Senior living

Investing in a growing population

2021

Senior housing and care is a critical element of our society and the need for additional senior living housing inventory is projected to increase dramatically. Throughout America, our aging population is a vexing challenge, with the number of households with seniors in their 80s and older projected to more than double by 2037.[1] At Ecofin, we believe we're on the cusp of a significant surge in demand for senior living communities, and we are investing in essential assets that will care for the impending baby boomer "silver tsunami."

How U.S. senior care has evolved

Before the 19th century, senior living communities in the U.S. did not exist, with many elderly cared for by family or placed in shelters for the poor. Often, the elderly were placed in "almshouses" or "poorhouses," a concept brought to the U.S. by English settlers.[2] These homes fell well short of providing quality care for aging workers who were no longer able to earn a wage. As the issue became more prevalent, the U.S. Social Security program was established in 1935, designed to pay retired workers age 65 and older a continuing pension income after retirement.

National health care

The 1965 passage of Medicare and Medicaid was kicked off when former President Truman, an early proponent of national health insurance, was issued the first Medicare card by President Lyndon Johnson. This was a milestone for seniors, propelling senior care forward.

July 30, 1965: With former President Truman at his side, President Lyndon Johnson signs the Medicare bill into law.
Source: LBJ Library

Choice, dignity and independence

As the industry grew, retirement housing for seniors matured and often included meals, housekeeping and transportation. The term "assisted living" came into vogue in the mid-1980s with a vision to bring together a physical environment that offered care, service and a more appealing living situation for "residents." Decisions about accepting or rejecting medical care and "aging in place" allowed residents to stay in one facility or move locations voluntarily. In the late 1980s, assisted living prototypes in rural communities began to emerge where land was affordable and older adults had few options.[3]

By the 1990s, consumer groups and public policy leaders became increasingly aware of senior living challenges. Multiple approaches of assisted living existed with four distinct scenarios emerging (hybrid, hospitality, housing and health care). Small-scale replication of care facilities grew and capital for real estate development projects proved difficult to access as financial institutions originally struggled to understand how to underwrite.

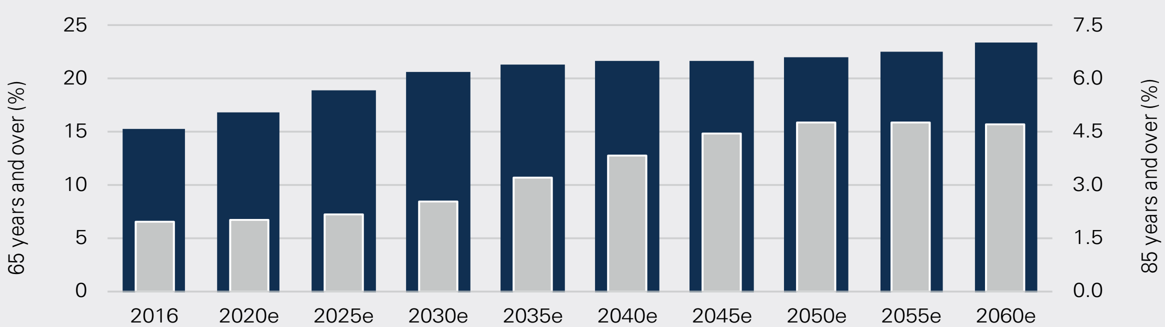
The late 1990s into the 2000s was a period of expansion for the sector as capital markets funding became more accessible and quality of care continued to be fine-tuned with new standards of care. Curb appeal, along with location, became increasingly important as growing numbers of seniors began to retire in their own communities, often near family, rather than moving to traditional, warmer retirement areas such as Arizona and Florida.

Shunning the early days of the poorhouse scenario, today's modern day senior housing looks nothing like your grandparents' "old folks home". Today's seniors are empowered, active and selective consumers of facilities that best suit their lifestyles.

