BEHAVIORAL HEALTH FACILITIES REPORT

Parity Means Opportunity in the Year Ahead

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The demand for behavioral health facilities has surged in recent years, driven by increased awareness, policy shifts, and the growing need for accessible mental health and substance use treatment services. As providers expand their reach, real estate decisions are becoming more strategic, balancing regulatory requirements, operational efficiency, and patient-centered care. Despite challenges such as staffing shortages and reimbursement complexities, investment in behavioral health facilities remains strong, with purpose-built developments and adaptive reuse projects reshaping the landscape.

In this special report, we examine the evolving role of behavioral health facilities in the healthcare real estate market, highlighting key trends, challenges, and opportunities for investors and operators alike. Read on for data-driven insights into this rapidly growing sector.

Healthcare real estate markets have continued to offer opportunities to both owner-operators and investors across existing markets such as senior housing, hospitals, and urgent care. However, with increased health insurance coverage for mental health treatment (mental health parity), real estate supporting behavioral healthcare growth has emerged as a new and important healthcare property class. Behavioral healthcare encompasses a variety of diverse segments, including substance use disorder (SUD), in-patient and outpatient mental health services, crisis intervention, and residential treatment, among others. The broad service offerings of behavioral healthcare provide a unique exposure to the markets sought by investors, REITs, lenders, and operators alike.

Real estate for behavioral healthcare falls broadly into three categories:

De Novo properties are purchased or developed for new operations. These are often former assisted living, skilled nursing care, and similar properties – even hotels – being converted for use as behavioral health facilities. Operators often create De Novo facilities as an entry into a new market, with transactions generally representing real estate only.

In acquisitions, operators purchase both real estate and operating assets to incorporate a facility into an existing platform of services. The acquisition of an existing facility often includes some allocation to intangible assets above and beyond the real estate contribution. Acquisitions may benefit operators by providing a complementary service line, an established payer mix, or a more aggressive approach to geographic expansion. Considering that acquisitions generally include the purchase of real estate and intangible assets, the market is highly correlated to trends in mergers and acquisition activity. In addition, it is common for entities to be analyzed on earnings before interest taxes, depreciation, and amortization (EBITDA) as opposed to most properties, which are analyzed on net operating income (NOI). While NOI and EBITDA are essentially the same, EBITDA is the preferred metric of performance in business valuation, and NOI is preferred for real estate.

Joint ventures allow two or more participants to leverage core competencies in an existing or proposed operation. Joint ventures are often found in highly specialized segments of behavioral health.

With the elevated interest rates of the past several years, we've seen an increase in De Novo facilities and joint ventures as acquisitions and mergers have slowed. However, acquisition activity will broadly increase in 2025 as inflationary headwinds and interest rates stabilize.

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While behavioral healthcare is not new, the sector has experienced remarkably greater relevance in recent decades. Significant sector growth drivers include the trend of mental health diagnoses and mental health parity legislation impacting insurance coverage for behavioral health services.

Recent survey data reports an upward trend of behavioral health diagnoses spanning a variety of segments, primarily substance use disorder (SUD) and in-patient/out-patient mental health. Based on survey data from Mental Health America, 23% of adults experienced mental illness between 2021 and 2022. The Substance Abuse and Mental Health Services Administration (SAMHSA) reports 24.9% of people aged 12 or older used an illicit drug in 2023. With nearly a quarter of the adult population in the United States reporting mental health or substance use challenges, demand is evident in the market for a wide array of services. The National Center for Health Workforce Analysis reported nearly 26%± of the 29.3 million adults with mental illness in the past year perceived an unmet need for mental health services. Challenges in meeting the market demand include high barriers to entry (licensing, state regulations, high start-up costs) and ongoing challenges in workforce labor and employee retention.

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It's a segment shaped by reimbursement and legislation.

The healthcare industry is significantly impacted by reimbursable coverage, generally orienting services towards health insurance or government reimbursement. The industry is influenced by regulation and legislative action, often administered at the state level. However, federal regulation impacts the way the industry accesses funding through insurance coverage and public program funding. Mental health services experienced a rapid increase in the 1970s and 1980s, but in the later part of the 1980s, many health insurers significantly changed how they paid healthcare providers for such care. The reduction from 28-day hospital stays for drug and alcohol to 10 days or less and the transfer of treatment to outpatient services had a catastrophic impact on psychiatric hospitals and residential treatment centers almost overnight. While legislation covering behavioral healthcare began to appear in the 1990s, several recent legislative actions have further supported the industry's growth. In 2010, the
Affordable Care Act (ACA) significantly broadened the scope of health insurance coverage regarding mental health services. Following this legislation, behavioral healthcare became classified as an essential health benefit with many insurance providers, including coverage in base plans for mental health and substance use disorder. In 2020, the CARES Act further benefited the behavioral healthcare industry by increasing federal funding for mental health services, including $425 million for SAMHSA, and allowing Medicare reimbursement for telehealth services. When considered in aggregation, legislation surrounding behavioral healthcare and insurance coverage has significantly increased the opportunity for market participants by providing broader revenue sources.

Expect expansion, with headwinds.

While we observe strong unmet demand for behavioral healthcare services in some markets and an improving regulatory environment for healthcare companies, the industry still needs to be more cohesive with various local and regional service providers. The 2024 IBIS World Mental Health & Substance Abuse Centers report notes that no company currently holds more than 5% of the industry market share in the United States, citing high startup costs, increasing labor expenses, and challenges in customer acquisition. Overall, the highly fragmented nature of the industry creates opportunities for operators and investors in the behavioral healthcare space; however, it poses challenges in creating brand recognition beyond regional boundaries.

With economic conditions stabilizing into the end of 2024, behavioral healthcare market participants remain optimistic for the coming year. The Federal Reserve's recent action to lower interest rates is expected to ease challenges in real estate acquisition and allow for greater deal volume in 2025. Considering this, we expect strong growth in the behavioral healthcare markets as investors and operators alike resume operational and geographic expansion in the coming year.

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For over 25 years, Integra Realty Resources, Inc. (IRR) has grown to become one of North America's largest independent CRE market research, valuation, and counseling firms. Our clients tell us that our nearly 600 professionals in 50+ offices deliver extraordinary insight, unbiased advice, and excellent service. In 2024, IRR valued more than $156 billion in real estate assets across more than 60 metro markets comprising more than 33,000 assignments.

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