SENIOR HOUSING UPDATE

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Near-term fundamentals are poised to produce substantial margin expansion in the senior housing sector, presenting an exciting opportunity for investors looking to gain exposure.

The senior housing sector is expected to experience a significant surge in demand over the next decade, driven by the unprecedented acceleration of the 80+ population. The aging demographic, which is projected to increase by 4.2 million individuals by 2029 as the Silent Generation (people born from 1928 to 1945) and Baby Boomers (people born from 1946 to 1965) enter the prime age range for senior housing (80+ years old).

This powerful demographic wave positions the sector for remarkable growth and indicates an average annual demand of approximately 40,000 units.[1] Historical construction starts over the last five and ten years have been approximately 30,000 and ~2,000 units, respectively, representing a 33% increase in unit production needed to meet increasing demand.[2]

The strong demand for senior housing is already reflected in rising occupancy rates and record-breaking revenue growth for private and public senior housing owners. Furthermore, the scarcity of aging-ready homes suggests that aging in place will be challenging, further bolstering the demand for senior housing. At the same time, with the forecasted growth of the 80+ population extending beyond 2029, the sector shows promising potential for continued demand longer-term. Near-term fundamentals are likely poised to produce substantial margin expansion, presenting an exciting opportunity to gain exposure to the sector.

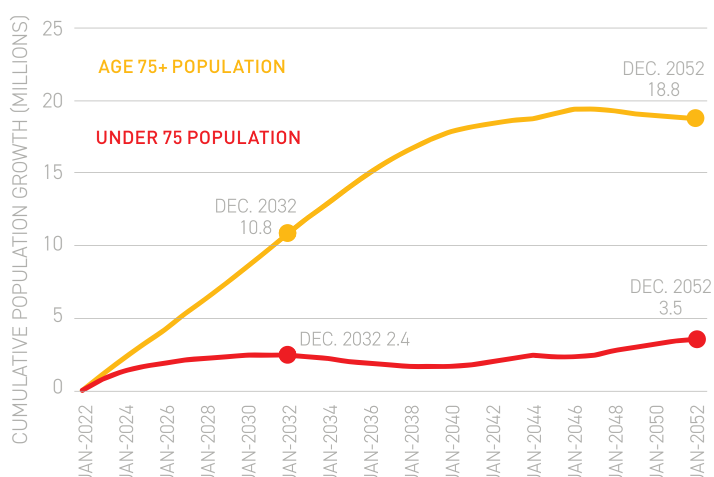
DEMAND OPPORTUNITY FROM UNPRECEDENTED ACCELERATION OF 80+ POPULATION THROUGH 2029

Senior housing demand fundamentals are strong and are poised to accelerate through the end of the decade, driven by the aging of the Silent Generation and Baby Boomers.

With entry into senior housing communities occurring at the average age of 82, the growth of the 80+ population is a valuable metric to forecast demand trends for the sector. Over the next seven years, the 80+ population is forecast to grow by 4.27 million individuals, from 12.97 million as of 2022 to 17.24 million (approximately 600,000 per year through 2029), as shown in *Exhibit 1*.[3]

EXHIBIT 1: THE AGING BABY BOOM (2022–2052)

Source: Moody's Analytics. Data as of March 30, 2023

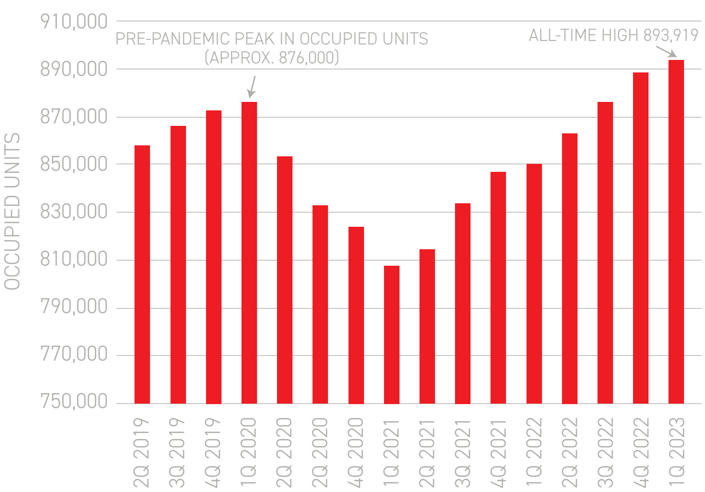


By comparison, the 80+ population grew by 610,000 individuals from 12.1 million to 12.8 million over the prior seven-year period from 2015 to 2022.[4] Based on historical senior housing utilization rates, 4.2 million cumulative population growth among the 80+ population implies average annual demand of roughly 40,000 units annually, equivalent to roughly 325 new communities, through 2029.[5]

Indeed, in 2022, demand for senior housing units nationally exceeded 42,000, more than any year on record, lifting national occupancy by 2.8% and bringing total occupied units to an all-time high, as shown in *Exhibit 2*.[6] Moreover, strong demand coincided with robust rent growth in senior housing, evidenced by average annual revenue growth of high-single-digit to low double-digit annual revenue growth among public and private operators.