The growing housing needs of seniors

With advances in medicine, more active lifestyles and better eating habits, today's seniors are living much longer. In 1940, individuals surviving to age 65 had an average remaining life expectancy of 12.7 years.[4] Today, individuals turning 65 are expected to live another 18.7 years on average.[5] About one out of every four 65-year-olds will live to be 90 years old, with one out of every 10 expected to live past 95 years.[6]

Growth of aging population



● 65 years and over ● 85 years and over

Source: U.S. Census Bureau, Population Division

By 2035, 78 million people in the U.S. will be 65 years or older, with those 85 years or older growing at an even steeper rate. The number of housing units needed will increase to keep up with demand. Making a decision about senior living facilities generally comes into play by seniors in their early to mid-80s. That decision is often hard for those hesitant to leave their homes or those concerned about the cost of care.

Senior living models

Today's senior living facilities offer an array of care services typically divided into four categories: independent living, assisted living, memory care and nursing care. As independent living properties continue to experience a rising entry age for residents, there is less distinction between the services provided in independent living ("IL") and assisted living ("AL"). Some independent living operators increasingly provide more of the services available in an assisted living community, either through third-party ancillary service providers or on their own.

Continuing care retirement communities (CCRCs), also known as life plan communities, are gaining popularity as they offer a continuum of care with at least two care segments in a combined campus setting. CCRCs focus on ensuring residents can age in place by using a flexible building design.

According to the National Investment Center, in 2019, there were over 10,000 nursing homes and 15,000 independent and assisted living facilities in America of investment grade quality, providing options to support seniors' changing needs. Determining the type of care needed is typically measured by activities of daily living (ADLs), such as eating, walking and personal hygiene. The number of assisted ADLs needed determines the level of care and costs. Assisted living facilities usually include a small number of ADLs services in the base monthly cost. Care services can include assistance with bathing, grooming, dressing, eating, medication management and other daily activities. Medical services can include skilled nursing, rehab therapy and long-term care. Besides housing, senior living facilities offer a variety of services including meals, transportation, housekeeping, entertainment and concierge services.

Senior living facilities overview

	IL communities	AL communities	CCRCs	SNFs
Key features	Three daily meals, central dining, housekeeping, transportation, and social and recreational activities.	All IL features plus management of medication, bathing, dressing, toileting and eating. Includes units dedicated to memory care.	Combination of all IL, AL and SNF features available to residents on one campus.	Licensed daily rate or rental properties. All AL features plus 24-hour nursing and/or medical care.
Average facility size*	156 units	79 units	121 units	129 units
Number of properties	2,900	9,400	7,700	10,300
Average rent	$3,229 monthly	$5,843 monthly	$3,353 monthly	$10,078 daily
Occupancy rate	84%	78%	81%	75%
Inventory units	452,100	746,800	932,000	1,328,300

Source: NIC MAP data via Bloomberg Intelligence. *Based on most recent NIC Investment Guide which includes data estimates as of Q4 2019 and NIC occupancy reports as of December 30, 2020 and an average of IL & AL for CCRCs.

Other data influencing the sector[7]

- Average unit count: 106
- Average cost: $34,725,000
- Average cost/unit: $269,400
- Average cost/square foot: $317

Source: CBRE – U.S. Seniors Housing Development Costs Report (December 2018)

Challenges and trends in senior living and care

Covid-19 and its impact on occupancy rates

While 2020 was a trying year, many of our operators inoculated residents and staff per the CDC's recommendation that they be among the first recipients of the vaccine. As you can imagine, a vaccine more than lifted the spirits in many of our communities. Given the salacious headlines and doomsday projections in March 2020, one might have expected senior living to be wiped off the map, but it wasn't, thanks to the industry's resilience and federal stimulus dollars.

On a positive note, the pandemic has strengthened the industry's infectious disease policies and procedures which has brought lasting change for the better. For example, the industry has been remarkably slow to adopt telehealth; however, telehealth visits have gone from approximately 3% pre-Covid-19 to more than 50% currentlysince the pandemic began. The dramatic positive shift was made possible by Congress passing bills in the spring of 2020 which now allow telehealth to be covered by Medicare.

The reality is senior that living is a high turnover model that's resilient and your average high acuity setting hasn't seen many more deaths than a typical year. Statistically, through December 2020, nationwide occupancy for independent living and assisted living decreased to 83.5% and 77.7%, respectively. Occupancy has decreased for independent and assisted living, 6.2% and 7.5% since the pandemic began. It's worth noting, the rate of decline from month to month is decelerating for both independent and assisted living and primary markets have seen a higher rate of decline than the secondary markets we typically invest in.[8]

Quality care

Preparing for the silver tsunami comes with a host of challenges, and one of the greatest is hiring and retention of a well-trained workforce to provide quality care. In today's low unemployment environment, the cost of quality labor continues to rise along with new state minimum wage standards. And while many providers have a passion to serve seniors, a quality wage for the provision of quality care is critical.

