LevinPro LTC

Fourth Edition

Spotlight

on Senior Care M&A

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2001-2022 | Fourth Edition

The SeniorCare **Investor**

Inside the World of Senior Care Mergers, Acquisitions and Finance Since 1948

SPOTLIGHT ON SENIOR CARE M&A
2001-2022 | FOURTH EDITION

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Introduction

The seniors housing and care merger and acquisition market has grown tremendously since the turn of the century in terms of deal and dollar volume but faces its toughest challenge to date.

Coming out of the COVID-19 pandemic, the seniors housing and care industry is certainly on the road to recovery, but new issues (as they always do) arose to affect the M&A market. Nevertheless, investors and capital providers were eager to put their money to use and generate a return after sitting on the sidelines during the worst of the lockdowns. Pointing to consistent occupancy increases beginning in early 2021, they were able to better forecast future performance and make deals make sense. Combining that with many beleaguered owners ready to sell after dealing with the pandemic for more than a year, M&A rebounded to near-record levels in 2021 and continued apace so far in 2022.

However, while the industry is recovering, owners and operators face a multitude of headwinds that could give investors and lenders pause. First, occupancy across numerous seniors housing and care properties remains below pre-pandemic levels, but just returning to the occupancy of 2019 will not be enough for many communities that were struggling in the wake of overdevelopment during the mid-2010s. They will also be competing for the same pools of residents, increasing the likelihood of discounted rents or other promotions being offered that eat into a community's REVPOR and profitability.

At the same time in this current inflationary period, rents must rise with the increase in wages and costs, shutting out more seniors who live on fixed incomes. Even if senior care facilities could afford to pay higher wages, they have to find and retain enough qualified (or competent) staff to care for their residents, who are frailer and require more care.

Overworked staff can lead to insufficient care, which brings headline risk to an industry already under the microscope by the media. Finally, higher interest rates and uncertainty surrounding recession have delayed deals already, leading to a somewhat unknown future as of this publication's writing.

On the other hand, investors continue to pour money into the senior care industry, pointing to attractive demographic trends, government support during the pandemic and higher yields than other commercial real estate sectors. And skilled nursing offers the highest potential return, with its higher risks outweighed by a falling supply of beds across the country, positive reimbursement rate changes and the possibility for added ancillary services (and revenues) in the eyes of many buyers.

Ben Swett

About the Editor

Ben Swett - Ben joined Irving Levin in the summer of 2014 and is responsible for the research and reporting on seniors housing M&A and finance news for *The SeniorCare Investor*, in addition to providing research and analysis for Irving Levin's healthcare sector reports. Ben graduated from Hamilton College with a B.A. in History (concentrating on the American Civil War) and received his MBA in Finance from UConn.

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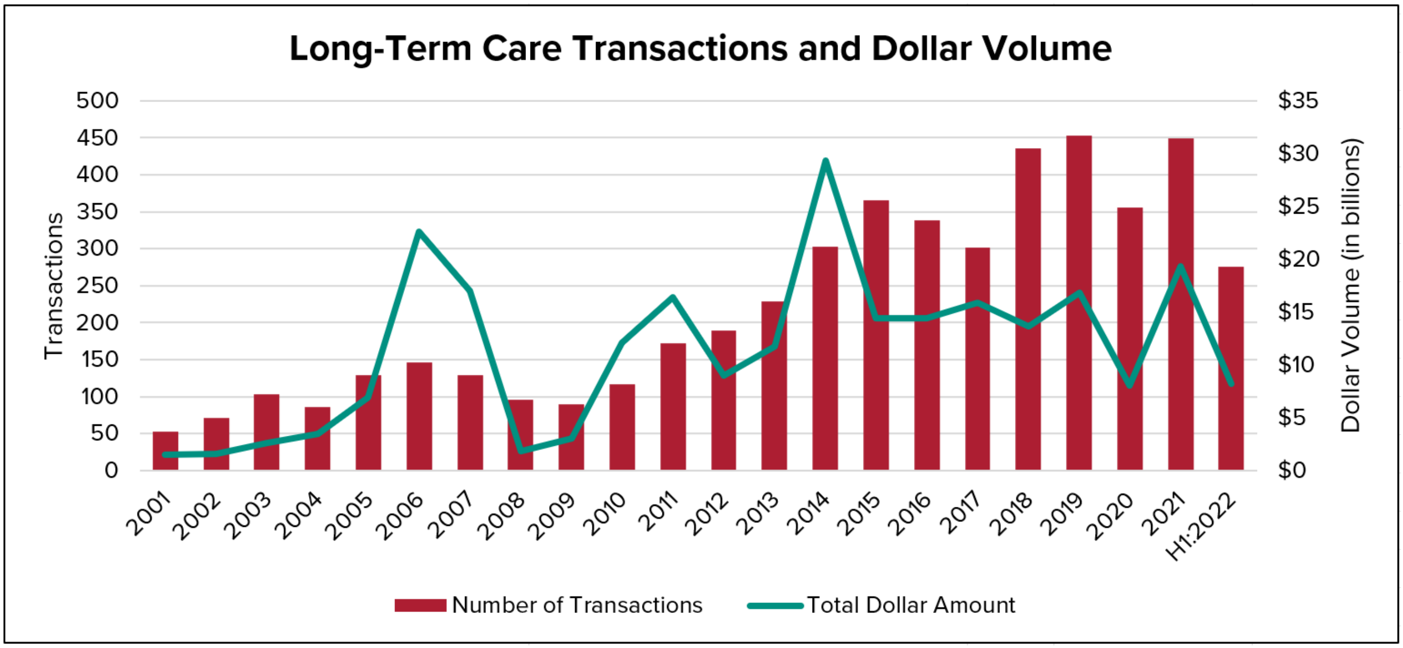
Long-Term Care

The number of mergers and acquisitions grew somewhat consistently throughout the 2010s in the seniors housing and care industry, peaking in 2018 and 2019. The pandemic led to an understandable drop in M&A activity, but signs in 2021 and 2022 suggest that transaction volume has already recovered, even if the operating environment improves at a slower, uneven pace.



Investor interest in the senior care sectors has boomed since the Great Recession, rising steadily from 89 publicly announced transactions in 2009 to a then-high of 365 deals in 2015, according to statistics from [LevinPro LTC](). After a couple of years of lower activity, deal making took off again in 2018 reaching 436 deals (a 44% increase over the 302 transactions announced in 2017) and peaking at 453 deals in 2019. Including transactions that were confidentially disclosed or took place off market, that total would be even higher.

The buying frenzy had to come to an end, but no one could have predicted how it actually did. The first confirmed case of COVID-19 was announced early in the first quarter of 2020 (January 21st, officially), and investors halted much of their activity by the end of the first quarter and through Q3:20. COVID-19 raged through the population (especially the frail and elderly), economic lockdowns forced providers to shut their doors, unemployment soared, political uncertainty persisted through the summer and fall, and much was still unknown about the virus or the prospect for vaccines. Hundreds of deals were put on the backburner, many just abandoned by the parties involved.

For many, the math just did not work anymore based on the agreed-upon purchase price and current financials. The gap between bids and asking prices widened so that the few willing buyers and sellers left could not get deals done. Plus, the CARES Act funds and Medicare prepayments kept many providers financially afloat and postponed many sellers' exit plans.

However, the pandemic proved to be just a blip in the booming M&A market, with an explosion of activity in the fourth quarter of 2020 (128 deals) bringing the year's total to 356 deals in 2020 before buyers announced 449 deals in 2021 (the second-highest annual count ever). That was followed by 276 publicly announced transactions in the first half of 2022, which annualized comes to 552 deals, which would be a record by nearly 100. But then interest rates started to rise, slowing acquisition demand and lowering prices.

