SENIOR HOUSING

A Growing Opportunity In Commercial Real Estate

What This Paper Will Cover

- Opportunities & Challenges of Senior Housing
- Trends in Senior Living
- Business & Financing Fundamentals

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Sometimes the biggest opportunities sit in the open, waiting for recognition. In commercial real estate, senior housing is one of those. There is a critical need for a range of property types and services under the umbrella, whether for older people who need ongoing medical care or still-active seniors who seek community.

The U.S. has a worsening senior housing crisis. An unhappy coupling of national demographics and inadequate planning and construction means that even as facilities see growing demand, supply falls behind.

Senior housing also faces the same challenging macroeconomic conditions endemic in the CRE industry. Lengthy periods of easy money and high leverage have left owners and investors facing difficulties refinancing loans when interest rates rose, meaning a need to either recapitalize, sell, or hand a property over to a lender.

Ironically, this combined environment presents an unusual and large opportunity for investors.

The Range of Senior Housing

Senior housing is a large and complex property category that can be a floating combination of residential and healthcare. The National Council on Aging lists multiple different types, though they can blend into one another on a continuum of care:

INDEPENDENT LIVING

People in relatively good health live in communities of condominiums or apartments, often with included or optional meal plans and light housekeeping. Amenity examples are guest rooms for overnight visitors, pickleball courts, putting greens, gyms, libraries, and restaurant-style dining rooms.

ASSISTED LIVING

Facilities help residents who need a greater degree of aid, which can include medication management and aid in daily activities, like hygiene, ambulatory assistance, and physical and occupational therapy. Residency typically includes meals, planned activities, and ambulatory assistance.

NURSING HOMES/ SKILLED NURSING

These are for people who need ongoing aid at a greater degree than possible in their home or through assisted living. Residents can get personal care and help from trained nurses, including help with chronic disease management, vital signs monitoring, and medication management and administration that can include injections. People may stay for the long term or sometimes for shorter-term convalescence and then return to their own homes.

MEMORY CARE

Specialized forms of care address the memory issues that people with forms of dementia experience. They typically have secured entrances and exits to keep residents from wandering without supervision. Some facilities are standalone; others are parts of larger campuses that include either assisted living or skilled nursing.

CONTINUING CARE

A continuing care campus would typically incorporate several types of care. A combination of independent living, assisted living, nursing care, and memory care creates a continuum of options with residents shifting from one type to another, as necessary.

RESPITE CARE

It's a temporary residence for older people who need continuing services but typically have caregivers at home. This gives the caregivers a chance for periodic breaks.

IN-HOME CARE

Older adults in their homes can receive types of in-house assistance, including companion care by non-licensed aides, personal care and assistance by non-licensed aides, or home healthcare by licensed medical professionals. Such services would not typically be variations on commercial real estate, although more traditional care facilities could incorporate in-house offerings to extend revenue opportunities.

CONGREGATIONAL RETIREMENT

Similar to independent living but includes different arrangements set around common facilities and services, as well as social activities and grounds and facilities management.

ADULT DAY SERVICES

Usually open during working hours, they provide health and social services outside the home.

HOSPICE CARE

Available in-home or at specialized facilities, they provide quality-of-life care for those with advanced terminal diseases.