With expectations that 1 million to 2.5 million additional caregivers will be needed between now and the end of the next decade to counter this lack of supply, many providers are offering key employee retention plans with attractive benefits packages including health insurance, paid time off, transportation, 401(k) plans and more.[9]

Affordability and the path to Medicare

As baby boomers age, there will be an increasing need for low cost senior housing and more subsidies needed for health care costs for those who have not adequately saved for retirement. While many developer projects focus on private pay or market rate projects, some are developing projects to serve the affordable segment of the aging population.

Medicare continues to be a major provider of health care for seniors. In 2018, there were 61 million people receiving health care coverage through Medicare, with spending reaching $590 billion, approximately 14% of total national health care spending.[10] While Medicare typically covers nursing home stays, there is no requirement that Medicare must pay for assisted living. As a result, the level and type of support varies widely for Medicare- assisted care from state to state.

Medicare Advantage, which offers private, Medicare-approved insurance, has experienced headwinds resulting in seniors receiving lower daily reimbursement rates, shorter lengths of stay for care and more referrals to home care instead of inpatient rehabilitation facilities.[11]

Uneven regulation

While the skilled nursing industry is highly regulated at the federal and state levels, regulation of assisted living and memory care facilities differs by state and is not uniform. Examples include building design standards, licensures and staffing requirements. This makes underwriting for investors a challenge which is only mitigated by experience and knowledge of regulatory idiosyncrasies.

CONNs – another layer of regulation

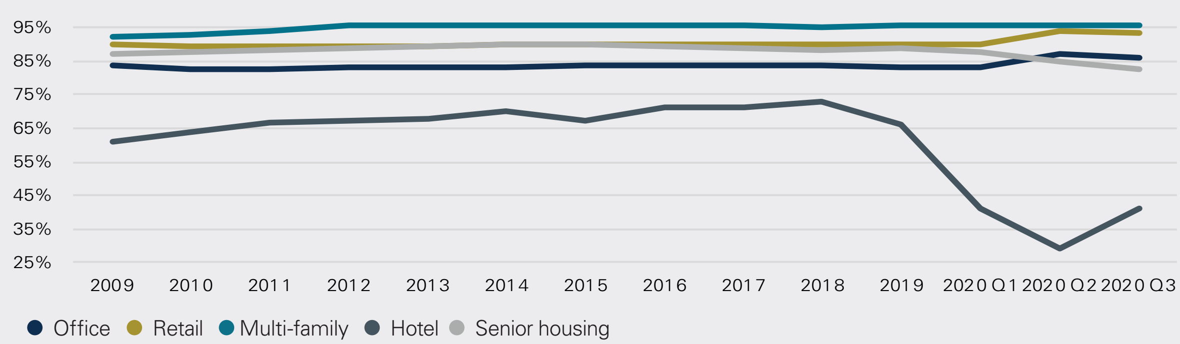
In addition to a state licensure, a certificate of need, or CON, is an endorsement that numerous states require before approving the construction of a new health care facility. From an underwriting perspective, CONs can create investment opportunities because they can create barriers to entry.

Assessing senior facilities – investment opportunity

As more investors take notice of senior living projects, asset valuations are rising which is spurring more lending. Today there are approximately 24,500 investment grade senior housing and care properties containing over 3 million units/beds.[10] Investment grade properties are those defined as age-restricted, with at least 25 units/beds.[11] They charge market rates for housing and services. The investment grade seniors housing and care market is estimated at $409 billion.[11]

As seen below, senior housing occupancy has been resilient, especially when compared to hotels. Office occupancy also includes leased and not physical occupancy. With the vast majority of senior housing residents vaccinated and communities opening back up for regular business, it would appear we are at or near the bottom of occupancy deterioration.[7]

