Featured

Senior housing faces the 'Silver Tsunami'

An aging population is driving the expansion of the senior housing sector in the US, writes Keith Button.

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Driven by a surging population of seniors and a supply-demand imbalance, investors in senior housing see a long runway of favorable conditions for the sector in the coming years.

Investors are watching several tailwinds pushing strong demand for senior housing in the US over the next 10 to 30 years, confirms Alanna Ellis, a senior housing debt and equity specialist with JLL in Seattle. One is the age of the Baby Boomer generation.

The first wave of Boomers will turn 80 next year, and the 65-and-older population will grow 44 percent by

2032, which compares with the general population growth rate of just 5 percent. Also, the ratio of potential caregivers per senior in each family is declining: from 6:1 in years past to a predicted 5:1 in 2024 and 3:1 by 2030, Ellis says.

Another tailwind is the population of seniors with Alzheimer's, dementia or other cognitive impairment, which will grow to 14 million over the next 30 years, from six million today, Ellis says.

In all, more than 800,000 units of senior housing will need to be added in the US by 2030, Ellis says. Currently there are 1.3 million skilled nursing units, 621,000 continuing care retirement community units, 452,000 independent living units, 667,000 assisted living units and 80,000 memory care units.

Another factor affecting supply and demand is that rising interest rates and elevated construction costs due to inflation have paused the construction pipeline. "The combination of both of those factors is a double whammy to construction projects," says Ellis.

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Harrison Street, the alternative real estate investment firm, is forecasting that senior housing demand in the US will increase by 40,000 units per year through 2029, while only 20,000 units per year will be added to the supply. And starting in 2029, the mismatch of supply and demand will grow even larger over the following 10 to 15 years, says Mike Gordon, the firm's global chief investment officer.

Imminent frenzy

Institutional investor interest in senior housing is also increasing, as pensions, consultants and private equity funds start to view senior housing as core to their investment strategies because of the favorable supply-demand and demographic trends, Gordon says. As those investors employ their dry power, their interest will push valuations higher.

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>
> ***Tim Robeson, Brookfield Asset Management***

"Once that frenzy begins to happen – and I do sense that it is on the precipice – it is something that over the course of the next 24 to 36 months will have a very positive impact on valuations and the sector as a whole," Gordon says.

Senior housing as an asset class is expected to double in the next 10 to 15 years, to about $1 trillion from $500 billion currently, says Eric Smith, chief executive of Locust Point Capital, a Miami-based senior housing lower-mid-market lender. Besides the demographics appeal of senior housing, investors are also attracted by its recession-proof characteristics: rents and occupancy levels tend to remain steady regardless of the economy.

"Once the decision is made to move a loved one into a long-term care facility, typically all other options have been exhausted," Smith says. That is why senior housing has the lowest delinquency rates and the lowest loan losses of all the major real estate asset classes.

With the senior housing segment, investment performance is correlated with quality of care, Smith says. "If you focus on finding operators that provide the best quality of care, they tend to outperform the competition," he says.

It pays to care

Smith says he prefers to finance owner-operators rather than projects where the provider of care is separate from the owner of the real estate because the alignment of interests in the owner-operator model produces a better quality of care. "This is not an asset class that, in our opinion, you can manage effectively from a corporate headquarters. You really have to be hands-on," he says.

"While this asset class may have some real estate component, it is also heavily an operating business that delivers healthcare to the elderly. So it is a more complex real estate asset class than other major real estate asset classes."

The types of senior housing most in demand is evolving, based on existing housing stock and the preferences of today's seniors and their adult children.

Most of the new senior housing that was built starting in 2015, in anticipation of the “Silver Tsunami” of Baby Boomers aging, was a mix of traditional senior housing: independent living, assisted living and memory care, with typically all three in one community, says Tim Robeson, senior vice-president at Brookfield Asset Management. One or two generations before, these three types of housing were built as separate communities.

In the last five years, the popularity of active adult communities for seniors has blossomed. It is essentially multifamily housing with high quality amenities for seniors, where people in their mid- to late-70s would move in, Robeson says. “From an institutional real estate perspective, that really boomed just in the last few years,” he notes. These properties now trade with similar investment return characteristics to multifamily properties.

