The DI Wire

Guest Contributor: Senior Housing in 2019 – Still a Trustworthy Investment

https://thediwire.com/guest-contributor-senior-housing-2019-still-trustworthy-investment/

December 27, 2018

For more than a decade, senior housing has seen unprecedented growth, fueled by the Silver Tsunami. It's become such an investment darling that some are concerned about market over-saturation. In my view, 2019 will be a year of slight correction with strong anticipated returns across almost the entire industry.

What fuels my optimism? First, the Silver Tsunami has just barely touched ground. The surge is anticipated to continue for decades. Second, there remains ample opportunity in all market sizes. While large operators tend to focus heavily on primary markets, there are over 750 municipalities in the USA with a population of over 50,000. These markets, and markets much smaller, can easily sustain a new senior housing community. The opportunity is market-specific; each market must be analyzed to determine if there is opportunity for new senior housing.

The following are a few key trends I see shaping the senior housing industry in 2019.

The Sector Will Remain Recession-Resistant

We are now in the 2nd-longest economic expansion period in the history of the United States. By mid-2019, most experts believe it will become the longest economic expansion period ever. The same group of experts predict a recession is likely not too far away. Senior housing proved it mettle in the great recession of 2007-2009 – it was the #1 performing commercial asset sector. During this period, rent growth for senior housing remained positive, despite large losses throughout the commercial real estate industry overall. When our next recession arrives, we should expect senior housing to exhibit similar performance characteristics it displayed in the Great Recession.

The only caveat: independent living. Although the segment has seen tremendous favor in the past year, it's also the only segment of senior housing with no clear "need." If the economy buckles, we'll likely see a hit in independent living as seniors choose to stay put and wait out the economic storm.

2018's Cautious Construction Will Mean Higher Occupancy Rates

In 2018 to date, total construction investment is down significantly from 2017 numbers. This can be attributed to several factors. 2017 construction investment was very high, and it would be hard to sustain that level. Credit markets, always a challenge for senior housing, tightened in 2018, requiring more equity capital in each deal. Interest rates went up as well. This put a crunch on new construction. 2018 occupancy rates suffered as the market absorbed the new supply from 2017 construction. In 2019, however, occupancy rates will likely rise, as the new supply is easier to absorb. This is especially true in combined assisted living/memory care communities, as the demand for specialized memory care communities will continue to decline.

Labor Shortage Will Continue To Be a Big Issue

The economy is white-hot, and recently experienced the lowest unemployment rate since 1960. While this is great overall, it certainly has caused labor shortage problems for senior housing. As long as we are in an economic expansion period, the labor shortage will not go away. I do not see the labor shortage subsiding in 2019. There will be deals in great markets that will not be built because there will not be a sufficient number of qualified people to hire to operate the senior housing community. The labor pool in that specific market will be carefully evaluated before a development is approved and funded.

Interest Rates Will Remain Relatively Stable

Interest rates will continue to inch up, but overall, I would expect to see a total 2019 increase of 50 basis points or less. While not a huge impact, this, combined with lower loan-to-cost ratio and a tight labor market, will negatively impact margins on new construction deals. Deals that were economically viable in late 2017/early 2018 will not be viable in 2019 – margins will be too tight. Accordingly, we will continue to see lighter total construction investment, similar to 2018.

Cost of Construction Will Continue to Rise

The cost of construction rose as much as 30% in some markets in 2018, while most markets experienced construction cost increases between 15% and 20%. The trend will continue in 2018, as the economy continues with its head of steam. The hot economy is causing cost increases for materials and labor. Combined with higher interest rates, these forces will continue to have an impact on the cost of the new facilities and reduce the number of new project starts.

Skilled Nursing Will Continue to Struggle

Nursing homes have been on active decline for years now as changes in the healthcare system, Medicare/Medicaid funding, and the overall quality of available housing continue to change, skilled nursing will continue to fall. Communities offering a continuum of care, allowing residents to receive treatment as needed, as they age, will continue to be the chosen option for seniors this coming year.

Private Pay Communities Will Continue to Outperform

While a demand for more affordable senior housing remains strong, I believe assisted living/memory private-pay communities will be the most reliable investments in the sector. The political environment is far too fickle to rely upon Medicaid/Medicare for funding and payment. To me, the best investments are ones based on strong demographics—income, education level, age, proximity to hospitals—that show potential residents can afford quality private-pay communities for years to come.

New Technology Will Make Aging in Place Easier

Other factors, including new technology, may also have an impact on the demand for senior housing throughout the sector. For instance, developments in the Internet of Things (IoT), remote/mobile healthcare, memory care safety, and other services like online grocery delivery, will make it easier for seniors to stay where they want to—in their homes—for longer periods of time. Will that impact senior housing in 2019? Not enough to move the needle, in my opinion. But I'd watch out for developments impacting the "need" for senior housing—especially in independent living communities—as time moves on.

As a fund manager in the senior housing sector, I have observed the ebbs and flows of the industry for more than 10 years. What I have found is that the sector has remained strong through almost every imaginable trend—economic or social—and I anticipate that stability to continue throughout the coming year.

—

Dan Brewer is chief fund manager of senior living fund, a private equity company investing in quality senior housing communities nationwide. Dan has more than 25 years of business development and real estate investment experience, including 15 years in commercial real estate (CRE), and is a frequent speaker and panelist at industry conferences throughout the country. He is passionate about the social implications of aging and bringing senior housing to the forefront of the impact investing sector.

The views and opinions expressed in the preceding article are those of the author and do not necessarily reflect the views of The DI Wire.

Click here to visit The DI Wire directory page.