BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT SENIORS HOUSING SUMMER 2020

Seniors Housing Adapting to Health Crisis; Sector Implements Numerous Changes to Manage Pandemic

Long-term outlook remains positive. As the nation advances through the health crisis and states outline plans to reopen the economy, the seniors housing sector continues to face near-term uncertainty. Operators are navigating a new path forward, prioritizing frontline healthcare workers' needs in order to keep seniors safe and healthy, while still facing challenges surrounding labor and supply shortages. The financial impact will be deep as expenses surge and revenue falls, potentially driving greater consolidation in the industry over the coming years. Larger operators that can leverage economies of scale are more favorably positioned to manage increased equipment, cleaning and operating costs. While the long-term ramifications of COVID-19 remain unclear, providers will adopt a new normal moving forward, enhancing staffing and infection control protocols, boosting inventories of PPE and altering isolation practices. The broader outlook for the industry remains positive with a demographic wave on the horizon that ensures strong demand for the needs-based asset class. Historically the sector has demonstrated resiliency through prior shocks and continues to illustrate safety for the elderly during a major crisis.

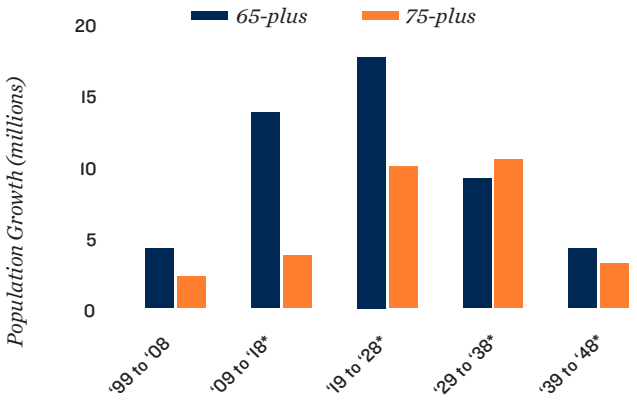
Testing and vaccine needed to overcome challenges. The sector currently faces some unique challenges that will weigh on performance over the near term, particularly as elderly populations are more vulnerable to the novel coronavirus. Broader testing industrywide will help create a path toward reopening the sector, in addition to other benchmarks including enough masks and other personal protective equipment for staff and residents.

Strong underlying demand unwavering despite pandemic. The leading edge of the baby boomer generation is approaching 75, accelerating growth among older adult households to pressure the senior living industry. The number of households age 75 to 79 will increase by roughly 4.7 million over the next two decades, a 78 percent increase, while those age 80 and older will grow at an even faster pace. Approximately 17.5 million U.S. head of households will be 80 years or older by 2038, more than double the 2018 total, as Americans continue to live longer. Developers have been active in recent years in anticipation of this demographic shift, resulting in the overbuilding of some segments, which will be realigned over the coming years as long-term demand comes into balance with supply.

