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## Seniors Housing Primer

AEW has been an active investor in private-pay seniors housing since the mid-1990s. Since we first began investing in seniors housing, the sector has migrated further into the investment mainstream and has become more accepted by the seniors demographic as the range of housing and service offerings has evolved to better match their lifestyle preferences. At its essence, seniors housing is an expanding real estate product type that provides a mix of real estate, hospitality and care services.



### SPECTRUM OF SENIOR HOUSING OPTIONS

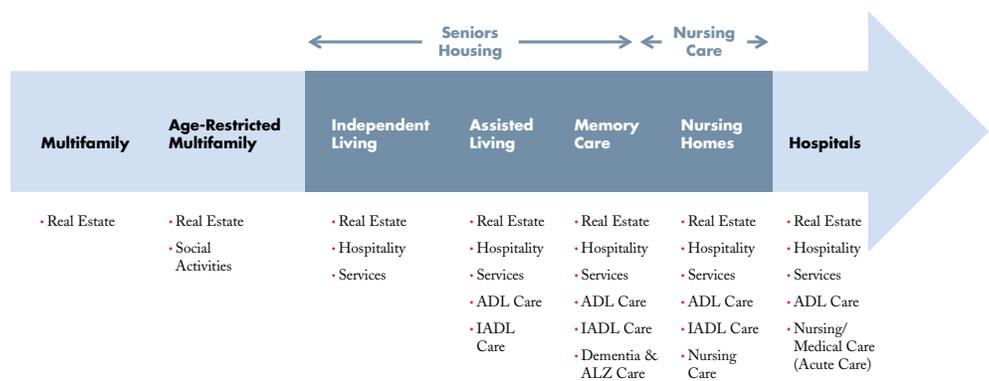
Today’s seniors are different from their predecessors. They live longer, have lower rates of disability, have achieved higher levels of education and live in poverty less often. These characteristics will become more pronounced as the baby boomers mature into the sector, further propelling demand for seniors housing. As a result, seniors housing has evolved beyond the traditional “nursing home.” Today, residential and care options for seniors include a broad array of housing products and services for both younger, more active seniors and older, more infirm seniors. Seniors housing has a unique blend of: (1) a rental component like traditional multifamily; (2) a hospitality and operating company component like hotel investments; and (3) a service and medical component like a skilled nursing facility.

At the least service-intensive end of the spectrum is age-restricted multifamily product, which essentially includes traditional forms of housing (homes, town homes, condominiums, and apartments) that do not provide ancillary services, such

as meals and housekeeping. The age restriction is typically set at 55 years and older. Age-restricted multifamily is essentially an apartment with the vast majority of its revenues from rental fees. A small premium is tacked on for hospitality services such as coordinated activities and transportation to the extent those services are available.

Next along the spectrum are independent-living communities. These communities generally provide apartment or cottage style living in conjunction with hospitality-oriented services including restaurant-style dining, social/educational activities, transportation, and housekeeping. A base level of these services is included in the standard rental fee although some add-on services may be charged separately. Medical services are not provided by the independent living operator due to licensing requirements. However, residents can hire external or third-party medical service providers such as home health providers to deliver additional levels of care within their unit.

**FIGURE 1: Spectrum of Senior Housing Options**



Assisted-living communities typically offer the same hospitality services as independent living with the addition of providing assistance with activities of daily living (ADLs), such as eating, bathing, dressing or personal hygiene.<sup>1</sup> Unlike independent living facilities, assisted living communities are regulated and licensed to provide medical care. The licensure is dictated by the state in which the property is located and each state is slightly different. Different operators have different models and some cater to lower acuity residents, while some choose to serve much higher acuity residents. Staffing models for these communities will be dependent upon the size and acuity levels of the residents and could include 24/7 nursing supervision and oversight.

