AEW RESEARCH

# Seniors Housing Research Perspective

Q2 2022

AEW

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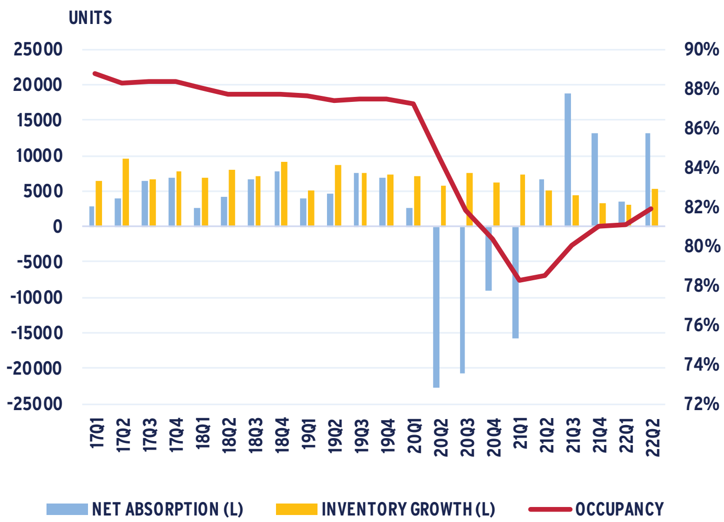
# Seniors Housing 2Q Market Update

The seniors housing recovery maintained its momentum in the second quarter as the typical seasonal factors faded translating into more material occupancy gains which is consistent with expectations. Demand remains elevated with large market players and REITs reporting absorption above pre-pandemic levels, in-line with the dynamics we are experiencing across our portfolio. Omicron was a speed bump in momentum with limited disruption to resident activities and overall operations in the first quarter and so far in Q2, the rise in other variants has not been as impactful given high vaccination rates and effective protocols. Operators have been able to maintain a high degree of normalcy providing the socialization benefits and activities that remain a big part of the sector's value proposition.

After a revised 10 bps increase in Q1, seniors housing occupancies increased 80 basis points in the second quarter to 81.9% across the primary and secondary markets tracked by the National Investment Center for Seniors Housing & Care (NIC). Aggregate net absorption returned to the robust pace seen over the second half of last year, eclipsing 13,000 units for the quarter or almost twice the 7,500-unit pace of a typical pre-pandemic second quarter adding conviction to the durability of the recovery. For perspective, net absorption is running at a 6.0% annual pace, notably higher than deliveries, which have slowed to an annual pace of 1.5%.  The needs-based sectors continued to lead the pace of recovery although gains were widespread. Occupancies for majority assisted living properties increased 100 bps in Q2 to 79.2% while majority independent living assets rose 70 bps to 84.5%

