HEALTHCARE & SENIOR HOUSING REPORT

2019

COMMERCIAL REAL ESTATE TRENDS REPORT

The healthcare and senior housing industries continue to grapple with change. Shifting services and technologies, along with the ever-present need to control spending, are reshaping healthcare supply and demand. Staffing and wage pressures are slimming provider margins, all while the Boomers are at the door waiting to bust in.

It's no secret Baby Boomers are living longer. Soon, they will impact the 75+ demographic, while the 85+ demographic is the largest consumer of Senior Housing. This older demo is expected to grow through 2055, with annual growth at just under 3% until 2040. That means demand is increasing for the foreseeable future within Senior Housing, Skilled Nursing and Hospitals.

SENIOR HOUSING

INDUSTRY PERFORMANCE

In 2018, Senior Housing inventory grew at slightly over 3%. The National Investment Center for Senior Housing and Care (NIC MAP) data service reported a decline in occupancy—87.9% in the third quarter of 2018, down from 88.5% in 2017. However, rent is increasing an average of 2.5 to 3%. Public companies, like Brookdale and Capital senior living, who provide greater transparency and up-to-the-quarter insights, have experienced occupancy declines, as they compete with ever-increasing, older buildings against increasing supply of newer, superior property. Their RevPOR figures continue to increase.

INDEPENDENT LIVING

New construction in 2018 was similar to 2017 and 2016. Occupancies have trended downward since 2015 but this has largely been driven by new property absorption. Existing properties have maintained occupancies in most markets. Significant oversupply has not yet appeared.

ASSISTED LIVING

New construction continues in most major markets, but the pace has slowed compared to the peak construction years of 2016 and 2017. Absorption has not kept up with supply and occupancies continue to trend downward in most markets, especially in markets where development costs are relatively low and developable land is readily available. Many major markets are now oversupplied with occupancies dropping into the mid-80s. Resident entry age and acuity continue to rise. Wage increases continue to place pressure on net incomes despite rent increases.

OUTLOOK

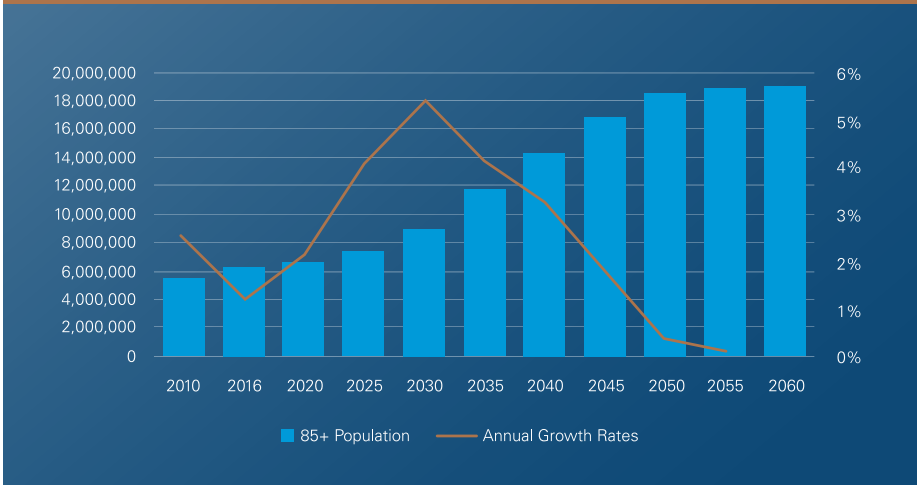
Demand for senior housing will continue to increase. New supply volume is likely to decrease until occupancies recover in many markets. Lenders have shown additional caution. Until the oversupply is absorbed, transaction volume is expected to maintain its current volume or decrease, and capitalization rates are expected to increase slightly if interest rates rise.