Further up the care spectrum are memory-care communities, which are designed for people with early- to mid-stage memory issues (Alzheimer’s and dementia). Memory care is often part of a continuum of care with independent living and assisted living, but it may also be provided on a stand-alone basis. This component provides the highest level of medical services and deals with all of the issues surrounding dementia and Alzheimer’s disease. Often times these individuals need assistance with ADL, but that is not always the case, so individual care and service plans are established for each resident based on their needs. Memory care staff includes RNs, LPNs, as well as care aides and activities personnel which means the staff to resident ratios are typically higher than assisted living-only communities.

<sup>1</sup>Activities of Daily Living (ADLs) are defined as routine activities that people tend to do everyday without needing assistance. There are six basic ADLs: eating, bathing, dressing, toileting, transferring (walking) and continence. An individual’s ability to perform ADLs is important for determining what type of long-term care (e.g. nursing-home care or home care) and coverage the individual needs (i.e. Medicare, Medicaid or long-term care insurance).

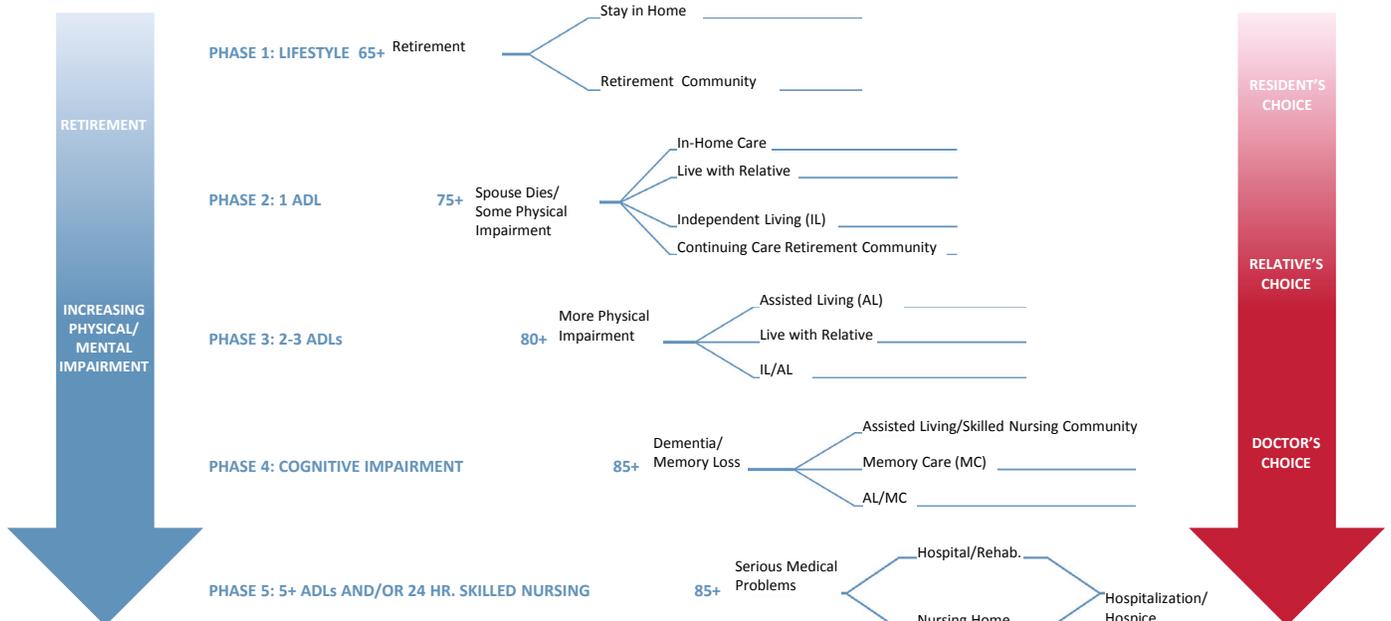
The most medically intensive segment of the market is skilled-nursing or nursing care, which is akin to the traditional nursing home. These communities are staffed by licensed nursing professionals 24 hours per day and provide high acuity services to individuals often requiring assistance with four or more activities of daily life. While there are private-pay nursing care communities, a large share of residents in these facilities rely on public funds (e.g. Medicare and Medicaid) to pay for rent and services. While not a focus for AEW, both public and private investors are active in this product.