**SENIORS HOUSING FUNDAMENTALS TREND***




Source: NIC MAP Data Services; *Primary and Secondary Markets

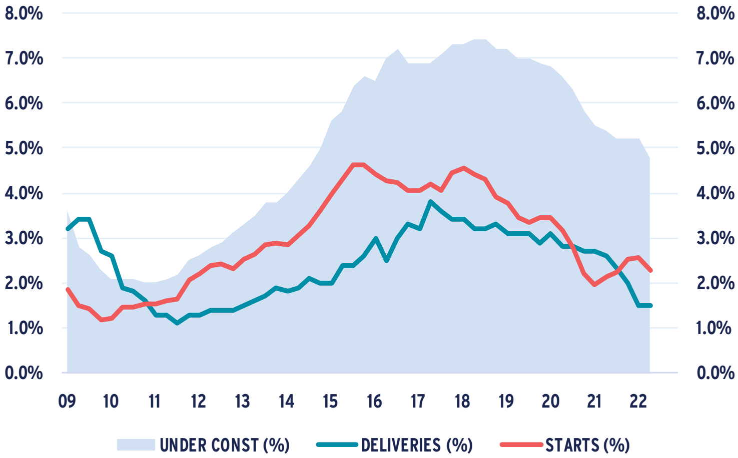
**SENIORS HOUSING MARKET FUNDAMENTALS**
**PRIMARY AND SECONDARY MARKETS**

| | 2022Q2 | 2022Q1 | 2021Q4 |
|---|---|---|---|
| PROPERTIES | 8472 | 8446 | 8367 |
| UNITS | 1,053,097 | 1,047,761 | 1,037,027 |
| OCCUPANCY | 81.9% | 81.1% | 78.5% |
| STABILIZED OCCUPANCY | 83.5% | 82.7% | 80.6% |
| MEDIAN OCCUPANCY | 85.0% | 84.0% | 80.7% |
| ABSORPTION | 13,152 | 3,412 | 6,676 |
| ANNUAL ABSORPTION | 6.0% | 5.2% | -4.6% |
| INVENTORY GROWTH | 5,336 | 3,077 | 5,105 |
| ANNUAL INVENTORY GROWTH | 1.5% | 1.5% | 2.6% |
| PROPERTIES UNDER CONSTRUCTION | 475 | 508 | 542 |
| UNITS UNDER CONSTRUCTION | 50,673 | 54,660 | 55,875 |
| CONSTRUCTION VS. INVENTORY | 4.8% | 5.2% | 5.4% |
| AVERAGE RENT | $4,515 | $4,476 | $4,319 |
| ANNUAL RENT GROWTH | 3.8% | 3.5% | 1.6% |

Source: NIC MAP Data Services

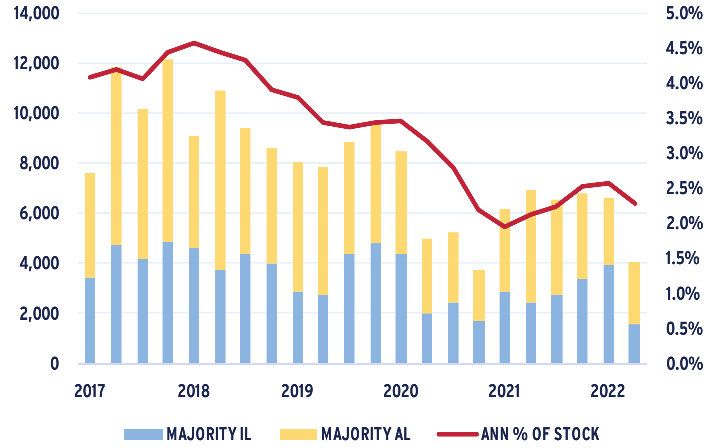
Supply side dynamics continued to show an unwinding pipeline. Roughly 50,600 units, or 4.8% of existing inventory, were under construction during the quarter with the pace of new projects breaking ground (new starts) dropping from 3.5% of existing inventory in 2018 to ~1.9% early in 2021 before settling slightly higher at a 2.3% annual pace in Q2. Putting revisions aside, it is difficult to see new construction rising above current levels as the FOMC lifts rates more aggressively and construction costs remain elevated. Bank loan officers are reporting tighter construction lending standards, adding another governor on new construction.

