Growing Competition Prompts Seniors Housing Investors to Explore Value-Add Opportunities

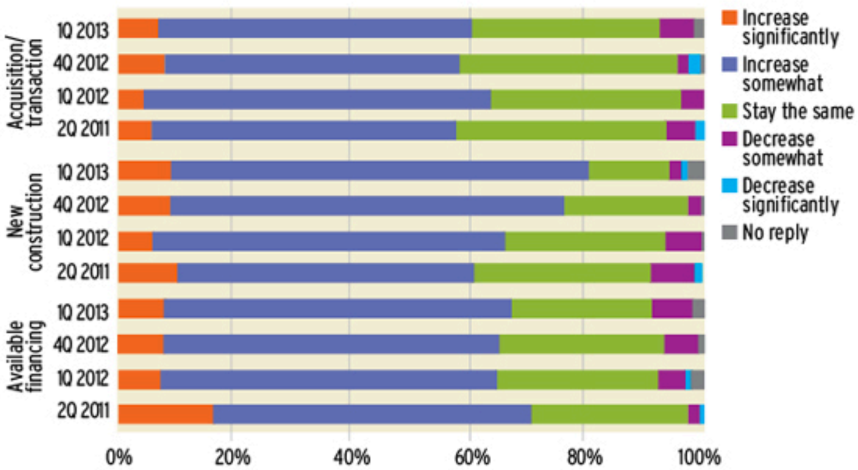
Beth Mattson-Teig

Apr. 29, 2013

The steady flow of capital moving into the seniors housing sector continues to gain momentum. the exclusive results of a first-quarter survey conducted by *NREI* and Senior Housing Global Advisors show an active pipeline on all fronts. A majority of respondents expect seniors housing activity—namely acquisitions, new construction and financing—to increase in the next six months.

All told, 67 percent of respondents believe that sales transactions will grow in the coming months **[Figure 1]**. "The pace of real estate transactions in the seniors housing space is accelerating due to an increased focus on the part of both domestic and international investors who finally have found the industry," says Mel Gamzon, president of Senior Housing Global Advisors Inc. in Fort Lauderdale, Fla. An overwhelming majority, 80 percent, anticipate a rise in new construction, while 60 percent believe financing will increase over the next six months.

[FIGURE 1] In considering the pace of activity in the seniors housing sector in the next six months, most respondents expect the availability of financing, the pace of new construction and acquisition volume to increase somewhat. The results show increased bullishness from past surveys, especially on the construction front.



Base: 153 respondents

The aging baby-boomer population certainly gets a large share of the credit for the fact that seniors housing has landed firmly on investors' radar screens. After all, the population of Americans over age 65 reached 40 million in 2010 and is projected to hit 55 million in 2020, according to the Administration on Aging. However, it is strong performance within this sector that is behind investors' push to continue expanding portfolios through both acquisitions and new construction.

Since the recovery began in 2010, the seniors housing market has continued to log steady gains in both occupancies and rent growth. Fourth-quarter occupancies among seniors housing properties improved to 89.1 percent, while occupancies at nursing care properties remained relatively flat at 88.1 percent, according to the National Investment Center for the Seniors Housing & Care Industry. As of the fourth quarter, seniors housing properties reported year-over-year rental growth of 2.2 percent and nursing care facilities posted growth of 2.9 percent over the prior year.

In fact, respondents remain optimistic that occupancies will continue to rise. More than half of respondents, 61 percent, expect the level of occupancy at their seniors housing facilities to increase over the next six months. That compared to 52 percent in the fourth-quarter survey. Respondents expect occupancy to increase by an average of 97 basis points over the next six months.

That confidence is reflected in the extreme amount of capital in the marketplace that is coming from both existing or experienced players, as well as a whole host of outsiders looking to enter the business.

"The seniors housing market is booming for a variety of reasons. Everybody that sat on the sidelines is now looking to put money to work," says Bradley Dubin, a principal at Kandu Capital in Beverly Hills, Calif. Kandu Capital specializes in value-add opportunities where the firm can improve occupancies and stabilize properties. Over the past three years, the firm has acquired five seniors housing communities in Indiana, Ohio and South Carolina. "I would say that the market overall is extremely competitive whether you are looking for stabilized properties or value-add," says Dubin.

Construction to the forefront

Respondents are much more bullish on the outlook for new construction than they were a year ago. The 80 percent of respondents who said they expect new construction to increase over the next six months is a significant jump compared to the 66 percent who held that view in the first-quarter 2012 survey.

“You certainly see existing product continue to fill up. That is great for existing properties, as well as opportunities for new development,” says Kevin Maddron, a senior vice president of fund management for CNL Financial Group in Orlando, Fla. The company’s primary vehicle for seniors housing acquisitions is its CNL Healthcare Properties. In 2012, the non-traded REIT acquired 27 assets with a total acquisition value in excess of $500 million.