Executive Summary

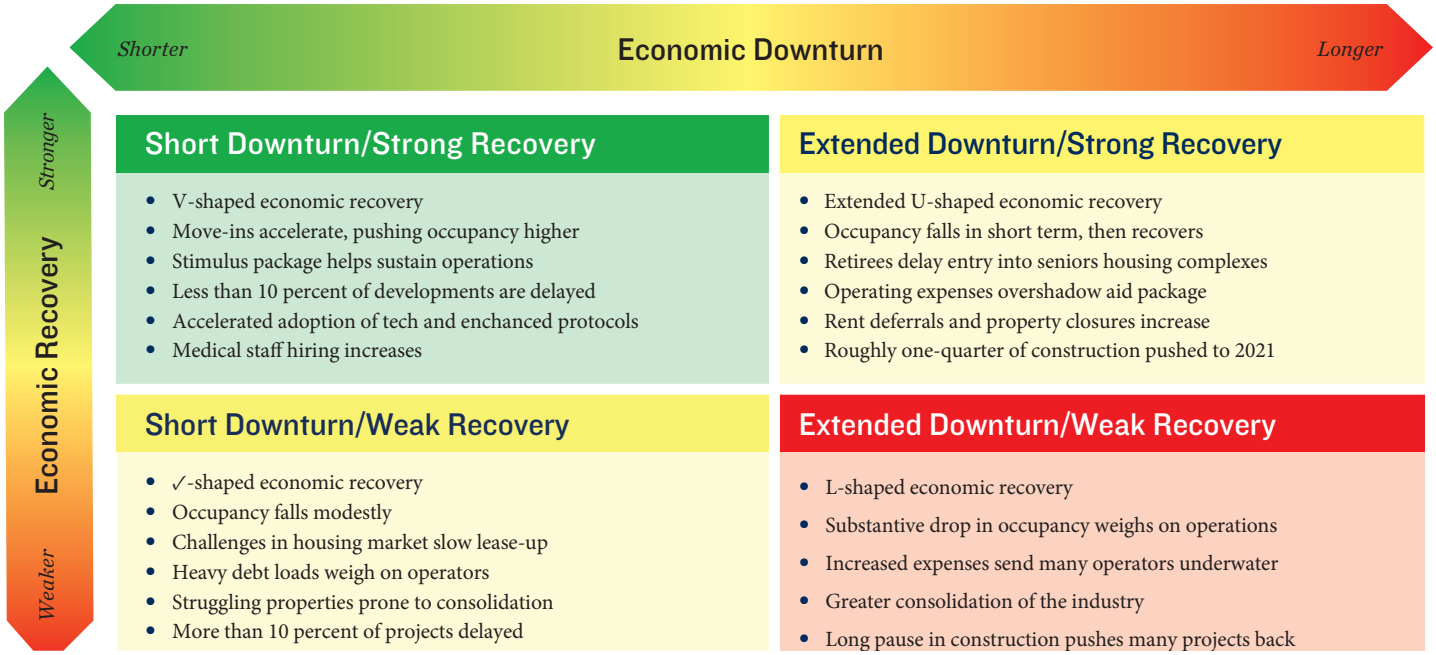
- Seniors housing sector faces steep challenges ahead as the health crisis continues to unfold. Many uncertainties remain and clarity will not likely emerge until the first wave passes and treatments or a vaccine can calm the fears of residents, staff and investors.
- Exceptional demand for the needs-based asset class on the horizon will not be greatly affected by the pandemic. Level of care provided across all segments unmatched in at-home and telehealth options.
- Skilled nursing segment faces unique challenges as the virus has gripped facilities across the nation. Prospects for nursing care remain unparalleled as the needs of the aging population are largely met by the medical attention provided at long-term care facilities.

Population Growth Among Older Americans



Sources: Marcus & Millichap Research Services; NIC Map® Data and Analysis Service (www.nicmap.org); Social Security Administration; U.S. Census Bureau

Depth of the Health Crisis Draws Multiple Scenarios for the Sector



Short Downturn/Strong Recovery

Rapid economic recovery to strengthen the sector. Assuming the health crisis is soon largely behind us and the economy begins to recover sharply, the impact on seniors housing will be less painful. The stimulus package will likely sustain smaller operations, and demand will pause only temporarily, providing for a resurgence of cash flow as move-ins accelerate. The industry will increase the rate of tech adoption, including telehealth systems and resident/family portals. Facilities will likely reconsider their staffing requirements while also enhancing safety measures to be prepared should outbreaks of COVID-19 make a return.

Short Downturn/Weak Recovery

Slow recovery to weigh on performance. A slower economic recovery creates challenges for the industry. Retirees may have problems selling their home before making the transition to seniors housing, leading to a deceleration of move-ins. Occupancy will take longer to return to pre-COVID-19 levels, hurting smaller operators that took on more debt. Heavy debt loads could boost bankruptcy filings and encourage less seasoned owners who have minimal expertise in the sector to exit. This will create investment opportunities and drive greater consolidation of the industry through a wave of acquisitions.

Extended Downturn/Strong Recovery

An extended downturn creates risks for operators. Expenses tied to the pandemic will soar if the health crisis and economic downturn continue past the summer. Occupancy will fall substantively as move-ins stall, constricting revenue. Baby boomers will delay entry until a vaccine can calm the fears of infection. Many facilities will be underwater as the stimulus aid will not be enough to cover a prolonged period of elevated expenses, boosting rent deferrals and consolidation. Most construction will be put on hold, trimming deliveries by roughly one-quarter in 2020. A recovery in 2021 will invigorate the performance of facilities that make it through the downturn.

Extended Downturn/Weak Recovery

Deep downturn puts much of sector in question. If the health crisis persists over the coming months and the economic recovery is slow and protracted, property performance will not return to pre-COVID-19 levels until at least late 2021. Struggling operators that are not well capitalized will be acquisition targets, while some will close altogether. New developments will be canceled or put on hold, while a long pause in construction considerably extends delivery schedules. While seniors who have the ability will delay entry into the segment out an abundance of fear, others will not have that option, sustaining moderate demand. The substantial reduction in supply growth will aid property metrics over the long term.

