NATIONAL REPORT

Marcus & Millichap

SENIORS HOUSING

SECOND HALF 2019

Seniors Housing an Indispensable Investment Component; Powered by Massive Demographic Shift Over the Next Several Decades

Aging population paints a promising picture for seniors housing outlook. Demand-side pressures are building in the seniors housing market as the approximately 73 million baby boomers move further into retirement and their older years, when they might need assistance. The leading edge of this cohort is currently 73 years old and captures those as young as 55, pointing to a strong wave of demand in coming years as the typical seniors housing residents are in their early 80s. Over the next five years, the U.S. population of those 75 and older will grow by 5 million, a 22 percent increase, a much more rapid expansion than the 2.8 million people age 75 or older added over the previous five years. This massive demographic shift, coupled with the rise in medical services the aging population could require, ensures broad-based demand across all forms of seniors housing. The level of care needed in the older cohorts points to continued momentum for the seniors housing market as well, reflected by robust estimates for healthcare expenditures over the next decade. By 2027, healthcare spending will account for nearly 20 percent of the overall GDP, driven in large part by the boomer generation. High rates of Alzheimer's and other dementia remain another factor fueling the need for more modern facilities with qualified staff, contributing to the bright outlook for the seniors housing sector.

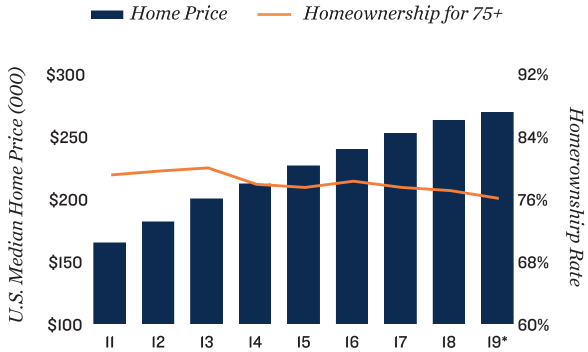
Construction cycle nearing a later stage for seniors housing. In preparation for the major influx of aging Americans in need of housing and long-term care over the next several decades, development in the sector has been at all-time highs this cycle. Seniors housing inventory has grown by more than 120,000 units since the beginning of 2015, according to NIC MAP®, most predominantly in the assisted living segment where almost 63,000 units have been added. A move toward combined campuses that integrate assisted living with a dedicated wing to memory care has been a major trend among developers and investors. Through diversification of these properties they can generate greater revenue streams while also benefiting from fewer regulations imposed on more staffing-intensive segments such as skilled nursing facilities. Occupancy levels have steadily declined in recent years following the massive wave of inventory though, leading developers to pull back on construction efforts and helping some sectors to finally bottom out.

Robust excitement surrounding seniors housing, bolstering investment activity. Favorable yield profile and consistency of demand have excited the investment community, motivating more investors to make their first foray into seniors housing. Against a backdrop of greater economic uncertainty than in previous years, the seniors housing sector has been considered a more recession-resilient asset class since the property type is impacted less by fluctuations in employment or a moderating GDP. An abundance of capital remains ready to be deployed into the sector and as interest rates have steadily declined over the past year more investors could move off the sidelines to search for opportunistic investments. Private buyers have been more active as institutions divest assets that do not align with their portfolio strategies, though institutions and REITs will continue to target newly constructed Class A properties in some of the larger metros.

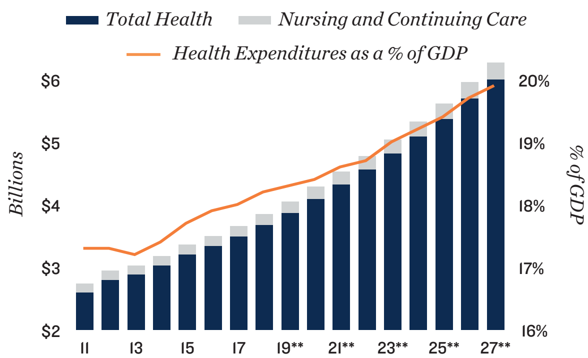
Executive Summary

- Baby boomers quickly approaching 75 to begin placing greater demand-side pressures on seniors housing. U.S. population of those 75 and older to increase at a rapid pace over the next five years and beyond.
- Seniors housing industry exiting a construction cycle as both independent and assisted living developers are slowly pulling back on supply additions, manifesting in tailwinds for the sector.
- Pace of occupancy erosion slows to a crawl and will nearly meet supply gains this year. Occupancy across all sectors beginning to find a floor or reversing course.
- Falling interest rates, abundance of capital likely to keep sales activity elevated. More private investors entering the sector in search of opportunistic investments and high yields.
- Institutional investors moved to the sidelines, growing the share of smaller, less-expensive transactions over the past year. After REITs spent several quarters streamlining their portfolios to achieve efficiencies, smaller investors moved into the market.

