SPECIAL REPORT

Marcus & Millichap

SENIORS HOUSING AND SKILLED NURSING

FIRST QUARTER 2022

Pent-Up Need for Critical Services Drives Record Absorption; Labor Shortage and Inflated Operating Costs Curb Sentiment

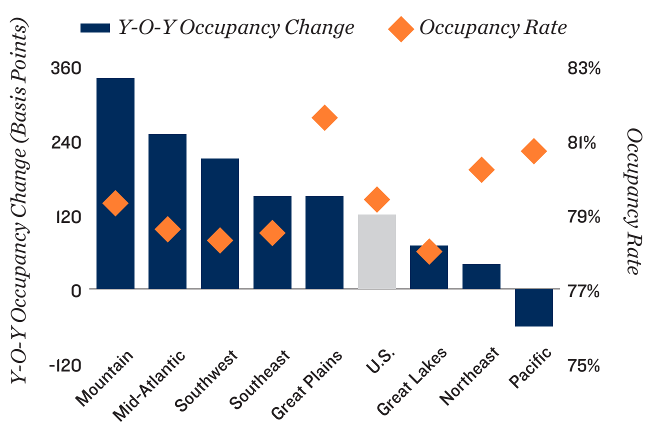
Two-thirds of relinquished units refilled in the second half of 2021. Across the final six months of last year, more than 30,000 seniors housing units were absorbed, according to NIC Map® Data Service. This was a very impressive rebound after roughly 44,000 units were relinquished on a net basis during the four quarters following the onset of the pandemic. The recovery last year was driven by a pent-up need for the care services that seniors housing communities provide, as well as a higher level of confidence among prospective residents once more of the population became vaccinated. This allowed move-ins to exceed pre-pandemic levels, while move-outs largely stabilized. Nonetheless, momentum was impeded in early 2022 amid the omicron surge, though case counts have since fallen and fears of community transmission have generally subsided. The potential for another unexpected variant leaves the near-term outlook enveloped with uncertainty, but the strong recovery last year and an aging baby boomer demographic substantiate a robust demand outlook in the years ahead.

Rates are climbing, but not as fast as inflation and expenses. For most levels of care, average monthly rents grew at a pace on par or faster than the 2015-2019 yearly average. Although, much of the growth came from stabilized properties aggressively pushing up rates, while discounting became increasingly common in facilities with occupancy well below pre-pandemic metrics. Additionally, the 3.1 percent rent growth for seniors housing as a whole last year was largely offset by historic inflation and an increase in operating costs tied to wages and infrastructure upgrades for virus mitigation. On a positive note, several states have recently elevated Medicare and Medicaid rates, or softened eligibility thresholds. As roughly 65 percent of long-term care is paid by these programs, this will be a critical vessel for industry support in 2022, as other forms of federal stimulus have dried up.

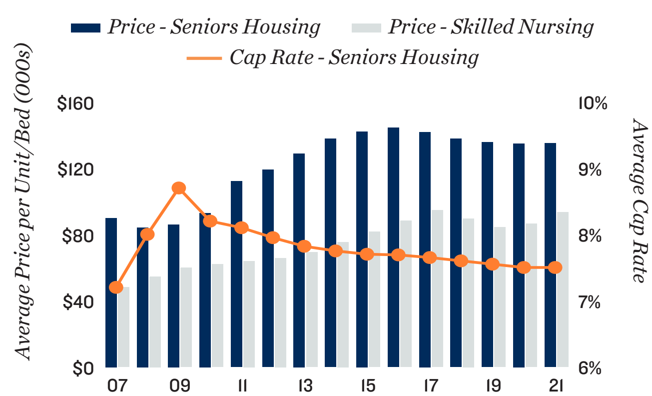
Labor shortage inhibits occupancy and lifts operating costs. While the headwinds directly related to COVID-19 have eased, the lingering labor deficit in the industry continues to plague operations. The American Health Care Association/ National Center for Assisted Living reported that over 95 percent of nursing homes and assisted living communities were dealing with staff shortages last year. Employment in assisted living, CCRCs and nursing homes each decreased by more than 10 percent from February 2020 to November 2021, according to the Bureau of Labor Statistics. Fewer personnel is forcing operators to limit admissions, which is slowing the pace of occupancy growth. Additionally, very high turnover among RA's, RN's, CNA's and even dining service workers is resulting in fast wage growth and sign-on bonuses to attract and retain staff. These expenses are especially costly in the current environment. Revenue streams are muted relative to pre-pandemic measures, while record-level inflation and higher insurance rates create additional costs for operators.

Competition for stabilized assets steers buyers to upside prospects. After most institutions hit pause in the early stages of the health crisis, many came off the sidelines as more stabilized properties entered the market. The large amount of capital built up during the pandemic translated to a rise in entity-level and portfolio deals in recent periods, potentially indicating an opportunity for private investors to acquire singular properties as institutions trim down portfolios; competition for stabilized communities is fierce, however, given the lack of assets that have recovered occupancy to 2019 levels. Buyers unable to compete may pursue upside prospects in a variety of ways. Lower occupancy communities in fast-growing regions of the U.S., like the Sun Belt, could present value-add potential. Some buyers are also converting distressed assets into mental and behavioral health centers.