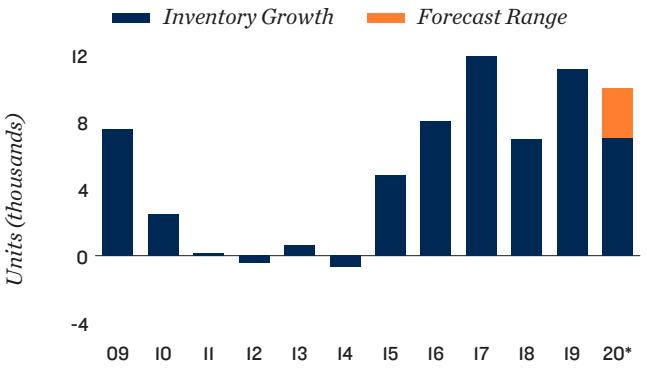
Independent Living Faces Unique Risks Despite Fewer Health Challenges

Initial virus impact remains minimal. Independent living residents are often younger and require little to no daily assistance or medical care, limiting the care segment's exposure to the health crisis. This has helped to limit occupancy erosion resulting from the novel coronavirus, though a strong supply influx in recent years has weighed on property metrics. A recent survey conducted by NIC Map® found that 54 percent of operators registered a month-to-month decline in occupancy in early May, the lowest in the sector. Operators have already contended with falling occupancy, however, which dipped 70 basis points year over year to 89.7 percent in the first quarter, the lowest reading since 2012. Move-ins and lease-up will continue to slow over the near term as aging seniors put off the move to a community until the health crisis abates, which may bring stabilized occupancy closer to 85 percent by year end.

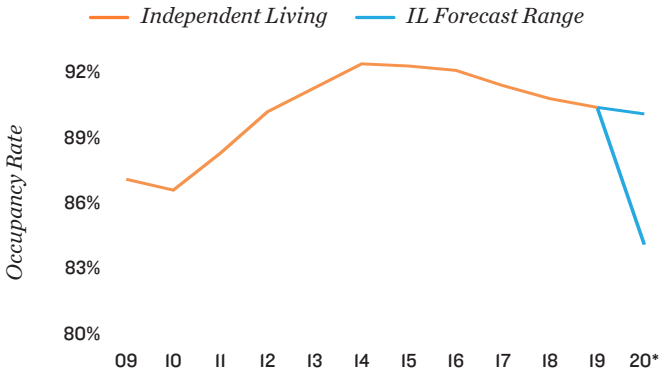
Public relations challenges loom ahead. Moving forward, marketing efforts will evolve to focus more on the health and safety of residents alongside the focus on amenities that has been prevalent for the past few years. Much of the outbreak has been concentrated to skilled nursing facilities, though public perceptions could be damaging to other care segments, emphasizing the need for communities to remain transparent. While the long-term ramifications to the sector remain cloudy, it is clear that operators will need to increase infection control protocols even after the outbreak is contained. Independent living providers will be able to leverage the mobility and independence of their residents as they are more able to take proactive steps on their own. While other care segments have struggled with staffing and will likely need to increase medical training, the less needs-based product allows it to be more nimble. Still, independent living providers will adopt a new normal, which includes enhanced social distancing and isolation measures, along with broad use of disinfectant and other PPE.

Expenses rise dramatically as cash flow ebbs. Maintaining frontline staff has been difficult across the sector, driving providers to raise pay and offer new benefits as caregivers face elevated risks. Labor costs have risen roughly 8 percent for communities with no reports of an outbreak, while those with infected residents posted a nearly 20 percent increase in payroll expenses. A shortage of personal protective equipment and technology purchases that provide telehealth, communication between residents and family, and virtual community tours are also pushing operating expenses higher. The added costs of the crisis are coming at a time when revenues are being impacted by changes in occupancy. An extended period of reduced occupancy would be especially difficult for smaller, less-capitalized providers, which could drive acquisitions of underwater care providers.

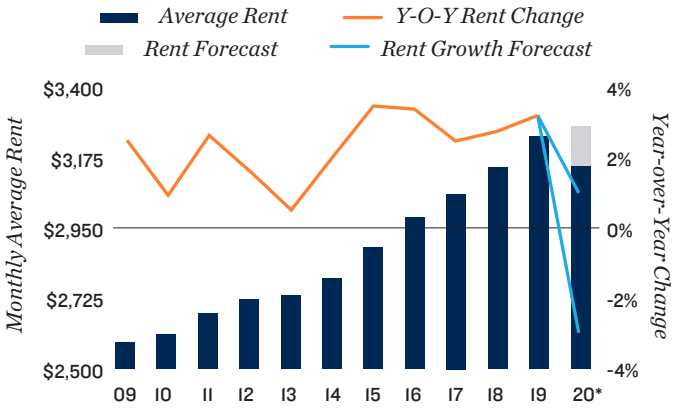
Accelerated Inventory Growth Weighs on Occupancy