Equity in Home Values Remains Strong



National Health Expenditure Trends



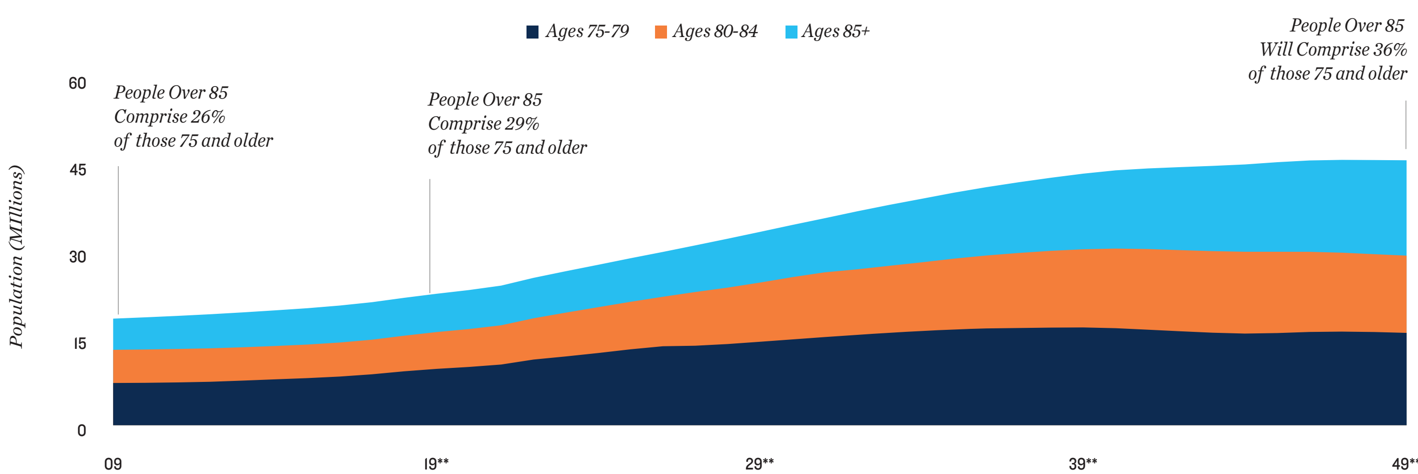
Rising Home Equity, Need for Healthcare and Life Longevity Extension Favor Senior Housing

- **Wave of retirees tapping into strong equity gains in residential market to fund retirement.** Homeownership among the older age cohorts remains well above the 64.2 percent rate recorded in the second quarter for the entire population, though it has been trending lower at a strong pace in recent years. After a post-recession peak of 81.6 percent for those 65 and older was registered in the middle of 2012, homeownership in this cohort now sits at 78.0 percent. For those age 75 and older, homeownership remains elevated as well, landing at 76.0 percent in the second quarter of 2019. Continual home price gains in the residential housing market this cycle will pad retirement funds as more aging Americans sell their homes in the coming years and move into seniors housing complexes.

- **Long-term healthcare expenditures paint a promising outlook for the seniors housing sector.** Healthcare spending will rise to approximately 20 percent of GDP by 2027 as the U.S. population ages. According to the Centers for Medicare and Medicaid Services, healthcare expenditures are expected to grow 5.5 percent annually to $6 trillion in 2027. At the same time, the front end of the baby boomer generation will surpass the 80-year-old threshold and begin applying more demand-side pressure on seniors housing facilities.

- **Older age cohort expanding rapidly to bolster seniors housing market demand.** Major advancements in healthcare and quality of living have pushed the average life expectancy considerably higher in recent decades, leading to the largest population of people entering their 70s and 80s in history as boomers age. Today, a 65-year-old man is anticipated to live to 84 years old, with a substantial share passing the 90-year mark. Women age 65 are estimated to live to 86.5 years. This aging population underpins the seniors housing market as the 75 and older cohort is forecast to grow by more than 10 million over the next 10 years, a 47 percent expansion.

Impact of Aging Baby Boomers/Growth of Senior Citizens



* 2Q
** Forecast
Sources: Marcus & Millichap Research Services; Federal Reserve: Consumer Finance Survey; National Association of Realtors; Social Security Administration; U.S. Census Bureau

New Supply Expected to Be Balanced With Growing Demand in Upcoming Years; Starts Continue to Slow

- **Seniors housing market adjusting to new supply.** As the past recession ended, seniors housing starts picked up as demand for housing for aging adults grew, particularly with assisted living units. Absorption remained strong up until 2014 when the seniors housing occupancy rate reached its peak of 90.1 percent in the forth quarter, according to NIC MAP® Data Service. As new units opened, occupancy slowly declined and now sits at 85.8 percent this past second quarter. The new inventory is considered supply that arrived early opposed to an oversupply that will not be occupied as the rapid growth of aging Americans combined with a longer life expectancy are expected to fill these residences in the upcoming years.

