Following many years of robust investment activity, the senior housing market in the United States is in the midst of redefining itself.

Like so many other commercial real estate sectors, senior housing has experienced unprecedented levels of development and sales activity over the last decade. Experts once characterized the senior housing sector as recession-resistant because of the underlying dynamics of the sector and market activity. While that characterization has propelled the sector, record activity levels have not been sustainable, as shown by decreases in both investment and development activity.

As a result, the industry is undergoing a significant transition, finding a new normal for investment and development activity, refining and building on the hospitality-oriented amenities within the newest generation of development projects and looking ahead to changes that will be necessary to further accommodate the Baby Boomer generation.

The Real Capital Markets (RCM) Senior Housing Snapshot is based on investor surveys, interviews with industry experts conducted by RCM, and statistics from Real Capital Analytics (RCA) and the National Investment Council for Seniors Housing & Care (NIC).

Recent Trends Impacting the Senior Housing Market

• **Investment activity is down 7.9 percent,** according to RCA for the first two months of 2019. Despite Jan/Feb activity, RCM survey participants believe 2019 activity will be sustained at or above the 2018 level of over $15.2 billion.

• Private investors lead the charge—**Private capital has remained relatively consistent** over five years while REIT activity has declined significantly.

• **Partnering with a proven operator**—is the most critical operational factor according to 61% of respondents.

• The delivery of **new construction declined by 14.8%** from 2017 to 2018, according to NIC; industry experts consider this a needed slowdown, as demand catches up to the strong supply cycle.

• Overbuilding or oversupply, the lack of quality product available for acquisition, and unrealistic seller expectations are of **even concern to investors**.

• While noting that investors should take a long-term view as certain markets absorb oversupply, **industry experts remain bullish**.

“The sector as we know it today is vastly different and rapidly changing from even just five years ago—with considerable demand and capital remaining in the market, investors need to look at the long-term as the market redefines its new normal.”

Tina Lichens
COO, Real Capital Markets
The Leveling of Activity

Globally, investment activity during the first two months of 2019 totaled $2.8 billion, a decrease of approximately 7.9 percent over activity during the same period one year ago ($3.0 billion), according to RCA statistics.

Activity levels over the last five years have increased one year, decreased the next. In 2015, activity hit $22.1 billion – the highest seen in the last five years according to statistics from RCA. 2018 activity was $15.2 billion, almost 70 percent of the level in 2015.

Despite varying activity levels since 2014, 66 percent of RCM survey participants expect that 2019 activity will be consistent with 2018 or nominally better. Conversely, almost 22 percent believe that activity will experience a nominal decrease in 2019. In spite of the year-over-year inconsistencies, the market remains strong for the best assets.

“Stabilized, high-performing assets continue to see competition for buyers,” notes Richard Swartz, Executive Managing Director of Cushman & Wakefield’s Senior Housing Capital Markets practice. “These properties have no trouble being sold, and often get bid up.”

“We’re still in a strong market with compelling demand and an enormous amount of equity available for investment deals. We’ve seen a lot of new construction in major MSAs in recent years, which occurred because of strong growth projections in the senior populations. It will just take a little while for demand to catch up with the new inventory.”

Deborah Street
Vice President, CBRE National Senior Housing Team
Construction Decreases as Demand Catches Up

The level of construction has softened over the past year, following several strong years when developers continued to follow demand projections in many markets. “One of the biggest challenges we’re seeing is the new construction,” says Street. “It’s not a matter of if it will be filled, but a matter of when.”

Most major markets across the country — such as Atlanta, Dallas, Minneapolis, Houston, San Antonio, and Denver — have seen significant building in recent years. “You have these quality assets and a good demand story in the market, but you have seven new developments in the same area so investors can get skittish. At this stage in the cycle, it’s important for investors to take a longer-term view,” Street says.

Daniel Walsh, a Senior Vice President in the Chicago office of Ryan Companies US, Inc., a national development firm, agrees there may be slight overbuilding in certain markets, but otherwise believes the senior housing sector is healthy. As a result, he is optimistic about its future.

“Demand, and consistent growth in demand, will be one of the fundamental building blocks of strong performance for the sector. The capital markets are really positive; there is a healthy pipeline of capital looking for placement.”

Daniel Walsh
Senior Vice President, Ryan Companies US, Inc.
Over the last five years there has been a significant shift in the buyer profile, with private buyers, followed by institutional investors, replacing REITs as the most prolific buyers. Private equity also remains active in the market, as those investors typically have a higher risk tolerance.

The changing investor dynamic, which makes it challenging for capital sources to place capital, is providing developers and investors, including those looking to complete renovations, with more options for the capital stack.

The greatest falloff, per the RCA statistics, has been from publicly-listed REITs. “REITs have sold a lot over the past two years but we do still see them in the market for the right deals,” says Street. “Many REITs are not afraid of the secondary markets. If there are strong demographics and good cash flow, they have money to deploy.”

Foreign investment activity also has fallen off according to RCA’s numbers. The Cushman & Wakefield senior housing team that is led by Swartz, Jay Wagner, Executive Director, and Aaron Rosenzweig, Senior Director, notes that Asian investors have been keen on U.S. senior housing not only for the investment returns, but also to gain insights on U.S. operations to leverage them in their own country.

“I have never seen so much private equity in the market.”

Kathryn Burton Gray
Senior Managing Director and Head of Healthcare, Hunt Real Estate Capital
Problems for Some, Opportunities for Others

According to Swartz, while there generally remains a lot of capital in the space, one of the biggest challenges facing the market today is the velocity during the lease-up phase of a new development. A strong initial lease-up, he says, would be reaching 30 to 65 percent leased in the first 12 months.