EXHIBIT 2: ALL-TIME HIGH IN OCCUPIED UNITS

Source: NIC MAP



While it is possible that the senior housing utilization rate among the 80+ population will fall in future years, Harrison Street Research indicates such a decline is unlikely given the difficulty for individuals to age in place. Notably, less than 10% of US homes were aging-ready.[7] Beyond 2029, the 80+ population is forecast to grow by another 10.6 million individuals from 2030 to 2050, underscoring the potential for the aging population to provide favorable demand tailwinds well through the end of the decade.[8] The short- and intermediate-term operating fundamentals should benefit from low and declining supply activity due to challenging capital market conditions, irrespective of demand drivers.

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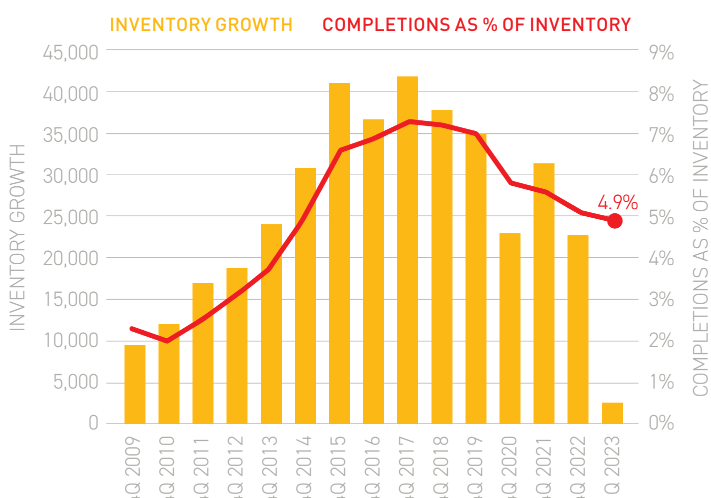
SUPPLY GROWTH RESTRAINED BY CAPITAL MARKETS, NOT FUNDAMENTALS, BENEFITTING MARGIN GROWTH

Despite the favorable demand outlook for the sector, senior housing inventory growth slowed significantly since deliveries peaked at 7.3% of existing stock in 2017 to 4.9% as of Q1 2023, as shown in *Exhibit 3*.

EXHIBIT 3: ALL-TIME HIGH IN OCCUPIED UNITS

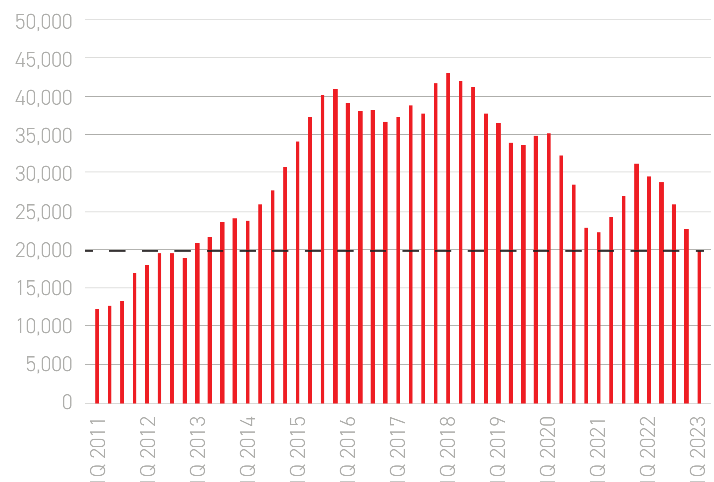
Source: NIC MAP



The trend is likely to continue in the short term.[9] Because senior housing deliveries typically lag construction starts by roughly two years, changes to the level of construction starts are leading indicators of supply growth. As of Q1 2023, high borrowing costs, elevated goods and services inflation, and volatility in the banking sector contributed to the number of senior housing starts falling to 3,100 units, shown in *Exhibit 4,* the lowest level since 2012.[10] As a result of historically low construction starts and an aging population, Harrison Street believes the supply-demand imbalance within senior housing is poised to favor established, quality operators in the short- to intermediate-term or until the capital market thaws which could ease development challenges.

EXHIBIT 4: ALL-TIME HIGH IN OCCUPIED UNITS

Source: NIC MAP



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OPERATING FUNDAMENTALS RESILIENT TO ECONOMIC CONDITIONS

Solid demand and low supply growth amid normalizing labor costs produce enviable operating margin expansion across the industry. For example, in Q1 2023, private market operators and public REITs reported strong occupancy and revenue growth year over year, marking the fifth consecutive quarter of double-digit revenue growth within same-store senior housing operating portfolios.[11]

Labor costs, which typically range from 55% to 65% of senior housing operating expenses, peaked in the first half of 2022 amid the labor shortage within healthcare broadly, and continued to moderate in Q1 2023, providing relief to senior housing operators. Examples of less temp labor usage can be observed in commentary from various publicly traded companies, including healthcare temp staffing companies, hospitals, senior housing REITs, and Harrison Street's own portfolio.