- **Potential evidence of construction slowing down overall as this sector's job growth slows.** Though construction jobs rose year over year, this past July's annualized pace of 2.8 percent was down by nearly half from the previous year-long stretch. In fact, the annual percentage increase for construction jobs nationwide has slowed almost every month since October of last year. Whether it is due to the scarcity of skilled labor or a decline in projects, the slower growth in this sector could reinforce limitations of new seniors housing projects starting the remainder of this year and possibly into 2020.

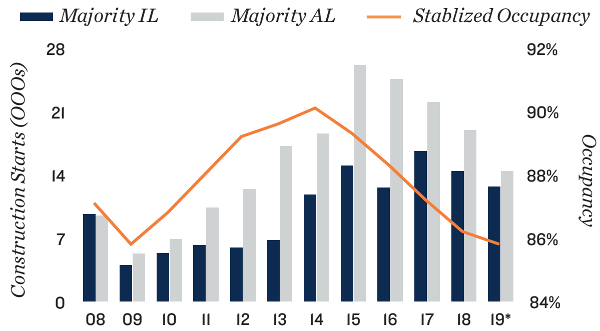
Investor Sentiments Highlights

- **Investors brimming with optimism over the seniors housing market.** According to Marcus & Millichap's recent Investor Sentiment Study conducted in collaboration with National Real Estate Investor, investor perception for seniors housing assets is healthy. The study conducted this past August found that 55 percent of investors consider now the time to buy seniors housing properties, beating out all other property types by a considerable margin, while 33 percent of investors think now is the time to hold in the sector. Investors in this property sector are some of the most enthusiastic as 76 percent of those surveyed expect the value of properties in their portfolio to increase 12 months from now, also the highest reading of all property types. The survey participants project seniors housing values to increase by approximately 8.9 percent over the next 12 months.

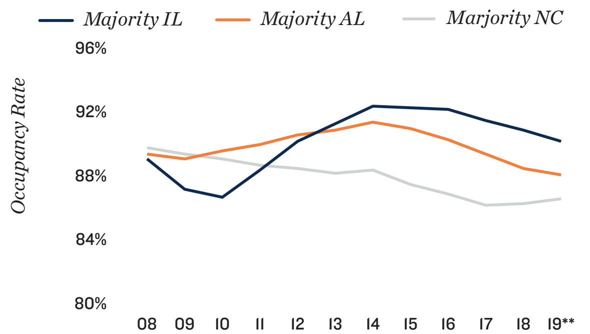
- **Elevated yields boost senior housing investor perceptions.** On average, the overall sector recorded a cap rate in the upper-6 percent to low-8 percent range over the past year. By comparison, the market rate multifamily sector posted an average cap rate in the low-5 percent territory in the second quarter. On average, independent and assisted living assets both trade near an 8 percent cap rate and can reach as high as the mid- 9 to 10 percent band. Some skilled nursing properties transacted at the highest cap rates, with some assets trading up to the 11 percent territory.

- **Concerns driven by unknowns**. Political uncertainty, unforeseen shocks to the economy, and the state of the U.S. economy are the three top concerns of commercial real estate professionals based on the Investor Sentiment Study. Topics indicated as a concern by fewer than one-fifth of the professionals surveyed include federal tax changes, how the debt ceiling will be handled and inflation buildup. Only 6 percent of all real estate participants are concerned about rising wages, the lowest-ranking concern.

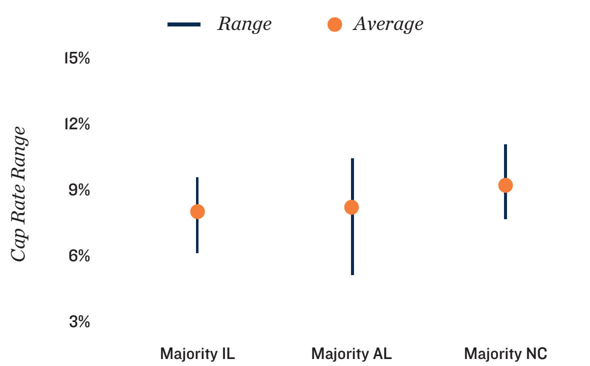
Demand Triggers New Unit Supply, Then Both Recede