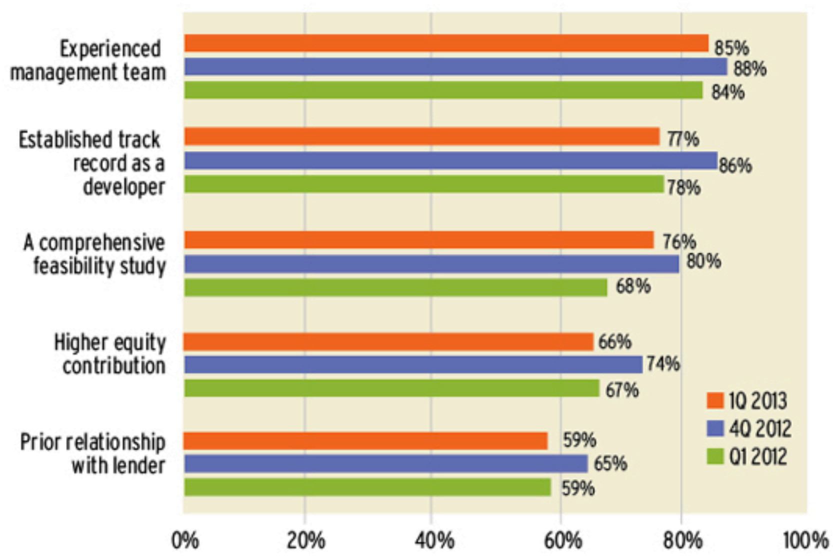
In addition to pursuing existing properties, Healthcare Properties has launched two developments: a $22-million, 96-unit property in Lady Lake, Fla., and a 90-unit development in Acworth, Ga., with Solomon Senior Living.

Although new construction remains modest, the pipeline of projects is growing. More than half of respondents, 56 percent, said they have new construction ventures planned in the next six months, which is up slightly from the 51 percent who were reportedly planning new properties in the first-quarter 2012 survey. The largest percentage of respondents (35 percent) is planning independent living/assisted living projects. However, a variety of other projects are in the works, including memory care (25 percent), age-restricted communities (9 percent), continuing-care retirement communities (7 percent) and skilled nursing (6 percent).

Conservative financing

Although capital is available for new construction, lenders remain disciplined in their approach to funding new projects. Respondents rated having an experienced management team as the most important factor when seeking construction financing in today’s market. Overall, 85 percent of respondents indicated that criterion as either a 4 or a 5 on a five-point scale, with 5 being extremely important **[Figure 3]**.

[FIGURE 3] Respondents rate having an experienced management team as the most important criterion when trying to obtain construction financing.



Base: 153 respondents

"Construction lenders who have been in this space for a long time are being very particular about who they are lending to, often restricting their client list to existing customers or going very, very selectively with clients who have a good reputation in the industry," says Casey Moore, a principal at Newark-based Prudential Mortgage Capital Co. The concern when new lenders step into the market is whether they will be as cautious, he adds.

Lenders also are responding to a spike in demand for value-add projects involving major renovation or rehab work. Debt financing is available for those deals. However, lenders are focusing primarily on good, seasoned operators with solid opportunities. "The market metrics need to support the property, and the property has to have a legitimate physical plant that is going to work," adds Moore.

As competition for core properties continues to increase, investors are turning their attention to renovation and redevelopment projects where there is more opportunity to add value and increase returns. As the costs to develop new seniors housing facilities increase, 67 percent expect that the acquisition, renovation and repositioning of older projects will become increasingly attractive to investors and operators.

"There is a substantial national inventory of aging market-rate seniors housing facilities that were built 15-plus years ago that can be acquired and repositioned," says Gamzon.