Now, there is investment opportunity in the need-based segments of senior housing: assisted living and memory care, which offer progressively more staffing and services for seniors as they age, Robeson adds.

“We see real opportunity right now and in the immediate future because those demographics are just so compelling. The 80-plus segment of the US population is probably the fastest growing segment out there. The numbers are going to be increasing really, really dramatically,” he says.

Independent living senior housing is typically defined by its level of service: assisting with one daily living activity, such as eating or dressing, while assisted living is defined by assistance with three or more daily activities, and memory care serves residents with Alzheimer’s or dementia.

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Most private equity investors consider skilled nursing care – the highest level of care for senior residents – as a separate category outside of senior housing, more in the healthcare arena, Robeson says. Unlike the other categories of senior housing, skilled nursing homes are regulated at the federal level and are paid for primarily by the government.

Besides the rapidly expanding segment of people in their early- to mid-80s – the average age of incoming residents to assisted living – new housing supply for these segments is constrained by the current lack of construction financing, which adds to its attractiveness from an investment standpoint. Also, demand for the need-based segments is relatively inelastic – the need for care and assistance is not optional – so these segments tend to perform better through economic downturns than other real estate segments, Robeson observes.

"It feels like a good time if you are in the institutional space and you are looking at durability of income and historically a very, very strong ability to grow rents, even in weaker economic times," he says.

In addition to the surging population of Baby Boomers in the senior housing age bracket, several trends support a strategy of investing in new development, says Steve Blazejewski, senior portfolio manager for senior housing strategies at PGIM Real Estate.

Refined tastes

Catering to the discerning preferences of seniors has become more important, by offering easy access to parks, libraries, train stations and performing arts centers, for example, so more new senior housing is going to be built in central city locations, Blazejewski says.

Today's seniors are also looking for more spacious housing units. One- and two-bedroom units of 700-1,200 square feet sell very well compared with studio units of 300-600 square feet that were more typical in the past, Blazejewski says.

In the past, a senior housing community typically had just one dining hall; now they have four or five, and maybe a bar, a bistro, a coffee shop and a formal dining room. Today's senior housing may have fitness centers with trainers and yoga centers. Multi-generational, mixed-use developments may combine apartment buildings, dining, a movie theater and senior housing.

Another factor that investors are considering is the aging condition of current senior housing, and that senior communities that were built more than 20 years ago will underperform, he says. New supply growth for senior housing is down more than 50 percent from its peak several years ago.

“We really have to be looking at the communities that we want to own for tomorrow,” Blazejewski says. “That is all going to require us to build new real estate and think about senior housing in a very different mold.”

The only “blip on the radar” for the needs-based segments of senior housing was during the pandemic, when covid and the labor shortage had an outsized impact on the senior housing sector, Robeson says.

Senior housing is similar to the hospitality sector in that it requires a large number of full-time employees for operations, with progressively more staffing for assisted living and then higher level of services for memory care. As well as the maintenance and sales staff needed for a multifamily or senior independent living property, assisted living and memory care requires dining staff, cooks, housekeepers and caregivers.

The tight labor market that trailed the pandemic has eased considerably for the senior housing segments over the last six to 12 months, Robeson says. Occupancies and operating margins are now growing, following their downturn during the pandemic, but they have not yet returned to pre-pandemic levels.

Private capital has focused mainly on senior housing that caters to the upper third most wealthy clients. But investors run into challenges at the very wealthiest end of the spectrum, in providing elite-level housing, services and amenities, because the residents and adult children who can afford $20,000 per month rent for senior housing can also afford to move out and replicate those services in their homes.

From a demographics perspective, the greatest demand opportunity lies with seniors in the middle two quartiles as ranked by wealth, but senior housing operations generally are too expensive to make the business case work. “If you are trying to squeeze on the top line, on the rents, to make it more affordable to a greater number of potential residents, sure, there is a ton of demand for it. But the math needs to work too. You need to make that operationally viable,” says Robeson.