Seniors Housing Occupancy Rates Stabilized Properties

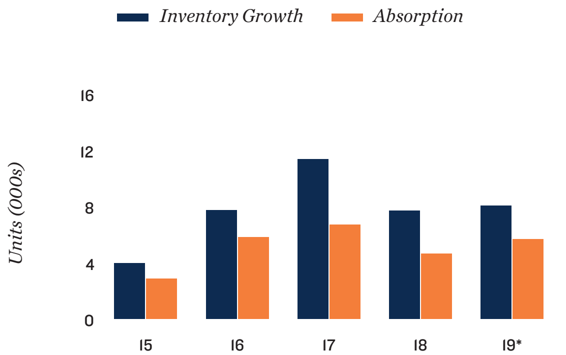


Seniors Housing Cap Rates❖

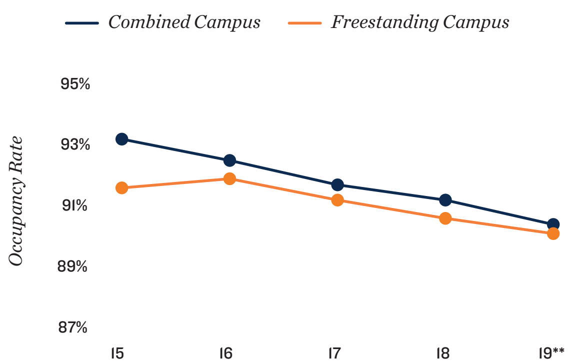


** Units are trailing 12 months through 2Q; Occupancy is 2Q*
*** 2Q*
❖ Trailing 12 months to 2Q
Sources: Marcus & Millichap Research Services; BLS; National Real Estate Investor; NIC MAP® Data Service

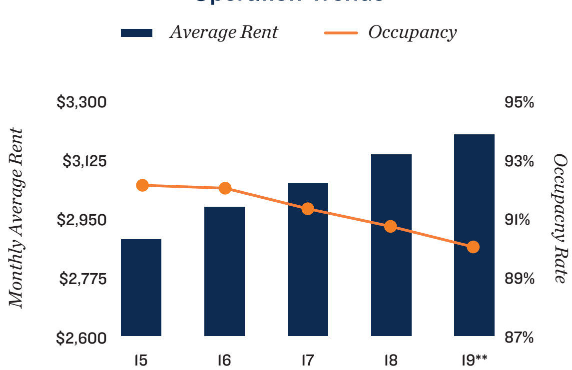
Inventory Growth and Absorption



Occupancy Rate Trends



Operation Trends



* Trailing 12 months to 2Q
** 2Q
Sources: Marcus & Millichap Research Services; NIC MAP® Data Service

Shift in Generational Preferences Toward Independent Living Leads Developers to Add Massive Influx of New Units

Supply growth in greater alignment with demand as delivery schedule shrinks. Aging seniors are being presented with more independent living options as just over 8,000 units were placed into service over the past year and more than 25,000 units are coming down the pipeline, according to NIC MAP® Data Service. Underway units account for just over 10 percent of overall inventory, which may present some downside risk, though boomers' preference for greater independence and highly amenitized complexes should bolster the sector. For the past two years, occupancy has hovered in the low-91 to low-90 percent range following a cyclical high for construction reached in 2017. As development activity trends lower this year and operators can absorb new units, stabilized occupancy will push higher over the next 18 months, supporting stable rent gains.

Fewer staffing and care needs along with healthy construction levels maintain stable investment outlook. Elevated first-year returns in contrast with market-rate apartments are attracting a range of capital sources to the independent living segment. More balanced supply growth and fewer staffing requirements than assisted living facilities have kept investor sentiment at healthy levels, though a shortage of listings and big portfolio trades did slow deal flow over the past year. Large institutional groups and REITs worked to find efficiencies and unload underperforming assets, leading private investors to dominate acquisition activity over the past year. Private buyers accounted for more than 40 percent of purchases, with smaller independent living complexes being a major target. Current pricing in the market averages in the upper-$100,000s to lower-$200,000s per unit, which could motivate owners of premier properties to take advantage of existing investor appetite, exiting at lower cap rates. On average cap rates are in the upper-5 percent to low-7 percent range, down modestly year over year.

2Q19 – Trailing 12-Month Independent Living Trend

Construction
8,000 units

Developers added just over 8,000 independent living units to inventory over the past year ended in June, a slowdown from the 10,200 units completed during the prior yearlong stretch. In the second quarter, more than 25,000 units were underway.

Occupancy
down 70 bps

Stabilized occupancy dipped 70 basis points to 90.0 percent in the second quarter on net absorption of nearly 5,700 units over the past year. One year earlier, the national occupancy rate was trimmed by 30 basis points.

Rent
up 2.9%

Following a 1.8 percent increase one year earlier, the average rent climbed 2.9 percent in the second quarter to $3,198 per month. The average rent has risen 14.8 percent over the past five years.