Occupancy to Fall as Move-ins Slow



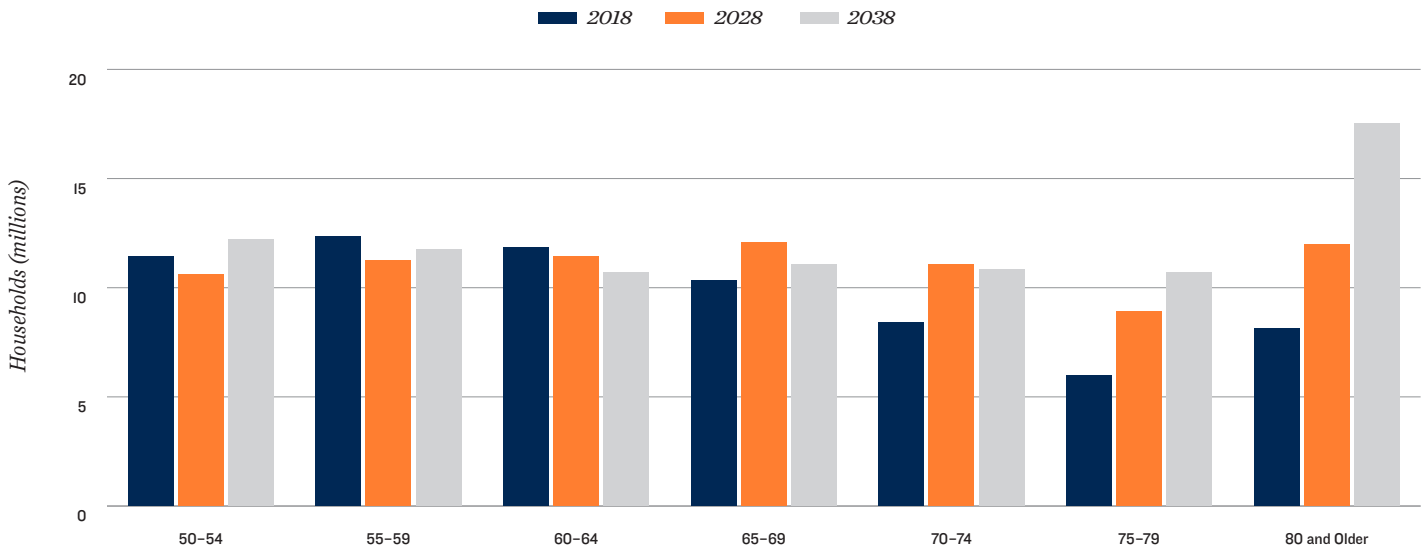
Rent Growth Abates as Occupancy Softens



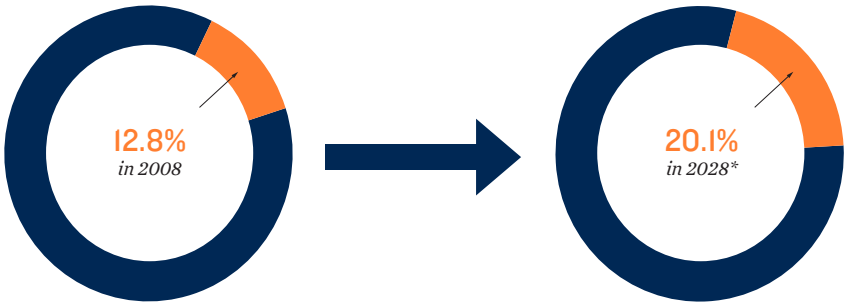
** Forecast*

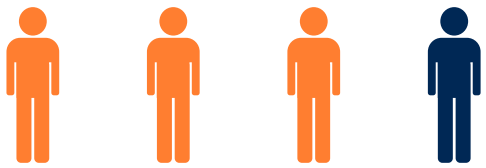
Marcus & Millichap Research Services;
NIC Map Data and Analysis Service (www.nicmap.org)

OLDER HOUSHOLDS' GROWTH ACCELERATES OVER THE NEXT TWO DECADES

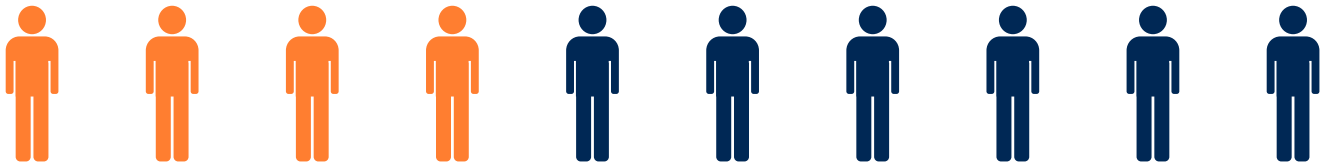


65+ POPULATION GROWS AS A PERCENTAGE OF TOTAL POPULATION





Almost 75% of Americans older than 65 will require some form of long-term care in their lives.