**DEMAND COMPOSITION**

The demand dynamics behind the spectrum of senior housing options is somewhat intuitive. It often begins with the lifestyle decisions made around retirement and adjusts through the aging process as the need for assistance increases over time. Life events such as retirement, the death of a spouse or physical/mental impairment are often the time at which decisions around the staying at home versus moving into a seniors community are made. In addition to the lifestyle choice, the ability to stay at home versus move is partially dictated by financial standing, but is also dependent upon the availability of one or more family members to provide assistance. Family dynamics have been shifting gradually over the past several decades influencing the availability of the adult children (or caregiver) to provide ongoing direct support at home. The rise in dual-working or dual-income families is reducing the time available for an adult child (often times the oldest daughter) to provide the necessary care giving services to their parents. The time requirement from a caregiver clearly rises as the senior’s need for assistance increases.

Perhaps somewhat less intuitive throughout the aging process is the shift in decision making capability of the senior as the level of acuity or cognitive impairment increases. While the ability of an individual to make clear decisions often deteriorates along with these impairments, the choice of which lifestyle path is most desirable also shifts from resident to the relative and ultimately to the doctor when serious medical conditions require constant attention. In the private-pay seniors housing space, the chart below presents a good representation of the decision process that links these dynamics with the continuum of housing options presented earlier.

**FIGURE 2: Aging Process and Housing Options**



**Impact and Influence of Adult Children on Demand for Seniors Housing**

Demand for seniors housing is frequently driven by the location of adult children, who are increasingly recognized as an important and often critical decision maker for assisted living in most instances, and for independent living in some instances. The influence of the adult child often increases with higher acuity needs. Typically seniors in their early- to mid-80s relocate to be near their children after having initially retired to other locations, frequently in the warmer climate regions of the country.

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The adult children cohort – the population between the ages of 45 and 64 – is growing, but at a slower pace than the overall population as this cohort straddles the baby bust (GenX) and baby boomer generations. However, both their sheer numbers – 84 million adult children– and their financial well-being are important because adult children create additional demand as they assist in the provision of housing for their aging parents. From an investor perspective, the demographics of both age cohorts factor into the feasibility analysis in determining the depth of demand in a particular location for seniors housing, especially in the assisted living and memory care segments, where the adult child more heavily influences decision making.

**MARKET COMPOSITION**

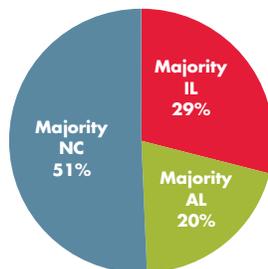
The typical seniors housing rental campus is either a standalone community with one level of care (e.g. memory care) or a combined community with multiple levels of care (independent living, assisted living and/or memory care). The combined rental product is becoming a lifestyle preference for both seniors and adult children who seek “one-stop-shopping” for their aging parents. This option provides the ability for the senior to age in place without the up-front financial commitment of the entrance fee model or the disruption of a move.

Today there are more than 2.8 million seniors housing and nursing care units in the United States with an estimated market value of over \$300 billion and growing. Nursing care communities currently represent roughly half of the units and about one third of the value for all seniors housing communities although their share has been falling over time. As independent living and assisted living communities have become more popular as a lifestyle choice, the majority of net new construction has occurred in these property sectors. These trends are likely to continue going forward.

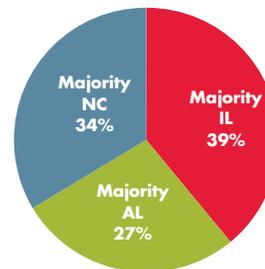
**FIGURE 3: U.S. Size by Property Type and Unit Type in the U.S.\***

Property Type	Properties	Units	Price Per Unit	Implied Value
Majority IL	3,700	825,000	\$144,000	\$118,800,000,000
Majority AL	7,500	579,000	\$144,000	\$83,376,000,000
Majority NC	10,900	1,443,000	\$71,000	\$102,453,000,000
<b>Total</b>	<b>22,100</b>	<b>2,847,000</b>	<b>\$107,000</b>	<b>\$304,629,000,000</b>