Investment

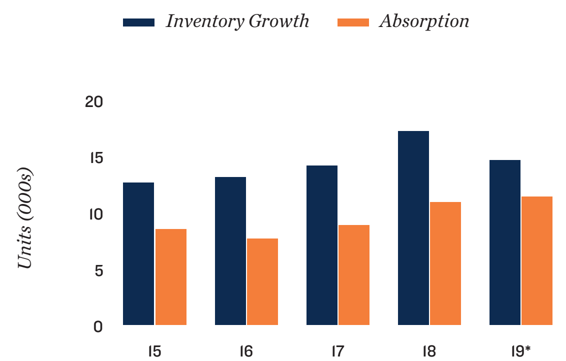
An abundance of capital remains ready to invest in the independent living sector, which will hold transaction activity at healthy levels this year. A smaller delivery schedule could curb institutional and REIT allocations this year as fewer assets that align with acquisition requirements come to market.

Long-Term Demand Factors, Favorable Yield Profile Gaining The Attention of Private Capital Sources

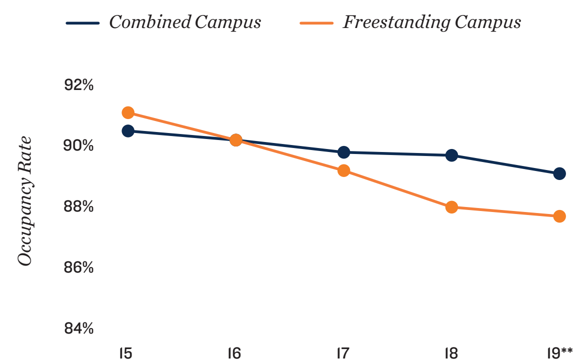
Pipeline shrinks as overbuilding weighs on fundamentals. Developers have been active this cycle in the assisted living sector as demographic and health trends point to a massive wave of Americans that will need varying levels of care through retirement. Construction in the second quarter was at 6.9 percent of overall inventory with more than 25,700 units underway, according to NIC MAP® Data Service, edging out independent living to account for the largest pipeline. Stabilized occupancy has retreated to its lowest reading in more than a decade, though, as some builders overestimated current demand trends, sending the rate to 87.9 percent in the second quarter. Inventory has jumped by more than 50,000 units since the start of 2016, extending lease-up well beyond the typical time frame. Rent gains remain stable against a backdrop of eroding occupancy, beating out inflation as operators are more confident when considering rent hikes at current occupancy levels. The development pipeline has been waning over the past year, providing greater relief for operators as well.

Investor activity shifts toward older facilities to capture outsized returns. Higher costs associated with healthcare labor and the growing capital expenditure requirements of outdated facilities led to greater divestment by institutions and REITs, transferring ownership to private groups. Pricing over the past year was pressured by strong sales momentum at average or lower overall quality assisted living communities, bringing the average down to the mid- to upper-$100s territory on a per unit basis. Private investors were on the buy side of more than 40 percent of transactions during the four-quarter period ended at midyear. Investor sentiment for assisted living communities is anticipated to remain healthy, in part due to the popularity of the sector and the minimal competition faced from the traditional multifamily market. Elevated cap rates also draw in more capital, which commonly fall in the low-5 to high-8 percent band.

Inventory Growth and Absorption



Occupancy Rate Trends



2Q19 – Trailing 12-Month Assisted Living Trend

Construction
14,700 units

Construction activity trended higher with the completion of nearly 14,700 assisted living units over the 12-month period ended at midyear. During the previous period, just over 14,200 units were placed into service.

Occupancy
down 40 bps

In the second quarter, stabilized occupancy declined 40 basis points from the same time last year to 87.9 percent as the net absorption of 11,400 units trailed deliveries. One year earlier the occupancy rate fell 80 basis points.

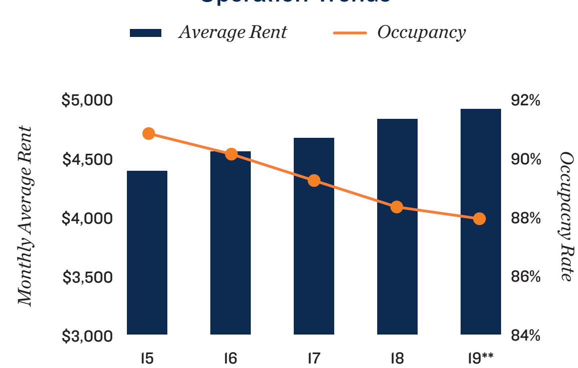
Rent
up 2.6%

Annualized rent growth in the second quarter matched the pace registered at the same time a year earlier, rising 2.6 percent to $4,910 per month. Over the past five years, the average rent has climbed 16.2 percent.