### SENIORS HOUSING SUPPLY PIPELINE (% OF INVENTORY)




Source: NIC MAP Data Services; Primary and Secondary Markets

### SENIORS HOUSING CONSTRUCTION STARTS (UNITS)

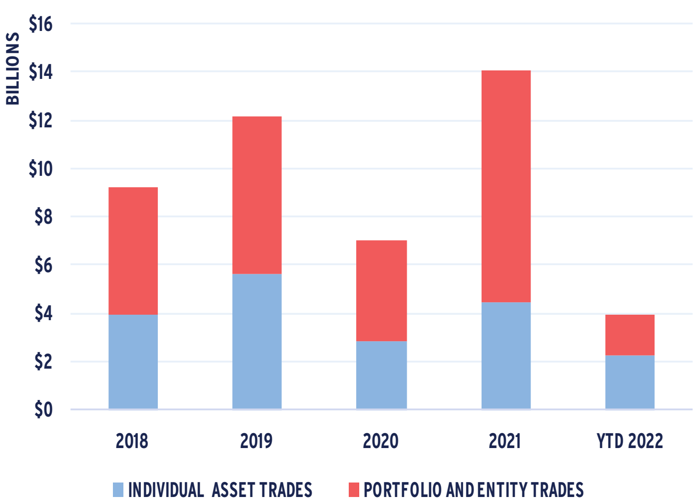



Source: NIC MAP Data Services; Primary and Secondary Markets

Operators continue to face a challenging labor environment both in terms of wages and availability. Pressures have eased somewhat over the past several months with many operators able to reduce agency usage and fill more full-time roles, helping to bring expenses more in focus. Exceptions have been more operator specific or in locations where COVID cases have reemerged. The revenue side has also turned more positive. While rent concessions and other incentives are prevalent, more operators are noting the ability to move rents, especially at communities where occupancies are approaching stabilized levels. NIC data reflects a similar pattern of strengthening rent growth on a broader perspective with needs-based communities at the forefront.

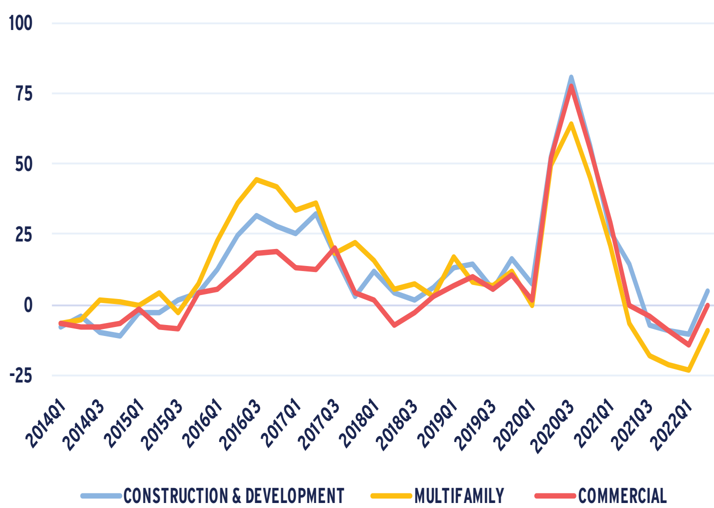
The transaction market has been off to a relatively slow start this year, reaching $3.9 billion in trades through mid-year. Activity is running just ahead of 2020 at the height of COVID but tracking well behind last year's pace that ended the year with over $14 billion in volume. The primary difference to date has been the lack of sizable portfolio deals mostly involving REITs while individual asset trading volume has remained consistent. Core assets continued to receive the most aggressive pricing while more recap and distressed individual deals are making their way to market. Buyers are underwriting lower NOI and margins in the first few years followed by material growth. Institutional capital remains patient, accounting for 20% of trades as both buyers and sellers continue to gauge the pace of near-term recovery and near-term capital market volatility while also maintaining confidence in the longer-term drivers.

### SENIORS HOUSING TRANSACTION VOLUME




Source: Real Capital Analytics (RCA)

### PERCENT OF LOAN OFFICER REPORTING TIGHTENING CONDITIONS




Source: Federal Reserve Board (FRB)

Lenders remain cautious on new loans and accommodating on existing loans to clients with assets managed by proven operators and strong institutional sponsorship. Covenant defaults are more prevalent although lenders have been flexible in return for credit support. Agencies (Fannie Mae and Freddie Mac), banks and insurance companies have maintained liquidity in the space, while the debt funds have pulled back more notably. Pressure on rates and spreads is being felt given the most recent interest rate moves by the FOMC and spreads have widened somewhat due to rising volatility across the capital markets, which is weighing on transaction volumes and pricing headed into summer. The pullback from lenders to date has been less severe than what is occurring across the CRE market generally given positive conviction for the sector based on strengthening demand dynamics and the positive longer-term trends associated with aging demographics.

Overall, current momentum in underlying fundamentals is encouraging, with solid resident move-in velocity, rising occupancies and a reduced supply pipeline all benefitting rents. That said, there remains a way to go before occupancies and NOIs are back to previously stabilized levels keeping pressure on margins. The FOMC’s more aggressive posture on inflation has increased volatility across the capital markets with higher rates and wider spreads across the broader commercial real estate market, including seniors housing, which deserves closer attention. Overall, we anticipate fundamental conditions will continue to improve from current levels over the course of 2022 while transaction activity may slow as investors digest the heightened volatility across the capital markets.

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