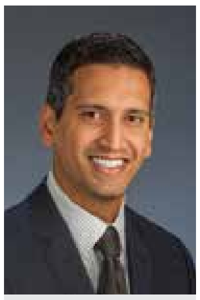
WESTERN REAL ESTATE BUSINESS

SENIORS HOUSING UPDATE

The Pacific Northwest and state of California have been hotbeds of activity for seniors housing options of all kinds. Below, three of the industry's top experts weigh in on what's to come, and what may prevent future growth.

STRATEGIES FOR SENIORS HOUSING IN HOT MARKETS

By Anand Kannan, President, Community Preservation Partners



Kannan

Affordable housing for seniors has been a growing issue on the West Coast for decades, and certain markets have recently reached a tipping point. Typically, the regions with the fastest-growing economies tend to have the tightest housing inventories, a correlation that can have tragic consequences for low-income seniors. We are seeing it today in cities like Portland, Ore., and the San Francisco Bay Area where booming technology sectors have driven demand up and priced a lot of renters out of their homes. Meanwhile, affordable housing landlords and government programs alike have struggled to keep pace.

As an affordable housing rehabilitation company, CPP looks for properties that are at risk of converting to market that we can purchase, invest in and preserve the affordability within the community. This strategy applies to the private for-profit developers, as well as nonprofit groups and municipal housing authorities.

San Jose, Calif., is a good example of this. The metro area has seen the largest annual increase in rent, which spiked 9.3 percent from 2015 to 2016, according to RealtyTrac's 2016 Rental Affordability Analysis. With this surge, private owners cannot afford not to convert to market rates — especially if the tax incentives they receive for keeping the rents affordable are due to expire within the next five to 10 years.

We recently purchased a 144-unit seniors community in this Silicon Valley region, which was CPP's seventh in the Bay Area. With $5.5 million invested in the rehabilitation, the deal will protect affordability there for 55 more years.

Our strategy is to prolong affordability by securing favorable financing terms and tax credits through local, state and federal programs, usually HUD for urban or USDA for rural. Clean energy funding is also available, depending on the investment. These incentives are often bundled and sold to a diverse array of investors, ranging from technology giants to Wall Street investment banks who use them to offset their own tax liabilities and receive a competitive return from an after-tax standpoint.

One of our challenges during this period of tax policy uncertainty is to stay relevant to investors who don't know what their tax liabilities are going to be in the near future. Due to our well-capitalized parent company, WNC & Associates, we are able to provide a surety of closing to interested sellers, offsetting some of the uncertainties/concerns investors may have.

Sellers like to do business with us because we don't go at any deal alone. We see ourselves as stewards of any building we acquire and take care of the residents who live there by rehabilitating their homes and providing senior-focused programs. Another recent project included the 144-unit senior citizen Bellflower Friendship Manor, just south of Los Angeles, which underwent a $7 million rehabilitation. This ushered in new amenities like a movie theater, community gardens, dog run, putting green, art room and computer lab. For the seller, who was the original owner, letting go of these residents was tough, but they were comforted by the knowledge that their tenants would be protected.

In addition to buying and preserving affordable housing projects from for-profit companies and non-profit organizations, CPP is also looking to increase the amount of deals completed with public housing authorities. With maintenance costs on the rise and tax-payer patience on the slide, many public-sector property owners are looking to unload some of their assets in favor of private-sector solutions. We found this to be the case in Portland, where CPP acquired Plaza Townhomes in a $16.5 million transaction that included a rehabilitation investment of about $50,000 per unit. The seller was Home Forward.

Portland has seen economic trends similar to the Bay Area, and CPP is looking to scale its strategy further into the Pacific Northwest in the coming year.

SILVER TSUNAMI: SENIORS HOUSING TRENDS IN CALIFORNIA

By Mary Christian, Executive Director, Cushman & Wakefield National Senior Housing Group

Christian

The U.S. is riding a "silver tsunami wave" as the Baby Boomers continue to age. By 2020, half of the 78 million Boomers will be over the age of 65. Many will need supportive living services in their lifetime. It is a well-known fact that seniors prefer to stay in their own home as they age. For those who cannot, a myriad of senior living options exists, from independent living, assisted living, memory care communities and on up to the highest level of care provided by skilled nursing facilities.

Due to demand factors such as higher education levels, relative affluence, improving healthcare, longer life expectancy and fewer family caregivers, the senior housing real estate market is on a trajectory path to move from its niche real estate status to core in the foreseeable future. The asset class proved to be resilient during the Great Recession due to the unique underlying factor that it is largely a need-based product that is not going to wither during an economic downturn. It was the only asset class that didn't experience declining asking rents during the down cycle. For the 10 years ending in 2015, seniors housing generated an annualized return of 11.9 percent compared to 7.8 percent for the entire NPI (National Council of Real Estate Investment Fiduciaries Property Index). By and large, this asset class has gained acceptance in the capital markets arena — more so than in previous years. Real estate investors in search of higher yields and lacking opportunities in other commercial real estate sectors are increasingly more accepting of this asset class.

More and more institutional capital from the U.S. and abroad is attracted to the sector due to the impending age wave. In fact, over the past 10 years, the vast majority of transactions were dominated by public entities, including REITs and operating companies. The total market capitalization of senior housing and long-term care properties in the U.S. is estimated to be $272 billion, composed of three million units in 23,400 properties, which is the equivalent of $124,000 per unit/bed.

California, other Sunbelt states and densely populated MSAs on both coasts are highly desirable investment target markets due to strong income and growth demographics. California boasts some of the highest per-unit pricing metrics in the nation, where it is not uncommon for Class A assets to sell in excess of $300,000 per unit. The Cushman & Wakefield National Senior Housing Group sold a 28-year-old independent and assisted living community in Orange County in December 2016 at an approximate 5.5 percent cap rate with per-unit pricing at $425,000. This is a testament to the strength of this investment sector. The highest per-unit pricing in California, according to our sales database, was the sale of two new assisted living and memory care communities that sold for more than $550,000 per unit in 2015 to a senior housing/healthcare REIT.

Average monthly rates vary greatly by region and care level. NIC reports that for the Western U.S., average independent living rates are $3,533 per month and $4,319 and $10,110 for assisted living and skilled nursing, respectively.

Capitalization rates for seniors housing varies across care levels and location. In general, on a national basis, independent living communities garner 7 percent caps, while assisted living is slightly higher in the 7.5 percent range due to the fact that it has much higher turnover and, thus, is considered riskier. It is not uncommon to see +/- 6 percent cap deals for large, Class A, institutional-quality deals in highly sought after markets. Skilled nursing, with its heavy reliance on state and federal funding, trades in the 11 percent to 12 percent cap rate range. Average per-unit pricing for independent and assisted living communities in the Western U.S. is in the low $200,000 range as compared to the Northeast region where per-unit pricing averaging is close to $300,000. Skilled nursing assets trade quite a bit lower, in the $100,000 per-bed range.

While the senior housing investment market is thriving, some perceived threats to the industry exist. These include rising labor costs, labor shortages, higher interest rates, advancing technologies in home care to keep people in their homes longer, potential overdevelopment and supply/demand issues in certain markets. California, in general, has not experienced the overdevelopment observed in some markets like Atlanta and Minneapolis, mainly due to the scarcity and relatively high cost of land, not to mention the difficulty and length of time to develop commercial real estate in coastal commission zones.

Investment in the seniors housing sector is expected to remain strong and continue to grow for the foreseeable future, as investors take advantage of the combined components of real estate, hospitality and needs-driven services. This will provide investors with a unique blend of real estate, along with the strength of the healthcare industry.