Investment

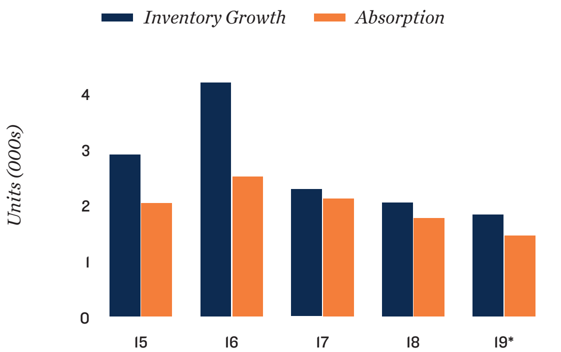
Institutions and REITs will continue to reposition their portfolios as they prepare for higher labor costs and possible affordability constraints. Buyers may take on greater capital expenditures at older complexes to compete with new facilities, in some cases adding a memory care wing to boost profits.

Operation Trends

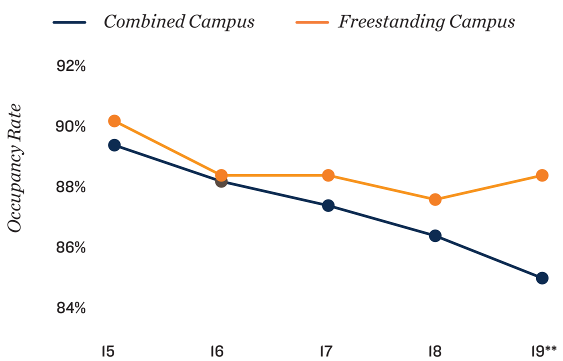


** Trailing 12 months to 2Q*
*** 2Q*
Sources: Marcus & Millichap Research Services; NIC MAP® Data Service

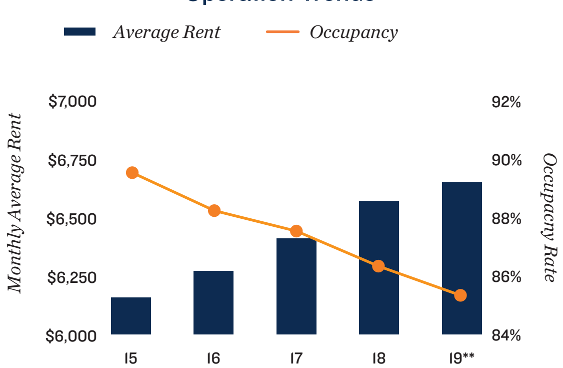
Inventory Growth and Absorption



Occupancy Rate Trends



Operation Trends



* Trailing 12 months to 2Q
** 2Q
Sources: Marcus & Millichap Research Services; NIC MAP® Data Service

Memory Care Facilities Running Into Competitive Disadvantages Following Development Boom

Flood of new memory care units cuts away at occupancy rates. In just under 10 years, the number of memory care units in the U.S. doubled as operators worked to provide the necessary level of care for an aging population facing greater risk of Alzheimer's and other dementias. Approximately 5.8 million Americans are currently living with Alzheimer's, a number that will swell substantially as the leading edge of the baby boomer generation is now 73 years old. While demographics and care requirements indicate greater demand for memory care units in coming years, a rush to add more units has overshot current needs, resulting in the lowest occupancy rates across the seniors housing sector. In the second quarter, stabilized occupancy was 85.3 percent, the lowest it's been in more than a decade and down 590 basis points from the cyclical high registered in the third quarter of 2014. A push toward memory care beds as a smaller component of independent or assisted living communities will bolster fundamentals as these types of properties can offer differing levels of healthcare to couples.

Combined campuses grow in popularity for their stable flow of residents. Standalone memory care faces greater competition from newer assisted living complexes that integrate memory care, boosting the attractiveness of combined campuses due to the pipeline of residents that assisted living can provide. In addition, many new freestanding memory care properties were built at higher price points, hindering their ability to compete on monthly rental rates. Due to the elevated risk profile of a standalone property, investors will continue to seek out integrated campuses this year to provide a buffer against potential challenges in the industry.

2Q19 – Trailing 12-Month Memory Care Trend

Construction
1,800 units

The completion total over the past four quarters was trimmed modestly as just over 1,800 units were opened, down from the 1,950 units delivered previously. In the second quarter, 2,400 memory care units were underway.

Occupancy
down 80 bps

Net absorption of more than 1,400 units was not enough to lift occupancy as the stabilized rate decreased 80 basis points in the second quarter to 85.3 percent. A 100-basis-point decline was posted one year ago.

Rent
up 2.2%

The average rent grew at an annual rate of 2.2 percent in the second quarter, reaching $6,647 per month. One year earlier a 1.8 percent gain was recorded.

Investment

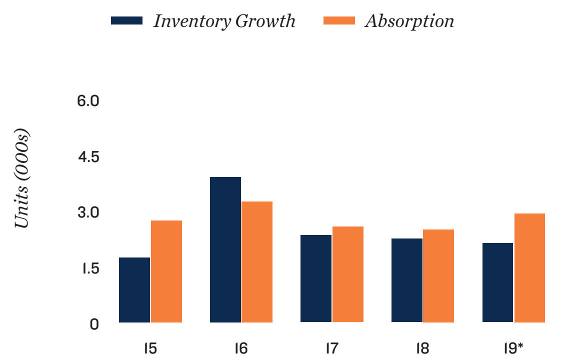
Families' need to care for their loved ones with memory issues will maintain demand for memory care units, keeping many investors active this year. More buyers will hedge their investments with a focus on assets that include another seniors housing component.

