McKnights Senior Living

Senior Housing: Positive Outlook with Challenging Unknowns

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By Matt Caine, Managing Director at SOLIC Capital Advisors, a leading financial advisory firm providing restructuring, investment banking and distressed asset support services

The coronavirus pandemic has presented a myriad of challenges for the senior housing sector. Even with the vaccine rollout earlier this year, many of these issues remain as the virulent delta variant and newer omicron variant complicate any potential robust recovery. Despite nagging issues with occupancy levels and labor costs, there is reason for hope based on an aging population — if development is balanced with demand and the virus is brought under control.

Occupancy levels still lagging

The senior housing sector is experiencing an ongoing struggle to increase occupancy to pre-COVID levels. According to the National Investment Center for Seniors Housing & Care, senior housing (independent living and assisted living) occupancy in the third quarter of 2021 was almost 80.1% compared with nearly 82.1% for the same quarter in 2020.

In addition, from late 2015 up through the pandemic's start, senior housing occupancy rates had been sliding due to developers overbuilding relative to demand. Construction going into the pandemic was strong, and inventory growth during 2020 almost reached all-time high levels of 2019. According to NIC, even during COVID-19 from the first quarter of 2020 to the first quarter of 2021, approximately 42,000 new housing units came online in larger markets. This trend hasn't subsided throughout the pandemic as developers continue to "chase the graying" of American demographics.

Although leasing activity has been slow to rebound, with some potential residents hesitant to move, vaccine rollouts have led to more onsite marketing visits and facility tours. According to NIC, almost half of senior housing communities experienced a jump in occupancy from the first quarter to the second quarter of 2021. Fortunately, higher rental rates on renewals have helped to offset large increases in operating costs resulting from inflationary pressure and other factors, such as labor and supply costs.

Although occupancy is slowly improving, concerns remain as to whether the industry can bounce back to pre-COVID occupancy levels or, at least, reach more sustainable levels without governmental intervention. It is important to remember that COVID-19 mortality rates in senior housing increased with caregiving complexity, with the highest mortality at facilities providing memory care and skilled nursing operations. According to a NIC-funded report from NORC at the University of Chicago, mortality rates at independent living communities, where residents required little or no care, mirrored the rates in their respective counties, indicating that those operators effectively stemmed the spread of COVID-19 to at-risk residents.

Labor costs continue to complicate operations

Increasing labor costs have long been a problem for senior housing operators, leaving many to turn away potential admissions to maintain appropriate levels of service and care. Labor shortages resulting from burnout and then fear of COVID-19 have driven up wages, especially with relatively low rates of vaccination among senior living and care staffers complicating this scenario. Federal government unemployment benefits also are believed to have kept many potential employees away, further fueling labor costs.

According to the U.S. Bureau of Labor Statistics, employment at nursing homes and residential care facilities dropped every month except one since March 2020. As of July 2021, the sector's employment was 3 million, down 380,000 from February 2020. Fortunately, there has been a recent uptick in the labor supply for lower-skilled and unskilled positions due to shutdown of retailers and restaurants, which often compete for this similar labor pool.

Research shows that understaffed nursing care facilities inevitably suffer quality and patient/resident care issues, including lack of attentiveness to patients/residents, troubling hospital readmission rates, and inadequate facility cleanliness. With so much on the line, such operators must be thoughtful about how to recruit and retain talent both inside and outside their communities. Financial incentives and acknowledgement of candidate concerns can go far, but because most reimbursement is government-related (Medicare and Medicaid), senior care operators have limited long-term options to increase wages while sustaining operations.

M&A activity gains momentum

Despite low occupancy rates, senior housing operators that were in good financial standing before the pandemic may see light at the end of the tunnel this year, despite waning government assistance. With occupancy rates well below historical norms in the upper 80th to lower 90th percentile, however, investors are looking for value-based transactions of struggling properties, and acquisition volume has increased.

According to Irving Levin Associates, the year-to-date August 2021 volume of 238 transactions in the senior housing sector was up 24% over a year ago. Similarly, the year-to-date August 2021 transaction value of $10.98 billion was more than two times the transaction value of $4.4 billion for the same period last year.

In addition, many real estate investment trusts had exited the industry before the pandemic, particularly those with smaller and mid-tier properties prior. More recently, they have been re-entering the market on an opportunistic basis with new purchases.

Access to capital has strengthened as visibility of the senior housing industry rebound has improved and in-place cash flow is stabilizing for a portion of these operators. Capital allocated to the senior housing sector has been in a holding pattern for a very long period, and competition for yield on these dollars likely will equate to higher acquisition pricing/valuation in the coming quarters.

Positive outlook, with challenging unknowns

As the rebounding economy and vaccination and booster rollout take hold, lead generation and occupancy trends appear quite positive. COVID-19 variants, however, certainly could thwart those gains. Adding to this uncertainty are labor trends, which remain highly concerning and are not dissipating.

On the flip side, according to MedicareGuide, the number of Americans using long-term care services is expected to double from 7 million to 14 million by 2065. In the short term those demographics are compelling, with male seniors expected to spend an average of $142,000 on long-term care needs between 2020 and 2024 and female seniors spending $176,000. People aged 65 or more years are projected to spend three to six years in states of mild or severe disability, with the majority of this spend at the end of their lives.

As we assess the post-COVID outlook for the senior housing sector, many factors are at play. Although excessive development may come under control due to market forces, the virus itself remains the most difficult factor to predict. In the meantime, increased access to capital combined with the availability of value-based properties will drive an uptick in merger and acquisition activity in the senior housing sector.

About The Author

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 and assisted living communities, life plan communities, skilled nursing providers, regional health systems, community hospitals, ambulatory surgery centers, home health and hospice organizations and multispecialty physician practices. Caine is a chartered financial analyst and a certified insolvency and restructuring adviser, and he holds a certification in distressed business valuation.

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