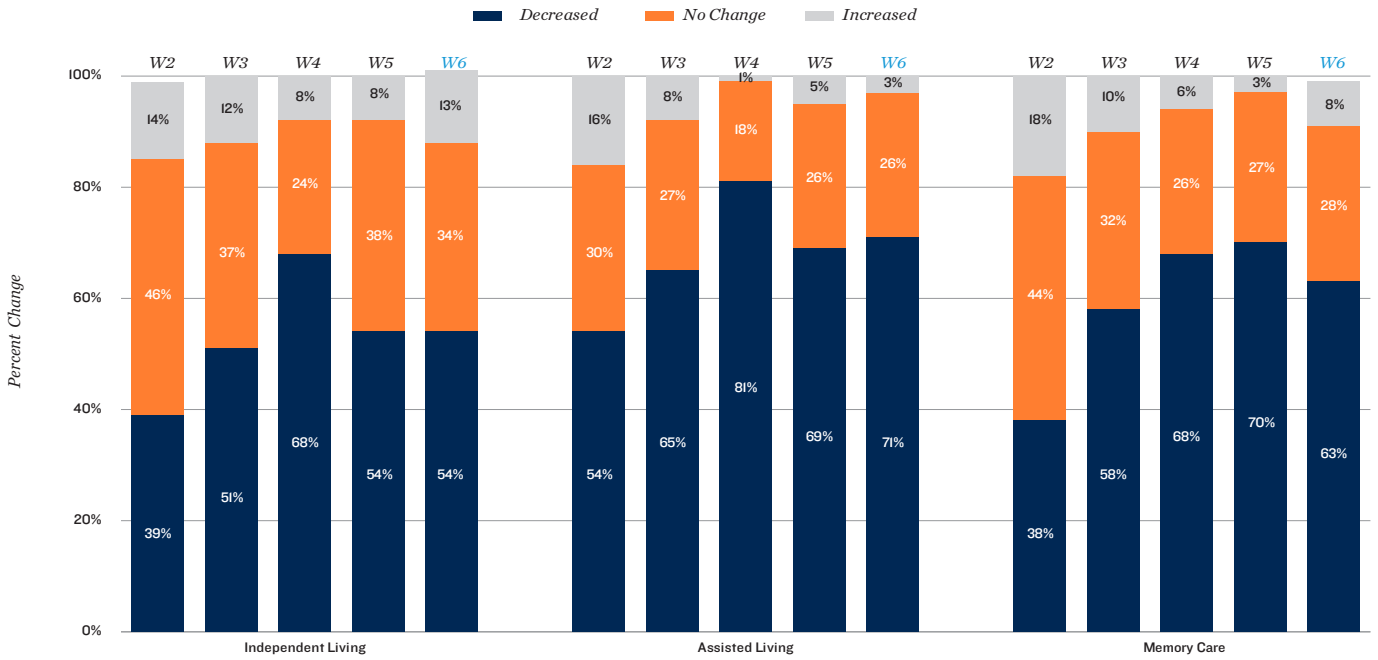


More than 40% of individuals will require long-term care in a nursing home.

Sources: Marcus & Millichap Research Services; AOA; BLS; JAMA; JCHS

CHANGE IN OCCUPANCY BY CARE SEGMENT:

CURRENT VS. ONE MONTH PRIOR



Week 2 responses collected April 6 to April 12.
Week 3 responses collected April 13 to April 19.

Week 4 responses collected April 20 to April 26.
Week 5 responses collected April 27 to May 3.

Week 7 responses collected May 4 to May 10.
Totals may not add to 100% due to rounding.