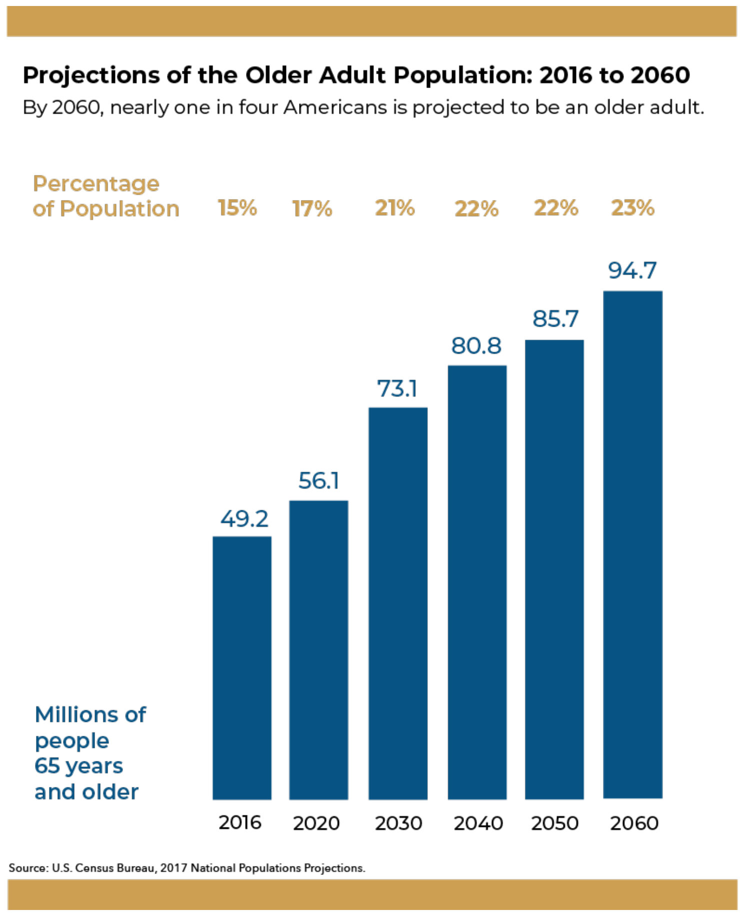
The range of care types offers investors, owners, and operators options to build collections of services or find those where a market has a particularly keen need. Each type has specific requirements, challenges, expenses, and operational constraints.

Addressing Opportunities & Challenges

Although different types of senior housing and care can vary in what they need to provide and the difficulties they might face, multiple factors have had an overall impact on the broader category. The most basic is the change in national demographics. The country is seeing a growing wave of older people. According to the Census Bureau, by 2030, all baby boomers will be older than 65. Twenty percent of the entire population will be of traditional retirement age.

This isn't a trend that suddenly ends. Instead, it will last for decades, as younger generations also age. Beyond 2030, the Census Bureau projects that the population will "grow slowly" and "age considerably." By 2034, for the first time in the U.S., there will be more older people than children. Look ahead to 2060, at which point 23% of the population — 94.7 million people — will be 65 or older.

The changes are part of a larger picture in which people live longer. In 1900, the global average life expectancy at birth was 32 years, according to Our World in Data. By 2021, it was 71 years. A large part is a reduction in child poverty, but the expansion has occurred at all ages.



Look only at the U.S. and the all-gender lifespan is now 77.5 years. People continue to get older and live longer on average than ever before, increasing future demand for senior housing of all types.

Even in the short term, there are major shortages. The National Investment Center for Seniors Housing & Healthcare (NIC) "predicts a need for 156,000 additional senior housing units by 2025, 549,000 additional units by 2028, and 806,000 additional units by 2030," wrote Lisa McCracken, head of research and analytics at the organization. That would take an estimated $400 billion investment by the industry. "With record-low construction starts observed in 2023, the projected gap between available and needed senior housing units will be significant," she added.

As current and future demand increase, there have been multiple constraints on supply. One was Covid-19. Reviews by the Department of Health and Human Services' Office of Inspector General found that more than 1,300 nursing homes had infection rates of 75% or higher, with for-profit facilities being a "disproportionate percentage." Fear of infection combined with significant losses of staff made it difficult to operate.

At its low point in the first half of 2021, senior housing occupancy was 77.8%, the NIC told the Wall Street Journal in April 2024. Investors in the various senior living property types found their assumptions and plans shaken by pandemic deaths and the resulting vacancies. In the fourth quarter of 2023, average occupancy had improved to 85.1% in the 31 largest U.S. markets, although still 200 basis points below 2020 Q1.

Unfortunately, the construction of senior housing is uneven in volume and frequently fails to keep pace with an aging population and increasing demand. Overbuilding was a concern in 2019, according to Senior Housing News. Starts plummeted during the pandemic. They were rebounding by the end of 2021. Then by the end of 2023, NIC estimated that senior housing construction would reach a low point in mid-to-late 2024. Given that construction duration is typically 24 months, projects that start in 2024 won't come to market until 2026.

Costs are a problem from several directions. One is the expense of new construction. The Weitz Company, which regularly publishes per-gross-square-foot price ranges, says that as of Spring 2024, independent living can cost from $237 to $283 for mid-level construction and $281 to $359 for high-level. Assisted living can cost $273 to $348 and $358 to $445. Skilled nursing runs $314 to $368 and $391 to $498. These prices did not include such considerations as special jurisdictional issues or code requirements.

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> *Flagler Healthcare Investments*

Senior housing prices can vary significantly by location. Weitz estimates for mid-level senior housing in Tulsa, Oklahoma ran $233 to $297 for assisted living and $266 to $313.