It was not only the number of transactions that was notable, but the kind of deals that investors and lenders were able to get done in the pandemic and post-pandemic market. June 2021 alone saw $5.08 billion in total disclosed value, with three billion-dollar-plus deals. That equated to about 65% of the total dollar value of publicly announced LTC deals (with disclosed prices) in all of 2020.

REITs were buyers in two of these. Welltower (NYSE: WELL) announced the acquisition of Holiday Retirement's owned portfolio of 86 independent living communities for $1.58 billion, or just about $152,000 per unit. That is another portfolio acquired "below replacement cost," which was a common theme post pandemic.

Simultaneously, Atria Senior Living announced that it was acquiring Holiday's operating business for an undisclosed price. So, Welltower also entered into a RIDEA agreement with Atria. Shortly after, Ventas (NYSE: VTR) bought New Senior Investment Group (NYSE: SNR) for $2.3 billion, including assumed debt of $1.5 billion, or about $185,400 per unit.

But another June deal signified the market had really turned a corner. In that transaction, Harrison Street Real Estate Capital paid $1.2 billion for 24 senior living communities located in California (23) and Nevada (1). The price point was one of the highest ever for a portfolio of that size, at $546,700 per unit, and certainly the highest in the previous two years. One of the reasons for the high price was that half the portfolio averages four years in age and the other half of the properties were recently built or are under construction. New usually translates into a high price, especially in the California market.

The seller of 12 properties was Healthpeak Properties (NYSE: PEAK), which spent two years divesting several billion dollars of senior living assets, and Gallaher Companies for the other 12. Oakmont Management Group managed all 24. But the fact that Harrison Street would pay that high of a price, and in a $1.2 billion transaction, showed a lot of confidence in the market, and in the future.

At that point, the vaccine roll-out was working, and more than 80% of residents in senior living had been fully vaccinated, giving operators and investors the confidence that they were once again safe to make big bets on the industry.

10 LARGEST LONG-TERM CARE TRANSACTIONS, 2001-June 2022

Target	Acquirer	Year	Price	Acquirer Sector
Nationwide Health Properties, Inc.	Ventas, Inc.	2011	$7.4 billion	REIT
Holiday Retirement Corp.	Fortress Investment Group	2006	$6.6 billion	Investment firm
Manor Care, Inc.	The Carlyle Group	2007	$6.3 billion	Private Equity
HCR ManorCare real estate assets	HCP, Inc.	2010	$6.1 billion	REIT
CNL Retirement Properties, Inc.	Health Care Property Investors	2006	$5.3 billion	REIT
Griffin-American Healthcare REIT II	NorthStar Realty Finance Corp.	2014	$4.0 billion	REIT
Quality Care Properties	Welltower Inc.	2018	$4.0 billion	REIT
Care Capital Properties, Inc.	Sabra Health Care REIT, Inc.	2017	$3.996 billion	REIT
DigitalBridge Group's healthcare assets	Investment group	2021	$3.21 billion	Investment firm
Atria Senior Living real estate assets	Ventas, Inc.	2010	$3.1 billion	REIT

And several more major deals were consummated, including DigitalBridge Group's $3.21 billion sale of its healthcare assets (seniors housing, skilled nursing, MOBs and hospitals), Welltower's $580 million purchase of The Fountains Portfolio (14 CCRCs) and Welltower's $548 million acquisition of 33 seniors housing communities with StoryPoint Senior Living. After being one of the more active sellers in 2020, Welltower was primed for growth and in search of bargains in the post-pandemic market.

The debt markets loosened in 2021 and into 2022, enabling buyers to buy at such a pace and such a scale. Terms, leverage and covenants remain more conservative than prior to the pandemic, and lenders have tended to stick with their existing clients for the most part. But more capital providers reentered the market, thereby increasing competition and benefitting borrowers. The transaction process also eased throughout the year, as property visits resumed, due diligence could be completed, and bid-ask spreads came down.

But mid-way through 2022, buyers began pausing deals in response to the economic uncertainty surrounding rising interest rates, high inflation and a recession. So as obtaining debt becomes more expensive, it should become harder too.

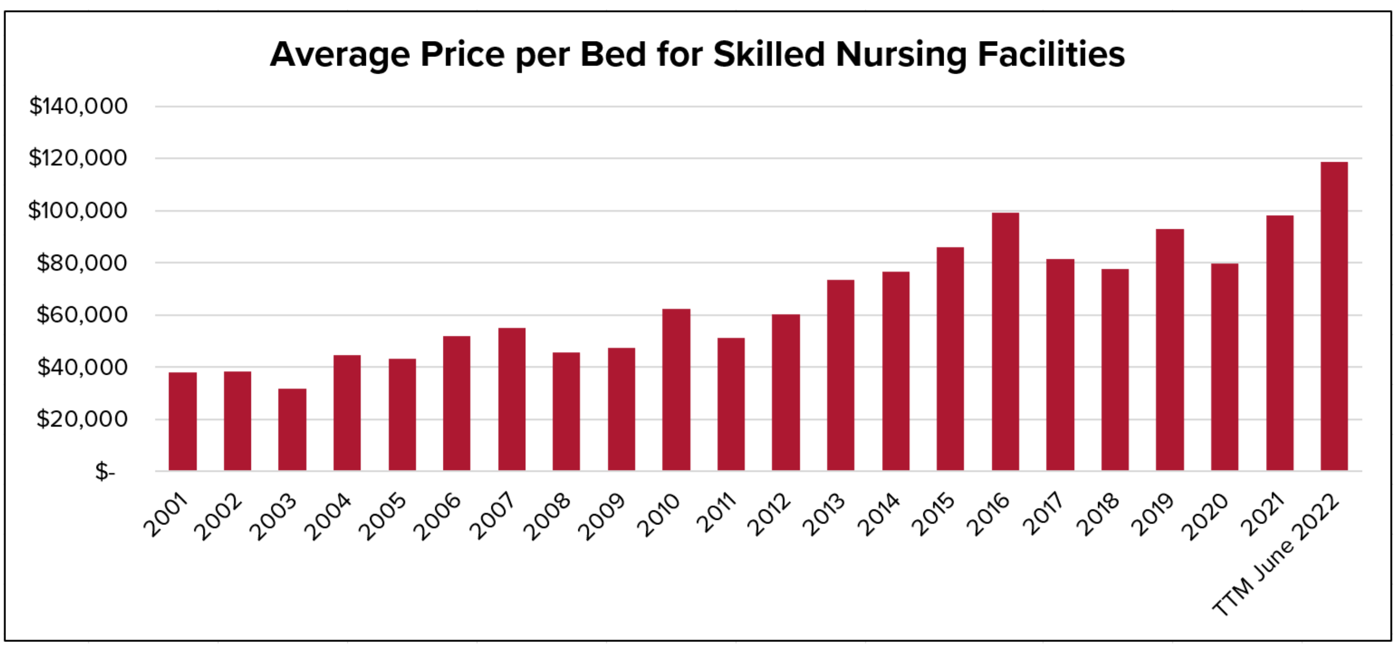
Skilled Nursing Market

Focusing on the skilled nursing market, its average The skilled nursing market has surprised many in the wake of the pandemic, with values continuing to soar despite numerous difficulties facing the sector from labor and low occupancy to media glare and the threat of reimbursement rate cuts. But many who see things differently have jostled for whatever SNFs are up for grabs: old or new, stabilized or…not.