Senior Residents Find Peace of Mind in CCRCs, Driving Occupancy Higher and Exciting Investors

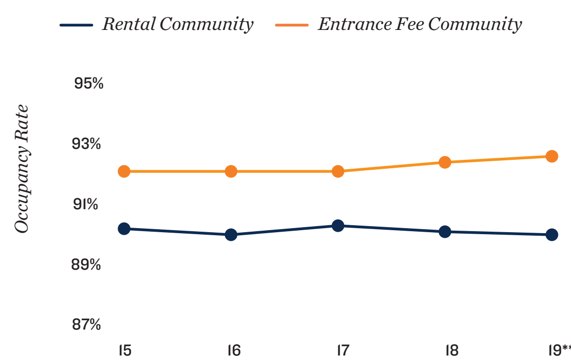
Upscale campuses with access to healthcare services in high demand. Continuing Care Retirement Communities remain a popular choice for residents, providing highly amenitized complexes and a seamless transition of care needs in a more luxury setting. Stabilized occupancy in this segment rested at 91.4 percent in the second quarter, the highest in the seniors housing sector to also support the strongest rent growth at 4 percent. Supply growth of CCRC units has been more aligned with current demand since construction as a percentage of inventory has not risen above 3.1 percent over the last decade. Just over 9,500 units were underway in the second quarter, representing 2.6 percent of current inventory. Strong demand in this segment has pushed the average entrance fee up to $359,000.

Popularity of CCRCs attracting more investors to the property type, though listings remain limited. Exceptional asset performance and strong tenant demand for Continuing Care Retirement Communities has lifted investor sentiment for this property type, though few assets trade every year. To break into this segment more investors are taking on ground-up development, undertaking massive projects with a multitude of amenities on a large campus. Some downside risks are beginning to form as the rising cost of healthcare labor and governmental reimbursement adjustments cut into operators' net operating income, giving some buyers pause before entering into the market. As entrance fees climb higher, limiting access to these communities, some investors may begin to favor rental communities to better manage fluctuating costs.

Inventory Growth and Absorption



Occupancy Rate Trends



2Q19 – Trailing 12-Month CCRC/LPC Trend

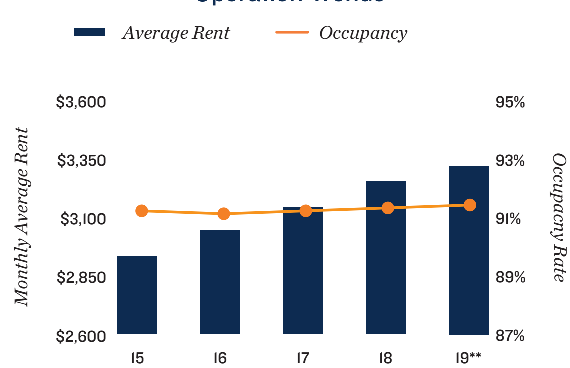
Construction 2,100 units — Supply increased by more than 2,100 units over the four-quarter period ended at midyear, though the total is down from the nearly 3,000 doors added to inventory over the previous year.

Occupancy up 40 bps — Stabilized occupancy in the second quarter climbed 40 basis points year over year to 91.4 percent, erasing the 40-basis-point decline posted one year ago.

Rent up 4.0% — The average entrance fee climbed 3.0 percent from a year ago to approximately $359,000. Rent growth of 4.0 percent was recorded nationally, reaching $3,317 per month. One year earlier the average rent increased 3.2 percent.

Investment — A limited number of CCRC listings will keep deal flow at much lower levels in contrast with the other major sectors. Sales activity could get a boost in the coming years as more modern campuses come to completion.