In contrast, BuildingJournal.com's online construction estimation calculator says an 8-to-10-story office building of 230,000 square feet at a median price in Indianapolis with 10% overhead, 5% profit, and 1% bonding would cost just under $28.4 million, or $123.39 per square foot. In 2021, ProEst, a software package that helps create estimates, looking at building estimates in the Midwest, cited conventional office building costs as $100 to $150 a square foot. Much is senior living construction — and so replacement cost as an investment consideration — is expensive.

There are other costs as well. Like any other area of commercial real estate, interest rates are high. So are insurance, utilities, and taxes. Types of senior housing also require trained medical staff. A shortage of available personnel pushes operational costs up even more. All this likely means a focus on new construction of Class-A properties will be necessary for the level of rents to justify the expenses and underwrite ongoing operations while providing profits.

Additionally, the costs faced by investors and owners interact with another set for operators, who must make the property work. That can be complex. Skilled Nursing News reports that shifts in Medicare-allowed rates had increased over Covid-related costs and then lowered for changed conditions. And wage and benefit costs have risen significantly.

Didier Choukroun, founder of Flagler Healthcare Investments, told GlobeSt.com that operators fight on price. "It's their only strategy," he said when instead they should look at both healthcare and non-healthcare services for the residents, including wellness, adult day care, and transportation.

The more continuing care facilities combine multiple service and residency types, the more complex specific combinations they support will affect how operations can work profitably. Skilled nursing and memory offerings in integrated senior living systems can reduce the earnings that independent living sections would see on their own, Fitch Ratings has noted. When the more medically demanding parts of an overall facility are between 23% to 61% of total units, properties were more likely to land on negative credit outlook or negative credit rating watch lists.

$5,350/mo.
ASSISTED LIVING

$8,669/mo.
SEMI-PRIVATE NURSING HOME ROOM

$9,733/mo.
PRIVATE NURSING HOME ROOM

"Many Fitch-rated Life Plan Communities (LPCs) have reduced their SNF beds in response to staffing and revenue pressures," the report read. "Others have reduced external admits to focus, often exclusively, on taking care of their own residents. This active management of SNF beds, along with higher monthly [independent living] rate increases close to or above inflation, helped LPCs absorb SNF-related operating pressures in 2023."

There is also the question of property owners and operators offering concessions to prospective tenants to help "secure move-ins and push often-choosy prospective customers over the finish line," says Senior Housing News. They are only part of the sales process but can have a significant impact on effective rents and margins.

Altogether, investors might look toward Class-A properties and operations that can bring higher levels of revenue that could generate greater margins to manage higher expenses. Median monthly charges for assisted living are $5,350, while a semi-private nursing home room is $8,669, and a private one is $9,733, according to long-term care insurance company Genworth. Compare that to luxurious assisted living options that can run upwards of $20,000 a month, depending on geographic location, reports U.S. News & World Report. Luxury senior living costs are about 30% over national rates, SeniorLiving.org reports.

Trends in Senior Living

Investors looking to enter the space, especially Class-A properties, should also know about trends in the industry because they can affect the potential for success and the necessary total investment. Success depends on understanding demographics, interests, technology, design, greater public scrutiny, and more.

One trend is that distinct types of facilities cater to residents with widely varying abilities for physical activity. Some will be limited in movement and need significant assistance. Others will look for such activities as golf, pickleball, swimming, walking a dog, trips to the gym, wellness activities, and more. Depending on the type of operation, a mix of amenities may be necessary.

Part of psychological health is to ensure that senior residents feel as useful and necessary as possible. Flagler Healthcare Investments founder Choukroun — who started a new company called SPHERE (Strategic Public Health Equities and Real Estate) Investments — pointed out to GlobeSt.com that facility operators could offer community services like child daycare or tutoring services and give interested residents roles.

Expanded use of technology opens new possibilities while potentially controlling long-term costs and supporting operational responsibilities. During the pandemic, video calls became a lifeline for seniors when properties couldn't receive live guests. Remote sensors can monitor resident wellbeing. Smart home technology can make ordinary tasks easier. Technology can also help deliver individualized entertainment preferences, whether television, movies, music, or games. Other systems help building management control energy use and identify irregularities that could be signs of developing problems.