CARE NEEDS OF ASSISTED LIVING RESIDENTS OVERSHADOW NEAR-TERM CHALLENGES

64% need help with bathing

57% need help with walking

48% need help with dressing

40% need help with toileting

29% need help with bed transfer

19% need help with eating

COMMON RESIDENT CONDITIONS

52% have high blood pressure

42% have arthritis

42% have Alzheimer's disease or dementia

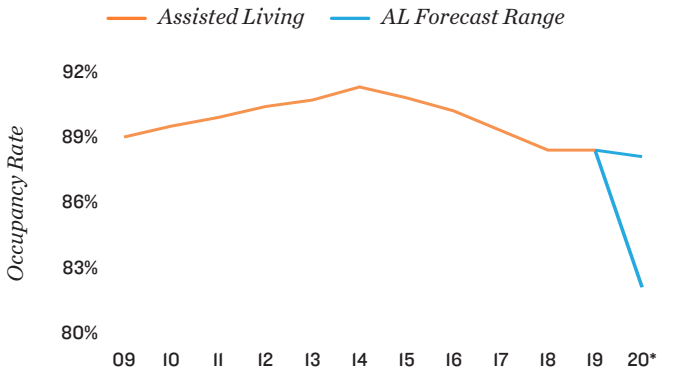
34% have heart disease

31% have depression

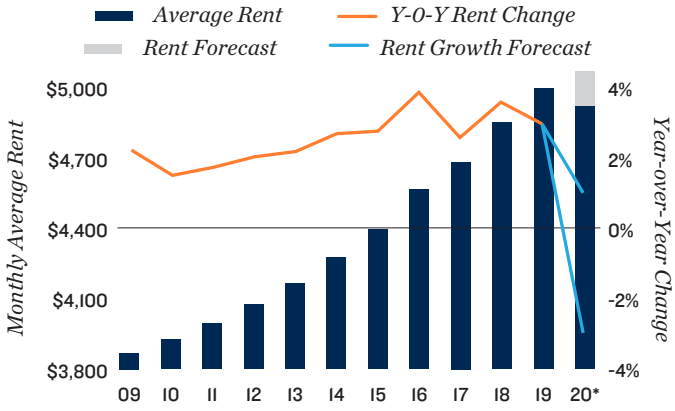
NIC Executive Survey Insights; National Center for Health Statistics

Pandemic Tempers Assisted Living Inventory Growth

Occupancy Trends Lower Over the Near Term



Rent Gains Pull Back as Occupancy Falls



*Forecast

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Long-Term Outlook Holds Positive for Assisted Living Complexes

Expenses surge in the battle against COVID-19. Infection rates at assisted living facilities have so far been low with less than 1 percent of the more than 800,000 residents in communities across the nation contracting the virus as of mid-April. Even so, operators have responded quickly to put residents and their care as a top priority. Operators face large challenges in obtaining enough PPE for staff and residents, which is currently one of the highest expenses for many properties. The preventative costs to fight the virus are small relative to the cost of an outbreak, though, with some providers forecasting a $500 to $700 cost per unit for increased labor, supplies and cleaning. Once the virus enters the building, the expense to each facility has been estimated at $1 million. The financial impact of the coronavirus could total roughly $60 billion industrywide as providers are faced with increased costs for labor and supplies. While expenses climb for many providers, REITs and capital partners are working closely with operators to provide the bandwidth needed to weather the storm through rent deferrals and abatements. Moving forward, though, occupancy is anticipated to fall as move-ins slow and seniors turn to home health and telemedicine alternatives over the near term, affecting revenue and the recovery of many facilities.

Care needs of seniors to provide long-term demand. The NIC Executive Survey found that 71 percent of assisted living organizations recorded a decrease in occupancy at the start of May in contrast with one month earlier. Stabilized occupancy rested at 87.7 percent in the first quarter, down 20 basis points from one year ago to account for the lowest level in more than a decade. Construction activity has slowed considerably from recent highs, helping to buoy property performance. Over the near term, though, occupancy will continue to erode, possibly trending below 85 percent before the end of the year. The increased level of care that many aging seniors require will maintain stable demand moving forward, especially as families realize they are unable to appropriately care for loved ones during a crisis.

Virus to transform investment activity. Investors and lenders have put activity on hold until greater clarity on the economy emerges as they are challenged with pricing risk. Over the near term, some properties will be repriced, creating favorable entry points and new opportunities for investors. Higher operating costs through the pandemic will weigh on operators with a weaker capital structure, leaving a greater share of the market open to merger and acquisition activity. The yield availability in seniors housing communities will continue to attract buyers once activity resumes, with some finding Class A assets that trade with an initial yield in the 5 percent to 6 percent band.