The difficulty now being faced is a protracted lease-up period. In some cases, he notes, you may have good leasing, but because the project is now 12-18 months old, there also may be resident turnover that weakens absorption.

“I think we’re going to see some distressed selling of projects that haven’t leased up,” says Swartz. “However, some buyers will be gun shy about buying into a development without discounted pricing unless the project is a unique in-fill development or there are strong barriers to entry.”

Further, Rosenzweig expects to see an overall slowdown in the development of what can be characterized as generic suburban properties.

“IT’s not just about having a unique location, but also what’s inside that matters. Investors like getting into high amenity developments that will resonate with Baby Boomers, now and into the near term.”

Aaron Rosenzweig
Senior Director, Cushman & Wakefield

At the core of these amenities are hospitality-oriented features, including pubs, state-of-the-art entertainment/theater rooms, WiFi connectivity and other smart-build features. Additionally, Walsh says the minimum acceptable standards on the finishes for the living spaces continues to inch upward, further separating this generation of senior housing development from previous generations. Ultimately, it’s all about resident satisfaction.
Greatest Concerns: Lack of Quality Assets, Unrealistic Pricing

Like investors in other sectors, senior housing investors surveyed are equally as concerned about a lack of quality assets available for sale as they are with unrealistic seller pricing expectations, as demonstrated by the growing disparity between bid and ask prices.

“Investor concerns reflect the tremendous level of activity that has taken place over the last decade, and the bidding up of prices that resulted,” says Steve Shanahan, Executive Managing Director, Real Capital Markets. “With so much product changing hands, and so much demand, investors are concerned about the quality of product that remains and whether sellers have an inflated impression of what properties can command.”

Close behind those concerns, according to 23 percent of survey participants, are fears that the sector is becoming overbuilt and that there will be a lingering oversupply of product. The greatest effect of the overbuilding is a decline in occupancy rates, which impacts operating incomes and ultimately, if not corrected, could put downward pressures on values.

According to NIC, the occupancy rate for senior housing properties across the country at the end of the fourth quarter 2018 was 88.0 percent. The rate has been essentially unchanged for at least a year. However, at the end of 2014, the occupancy of senior housing units was 90.2 percent.

The good news, however, is a recent reduction in construction levels that likely will stabilize the balance between supply and demand. According to NIC, senior housing construction in 31 primary markets across the U.S. is slowing. Fourth quarter 2018 data showed a decline in the delivery of units totaling approximately 6,500 units—or 14.8 percent—from the same period in 2017.

Geographic Strongholds & Markets to Watch

Among the markets that experts note as being “in favor” at this stage include Southern California and the Bay Area in California as well as the metro areas in Seattle, Boston, Washington D.C., and New York (including Northern New Jersey and Long Island).

“Many investors are focused on the affluent gateway markets, those with strong demographics and/or new market areas where strong barriers to entry exist,” says Rosenzweig.

The most attractive areas for development for Ryan Companies, says Walsh, are “diverse collections of markets”. He notes, “Regardless of the size, geography, or demographics of the markets we target, each submarket must pass through proprietary filters that support the business plans of Ryan and our operating partners.”
Conclusion

RCM survey results showed more than 61 percent of investors agreed that partnering with a strong operating firm is the most critical factor impacting property profitability.

“There needs to be strong follow through to ensure efficient and profitable operations in the Senior Housing sector,” Lichens says. “Investors must understand the level of expertise needed in managing those properties and operations for the greatest returns.”

The specialization that established operating firms possess are essential when overcoming the greatest operational issues and concerns facing the industry—a shortage of skilled labor, cost management and shrinking profit margins.

“The market in the aggregate will see a tapering as lenders and capital partners scrutinize underwriting and steer clear of mediocre opportunities,” Walsh says. “We expect our business volume will continue to increase due to the strength of our partnerships and lending relationships, and the ability to tackle more complex, capital-intensive opportunities.”

Swartz notes that the senior housing market represents a great long-term demographic. While there has been a shift in the level of investing, “No one is leaving the space, but underwriting is tightening,” he says.

Underlying these assessments is the fact that there remains considerable capital in this market sector. While the investor profile may have shifted away from REITS, there still is significant capital allocated to senior housing.

“There is a lot of institutional quality capital in the senior housing market compared with 20 years ago,” says Street. “It’s all about demand. A lot of big players want to be in primary markets, but when those markets become too competitive, they continue to focus on this sector and expand their reach.”

Burton Gray suggests that the majority of senior housing investors have been attracted to the long-term nature of the product, and the need for the product isn’t going away. She also notes this latest generation of properties could be obsolete within the next five plus years.

“The first wave of Baby Boomers will enter the market in 2020 and will expect a different product and value. Popcorn and happy hours just won’t cut it,” she says.

Burton Gray believes a period of significant disruption looms ahead in senior housing. That disruption could mean senior housing projects that are developed more in keeping with luxury apartments and hospitality properties.

In the long run, that perspective likely bodes well for a new generation of development and investment activity. Until that time, the question for investors, owners and operators of senior housing facilities alike will be, “How do we pivot to meet the needs of the senior population to stave off obsolescence of the developments that already exist?”
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  *Executive Managing Director - Cushman & Wakefield*

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About Real Capital Markets:

Founded in 1999, Real Capital Markets (RCM) is the global marketplace for buying and selling CRE. RCM increases the speed, exposure, and security of CRE sales through its streamlined online platform. Solutions include integrated property marketing, transaction management, and business intelligence tools to unify broker-level and firm-level data and work flows.

RCM has executed 65,000+ assignments with $2.3 trillion in CRE transactions. Approximately 50% of all U.S. commercial assets sold, over $10 million, are brought to market using RCM's online marketplace annually.