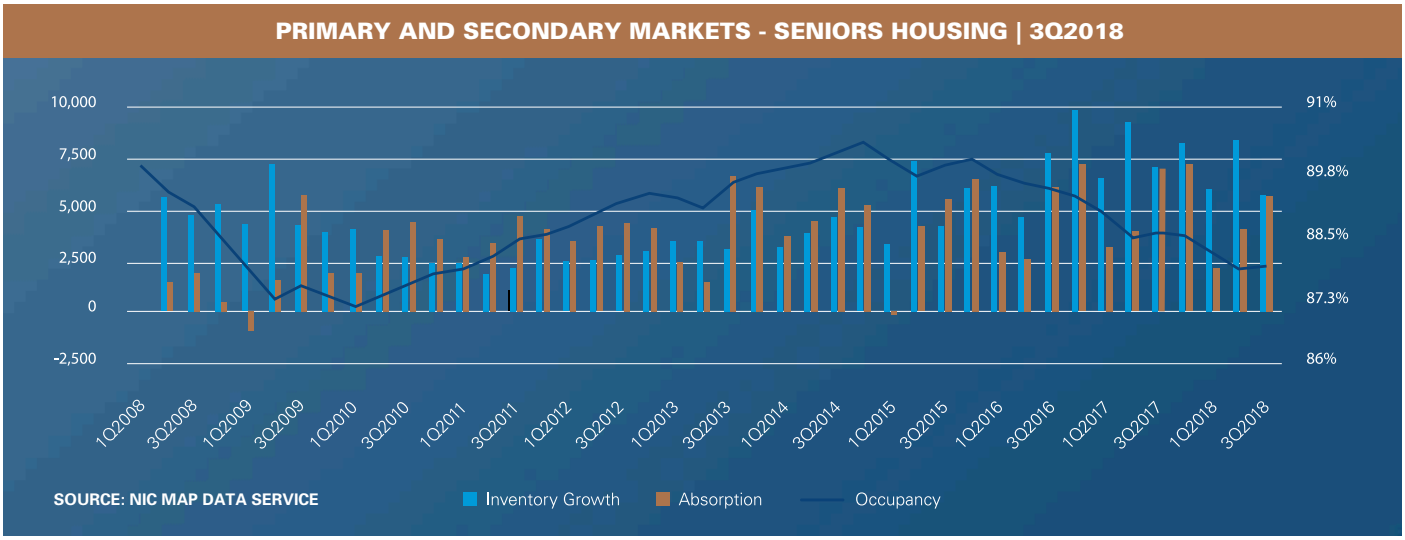
TRANSACTIONS

According to Real Capital Analytics, transaction volume for senior housing declined 36% in 2018. Capitalization rates compiled by IRR for senior housing properties have been relatively stable for the last year but are showing signs of increases.

The industry at a glance
- ▲ Inventory up 3%
- ▼ Occupancy down
- ▲ Rents are rising

85+ POPULATION AND GROWTH RATES





SKILLED NURSING

INDUSTRY PERFORMANCE

In contrast to independent and assisted living segments, the nursing home sector is not adding a significant number of new beds. Over the years, competition from assisted living facilities, home health and hospice providers has driven occupancy down. As managed care utilization rises and the trend to value-based care increases, there is immense pressure to shorten the length of stay for rehab-based care, also affecting occupancy. Nursing Home occupancy in 2018 was approximately 86.0% and essentially unchanged from 2017.

The occupancy pressures within the industry have driven facilities to search for higher acuity residents and new service lines such as memory care to bolster occupancy.

Wage increases and lack of staff continue to place pressure on facilities, especially those with slim margins. The number of facility closures is on the rise due to these pressures.

ACTIVITY

Deregulated states have seen new construction in transitional rehab centers that are geared toward short-term rehab. In some cities there has been overbuilding and intense competition. Some of these areas have seen multiple buildings constructed and the latecomers may never even open as a skilled nursing facility. New construction volume is likely to remain modest until demand forces States to open up building opportunities.

Demand for skilled nursing will increase with population; however, advances in technology and the growing emphasis on value-based care will be offsetting forces.

TRANSACTIONS

According to Real Capital Analytics, transaction volume for skilled nursing declined 6% in 2018. Capitalization rates for skilled nursing compiled by IRR have been relatively stable for the last year but are showing signs of increases.

OUTLOOK

A new payment model for Medicare (PDPM) is coming October 2019. This payment model is expected to be an industry disruptor. The payment model is expected to more appropriately reimburse facilities based on resident needs. This system will increase payment for clinically complex residents, making them more desirable from a profit standpoint. This change may drive additional demand—an optimistic view reflected in share prices of for-profit operators in 2018. Still, there is uncertainty and the march toward value-based purchasing. That uncertainty will likely create buying opportunities for sophisticated, better-positioned companies.

Lenders have shown additional caution. Until the new payment model is in place, transaction volume will likely consist of less sophisticated owners getting out of the market.