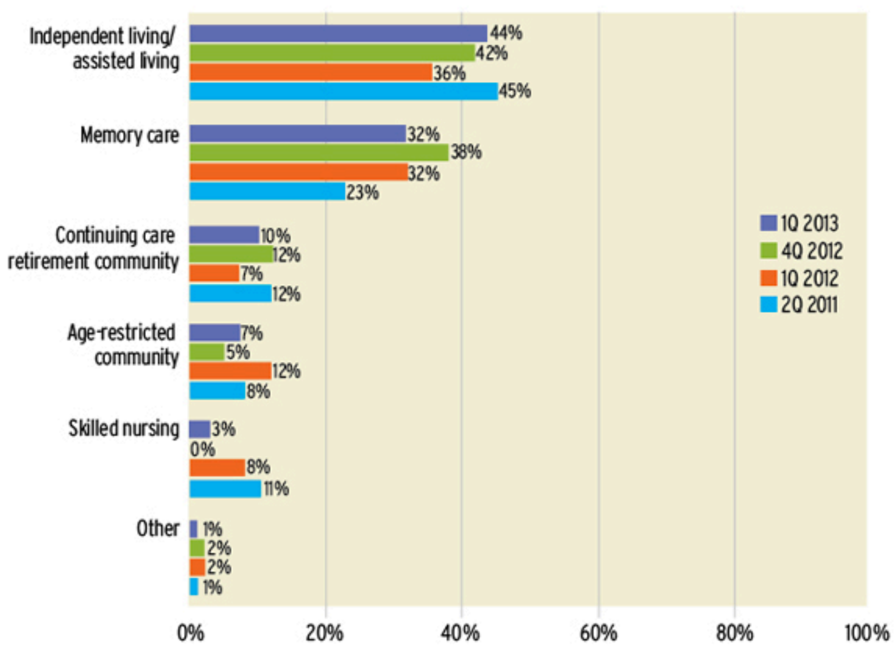
More buyers chasing deals

Seniors housing is seeing heightened interest among national and even international investors. "It is more competitive today than it was five years ago. The real reason for that is people took notice of our space when they saw how well our respective portfolios performed during the Great Recession," says James "Jay" Flaherty III, chairman and CEO of HCP Inc. in Long Beach, Calif. HCP has continued to deliver an increase in its annual dividend each year, even during the economic downturn.

Not including mergers and acquisitions, sales surged in 2011 to $13.87 billion due to some large portfolio sales, according to New York City–based Real Capital Analytics. Although transactions fell to $9.96 billion in 2012, that level still represents solid demand and is double the $5.36 billion volume in 2010. In addition, 2013 is already off to a strong start, with sizable transactions such as HCP's $1.73 billion acquisition of 133 senior housing communities across 29 states. The acquisition includes 10,350 units of assisted living, independent living, memory care and skilled nursing facilities.

Similar to the first-quarter 2012 survey, respondents predict that independent living/assisted living properties will experience the biggest growth in investor demand in the coming six months. Forty-four percent of respondents believe investor appetites for independent living/assisted living properties will grow, while 32 percent see the greatest growth in memory care **[Figure 2].**

[FIGURE 2] Respondents expect the independent-living sector to see the greatest growth in investor demand in the next six months. Expected demand for memory care dropped from the previous survey's reading.



Base: 153 respondents

Respondents are split on their expectations for how increasing competition for properties will impact cap rates. More than one-third of respondents (36 percent) expect no change in cap rates in the next six months, while 34 percent predict an increase and 28 percent expect cap rates to decrease. Three percent had no response.

Access to capital

Much like the growing field of investors, lenders also have a very favorable opinion of the seniors housing sector. As a result, borrowers are finding good access to both debt and equity capital. Respondents' views on financing remained comparable to prior results, with 60 percent who believe financing will increase over the next six months.

Compared to the standard commercial real estate classes, seniors housing performed well throughout the downturn with very little delinquencies and the metrics remain very solid, says Moore. Prudential Mortgage Capital has seen its origination volume for seniors housing properties jump in the last year from $405 million in 2011 to $760 million in

2012.

Investors continue to access multiple sources of capital. When asked what types of debt financing they are considering for acquisitions and new construction, more than half of respondents, 52 percent, said they are considering local/regional banks for debt financing. Respondents are also exploring a variety of options, with top picks including HUD (35 percent); national banks (33 percent); Fannie Mae and Freddie Mac (29 percent); and institutional lenders (27 percent).

Although the seniors housing sector has proved to be very resilient throughout the recession, respondents do believe the state of the U.S. economy has had a negative impact on occupancy rates. Overall, 59 percent of respondents believe the U.S. economy has had a negative impact on seniors housing facilities in the past year, compared to 78 percent who held a similar view in the fourth-quarter 2012 survey.

Even as both the economy and the single-family housing market continue to improve, a variety of other factors will continue to influence growth in the seniors housing industry in 2013 and beyond. However, the broader outlook for both short-term and long-term growth in this sector remains very positive. "Operating margins are strong, occupancies are strong. We are coming out of the recession with limited new construction," says Gamzon. "All of this bodes well for existing assets and the select new development ventures that we will see in 2013."

Discuss this Article 0

POSTING AS: bdubin (Sign Out)

YOUR COMMENT: *

SUBMIT COMMENT

Related Articles

Seniors Housing Investors Work to Grow Portfolios as Occupancies and Rents Continue to Rise

Life Companies Eye Opportunities in Competitive Market

Is "Seniors" One Demographic Group?

NREI Seniors Housing Study First Quarter 2012

Will the Buying Frenzy in Retail Real Estate Continue?