In-Migration Regions Lead the Recovery

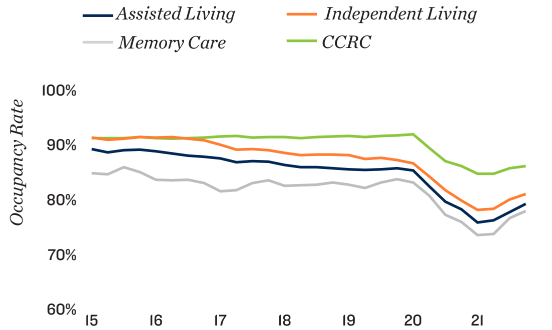


Sales Trends

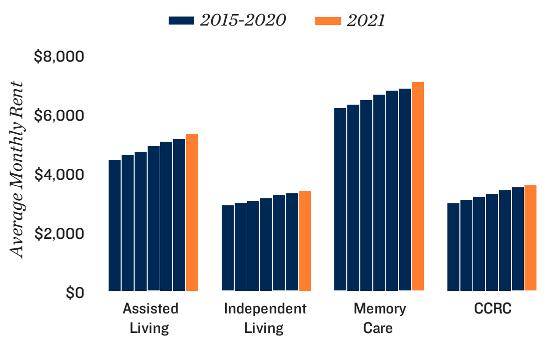


Sources: NIC Map® Data and Analysis Service (www.nicmap.org); Moody's Analytics

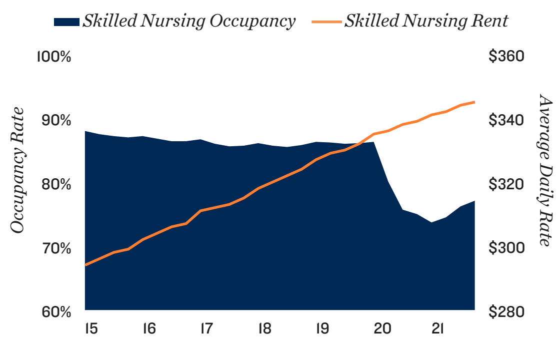
Occupancy Rebound Gaining Steam



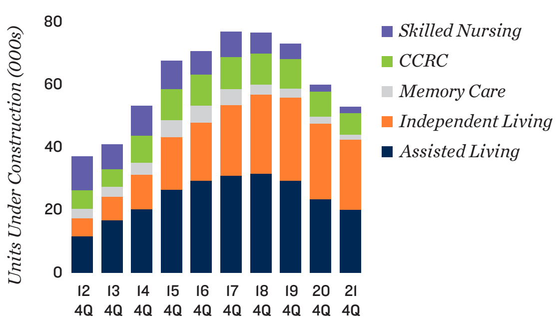
Rents Growing at a Sturdy Pace



Fundamentals Improving in Skilled Nursing



Construction Below Pre-Pandemic Norms



Sources: NIC Map® Data and Analysis Service (www.nicmap.org)

Unbalanced Seniors Housing Recovery Transpires

Levels of care that require more staff face steeper hurdles. Many assisted living and memory care communities are facing headwinds recruiting and retaining staff, slowing the pace of occupancy recovery. Ending last year, both segments recorded sub-79 percent occupancy on a national level. By comparison, independent living facilities, which require fewer staff, posted a national occupancy rate above 80 percent. Nevertheless, the services that assisted living and memory care provide are less replaceable by alternatives, which should aid occupancy once they achieve adequate staffing levels.

Dense coastal areas trail in the recovery. Seniors housing was put in a negative spotlight early in the pandemic amid virus outbreaks at facilities, particularly in the Northeast and Pacific regions. The stringent restrictions in the states that encompass these two areas, combined with the possible lingering impact on the local population's perception, could explain the comparatively slower occupancy recovery. Entering this year, occupancy in the Northeast and Pacific regions trailed their respective 2019 measures by 730 and 860 basis points. The U.S. rate was down 630 basis points.

Low construction alleviates other sector challenges. Across seniors housing last year, inventory growth totaled just 3.4 percent — the slowest expansion since 2014. The sluggish pace of development will extend into 2022 amid high material costs and supply chain bottlenecks. In the fourth quarter of last year, 6,000 fewer units were under construction relative to the same period in 2020. Less competition from new communities should help existing facilities attract residents and also workers.

Skilled Nursing Slowly Moving in the Right Direction

Occupancy climbs in three straight quarters, but a lot of ground to make up. As skilled nursing facilities are particularly labor intensive, many facilities are struggling to maintain sufficient staffing in the current environment. This is limiting admissions, and therefore, occupancy gains. Nonetheless, the recovery is underway, as the segment recorded positive absorption of at least 4,500 units in each of the past three quarters, bringing occupancy to 77.1 percent entering 2022. Still, this is 900 basis points behind the 2019 measure. Meanwhile, average daily rates continued to steadily elevate, with the fastest climbs in the Mid-Atlantic and Pacific regions.

Healthcare Real Estate Division

Todd Lindblom
Vice President | National Director, Seniors Housing Division
Tel: (262) 364-1910 | todd.lindblom@marcusmillichap.com

Prepared and edited by:
Benjamin Kunde
Research Analyst | Research Services

For information on national seniors housing and skilled nursing trends, contact:
John Chang
Senior Vice President | National Director, Research Services
Tel: (602) 707-9700
john.chang@marcusmillichap.com

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Sources: Marcus & Millichap Research Services; NIC Map® Data and Analysis Service (www.nicmap.org); U.S. Census Bureau; Moody's Analytics; Real Capital Analytics