**Share of Units**



**Share of Value**



Source: NIC Research, AEW Research

\*As of Q4 2014. Estimates are representative of properties with at least 25 units/beds that charge market. One nursing bed is equivalent to one unit

## GEOGRAPHY AND MARKET SELECTION

Unlike other real estate sectors, seniors housing investment can be compelling in primary, secondary or even tertiary markets, similar to community retail centers (grocer and drug anchored). In AEW's experience, total returns on seniors housing are less about the market (first-tier versus tertiary) and more about the underlying income demographics of seniors and adult children (decision makers) as well as the market's supply/demand characteristics. Relative to other property types, there is generally less pricing disparity for stabilized assets in a first-tier market with strong underlying demographics and secondary markets with strong underlying demographics.

The more relevant geographic analysis for seniors housing focuses on the surrounding trade area. For a typical suburban-located community, the primary trade area tends to extend between five and ten miles from the property with about 70% of total demand expected to come from within the primary trade area. Some of the more important trade area characteristics utilized to determine the relative depth of market for a private-pay community include:

- number and growth of seniors
- number of seniors above certain income thresholds (different by product)
- number and growth of adult children households above a particular income threshold (typically \$75,000 or \$100,000)
- housing values (a good proxy for wealth)
- competitive landscape (number, type & unit mix, age, quality, operator)
- trade area performance (occupancy, rents)

**In addition to income, a senior's household wealth is an important component in determining the depth of demand and affordability of seniors housing.**

## SOURCES OF FUNDING FOR THE RENT PAYMENT

In general, multiple resources are available to help pay the monthly rent and the ancillary service fees associated with seniors housing. For a broad segment of the seniors housing market, most notably nursing care, public funding sources are also available (e.g. Medicaid), but the focus of this report is on private-pay seniors housing.

The primary financial resource is the income of the seniors themselves. Nationally, the median household income for the 75-plus cohort is estimated at \$29,512 per year in 2015 according to Claritas, Inc. The primary sources of this income is typically Social Security benefits, an employer-sponsored pension (about half the workforce is covered by an employer-sponsored pension either through a defined benefit (DB) plan or a defined contribution (DC) plan<sup>2,3</sup>), veterans benefits and investment income such as dividends or interest. For many, income alone is not sufficient to cover the cost of rents and services for the average senior housing unit. According to NIC, this cost is about \$4,250 per month or \$51,000 per year which implies that additional resources necessary to cover the average expenses at a seniors housing community are near \$20,000 annually. For memory care the figure is higher, while for independent living the figure is much closer to median income of seniors. It is important to keep in mind that these figures reflect averages and that demographics and incomes often vary dramatically by location. Feasibility analysis is an important tool for investors determining the depth of demand relative to supply for a particular investment.

<sup>2</sup>Congressional Research Service, "US Household Savings for Retirement in 2010", John J Topoleski, July 23, 2013

<sup>3</sup>The major sources of income as reported by older persons in 2009 were Social Security (reported by 87% of older persons), income from assets (reported by 53%), private pensions (reported by 28%), government employee pensions (reported by 14%) and earnings (reported by 26%) according to "A Profile of Older Americans: 2011", U.S. Department of Health and Human Services

**FIGURE 4: Private-Pay Rents and Level of Service**  
**Monthly (Annual) Asking Rent by Unit Type as of Q4 2014**



Source: NIC Research, Real Capital Analytics, AEW Research

Note: Rents are the average asking private-room rent plus the average fee for care services.