The skilled nursing sector's average price per bed did drop 14% from $93,000 in 2019 to $79,700 in 2020. We have seen larger percentage declines in the past, most recently an 18% decline from the $99,200 per bed average price in 2016 to $81,355 per bed in 2017.

Considering the circumstances of 2020, there could have been a steeper fall in average price, with the sale of many ailing facilities by highly motivated owners. But federal and state aid programs prevented many owners from having to sell, leading investment demand for SNFs to outpace supply of facilities available for sale.

That trend was only exacerbated throughout 2021 and into 2022, when the average price per bed rose



to $88,500 in the four quarters ended June 2021, to $98,000 in calendar year 2021 and to $118,600 in the four quarters ended June 2022.

But this has not been a phenomenon of only the highest quality facilities. Rather, according to our statistics, from 2020 to 2021, per-bed prices rose 50% for facilities aged 40 years or more, 36% for facilities built between 20 and 40 years ago, and 27% for the newest facilities opened in the last 20 years. Yes, those oldest facilities started at a lower basis, but buyers nonetheless paid more for them despite their age.

The sale of Stonerise Healthcare's 17 skilled nursing facilities in West Virginia was emblematic of the new market, with an estimated price of more than $315,000 per bed. For a variety of factors, the deal stands out among all the rest, with its geographic concentration, relatively young age, high quality facilities and ancillary businesses. The cap rate was also estimated between 8.7% and 9.7%, much lower than the traditional SNF range but appropriate for their quality and risk level.

But the hyperactive bidding process and aggressive valuations seen in that deal have become almost standard in the industry in the last six to 12 months. Interest rates have risen and squeezed the spreads of other real estate sectors like seniors housing and multifamily, leading investors in search of yield to the SNF business, where cap rates have traditionally stuck between 12% and 13.5% in good economic times and bad.

Average census across the skilled nursing industry was already languishing between the mid- to low-80% range before the pandemic temporarily shut the doors to many facilities, paused elective surgeries and sent more post-acute patients home to recover. COVID-19 outbreaks did not distinguish high-quality facilities from lower quality ones.

For much of the pandemic, low census was not always the fault of the facility, given that asymptomatic sponsored content

Spotlight on the Seniors Housing & Care M&A Market

Erik Howard – Executive Managing Director of Business Development and Marketing | Capital Funding Group

Over the past few years, the industry has had to navigate the impacts of COVID-19 and its aftermath. It's important for owners and operators of healthcare facilities to understand the current financing trends and options available to them.

Although the number of lenders and availability of capital has fluctuated in the M&A market, Capital Funding Group (CFG) continues to lead the industry with its one-stop-shop offerings and entrepreneurial approach to lending. Committed to supporting its healthcare clients, CFG takes on client challenges and goals as their own and executes creative lending solutions to help grow their business.

Executive Managing Director of Business Development and Marketing Erik Howard speaks to industry trends, innovations, and how CFG helps clients reach their goals and makes a positive impact on the healthcare industry.

What are the latest trends you are seeing with seniors housing and long-term care industry M&A transactions?

As the industry rebounds from the impacts of COVID-19, we continue to expect a strong flow of M&A. While the volume of HUD loans will likely be down, comparing FY 2022 to FY 2021, the rising interest rates have driven demand for the HUD LEAN 232 Program as borrowers seek to convert floating-rate bridge loans to permanent, fixed-rate HUD-insured loans. Additionally, as facilities continue to recover from COVID-19, the number of loans that currently qualify for the 223(f) Program remains depressed.

Typically, the value creation expected at the operating level would allow for a HUD refinancing within 12 to 24 months following those closings. For a few borrowers, the profitability required to fully retire their bridge debt has taken longer to achieve due to staffing and occupancy challenges, thus, slowing the pipeline for and closings of 223(f) loans. Despite this, HUD continues to be a great partner to borrowers and lenders in the face of a challenging underwriting environment.

While types of financing available to the industry have remained consistent, the number of lenders supporting the industry has fluctuated. Why has there been fluctuation? How has CFG continued to support its clients?

The fluctuation can largely be attributed to the impacts of and recovery from COVID-19. Many lenders stepped away from the industry – no longer lending to borrowers during the challenging times – and now have begun to re-enter the space. We've seen many lenders return within the last 12 to 18 months; however, they are exercising more caution – lowering their leverages and quantity of borrowers.

Despite this fluctuation, we have maintained our strong lending presence, supporting the sector the best way we can – and even having record years in both 2020 and 2021. In particular, we expanded our presence in the bridge space to fill the shortage of lenders, increasing our business and diversifying our portfolio into the seniors housing and multifamily sectors – having closed in excess of $3 billion in bridge loans since the beginning of the pandemic.

What sets CFG apart from other healthcare lenders in the space?

CFG is not your typical lender. We are leaders in the healthcare financing industry and are able to accomplish what other lenders can't with our one-stop-shop host of loan offerings, including: HUD financing, short-term conventional loans, working capital financing, non-bank finance & equity, and group purchasing discounts for facilities. Our 25+ years of industry expertise, paired with our unique sole-ownership structure, give us the competitive edge to execute transactions of all sizes and complexities – with a strong appetite for those involving value-add or 'turn-around' opportunities.

We are strong supporters of industry organizations such as AHCA/NCAL, NIC and individual state healthcare associations. We actively work with Congress and other groups to champion for the industry and help develop solutions to support industry growth and success.

Our Owner, Jack Dwyer, is actively involved with our clients and the communities we serve. Recognizing additional support needs in the industry, Dwyer launched Dwyer Workforce Development in 2021. Through the nonprofit, we are committed to helping solve the severe healthcare workforce shortage by providing CNA training and healthcare job positions to individuals who lack opportunity and aspire to pursue a career in the healthcare industry – all while improving the lives of seniors.

people can still carry and spread the virus. Thus, trailing occupancy may not have been the biggest factor as far as pricing in 2021.

However, there comes a point in the pandemic when these problems will start to adversely affect the older, mostly-Medicaid facilities. Stagnant census and lower quality mixes will make paying for higher labor costs a tough ask. So, the difference in price between stabilized and non-stabilized facilities may grow in 2022.