Record rental rate growth and slowing labor expense growth are on track to produce enviable same-store net operating margin expansion in 2023. The Green Street 2023 sector outlook research report noted a base case for NOI growth of 19% per year from 2023 through 2025. Public and private market valuations reflect resilient senior housing sector operating fundamentals.[12]

PUBLIC AND PRIVATE MARKET VALUATIONS REFLECT FUNDAMENTALS

Since the S&P 500 Index bottomed from mid-October through June 2023, the senior housing sector REITs returned 31.5%, compared to 23% for the S&P 500 Index and 7% for the FTSE NAREIT Index.[13] According to Green Street, nominal cap rates for senior housing fell 10BPS year-over-year in Q1 2023, the only sector to experience cap rate compression among traditional and alternative real estate sectors in their universe. While senior housing nominal cap rates may widen in 2023, given challenging capital market conditions, Harrison Street believes the sector fundamentals are favorable and should provide downside protection relative to other real estate sectors.

POSITIONED FOR PERFORMANCE

The senior housing sector is experiencing a supply-demand imbalance that favors quality operators in the short- to intermediate-term. While the demand for senior housing is expected to surge, supply growth has been restrained due to challenging capital market conditions. The slowdown in senior housing deliveries and low construction starts underscore the advantage for established operators. Operating fundamentals in the sector remain resilient, driven by solid demand and limited supply growth. Labor costs, a significant expense for senior housing operators, have moderated, providing relief and contributing to enviable operating margin expansion. Record rental rate growth and slowing labor expenses position the sector for impressive net operating margin expansion in 2023. These favorable operating fundamentals are reflected in the strong performance of the senior housing sector in both public and private markets.

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ABOUT THE AUTHOR

Tom Errath is Managing Director and Head of Research at Harrison Street, a leading investment management firm exclusively focused on alternative real assets.

NOTES

[1] The 40,000 annual unit demand projection is based on the pre-pandemic seniors housing utilization rate among the 80+ US population, according to data from NIC MAP

[2] NIC MAP

[3] Moody's Analytics

[4] Moody's Analytics

[5] Harrison Street Research

[6] NIC MAP

[7] US Department of Health and Human Services, National Institutes of Health, National Institute on Aging. Aging-ready home is a housing unit with a step-free entryway, a bedroom and full bathroom on the first floor, and at least one-bathroom accessible feature.

[8] Moody's Analytics

[9] NIC MAP

[10] NIC MAP

[11] Welltower corporate financials

[12] Corporate financials

[13] Bloomberg

While the demand for senior housing is expected to surge, supply growth has been restrained due to challenging capital market conditions.

REVIEWER RESPONSE

Both pieces in this senior housing section manage to make clear the mathematical demographic case for senior housing – and in absolute figures, the numbers are quite compelling, with Errath noting that in the next six years, the elderly population is projected to increase by 4.2 million as the Silent Generation and front end of the Baby Boomer generation reaches the 80+ threshold. That's nothing for future-focused real estate investors to sneeze at!

While it's true that the size of this population wave is generally unprecedented as it relates to correspondingly real estate opportunities here in the U.S. (perhaps with the exception of the much-anticipated apartment demand stemming from the coming-of-age of the Millennial generation), investors considering this asset class would do well to consider what portion of this cohort may never be within reach of institutional senior housing by virtue of high price points, as well as what percentage may elect for other, less-institutional alternatives as they age (such as aging in place or opting for multi-generational living schemes with children). Suffice to say, the true pool of potential tenants is considerably smaller than the estimated 17 million people that will be 80+ by 2029.

Cost is a huge consideration and downside limiting factor – according to Green Street's 2023 U.S. Senior Housing Outlook, the average cost of an independent living facility for a resident is ~$3,700, while the average monthly memory care stay runs $7,400 or more. This is considerably higher than the average monthly mortgage across both the Silent Generation and Baby Boomer cohorts, which stand at +/- $1,400 according to the National Association of Realtors' 2023 Home Buyers and Sellers Generational Trends Report. While home equity is a considerable nest egg from which these cohorts can tap to bridge the gap, absent medical necessity, many have stated their desire to age in place. A 2021 survey conducted by AARP showed that 77% of adults aged 50 and older want to remain in their homes for the long term – a number that has been consistent for more than a decade.

The reality is, though people are living longer, they are generally living more healthily, which enables them to stay in their homes longer and delay or forego moving into care facilities. There is also a growing aptitude for home health, which was accelerated by the pandemic as more care providers are offering telehealth services, all of which could dampen future demand. Though current housing may need to be modified to accommodate aging (stepless entryways, bedroom/bathroom on main floor, added accessibility), for many a home equity line of credit to renovate may be a more appealing and cost-effective option.

So while yes, there will undoubtedly be opportunities for investors in the coming decade to capitalize on the graying of the U.S. population, a nuanced approach to longer-term supply exposure, demand erosion and price point are essential.

– Sabrina Unger
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