Senior housing vs. other commercial occupancy

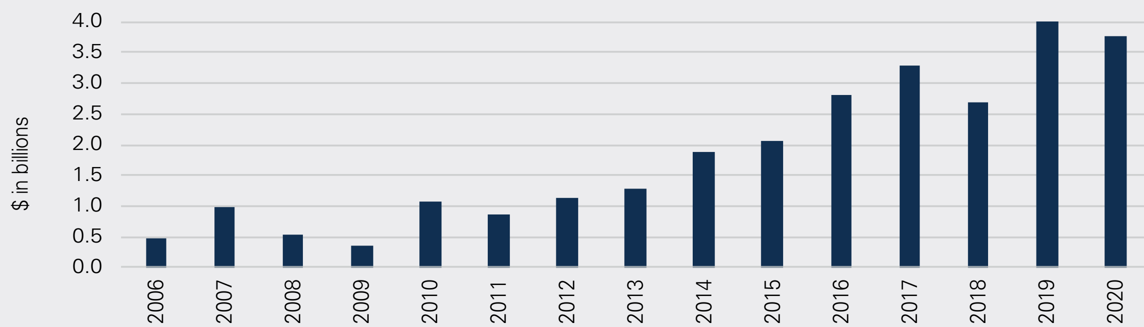


Source: NIC Investment Guide – Investing in Seniors Housing & Care Properties, Fifth Edition

Covid-19 brought new construction starts to a halt in 2020

As the aging population has grown, so has the number of units under construction up until recently. Due to Covid-19, 70% of new construction projects in 2020 were postponed[12], but we have since started to see some of those projects re-start. New construction may have pressed pause in 2020, but many projects were already underway as indicated by the figures below including construction in progress. As new construction projects reach completion, what we believe you will see is a much lower number of units under construction in the near term. That said, new construction will pick back up as more projects vie for the first movers advantage now that communities have opened back up.

Number of units under construction



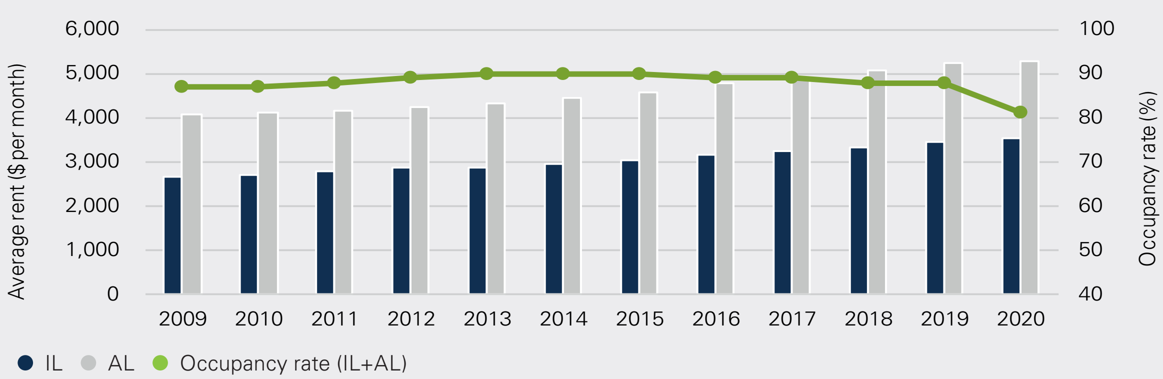
Source: NIC MAP data via Bloomberg Intelligence as of 12/31/2020

Variability in market performance

In large part due to the nuances of senior living and resident absorption, communities only a few miles from one another can perform very differently. Thus, it is important to find partners that know and understand the local market very well – potentially to include regional operators that have "sister" communities nearby.

Even though occupancy rates have varied market to market, rents have been relatively stable and in certain cases increased. Historically, seniors housing and care properties delivered relatively steady leasing revenue when compared to other real estate property types.

Occupancy rates stable while rent increases



Source: NIC MAP data via Bloomberg Intelligence as of 12/31/2020

Interest rate environment – a possible headwind

In the ever-changing geopolitical environment, interest rates can change. In these instances, increased borrowing costs could negatively impact project cash flows. An offset to rising rates could be stronger net operating income from improving market fundamentals, rising occupancy rates and new inflows of capital into the sector.