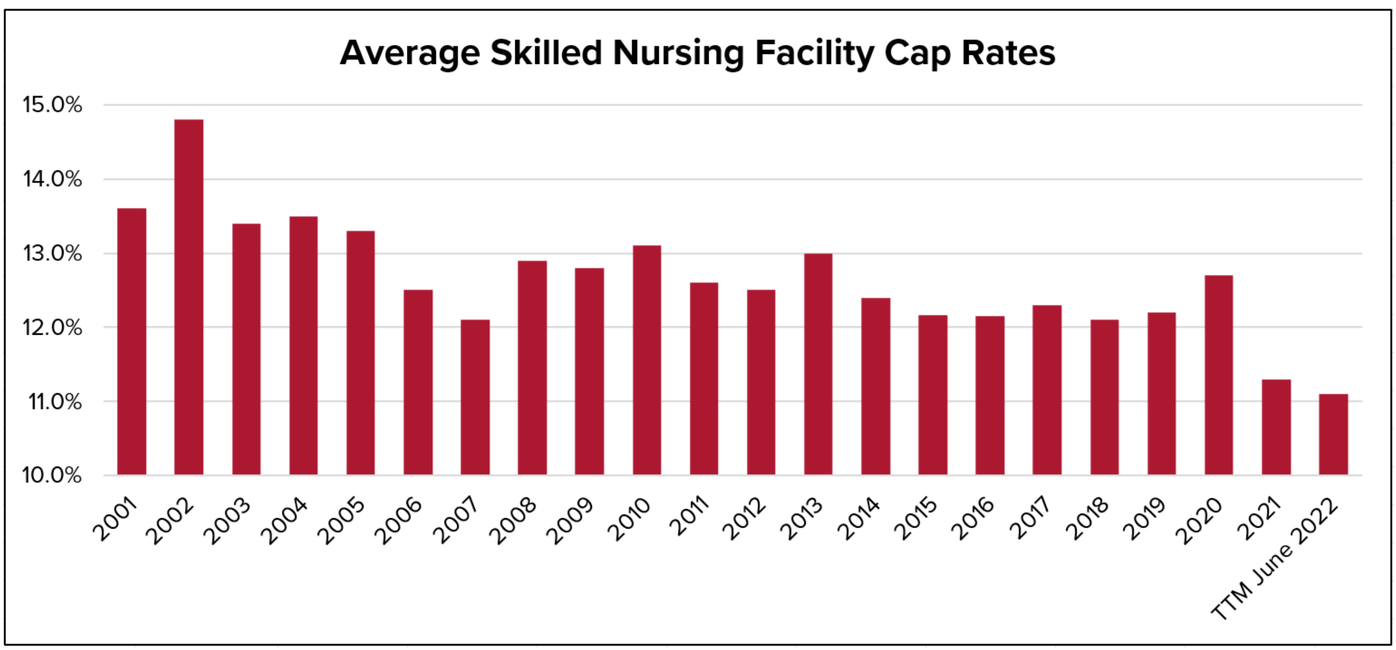
Quality and case mix will continue to be a major factor in SNF values too, with the introduction of the Patient Driven Payment Model (PDPM) reimbursement rule change in October 2019, rewarding those facilities with more medically complex Medicare patients. And CMS' announcement in the summer of 2022 staving off a downward rate readjustment to account for inflationary and labor issues was a positive development for those in-demand facilities.

For two decades, skilled nursing cap rates have continued their general downward trend. However, they have not compressed to the degree that seniors housing communities have experienced and have largely stayed between 12.0% and 13.5%. The sector maintained that consistency amid more volatile interest rate changes and global economic trends. During the Great Recession, the sector saw a moderate increase in cap rate, rising from 12.1% in 2007 to 12.9% in 2008 and peaking at 13.1% in 2010.

Other real estate classes were not so lucky. In the years afterward, the consistently high yields that skilled nursing offered drew investors to the sector, helping compress the average cap rate to around 12.0%. Incredibly low interest rates after the Great Recession and abundant capital also contributed to the cap rate compression, but not nearly as much on the seniors housing side.

Then, the risk of owning and operating a skilled nursing facility shot up as COVID-19 cases and deaths rose across the country, unfortunately all too often in the facilities themselves. And the average cap rate followed, increasing 50 basis points from 12.2% in 2019 to 12.7% in 2020. But then came 2021, when the average skilled nursing cap rate fell out of the standard 12.0%-13.5% range to 11.3%.

The four quarters ended June 2022 showed a further decline in the average cap rate to 11.1%, which is the lowest average cap rate ever on record as the frenzied bidding environment that pushed prices up also pushed cap rates down. This drop came despite the rise of interest rates in the first half of 2022, further



highlighting the strong buyer demand and many observers' confusion.

However, the average cap rate reflects the SNFs sold during the year, and the financials used to calculate each cap rate. Because of the stress on the sector, there were many struggling SNFs that sold in 2021 with negative trailing EBITDA and thus negative cap rates not included in the average. Facilities with little positive cash flow that yield very small cap rates would also not be included in our calculations, since they were not "cap rate" deals but rather "per-bed" deals. This happens every year but was only exaggerated in the last two years.

There were simply so few stabilized deals, with market cap rates, that the average cap rate is not totally representative of the 2021 and 2022 M&A market.

Our question for the skilled nursing market is how long will the incredibly high valuations continue? But also, would higher interest rates and a recession reduce the number of buyers on the hunt for facilities, or would it drive more investors out of lower-yielding seniors housing to SNFs? Will owners jump off the sidelines to sell their facilities while values are still so high, leading to a potential decline in the average price?

Independent/Assisted Living Market

The seniors housing M&A market was very active in 2021 and 2022, with a number of major institutional owners paring or growing their portfolios on a large scale. Healthpeak Properties completed its exit of the seniors housing industry, while some private equity firms and REITs like Harrison Street and Welltower made huge additions. Healthpeak was eager to exit, and its properties were considered to be largely "B" quality, resulting in many of its properties selling at a steep discount.

After the average price per unit for seniors housing communities (including independent living, assisted living and memory care) rose 20% from 2018 to an all-time peak of $244,200 per unit in 2019, the market

Behavioral Health - A Solution for Older Seniors Housing and Care Buildings?

Jesse Prato – MAI - Director | HealthTrust, LLC

Over the past century, attitudes towards and treatment for mentally ill individuals have changed considerably. Mentally ill persons were once confined to state-run mental hospitals with little chance for treatment and recovery. We now recognize the economic and social costs associated with these illnesses and view treatment as both the most humane solution as well as the most cost-effective.

With medical and technological advances, many experts see a community-based approach to treatment and prevention as the most effective. In the healthcare real estate world, we have seen both a massive increase in the number of Behavioral Health Facilities (BHF) and an increase in the sophistication of the capital providers in the market.

There are a wide variety of behavioral health conditions, ranging from mental health disorders to traumatic brain injuries. But the category we have seen the most growth in are substance abuse facilities, a trend that was only further compounded by the pandemic.

Substance Abuse as a Sub-Sector of Behavioral Health

There are three main types of substances abuse facilities: Detoxification (five-seven-day stays with expensive detox drugs), Residential Treatment (28–45-day stays), and Outpatient Care (think group therapy). The sub-sectors with the highest pay rates & operating margins are detox and residential treatment facilities. As such, detox and residential treatment have caught the attention of capital providers.

Although the exact details depend on the state and the program, both facility types generally are paid through a combination private insurance reimbursement, private pay, or state assistance. Like nursing care, Medicaid program reimbursement is significantly less than private pay and insurance rates. Rates vary widely, with most operating between $400-1,000 daily. There are also a few luxury outliers at $1,500 daily.

Many new detox and residential treatment facilities are not new builds, but typically conversions from shuttered and struggling assisted living and nursing facilities. These locations have similar zoning regulations that allow developers to fast track approvals. In addition, vacant facilities provide a useful shell for substance abuse developers, already containing the correct build out, resident rooms, dining rooms, therapy spaces, etc.

Over the past few years, these buildings have mostly transacted between $25 to $75 per square foot, with a median of $60 per square foot. The conversion costs vary greatly, but have typically ranged from $75 to $195 per square foot, with a median of $118 per square foot, inclusive of hard and soft costs. The conversion range from gut renovations to aesthetic upgrades, depending on the target patient population.

Looking to Learn More About Behavioral Health?

Compared to other asset classes, rental, operating, and sales data for healthcare real estate is notoriously hard to obtain. We work with investors who want exposure to the space, operators who want consultation or assistance with underwriting, and lenders who need valuation expertise. If that is you, reach out to Jesse.Prato@healthtrust.com.

