SENIORS HOUSING BUSINESS

Forge a Strong Financial Year in 2023
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As 2023 kicks off, seniors housing operators are looking for ways to find optimism regarding the market's outlook.

While there certainly are bright spots to anticipate and ways operators can counteract the damages of the past couple of years (more on that below), unfortunately many may find themselves at risk of default as they continue to grapple with labor shortages, higher wages, occupancy rates that have not quite recovered to pre-pandemic levels, and a lack of any new or ongoing government stimulus funding programs.

According to data compiled by Reorg, the number of seniors housing operators incurring bond covenant default (covenant, payment, forbearance, etc.) saw nearly a three-fold increase from 2020 to 2021 and the year-to-date pace in 2022 was also well ahead of 2020. According to Moody's, seniors housing represented 25 percent of all municipal bond delinquencies over the last two years, and, according to Bank of America, defaults in the sector are estimated to reach nearly $2 billion in 2023.

Let's address the negative realities the seniors housing market faces this year:

- ✓ A rising interest-rate environment is poised to further constrain high-yield municipal bond issuances, particularly for CCRCs aiming to refinance existing debt. Operators of these communities will have to choose between locking in rates before they increase again or risk paying for more expensive capital in the future.
- ✓ Government relief programs established during the pandemic, such as the CARES Act and American Rescue Plan, which provided support like the Payroll Protection Program, payroll tax deferral, advanced Medicare payments and Provider Relief Funds, and the employee retention tax credit, have all but gone away. Without future federal stimulus payments, many undercapitalized senior living facilities will be back where they were financially prior to the pandemic.
- ✓ The broad-based downturn in the housing market is creating challenges for seniors to sell their homes as a primary, or often sole, means for accessing a life plan community, thus impeding move-in activity.
- ✓ The seniors housing sector continues to struggle with the effects of post-pandemic operating pressures such as lower census, increased expenses and ongoing labor issues.

The good news
While lower census has been a challenge, the seniors housing sector is beginning to see some "green shoots" as we move into this year.

Occupancy: Senior living occupancy levels have increased for the fifth consecutive quarter and are currently approaching pre-pandemic levels. According to the National Investment Center for Seniors Housing & Care (NIC) MAP Vision, the market saw 82 percent occupancy in the third quarter of 2022 compared with pre-pandemic level of 87.2 percent. In fact, occupancy for assisted living units reached an all-time high, signaling a post-pandemic market response that cannot be suppressed through lower-cost alternatives.

Demand: Demand for seniors housing outpaced new supply while marking its sixth consecutive quarter of positive increases. If this pace of demand growth continues, we may soon start filling new inventory that came online during the pandemic. While it's true that the pace of year-over-year inventory growth for both independent living and assisted living continues to be very slow compared with the exuberant pre-pandemic activity levels, demographics remain strong as the population of adults over 85 is projected to more than double to exceed 14.4 million over the next two decades. Inventory absorption has now swung positive after sustained negative periods since 2020.

Labor: Some operators are employing creative new designs for labor, particularly in life plan communities, to help offset the skill shortage. Strategies such as redesigns in resident support services and amenities and adjusting the number of skilled nursing beds to match its staffing capacity, are helping to counteract the skilled nursing and aides shortage. Continually managing the workforce pipeline is essential to manage operating costs, particularly on the precipice of a recession.

Wages: Fitch Ratings reports that labor shortages have led to significant wage growth of 18 to 21 percent for most types of seniors housing through August 2022 as compared with early 2020, which is creating material profitability and cash flow challenges for many operators.

Five key strategies for 2023
As we look to help our clients in the seniors housing market navigate this (hopefully) waning storm, we offer five key points of recommendation for 2023 implementation:

1. **Build Occupancy:** While skilled nursing facilities are downsizing, independent living and other less-intensive care segments are increasing in scale to accommodate the pace of baby boomers retiring healthier and more active than previous generations. These nonprofit providers are accessing the bond market to finance independent living expansions, even as rising interest rates are constraining new revenue bond issuances. Also, operators should be proactive and not defensive with pricing their units in the market. While responding to competitive forces is a reality, astute operators can structure leasing arrangements to attract new move-ins, while also proactively pricing their units. Further, pricing models can be adjusted relative to levels of care and support amenities to avoid simplistic baseline pricing comparisons.
2. **Select Capital Improvements**: Emphasize capital spending where demand is growing in IL and AL, which often are not as capital-intensive as skilled nursing infrastructure. Many providers are capital constrained and are faced with allocation exercises. It is typically not necessary to upgrade or refresh all units equally. Be selective with the capital budget and dedicate dollars to the specific initiatives to meet growing demand in IL and AL.
3. **Staffing Shifts**: Consider employing a few tactics to bring down labor costs. As an example, some operators are decreasing skilled nursing capacity in favor of independent living and assisted living expansions, part of a concerted effort to reduce reliance on labor-intensive skilled nursing services. As the care needs of residents increase, which drives higher staffing needs, the associated level of care pricing should be proactively adjusted and continually monitored. Of course, timely management of changing staffing levels is critical to effective cost control.

4. **Hiring/Retaining Incentives:** For the past couple of years CCRC operators have relied on a variety of methods to recruit and retain employees ranging from signing bonuses, incentive pay and enhanced benefits for frontline staff. Operators also can attract new talent through creative social media recruitment and referral bonuses from current staff. Further, a positive, empowering culture that engages staff has been and continues to be the best method for retaining staff. Now is not the time to stop.
5. **Cost Management**: Seniors housing operators must be highly attuned to cost management measures as they build occupancy. The payor mix of occupants, particularly in the skilled nursing areas, can significantly impact the profitability of the entire senior living facility. Certainly, resultant payor mix of a facility could be the function of various factors, including area demographics, managed care reimbursement levels, emphasis on directed marketing campaigns, mission commitments to name a few. However, these providers must calibrate cost efficiencies with this payor mix. That is, the measurement and monitoring of prescription drugs and medical supplies must be assessed in the context of the reimbursement of this resident base. All too often, key metrics, such as unit cost per patient day, are overlooked and creep into the constant drag of a seniors housing operator's profitability and longer-term viability.

While it's been a long few years for senior housing operators, for sure, there is plenty of reason to look forward to 2023 and what it can bring to your facilities. With demand ever-increasing, a few business strategies can go a long way to help realize growth this year.

Matt Caine is a managing director with SOLIC Capital Advisors, where he provides financial advisory services, including investment banking and capital restructuring support, to taxable and tax-exempt facilities-based providers, such as independent living and assisted living facilities, life plan communities, skilled nursing providers, regional health systems, community hospitals, ambulatory surgery centers, home health and hospice organizations, and multispecialty physician practices.

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