Pandemic to Have Far-Reaching Impact on Skilled Nursing; Unparalleled Quality of Care Vital to Aging Population

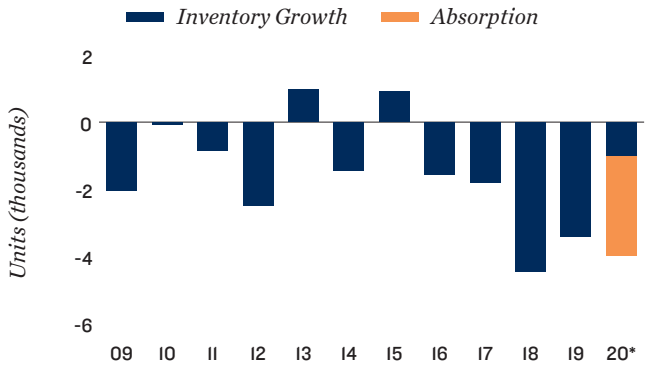
Fixed revenues stress care capabilities. The skilled nursing segment has been particularly hard hit by the outbreak as many residents face increased health risks, accounting for a large portion of the death toll nationally. Across 38 states that are reporting data, 42 percent of COVID-19 deaths have been in long-term care facilities as of May 21. While most nursing homes are prepared to fend off known viral outbreaks and have greater access to medical supplies and PPE, many workers have been sidelined by the pandemic. Elevated fear among staff has created challenges in stemming the spread of the outbreak and an average wage between $14 and $15 per hour for nursing assistants has made it difficult to attract new workers. Low reimbursement rates for Medicaid patients have strained budgets and limit the ability to boost staffing ratios, creating workload gaps. As the care segment begins to emerge from the health crisis, facilities will take a closer look at their staffing needs and move to enhance their acute care capabilities.

Nursing facilities formulate plans to reopen. Long-term care facilities have been in lockdown since March 13 under guidelines set by the Centers for Medicare and Medicaid Services. Plans for reopening the skilled nursing sector through a multiphase approach were released on May 18 by federal health regulators, relaxing restrictions following 14-day periods of no new COVID-19 cases. The recommendations call for PPE for staff and adequate testing plans to be in place before reopening in phases. Under the guidelines, facilities could open visitation to nonessential healthcare personnel and contractors in stages, and resume communal dining and group activities under social-distancing protocols. Many facilities still have limited access to tests and personal protective equipment, encouraging some states to issue executive orders to deploy the National Guard and other teams to ramp up testing.

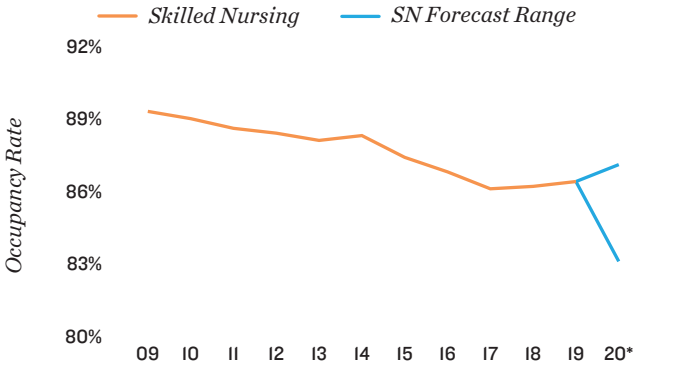
Providers face lasting disruptions from all angles. Operators, lenders and government agencies are navigating a new path forward for the skilled nursing category, which could result in increased oversight. Front-page headlines about the impact in the skilled nursing market has worsened the sector's reputation, creating public relations challenges for many facilities. Care providers will need to counteract the negative news coverage with industry leading safety practices and new standards for infectious diseases, restoring confidence and ensuring patient safety. Still, some facilities will be at risk of lawsuits from patient protection groups and affected families, straining resources over the near term. Legal protections have been issued in at least 10 states with more likely to follow, shielding healthcare facilities, including skilled nursing providers, from civil and criminal liability during the health crisis.

Lockdowns weigh on near-term census. Most nursing care properties have recorded a change in occupancy in recent weeks as move-outs accelerate and imposed bans on move-ins stretch on. In the NIC Executive Insight Survey, 79 percent of organizations reported a decrease in occupancy in the first week of May from the same week a month earlier, the highest in the industry. Stabilized occupancy which remained unchanged year over year in the first quarter at 86.5 percent, held stable as inventory continues to decline. As more beds continue to be removed from inventory than are being built, this will help to buoy occupancy levels over the long term. As the health crisis abates and restrictions are lifted, demand will return to the category as the quality and expertise of care provided cannot be easily matched in other segments. The front end of the baby boomer generation is approaching the average age of skilled nursing residents, providing a long runway for the sector.