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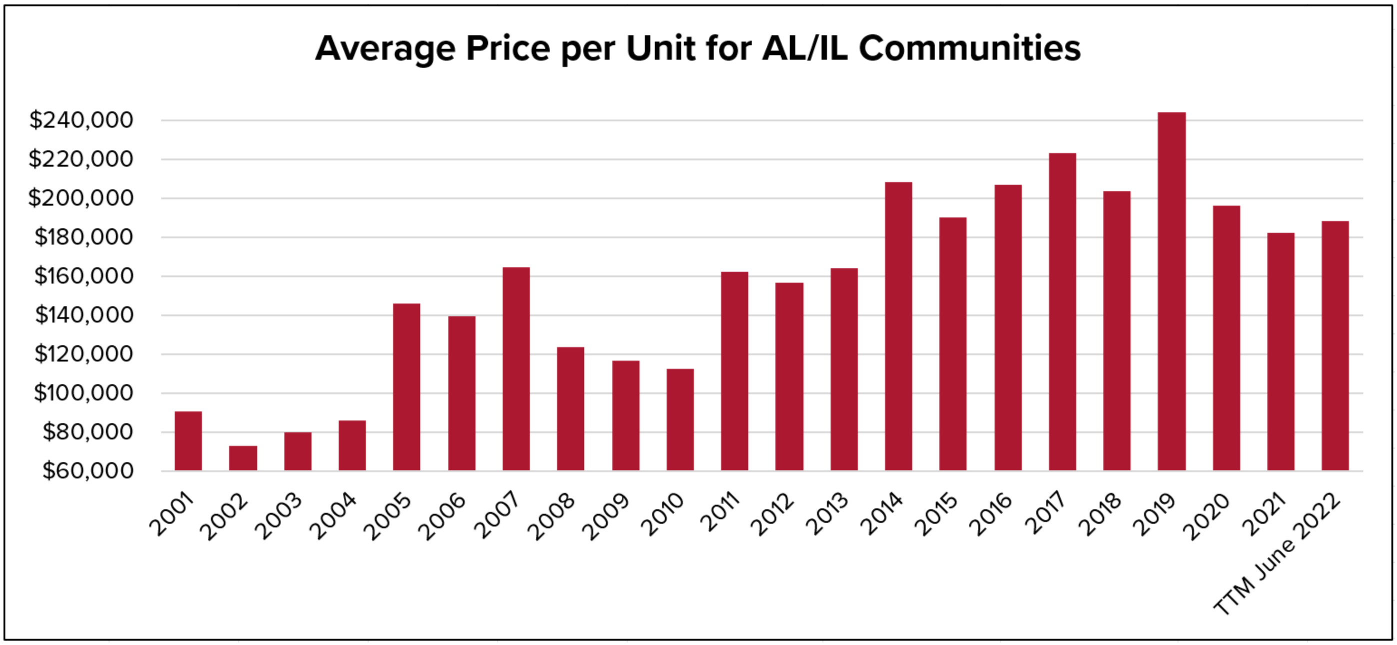


readjusted, dropping the average price per unit by 20% to $196,000 per unit in 2020 and another 7% to $182,300 per unit in 2021.

Prices rebounded slightly in 2022, with the four quarters ended June 2022 averaging $188,300 per unit. Improvements in occupancy across the board likely contributed to the bump in values, but a few more owners of high-quality communities were also tempted off the M&A sidelines knowing that their well-performing properties would command a significant premium in a market flooded with struggling operations.

Since the turn of the century, assisted living communities have accounted for the majority of sales and of dollar volume in the overall seniors housing market, and 2021 was yet again no exception, with assisted living representing close to three of every five seniors housing properties sold. The sector was clearly affected by the pandemic, ensuing lockdowns and inflation, more so than independent living.

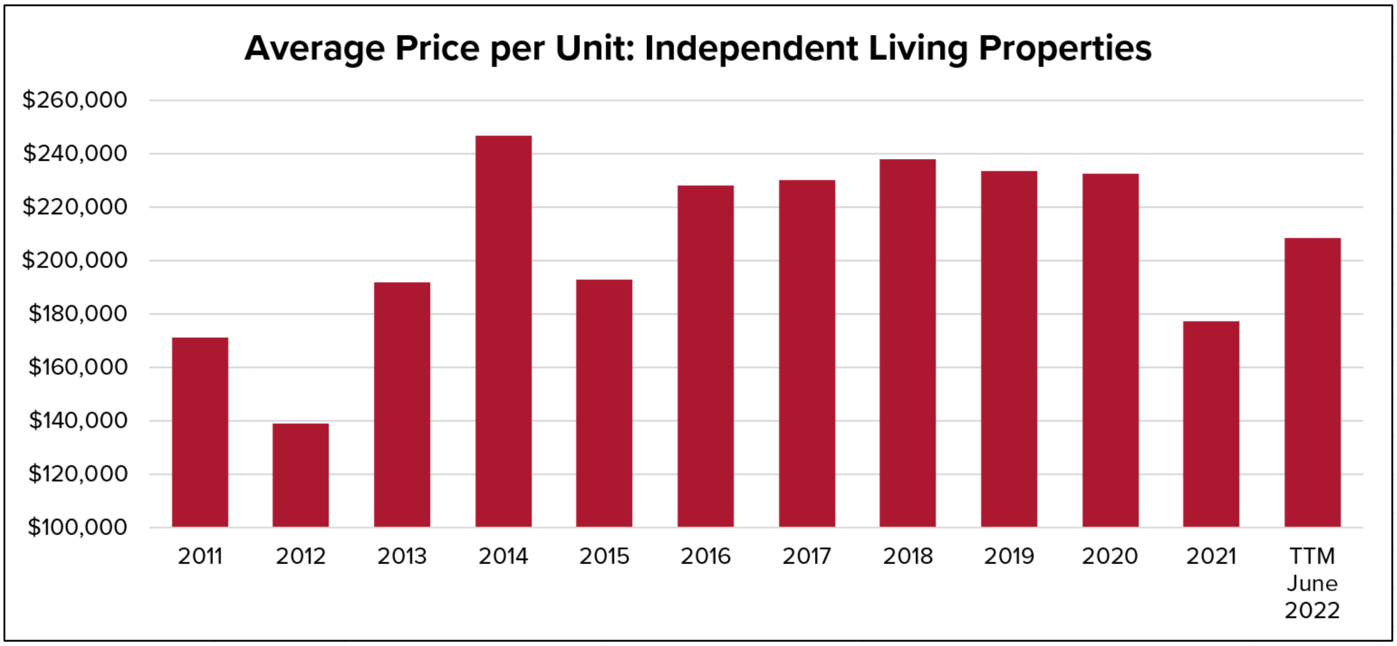
Prior to the pandemic, the AL sector also faced serious labor problems, both the scarcity and cost of it, which only worsened in 2020 and more so in 2021 and 2022. As in the skilled nursing market, the newer, high-quality communities with their higher monthly rents had more financial flexibility to weather the storm, leaving the older, traditional assisted living communities to watch their occupancy and cash flow drop, all while trying to retain an overworked staff.

Independent Living Market

Despite being a much smaller market compared with assisted living, which could be prone to wider swings in its average price per unit, independent living was remarkably consistent in the four years leading up to the pandemic, and even during the pandemic itself.

The average price hovered between $228,200 per unit and $238,100 per unit during that entire period, which was possibly a reflection of the sector's more stable operating environment. However, a few high- or low-priced sales can sway the average price, and the sector experienced a significant 24% drop in 2021 to $177,400 per unit followed by a 17.5% increase in the four quarters ended June 2022 to $208,300 per unit. As such, a few deals could dramatically affect where the calendar year 2022 average settles as well.

