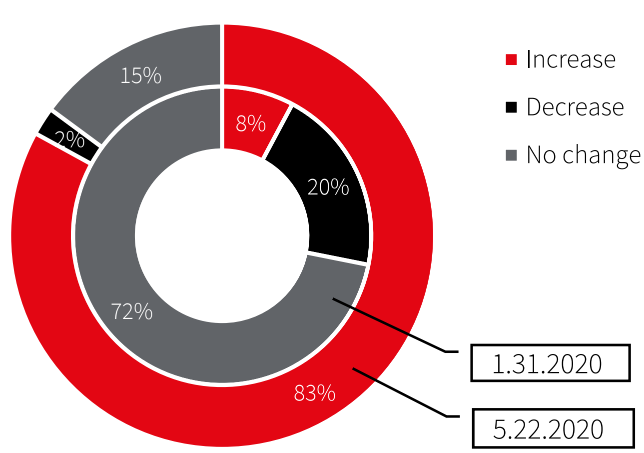
The COVID 19 update survey was sent only to the prior participants with a similar distribution of respondents.

Outlook for capitalization rates

Investor sentiment jumped from 72% of respondents expecting no change in seniors housing capitalization rates, to 83% expecting an increase as a result of COVID-19.

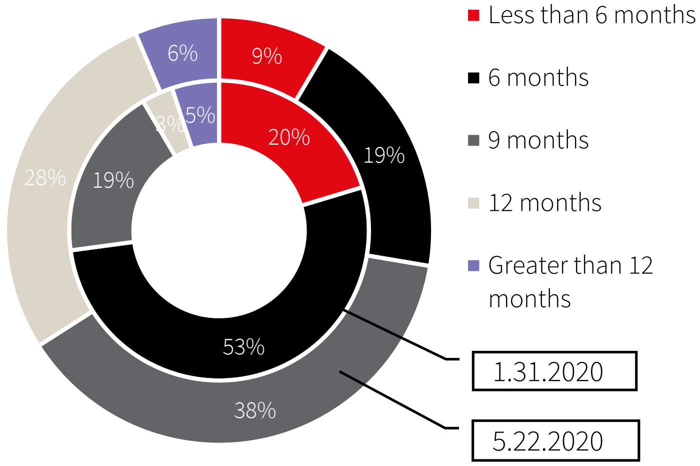
The industry consensus is that capitalization rates will mostly return to pre-COVID-19 levels post recovery.





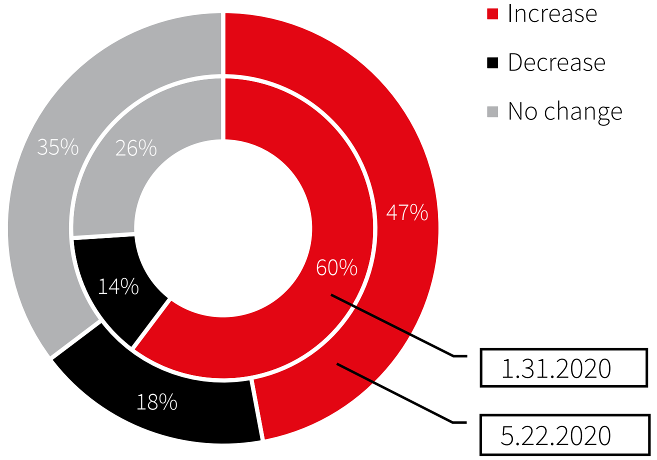
Marketing time

The expected marketing time has increased from six months to nine to 12 months. While most investors remain cautiously active, logistical uncertainties related to due diligence and closing procedures has delayed marketing time. However, transaction activity is picking back up.



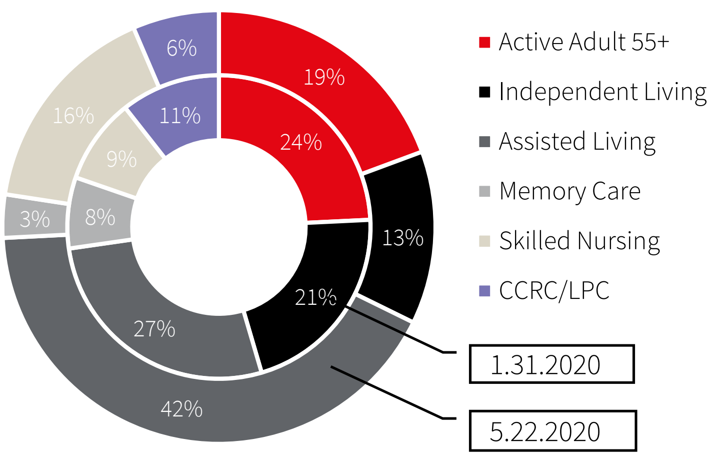
Investment exposure

While the amount of survey respondents expecting to increase their exposure to seniors housing and care decreased, this category still represented most respondents at 47%. The number of respondents looking to decrease their exposure increased slightly from 14% to 18% with the remaining 35% expecting no change in their exposure.