New design choices allow for reimagined and improved living spaces, according to the Elders Club International (ECI) Foundation. Incorporating more natural light can improve mood and sleep patterns. Increased green spaces and natural elements reduce stress. Many seniors look for multi-generational settings, creating potential for new types of properties that incorporate senior living with other development. Wellness and fitness facilities can help maintain physical and mental health.

Green and sustainable offerings — building materials, renewable energy, reduced carbon footprints, rainwater harvesting, high-efficiency lighting, and LEED building design, to name some — are important to many. Improved air quality is also important. A Harvard School of Public Health study found that "CO2, VOCs [volatile organic chemicals] and ventilation rate all had significant, independent impacts on cognitive function" in buildings.

After experience during the height of the pandemic, owners and operators must also improve transparency and be ready for greater scrutiny from regulators, the press, and the public.

Business & Financing

Ultimately, all investment considerations are bound in with financial and business fundamentals — where the market might be going, how rents are developing, government and regulatory directions, and lenders. After their projections out to 2030, NIC looked at longer-range estimates to 2060 and said that the typical age of a senior housing resident is considered to be mid-eighties. “By 2030, the oldest baby boomer, born in 1946 will be 84, the prime age for moving into senior housing,” they wrote. “Conversely, the youngest baby boomer born in 1964 will not be 84 until 2048. This suggests great need in the future for care and housing options for seniors for a very long time.”

Up to 2025, depending on the planning scenario, between 48,000 and 70,000 additional units a year would be needed. At the high end, the upper bound reaches 121,000 units annually between 2025 and 2030. Between 2035 and 2040, the range runs from about 70,000 units on the low end to approaching 130,000.

According to the most recent NIC data for the first quarter of 2024, occupancy stood at 85.6%, with annual rent growth of 4.4% (so about 1% of real growth over inflation), 4.4% yearly absorption, 1.3% of annual inventory growth, and construction standing at 4.2% of inventory. That is based on data from more than 15,000 senior housing and care properties in 140 metro markets across the United States.

JLL’s 2024 Spring survey for senior housing for showed average capitalization rates for various class properties by core and non-core senior housing property types. Class A core types and cap rates were Active Adult (5.8%); Independent Living (5.9%); Assisted Living (6.5%); Memory Care (7.7%); and Nursing Care (11.4%). Continued senior retirement care or life plan community concepts, which span multiple types, were 11.5%. Cap rates correlate to facility and service costs. Still, as the company noted, “Interest in seniors housing investments remains strong as investors seek higher yields from alternative asset classes.”

There are affordability challenges for many seniors. The Joint Center for Housing Studies of Harvard University reported that in 2022, the homeownership rate of those 65 and over was more than 79%. That is one in three homeowners. However, many seniors cannot count on living on their own for their entire lives, and household incomes of older adults tend to decline and eventually converge regardless of race. Whites maintain an advantage on the whole but that eventually falls to less than $15,000 a year.

Sources of lending for acquisition or construction fall into two general categories: government and private. The Biden administration announced in February 2024 that the Department of Housing and Urban Development has focused on the issue of housing for low-income seniors, with $115 million in grant funding “to support the development preservation of supportive housing for an estimated 1,100

units for low-income seniors through the **Section 202 Supportive Housing for the Elderly program**." Of that, $35 million was for creating intergenerational housing units for households headed by seniors raising children under 18. "This builds off of over $161 million in Section 202 grant awards HUD announced in October 2023, which will support nearly 1,300 units for eligible households," it continued.

More generally, under Section 202, HUD can provide a "capital advance" to "construct, acquire, or rehabilitate multifamily properties that serve very-low-income individuals 62 years of age or older." Renewable Project Rental Assistance Contracts (PRACs) cover "reasonable and necessary operating expenses" beyond what the "tenant's portion of the rent" can provide. In the 2024 budget, total program resources were $1.39 billion.

HUD Section 232/223 (f) "insures mortgage loans to facilitate the construction and substantial rehabilitation of nursing homes, intermediate care facilities, board and care homes, and assisted-living facilities." There is long-term financing for up to 40 years for new and rehabilitated properties and up to 35 years for existing properties that can be financed with Government National Mortgage Association (GNMA) mortgage-backed securities. A facility must house at least 20 residents. Multiple facility types can be included in a single project. However, assisted living facilities, nursing homes, intermediate care homes, and board and care homes must be appropriately licensed by the appropriate body. The maximum amount of a mortgage for new construction is 90% of the total estimated value or 95% for non-profit sponsors.