Proponents of independent living touted its durability during the pandemic, especially relative to the assisted living market, since it required fewer staff,



catered to a younger, healthier population and did not suffer from the effects of overdevelopment. The sector's average occupancy hovered around the healthy level of 90.0% just before the pandemic, so it had a larger census cushion to absorb the impacts of COVID-19.

That strong occupancy also gave these communities more flexibility to charge higher rents, resulting in surer financial footing going into the pandemic as well. Independent living is also a lot closer to attracting the oncoming baby boomers, since the average move-in age is theoretically lower than assisted living.

That relative strength caught buyers' interest and led to a few of the largest transactions seen in years. First was the largest deal of 2020, which featured 11 majority-IL communities in California, Nevada and Washington owned by Welltower. The portfolio sold to a joint venture between AEW Capital Management and Merrill Gardens for $702 million, or $465,800 per unit, at a 5.1% cap rate.

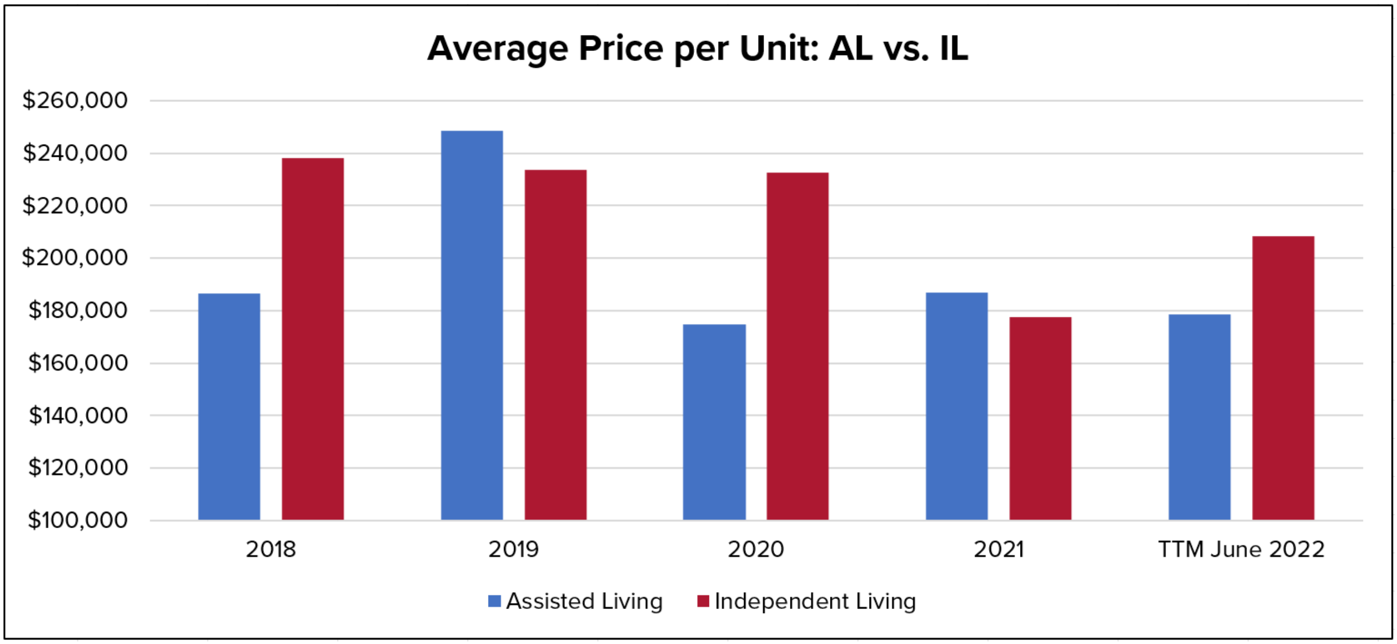
Then June 2021 saw Atria Senior Living's acquisition of independent living operator Holiday Retirement, Welltower's $1.58 billion acquisition of Holiday's owned portfolio of 86 communities, and Ventas' $2.3 billion acquisition of the majority-IL REIT, New Senior Investment Group.

These three deals announced in quick succession almost certainly would not have taken place without the continued strength and stability of the IL sector, despite the deals coming in with below-average per-unit prices.

The growth of the active adult community space has emerged as a potential new threat to independent living, potentially capturing those younger seniors and keeping them for longer, especially if those residents can obtain any needed home health care services. It could also prove to be a boon for other seniors housing sectors, since it gets those elderly adults out of their homes, a major barrier to moving into seniors housing anyway, and out living among their peers, another major draw to seniors housing communities.

Because active adult communities come with fewer services, they typically charge lower rents than independent living. But they usually still offer activities and a better social life than if the seniors just stayed at home, which is a big selling point for independent living.

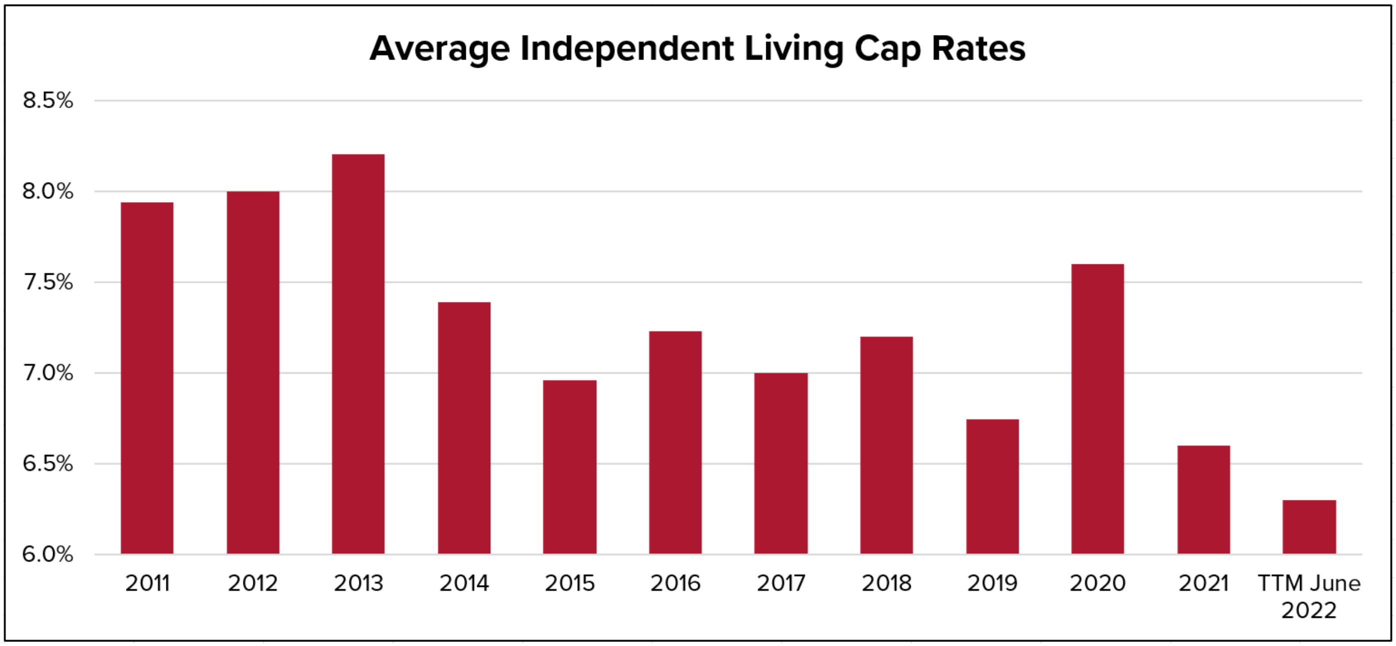
Sometime down the road as their resident population ages, active adult communities could begin to