Ecofin's take on senior living investment opportunities

Ecofin's investments provide capital to the dislocated senior facilities market, including those that offer the entire continuum from independent living to assisted living, to palliative care and hospice, and to a lesser extent, skilled nursing for targeted opportunities. Ecofin's approach is to source investment opportunities and deploy capital by investing in directly originated securities. Ecofin focuses on not-for-profit residential care and with for-profit developers with a goal to provide capital to provide bridge financing to entities until they are better positioned to obtain traditional financing.

Ecofin's process focuses on risk mitigation

When underwriting directly-originated securities, Ecofin's social impact team considers how best to mitigate risk in order to balance the interests of investors and borrowers. When originating an investment, Ecofin assesses how a senior living facility opportunity fits into its specific market area and regulatory environment. In addition to personally vetting the principals and visiting the site, Ecofin deploys and utilizes third party market studies and financial feasibility studies to reaffirm the project's viability. Ultimately, the goal is to find and invest in well-managed assets that are highly-essential to their markets and make a strong impact in their communities, which means a higher likelihood of success.

Once a deal passes an initial screen, it is structured to balance the needs of our borrowers while still accomplishing the goals of our investors. As part of the deal structuring, documents are drawn up to outline the borrower's accountability to Ecofin and its investors. There is not a one-size-fits-all approach to the document structure.

Documents are tailored based on projected performance and reasonable targets for a facility. For instance, while it might be ideal to require a senior living facility to reach 90% occupancy within six months of its grand opening, putting that as a covenant in the contract could be setting a facility up for failure – which benefits neither the facility nor our investors. Regular communications on financial performance, progress towards stabilization and any other changes that could impact the success of the project are routinely reviewed.

While upfront due diligence mitigates risks, contractual covenant violations can periodically occur. Typically, these can be resolved by ensuring that a solid property management team is in place.

CASE STUDY

In late 2020, Ecofin "closed the gap" on an acquisition financing of Drumlin Reserve, an existing 154-unit senior living community located in Cottage Grove, Wisconsin, a suburb of Madison. Drumlin Reserve is located in Dane County, the fastest growing county in Wisconsin. The community provides Independent Living, Assisted Living, and Memory Care services and has held steady levels of occupancy despite Covid-19. The management company, a repeat client of the firm, took over day-to-day operations in 2019, and saw this as a strategic addition to their portfolio of over 20 properties throughout Wisconsin.

Source: Capri Communities. The investment presented here is to illustrate the historical application of the firm's intended investment process only. The investments shown and any future investments, if any, will not be identical. The strategies can have nuances in their investment guidelines, and as a result, it is important to understand that the investments shown may not necessarily represent an investor's experience in certain strategies. It is important for you to review the specific characteristics of any strategy before making an investment. Each case study selected for inclusion represents the most recent direct origination structured by the team in its respective sector through 12/31/2020."

Transaction summary

Type: subordinate bonds

Amount: Approximately $4,500,000

Maturity: five years

Conclusion

Senior housing and care has advanced and evolved to become a consumer-centered industry focused on the needs and preferences of older adults. Keeping pace with constructing quality senior facilities for America's aging population will be a challenge for years to come. A healthy rebalancing of supply/demand is underway, following the Covid-19 pandemic which upended the world and the senior living industry. This market dislocation allows Ecofin to be a strategic provider of capital for demand growth. As investors, Ecofin recognizes that senior living projects are indispensable to our economy and society. Providing quality care for our society's parents and grandparents speaks to the heart of Ecofin's essential assets focus.

[1] JCHS of Harvard University – Housing America's Older Adults 2018
[2] Foundation Aiding the Elderly – The History of Nursing Homes
[3] The Gerontologist – Historical Evolution of Assisted Living in the United States, 1979 to the Present
[4] Social Security Administration – Life Expectancy for Social Security
[5] Kenan Institute of Private Enterprise – The Business of Healthcare: Adapting to an Aging Economy
[6] Social Security Administration – Retirement & Survivors Benefits: Life Expectancy Calculator, 2018
[7] CBRE – 2020 Senior Housing Market Insight Report
[8] NIC Press Release –Fourth Quarter 2020
[9] The Senior Care Investor – Dec. 2018 - Volume 30, Issue 12
[10] MedicareResources.Org – A Brief History of Medicare in America
[11] NIC – Quarterly Map Data (as of 4Q 2018)
[12] Senior Housing News, November 22, 2020