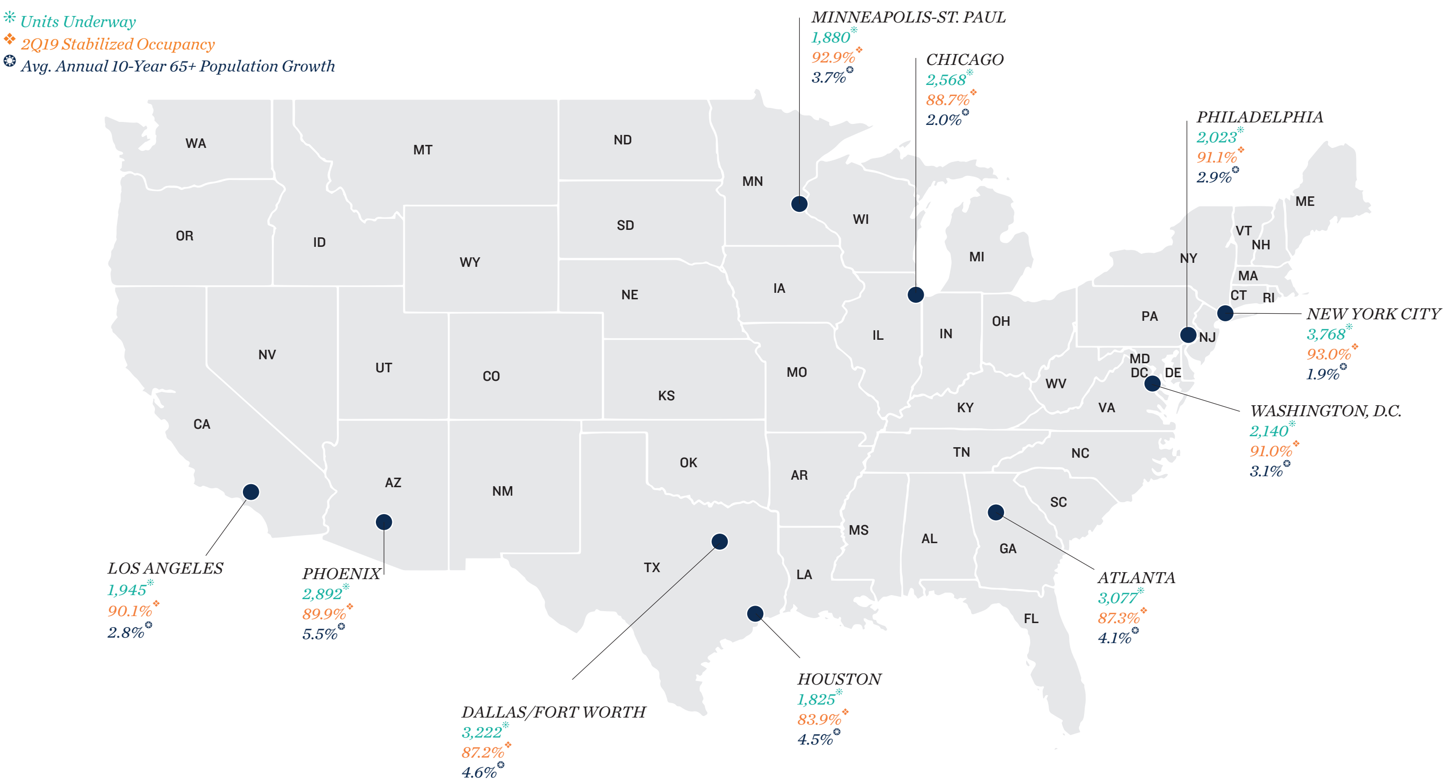
Operation Trends



* Trailing 12 months to 2Q
** 2Q
Sources: Marcus & Millichap Research Services; NIC MAP® Data Service

Marcus & Millichap

Top 10 Seniors Housing Construction Markets 2H19



Source: NIC MAP® Data Service
Units underway and stabilized occupancy represent Majority IL and Majority AL units, which may include some skilled nursing and memory care units when part of a community.

Seniors Housing Capital Markets

By DAVID G. SHILLINGTON, President
Marcus & Millichap Capital Corporation

- Underwriting standards in some facets has become more conservative for seniors housing properties as there is increasing scrutiny on operations and management's alignment with ownership. While lending for seniors housing deals is strong, it is still considered a specialty niche. Investors without experience in this asset class should use an expert adviser, particularly with facilities servicing higher acuity populations requiring more intensive management often associated with assisted living or skilled nursing. Independent living properties have a larger variety of capital sources available.

- GSE underwriting standards are very competitive based on loan-to-values ranging from 60 percent to 75 percent and minimum debt service coverage ratios ranging from 1.35x to 1.50x depending on underwriting parameters. HUD insurance offers higher LTVs, 60 percent-85 percent, with 1.45x coverage and longer terms for certain products. HUD rates with 35-year amortization range from low- to mid-3 percent for existing product and high-3 to low-4 percent for new construction. GSE rates are slightly higher than HUD at high-3 percent range to low-5 percent but offer attractive interest-only periods and quicker closing times. Short-term or bridge financing is readily available for performing assets and quality sponsors. Mezzanine equity is looking for opportunistic plays as well.

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Sources: Marcus & Millichap Research Services; American Health Care Association; BLS; Federal Reserve: Consumer Finance Survey; Irving Levin Associates, Inc.; JAMA; Moody's Analytics; National Association of Realtors; For more information on the NIC MAP® Data Service, please visit www.NIC.org/NIC-map or call 410-267-0504; Real Capital Analytics; TWR; Social Security Administration; U.S. Census Bureau