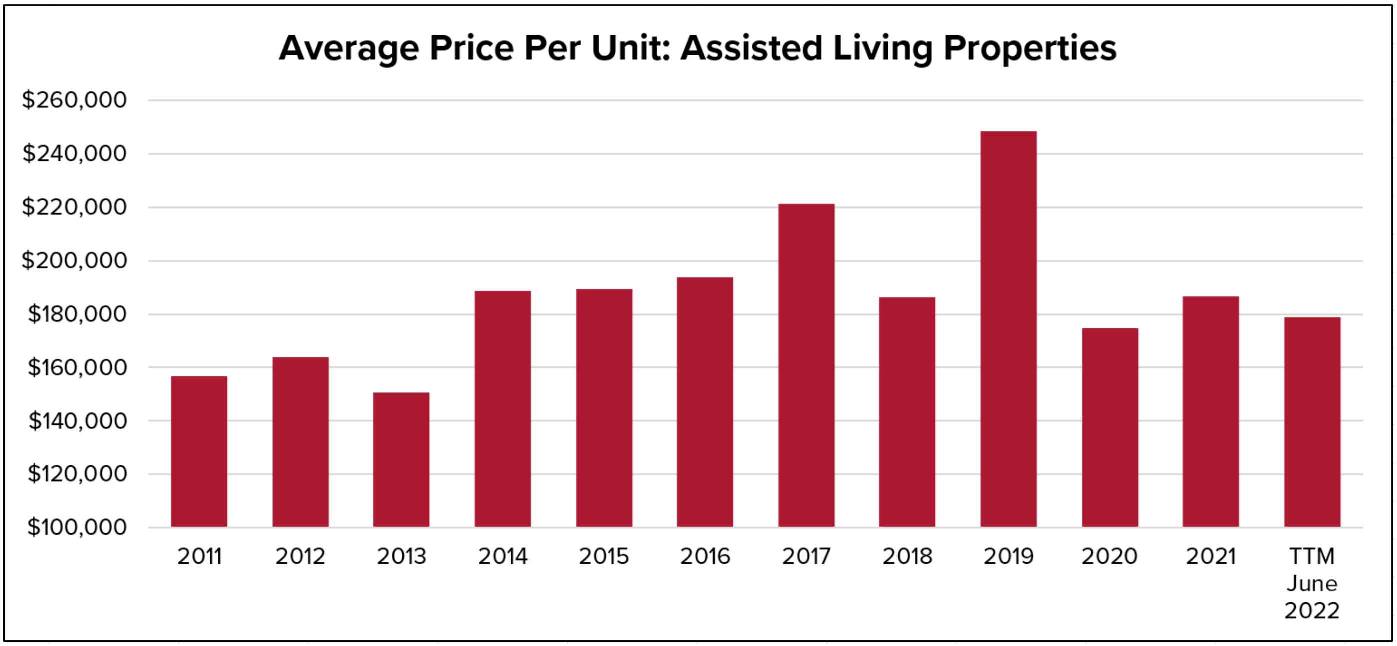


add IL-like features, such as communal dining and laundry services and even certain care options. That could have ramifications across the entire seniors housing spectrum.

Comparing the two main seniors housing sectors, assisted living beating independent living in terms of average price per unit in 2019 was an interesting phenomenon, but it was repeated in 2021. However, independent living communities regained the top position in the four quarters ended June 2022, by a relatively narrow margin. A few high-quality, high-priced deals in this small sector helped maintain a high average price per unit. However, far more struggling assisted living communities sold during the year, leading to the continued drop in average assisted living prices.

Unfortunately, the small size of the IL market can





yield wide swings in the average cap rate, including swings that sometimes may seem antithetical to how the market was actually valued during the year. Thus, when the independent living market observed a significant decline in its average price per unit in 2021, its average cap rate also plummeted from 7.6% in 2020 to 6.6% in 2021, and even further to 6.3% in the four quarters ended June 2022. The continued decline into 2022 also occurred when the Federal Reserve was raising interest rates at the quickest clip since the 1990s.

Looking forward, the pandemic's effect may very well hit the assisted living market harder than independent living because of its older, frailer residents, its shorter lengths of stay and high labor costs, but the IL sector will not be immune either.

There is certainly a case that more "need-based" services will rebound more quickly, and that a "luxury" like independent living may result in potential residents deciding to stay home. Also, a drop in home values may not allow many seniors to feel financially secure enough to cash out and move into an IL community.

On the other hand, a yearning for socialization and the convenience of living in an IL community may actually boost demand in the next several years, unless active adult communities absorb many of those residents. It is too early to tell, but some caution from investors (in the form of a slightly higher cap rate) could be warranted, even for high-quality communities.

Assisted Living Market

Assisted living went through a roller coaster decade, when a "recession-resistant" reputation and demographic-fueled enthusiasm led to a period of overbuilding in the mid-2010s and decreased occupancy as a result. Increased competition in many markets across the country exacerbated the problems caused by an already-tight labor market, with poaching of key staff an all-too-common and expensive trend.

These issues hit lower-end and middle market assisted living communities more, as they could not raise rents as easily to counteract higher wages and rampant discounting. And they left the sector in a more precarious position going into 2020.

Even as the pandemic took a heavier toll on assisted living communities than independent living, investor interest still targeted the higher acuity sector, since those communities accounted for three-fifths of the seniors housing communities sold in 2021. However, it has yet to be seen how COVID-19 will affect future demand for community-based senior care, especially with the growth and improvement of home health care as a service. Demographics will come to the sector's aid at some point, but likely not starting until the late-2020s.

Following the pandemic, the sector's average price remains well below the pre-pandemic high of $248,400 per unit in 2019. It plunged by 30% to $174,700 per unit in 2020 before rising a modest 7% in 2021 to $186,800 per unit.

The four quarters ended June 2022, however, saw the average price sink below $180,000 per unit yet again to $178,700, which was the result of more owners of struggling communities agreeing to price discounts on their properties. The term "below replacement cost" was the phrase of the year in the assisted living M&A market. At the same time, many owners of newer, more stabilized communities chose to wait it out, accepting government aid while biding their time for a better M&A environment.