HOSPITALS

MERGERS & ACQUISITIONS

The Health Care M&A Report, published by Irving Levin Associates, reported 89 transactions in 2016, 78 in 2017, and 79 in 2018. The pace of M & A activity in the hospital segment has been strong. Providers have sought scale and breadth in order to thrive in the evolving landscape of changing reimbursement models, population health management, and the rise of consumerism. There is an expectation that M & A activity in 2019 will slow as health systems look to other business growth strategies.

AFFORDABLE CARE ACT

Passage of the Affordable Care Act ("ACA") in 2010 was a transformative event for the healthcare industry. The ACA introduced changes to the Medicare program designed to reduce costs and encourage the development of new systems of health care delivery. The ACA also provided for the expansion of Medicaid eligibility by the States – originally a requirement, but later ruled to be an option. Millions of additional people are now covered by Medicaid, although the distribution of people that gained coverage is uneven because states under Republican control have been less inclined to expand eligibility than those under Democratic control.

To date, 36 states have expanded eligibility. States that have not expanded eligibility are concentrated in the South. When eligibility is expanded, the uncompensated care burden for providers is reduced. Studies have found that most hospital closures that have occurred since the passage of the ACA are in states that have not expanded Medicaid.

The ACA has been a politically contentious matter since its passage. There have been many attempts to repeal the Act, have it deemed unconstitutional in courts of law, and undermine it by executive order. While much of the Act remain in effect, challenges are ongoing. A divided House and Senate, and a President that has yet to seemingly put much attention on healthcare, may delay movement on major federal healthcare changes.

PROVIDER REIMBURSEMENT

The ACA set into motion the healthcare industry's move toward population health and value-based care delivery and payment models. CMS launched numerous programs and alternative payment models to encourage care coordination, cost savings, and improved clinical outcomes. Among the most significant changes was the introduction of Accountable Care Organizations (ACOs) -- provider and payer arrangements established to improve care coordination between providers and payers, with payments tied to quality metrics and the cost of care.

This CMS program also spurred commercial ACO contracting. Providers have increasingly shown a willingness to accept the downside risk inherent in value-based purchasing. Surveys suggest they expect more of their payments to come from risk-based payment models in the future. On average, hospitals now generate about half

their revenues from some type of value-based arrangements, including ACOs, capitation payments, shared savings/ risk, and bundled payments.

OPERATING PERFORMANCE AND MARGINS

Annually, the credit rating agencies issue reports summarizing historical operating performance and expectations for hospitals. Reports for the 2017 operating period indicated that expense growth exceeded revenue growth, driving down operating margins. The strong economy is contributing to higher labor costs. Meanwhile, pharmaceutical costs continue to riser. In addition, more employers are pushing their covered employees into higher deductible plans, which raises the bad debt exposure of hospitals. Margins will remain under pressure.

OUTPATIENT GROWTH

For most hospitals, outpatient revenue continues to grow as a percentage of total patient revenue – now near an average of 49 percent for U.S. hospitals, per the American Hospital Association's 2019 Hospital Statistics report. These ratios vary widely among hospitals, with smaller ones often experiencing outpatient revenues that exceed inpatient revenues. The revenue shift is occurring as medical procedures are increasingly performed in outpatient settings. Also, hospital systems are directly employing higher percentages of physicians. In some markets today, more than two thirds of physicians are hospital employees.

ALTERNATIVE SITES AND PROVIDERS

Healthcare consumers increasingly expect greater convenience and a better experience when seeking care. Traditional hospital-based care is not particularly conducive to that changing paradigm. There are new competitors with less costly and more efficient delivery models making inroads into the healthcare system. We see this occurring faster in states with little or no certificate of need impedance. Hospitals and health systems will increasing be compelled to shift their business models to compete with the innovators. Operating in this fashion is less capital intensive than traditional modes of operation. The ability to adapt to a changing marketplace with ever-increasing expectations from payers and consumers will be required to thrive in the future.

SOURCES & REFERENCES

Property Reports

Healthcare & Senior Housing

Written By: James K. Tellatin, MAI, Victor D. Cremeens, MAI, Bradley J. Schopp, MAI & Mark R. Tracy, Managing Directors, IRR– Healthcare & Senior Housing

85+ Population and Growth Rates
Source: U.S. Census Bureau, Population Division: Washington, DC.

Primary and Secondary Markets–Seniors Housing | 3Q2018
Source: NIC MAP Data Service

About Viewpoint

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About IRR

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