Biggest opportunity for investment

Most interesting, investors are gravitating back to the more need driven or traditional seniors housing component, after the emergence of active adult.



Investment class and locational descriptions

Investment class

Class A:
Excellent quality assets located in highly desirable market locations, primarily core markets, but can be in non-core markets. Construction is steel-frame or reinforced concrete, with an average age less than 10 years. Building finishes are high-end or superior to the market with top quality FF&E, state-of-the-art technology, and enriched amenities. Capture a greater than its proportionate share of the market with occupancy levels and rent growth that outperforms the market, targeting a high net worth population. Nursing care properties are best described as being located on or near a healthcare campus with state-of-the-art therapy space and equipment. Resident rooms are primarily private with quality mix that outperforms the market.

Class B:
Good to average quality assets located in core and non-core market locations. Construction consists of steel-frame, reinforced concrete or wood frame with an effective age between 10 and 25 years. Building finishes, FF&E, technology, and amenities are considered adequate or average to the market and becoming dated. These properties capture their proportionate share of the market with average occupancy and rent levels consistent with the market, but generally do not compete with investment class A assets. For nursing care, functional design, primarily containing private and semi-private resident rooms, and adheres to life safety code. The payor source is primarily Medicaid with a census mix and private pay rates consistent with the market.

Class C:
Average to fair quality assets located in non-core locations. Construction is wood frame with an effective age older than 25 years and may be non-purpose built. Investment class C properties contain amenities and finish that is inferior to the market, may contain deferred maintenance or require other cosmetic improvements in order to maintain competitiveness. Resident rooms may not have full bathrooms or kitchenettes. Rent and occupancy levels typically fall below market averages and may contain a significant percentage of subsidized rents. For nursing care, properties are located with little to no access to healthcare providers. The improvements feature a more institutional design and functional obsolescence with a high percentage of semi-private or ward rooms, outdated mechanical systems, inadequate ventilation systems, and may not meet all life safety code requirements.

Market classifications

Core (Primary):
Market locations are consistent with the NIC MAP top 30 MSAs, generally more densely populated and established areas of the respective metropolitan area, with high barriers to entry. Demographic growth and the economic base outperform national and regional averages. Specific to nursing homes, this includes properties in states with a CON or similar restriction on development, and in states with sustainable Medicaid reimbursement programs.

Non-core (Secondary):
Market locations that are typically outside the NIC MAP top 30 MSAs, or the surrounding suburbs, generally less populated areas with a thin target population base and low barriers to entry. The economic base is similar-to or inferior-to national averages. Specific to nursing homes the market will not have a CON or similar restriction that limit new development. Medicaid reimbursement for nursing homes may also be challenged or underfunded.

A message to the caregivers in capes

JLL Valuation Advisory would like to offer our sincere gratitude and admiration to the caregivers serving the senior housings and care industry during the COVID-19 pandemic.

While most of us are fortunate enough to endure these times from the safety of our homes incorporating social distancing intermittently as needed, caregivers play an essential role in the health and wellbeing of our senior population in their care. We recognize that this dedication came at a high personal cost that is hard to measure.

Their dedication made in the name of caring for others, in unprecedented conditions, makes them extraordinarily honorable. We sincerely thank them and their families for their tireless commitment and endless sacrifice for the greater good – they indeed are heroes. We are proud to be associated with this extraordinary group of people and thank them for their courage, hard work, and commitment to humanity.

"Too often we underestimate the power of a touch, a smile, a kind word, a listening ear, an honest compliment, or the smallest act of caring, all of which have the potential to turn a life around."

— Leo Buscaglia

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JLL's research team delivers intelligence, analysis and insight through market-leading reports and services that illuminate today's commercial real estate dynamics and identify tomorrow's challenges and opportunities. Our more than 400 global research professionals track and analyze economic and property trends and forecast future conditions in over 60 countries, producing unrivalled local and global perspectives. Our research and expertise, fueled by real-time information and innovative thinking around the world, creates a competitive advantage for our clients and drives successful strategies and optimal real estate decisions.