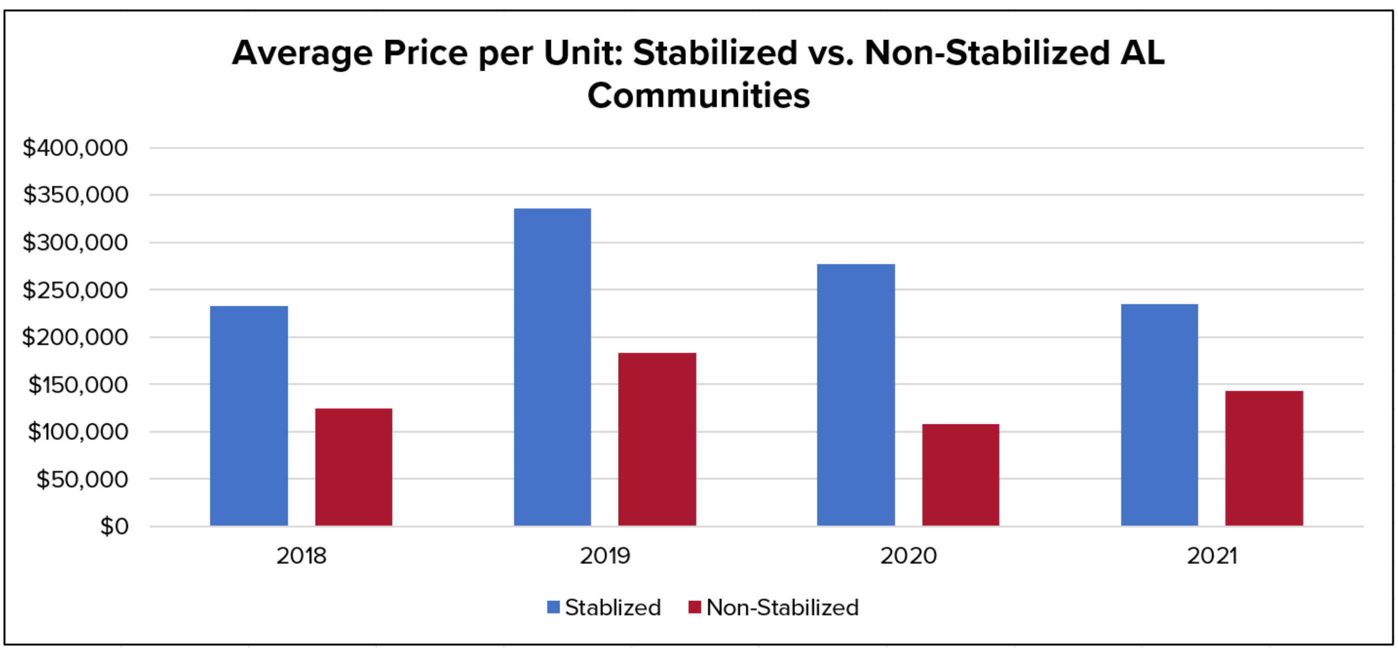
It makes sense that buyers thus placed a premium on census in 2021, paying $235,000 per unit on average for stabilized assisted living communities, or those with 85% occupancy, or higher. Non-stabilized communities sold on average for $143,000 per unit, or $92,000 lower than that of stabilized communities.

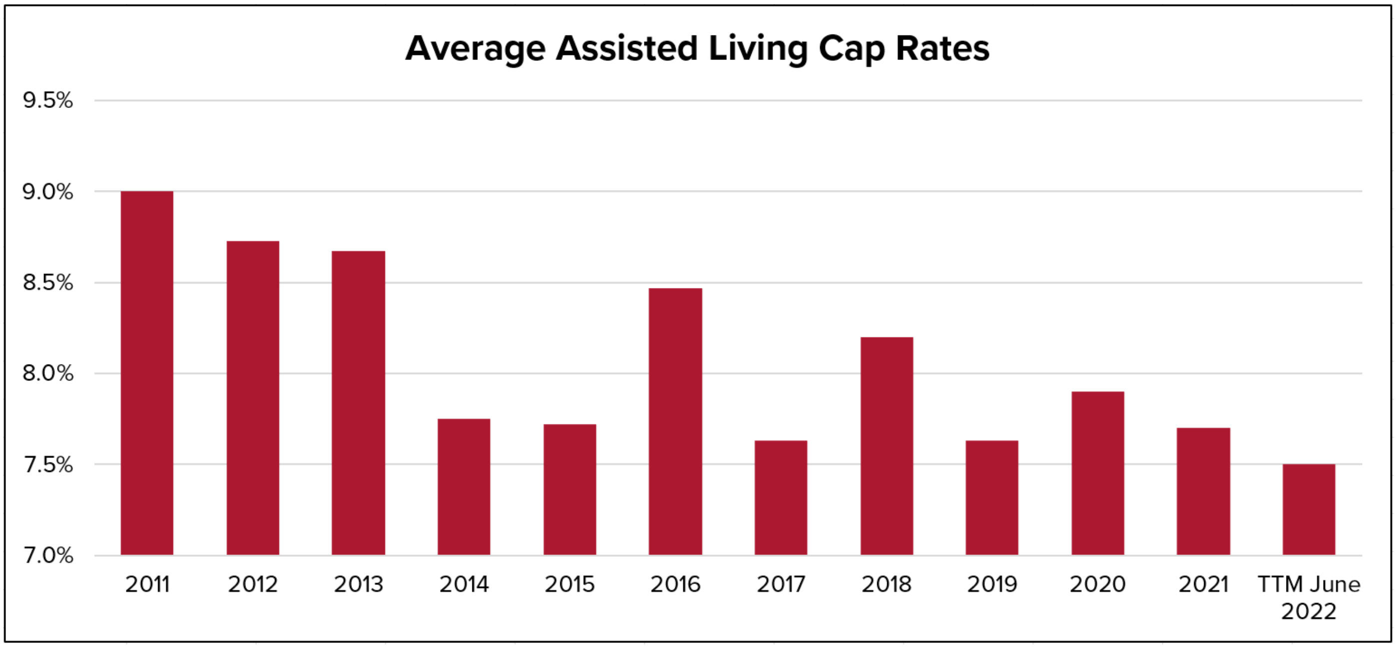
Both groups of properties were priced lower when compared with 2019, but the spread shrank dramatically on both a percentage and absolute basis. This suggests that with so many communities struggling with census, other factors like staff retention or cash flow may have mattered more to investors.

There are still communities that can be extremely profitable at 80% occupancy (and some even unprofitable at 100% occupancy), and profits usually matter more to the buyer anyway. But overall, if a property is well-occupied, clearly it is doing something right with either its local reputation, its employees, its appearance and amenities, or its quality of care, and usually some combination of those.

Because of that, they do (and should) command a premium, especially since the buyer will more or less be able to hit the ground running instead of investing in renovations.

Assisted living has come a long way from the throes of the Great Recession, when average cap rates





exceeded 9%, and when 6% cap rates were nearly unheard-of. And despite the numerous risks facing the industry and the rising interest rate environment, average cap rates kept declining throughout the pandemic, from 7.9% in 2020 to 7.7% in 2021 to 7.5% in the four quarters ended June 2022.

This was partly because there was a lower cash flow to cap, and buyers were pricing based on the near-term pick-up in census and cash flow. Even in the pandemic, there were still plenty of 6% or lower cap rate deals, as buyers clamored for the few stabilized, high-quality deals on the market. Which EBITDA period was used also affects each transaction's cap rate, and 2021 was another volatile year for most operators and their bottom lines. So, the average may not be totally representative of how investors valued these communities in a post-pandemic world.

Conclusion

There is much opportunity and many potential pitfalls in the seniors housing and care industry through the next decade. If demographics had attracted new investors to the industry in the mid-2010s, despite baby boomers not aging into most seniors housing communities or skilled nursing facilities until at least 2026, then many new entrants will surely be drawn to those sectors in the mid-2020s.

Mistakes will be made and attract negative headlines, markets will get overdeveloped, qualified labor could become more scarce, the government could become more involved in private pay seniors housing, and baby boomers could reject much of the current product available right now.

But therein lies the opportunity. The 21st Century has so far proven that the seniors housing and care industry can adapt to crises big and small, economic and epidemiological. For it to survive and thrive in the next decade and beyond, providers, investors and capital providers need to work together to accomplish several things.

First, demonstrate the true value of seniors housing and care services to potential residents, their families, current and future staff, the government and the public, emphasizing that these communities are fulfilling places to live and work. Second, understand how the next generations of seniors want to live out their retirement. And third, match or exceed the new prevailing wage to attract the staff they will need, even if it means taking a hit on returns.

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