"Residents requiring skill nursing, custodial care, and assistance with activities of daily living are eligible to live in facilities insured under this program." Borrowers can be investors, builders, developers, public entities, or private nonprofit corporations and associations. Nursing home applications can be public agencies licensed or regulated by a state "to care for convalescents and people who need nursing or intermediate care." Applicants need a state-provided Certificate of Need for a nursing home. For care homes or assisted living facilities, the appropriate state agency needs to provide a supporting statement.

Small Business Administration 504 loans aren't supposed to be used for speculation or investment in typical rental real estate; however, they can be used for assisted living facilities. The borrower must be a for-profit business with a tangible net worth of less than $15 million and an average net annual income of less than $5 million as documented by federal taxes for the previous two years. The maximum amount of a loan is either $5 million, or, if there is a goal of green efficiencies, $5.5 million. It requires a 10% energy savings.

There are 10-, 20-, and 25-year maturity terms available. Rates are based on market rates for 10-year Treasury issues and total about 3% of the debt, with the rate financeable with the loan. The loans are available only through Certified Development Companies that "are uniquely qualified to understand 504 loan program regulations and will help you navigate the lender channels to create your project financing."

According to Senior Housing Business, a 504 loan can consist of two mortgages — the first from a conventional lender for about 50% of the project, the second being the SBA 504 loan that represents about 40% of the total loan with fixed interest fully amortized for the full term of the loan with fixed monthly payments. In comparison, conventional assisted living financing could require a 30% down payment.

USDA OneRD Business & Industry loans provide up to $25MM. The project must be located in a qualifying rural area as defined by the USDA.

B&I loan terms for senior care projects are typically 25 years with fixed or variable rates available. The borrower can be a public body, for profit or non-profit business or organization, or a federally-recognized tribe.

A USDA Business & Industry Loan can be used for a variety of purposes like converting, expanding, repairing, or modernizing operations, purchasing land, buildings, or associated infrastructure, acquiring equipment, supplies, or inventory, refinancing business debt, and funding business acquisitions.

One of the benefits of a USDA loan is that it can be paired with Commercial Property Assessed Clean Energy (C-PACE) and tax credit equity to complete the capital stack.

Fannie Mae and Freddie Mac both have programs for senior housing.

Fannie Mae offers "financing options for properties that provide Independent Living (IL), Assisted Living (AL), Alzheimer's/Dementia Care (ALZ), or any combination thereof." Terms and amortization are up to 30 years; fixed and variable rate options; 75% maximum LTV (80% for fixed-rate tax-exempt bonds); and minimum debt service coverage ratio is 1.30x for 100% independent living, 1.40x for 100% assisted living, 1.45x for stand-alone Alzheimer's or dementia care, and special rules for combinations. Loans may be voluntarily prepaid upon payment of yield maintenance for fixed-rate loans and declining prepayment premiums for variable-rate loans. There are rate locks from 30 days to 180 days. Non-recourse execution is available with carve-outs for "bad acts" like fraud or bankruptcy. Loans are typically assumable, subject to review and approval of the new borrower.

Freddie Mac has its Optigo loans for senior housing, including independent living, assisted living, skilled nursing (maximum of 20% net operating income), or memory care properties. Borrowers must have experience with similar properties. For a loan under $5 million, the borrower may be a single-asset entity with some additional restrictions. Loans over $5 million require a single-purpose entity limited partnership, corporation, or limited liability company. Terms are 5 to 30 years. There are fixed-rate loans; standard and capped floating-rate loans; and supplemental loans. Escrows for replacement reserve and tax and insurance are generally required. No refinance test is necessary if the LTV is 55% or less and the amortizing minimum debt coverage ratio of 1.45x for independent living; 1.55x for assisted living; 1.60x for assisted living with skilled nursing beds; and 1.75x for stand-alone memory care. There is also a securitization program through special lenders with experience in senior housing. Freddie Mac requires authorization if money from government sources like Medicare and Medicaid is done for more than 5% of residents.

Closing

Something to keep in mind is that with current conditions of higher interest rates, expensive rate caps, tighter underwriting standards, and owners finding refinancing difficult to obtain, there will be many opportunities to identify and obtain quality properties at low prices.

The time to start considering financing is now, to be prepared in advance just in case. However, some of the most advantageous financing programs in senior housing can get complicated. Plan carefully, consider business goals and social obligations, and work with an experienced partner to explore the best way to finance a project.