In addition to income, a senior's household wealth is an important component in determining the depth of demand and affordability of seniors housing. Household assets include both financial assets (such as checking accounts, savings accounts, stocks, bonds, mutual funds, defined contribution retirement accounts (DCs)<sup>4</sup>, IRAs and the cash value of life insurance) and non-financial assets (such as housing and other real estate assets, vehicles and businesses). Seniors may also have long-term care insurance policies that are specifically held to pay for senior care rent and services. The Congressional Research Service analysis of the 2010 Survey of Consumer Finances (SCF) estimates that in 2010, the median net worth of a married household older than 74 was \$295,870 and for single households it was \$151,900. Of this, the median share of net worth held as equity in a primary residence was roughly 55%. While the most recent recession took a bite out of household net worth, wealth is now back to pre-recession levels, which suggest that more households have the means to pay the services associated with seniors housing.

Equity in a primary residence is a particularly important component of wealth for lower income, older households<sup>5</sup>. In most cases the sale of the home is a precursor to moving into a seniors housing community. Approximately 80% of seniors aged 75 to 84 own a home, with that number being slightly lower at 76% for those older than 85<sup>6</sup>. While the recent bust in the housing market eroded residential equity for many seniors (home values fell 28% from a median existing home value of \$226,337 in late 2005 to \$163,450 in late 2011 (NAR data), home prices have since recovered to within 7% of their previous peak reaching \$211,592 at year-end 2014.

<sup>4</sup>Note in the calculation of household net worth, proceeds from DB pension funds is considered income and not household net worth; i.e., it is not measured in the Survey of Consumer Finance

<sup>5</sup>www.NAHB.org/NAHBSELECT "Homeownerships remains a key component of household wealth" by Michael Neal, National Association of Home Builders, September 3, 2013

<sup>6</sup>Center for Housing Policy, "Housing an Aging Population: Are we Prepared" and "Housing for Older Adults: Impact of the Recession", Rodney Harrell, 2011

Finally, financial support from the adult children who are often the key decision makers regarding moving seniors into the more needs-based segments are important. For adult children, the decision to move an aging parent into seniors housing is both a financial choice and a needs-based choice. Anecdotal evidence suggests that even during the Great Recession, need-based seniors housing services remained a high priority for adult children, while other choice-based services were postponed or canceled. Along with the senior, the adult child has also seen household net worth return back to pre-recession levels providing an additional cushion and level of confidence that they are in a financial position to help. Moreover, the adult children of the 80-plus cohort, most of whom are baby boomers, have the means, the desire and the heft (about 84 million Americans are aged 45-64) to provide supplemental support for their aging parents.

## CONCLUSION

AEW has been an active investor in private-pay senior housing since the mid-1990s and continues to find the sector to be an attractive investment opportunity for many reasons. Compelling demographic trends are in place with the number of seniors (people age 75 and older) expanding at roughly twice the pace of the general population. This will accelerate to three times that over the next five years and even faster over the following decade. Over the past ten years, the sector has proven to be recession-resilient by maintaining positive rent growth throughout the last economic downturn. This translated into strong relative performance for seniors housing with annualized 10-year total returns of 14.7% compared to 8.4% for the NCREIF NPI, according to NCREIF.<sup>7</sup> Over the past year, the outperformance has been more pronounced, helped by strong underlying fundamentals with occupancies moving above the 90% mark in 2014, driven by solid demand that continued to outpace supply by a healthy margin.

The broader U.S. economic expansion is benefiting seniors housing along with the other commercial property sectors. In particular, the stronger labor market, an improved housing market, and better wealth metrics benefit the mobility and financial capability of a senior deciding to move to a seniors housing community. Seniors housing is evolving into a sector that offers a broad spectrum of alternatives that align much better with what is demanded from prospective residents and their adult children. As a result, the sector is increasingly being accepted by institutional investors. Much like the evolution of the multifamily sector as an institutional investment in the 1970s and 1980s, seniors housing is evolving from an “emerging” component of commercial real estate investment portfolios.

Prepared by AEW Research, May 2015

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<sup>7</sup>As of fourth quarter 2014. The seniors housing data currently resides in NCREIF’s “other category” and is not part of the NPI index. For NCREIF purposes, seniors housing does not include traditional institutional “nursing home” facilities, but rather it is comprised of assisted living and independent living facilities that make up the narrower definition of senior housing. AEW believes the senior housing assets in NCREIF are reflective of the broader institutional private-pay market.