Seniors housing fundamentals bring positivity despite economic hurdles

As the operational challenges caused by the pandemic ease, interest in moving increases, and occupancy rates rise, the mood in the seniors housing industry is trending positively as well. Lana Peck, senior principal with National Investment Center for Seniors Housing and Care (NIC) moderated an insightful discussion with KeyBank Real Estate Capital® (KBREC) Senior Vice Presidents Brian Heagler and Morgin Morris. The trio focused on the evolution of seniors housing lending, how this segment has fared throughout economic and public health hardships, and what trends are driving this sector as we look to the future.

Seniors housing brings risks with rewards

Seniors housing is rewarding because it has the ability to be impactful to so many people. However, banks have recognized that along with the real estate itself, the operating and care component in seniors housing is very specialized and carries a great deal of risk. Regulatory risk, reimbursement, and private pay components are just a few examples of the complexities surrounding seniors housing lending. While KBREC lends on all seniors asset classes including independent and assisted living, memory care, and skilled nursing, each asset class has different regulatory environments within the different states to consider.

Heagler noted that the supply and demand characteristics of each market can't be measured with statistics from a large MSA. "In certain segments of seniors, when looking at the real estate, it's a misstep to speak in terms of a large market because the five-mile 'micro-market' is a much more telling measurement of a particular facility. These micro-markets are a nuance that you might have in seniors that you wouldn't in other asset classes." Thankfully, demographics and tools can be used to evaluate the real estate in concrete ways. On the operations side, there are no hard and fast evaluation metrics, so an operator's track record is imperative.

A look back: multifamily and affordable housing lending volume helped agencies

Heagler looked back on the early part of the pandemic and indicated that lenders like KBREC were "heads down," focused on modifying operations with little to no precedent so they could continue to add value to clients. "The pandemic had a tremendous change on underwriting and the way we look at expenses. Many people thought that the spike in labor and supplies would decline, and that hasn't been the case. The biggest challenge has been being nimble, so that we could address what was happening with the pandemic in real time and adjust accordingly."

Government sponsored enterprises (GSE) Fannie Mae and Freddie Mac, amidst skyrocketing operational challenges and unknowns and more conservative underwriting parameters, saw annual lending volume in the seniors housing sector fall precipitously during this time. Freddie Mac fell 45% from nearly $4B in 2019 to $2B in 2020. Even worse, Fannie Mae lending fell 71%, from $3B in 2019 to $1B in 2020.[1]

"We saw many clients sit on the sidelines during the early days of the pandemic, unless they had a maturity date they couldn't extend. Those deals that did come up for maturity ended up closing on a bridge loan or with a life company at a lower leverage point." But Morris also noted that overall, when considering the historic lending volumes in traditional multifamily and affordable housing driven by an all-time low-rate environment, the agencies actually fared well.

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Now, owners and operators focus on existing portfolios

Morris commented on how her client's needs have evolved as the pandemic has progressed. "Our clients are asking for greater flexibility. We are closing fixed-rate loans at shorter terms. We have processed hundreds of ownership transfers, management transfers, and large-scale CapEx renovations. Owners and operators have been very active – not with traditional M&A and construction lending, but rather, a laser-sharp focus on existing portfolios. We should be busy on the permanent loan front as we look ahead to the second half of 2022 and into 2023. As facility vaccination rates exceed 90% and buildings lease, that uptick in M&A and construction activity should follow. "

[1] Jeff Shaw, "Fannie, Freddie Shake Off Effects of Pandemic", SeniorsHousingBusiness.com, France Media, March 21, 2022, https://seniorshousingbusiness.com/fannie-freddie-shake-off-effects-of-pandemic/#:~:text=Freddie%20Mac's%20annual%20lending%20volume,fallen%20precipitously%20in%20recent%20years

Ground-up development is a strong option, for some

While KBREC lends for acquisitions, expansions, and new development, there is some cautiousness around ground-up construction, especially as we see longer entitlement periods, supply chain issues, and skyrocketing subcontractor rates. Fear of oversupply adds to concerns. "In my time at KBREC, there have certainly been periods of oversupply, which hurts everyone," said Heagler. "We generally lend first to the sponsors and operators, and then finance what they want to do, whether that means an expansion via acquisition, expanding a current facility or campus, or ground-up development."

HUD activity, especially, is starting to see a notable increase in new development and expansion projects. HUD projects have their own set of challenges, such as implications of the Davis-Bacon and Related Acts, which applies to contractors on federally funded or assisted projects, but the panel indicated that the long-term fixed rates for HUD projects have made it a viable option for developers in this rising-rate environment.

Active adult blazing trails; raising questions

The active adult segment has been taking root over the last several years and is steadily growing in consumer popularity. There is a compelling argument to pay close attention to this younger sub-demographic that wants to live independently and have access to resort-style amenities, community programs, and convenient services. The lending community has yet to reach true consensus on the underwriting of active adult projects.

"The number one question we get is, 'Should we underwrite active adult more like multifamily or seniors housing?'" said Heagler. "The activity we have seen shows that active adult really belongs in the seniors space, as a feeder to traditional seniors housing. For now, it still processes through the multifamily pipeline at the GSEs."

Morris added, "It's all about making the argument for recognizing the seniors component but allowing the favorable lending terms and higher LTV of multifamily. This is such an interesting segment with so much potential, so it will be advantageous to collectively agree on a home for active adult within the lending community."

A look forward

Despite the continued strife associated with a global pandemic and economic challenges, there is consensus that 2022 is certainly not 2008. Banks are healthy, and abundant capital providers are chasing high-quality seniors housing deals. Clients are diversifying. That's not to say financial concerns are clear ahead. Expense margins, inflation, treasury rates, access to capital, state and regional trends for reimbursement, taxes, and insurance costs are all being monitored very closely within the lending community. Labor is and will continue to be an exceptionally difficult hurdle. The panelists agreed that most operators are recognizing the need to raise both wages and rates and are planning a 6% to 9% increase on both fronts, with the hope that an increase in Social Security payments will help offset that cost for seniors.

The low-hanging fruit lies in the demand metrics of an aging population. Many lenders will put weight in an operator's ability to reach that population with a platform that values resident and employee experience over financial metrics. Morris confirmed that KeyBank looks for partnerships with operators that invest in a human-focused brand mission.

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To learn more:

Visit key.com/nic, or connect directly with Morgin Morris and Brian Heagler.