Reduction in Inventory to Backstop Property Performance



Health Needs of Aging Population Bolster SNF Occupancy



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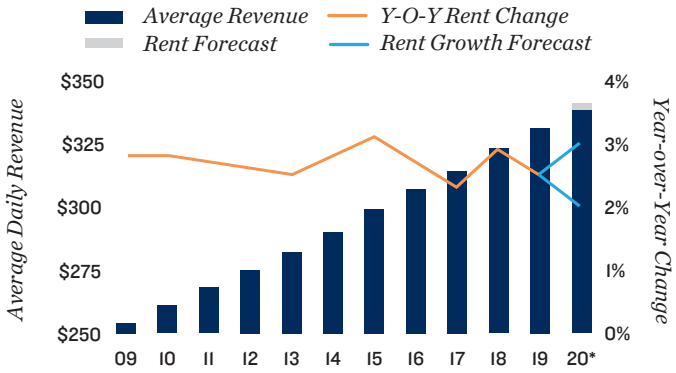
Immediate Obstacles Faced by Skilled Nursing Providers To Be Overshadowed by Greater Care Needs of the Elderly

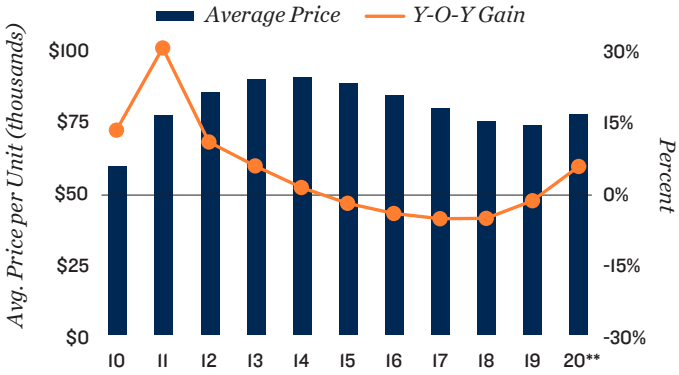
Long-term demand drivers maintain positive outlook. Skilled nursing facilities will emerge from the health crisis as an integral part of the healthcare system, just as they have during previous disasters. The long-term prospects for the segment remain stable as the level of care and assistance provided in these facilities is critical to the elderly population. Actuarial tables state a man born in 1950 will, on average, reach the age of 84, while a woman born in that year will live to reach 87. As the baby boomer generation ages, more pressure will be placed on the system. The position of skilled nursing facilities and assisted living properties has grown on the healthcare continuum in recent years and will continue to play an integral role for acute and post-acute care. According to the most recent data from the Centers for Medicare and Medicaid Services, 66 percent of payments come from some form of insurance. Total expenditures in the sector are expected to rise 63 percent to $271 billion between 2017 and 2027.

Multiple factors to impact pricing. The investment market will remain clouded until the first wave of the pandemic passes and buyers and lenders are able to asses risk and follow through on due diligence, which will lead to a clearer picture of valuations. Investor sentiment will be sustained over the long term by pent-up demand and an attractive yield profile, maintaining a strong flow of capital into the care segment. Hot spots of the pandemic including the Northeast face an extended path toward normal market conditions as these areas could face added scrutiny over operations, funding and oversight. Borrowers could also face added scrutiny as lenders closely examine their operating history and ability to manage in the highly complex skilled nursing space. Some who entered into the market during the recent growth cycle and do not have as much experience may wish to exit the industry, creating new opportunities for investors.

Revenue Growth Held Stable By Medicaid and Medicare



Investor Sentiment Bolsters Pricing for SNFs



** Forecast*
***Trailing 12 months through first quarter*
Sources: Marcus & Millichap Research Services; NIC Map Data and Analysis Service (www.nicmap.org)

Seniors Housing Division
Todd Lindblom
National Director | Seniors Housing Division
Tel: (262) 364-1900 | todd.lindblom@marcusmillichap.com

Marcus & Millichap Capital Corporation
Tony Solomon
Senior Vice President, National Director | MMCC
Tel: (310) 909-5500 | tony.solomon@marcusmillichap.com

Prepared and edited by
Michael Murphy
Research Analyst | Research Services

For information on national commercial real estate trends, contact:
John Chang
Senior Vice President, National Director | Research Services Division
Tel: (602) 707-9700 | john.chang@marcusmillichap.com

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Sources: Marcus & Millichap Research Services; Harvard Joint Center for Housing Studies; Kaiser Health News; National Center for Assisted Living; NIC Map® Data and Analysis Service (www.nicmap.org); Social Security Administration; U.S. Census Bureau

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