AEW RESEARCH

Seniors Housing Research Perspective

Q4 2023

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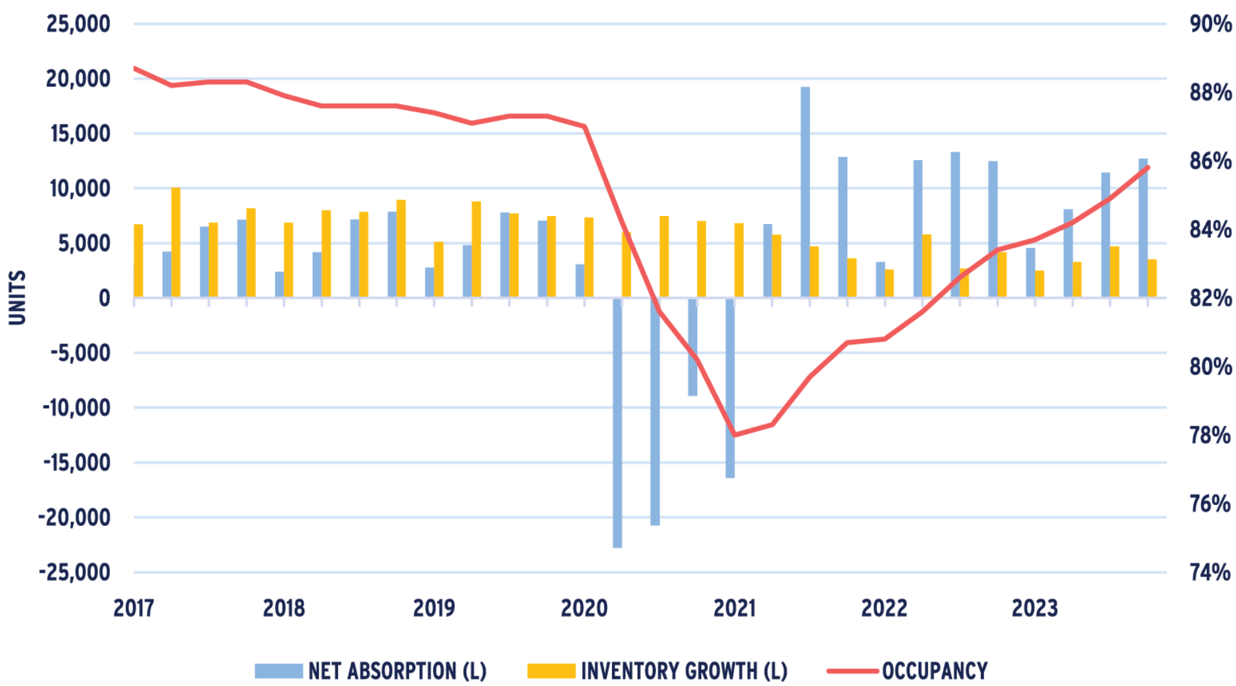
Seniors Housing 4Q Market Update

It's difficult not to be excited about the prospects for seniors housing in 2024. While capital market dynamics continue to weigh on assets and portfolios that were constructed at peak valuations with variable rate debt when borrowing costs reflected a different rate environment, the strength of the underlying fundamentals driving top-line revenue growth are difficult to ignore. Demand remained robust though 2023 with momentum expected to carry forward over the long term as the push from demographics and the need for third-party (non-family) care persists, all at a time when building new product remains constrained. Acceptance of the product has proven out after a health crisis that few anticipated would be so severe supported by new studies[1] helping confirm the health benefits of living in a seniors housing community. Capital market pressures have clearly altered the current valuation landscape presenting challenges for owners lacking time and/or the resources to fully participate in the recovery. Correspondingly, an attractive opportunity exists for putting new capital to work. These dynamics became more evident in the fourth quarter as the underlying demand recovery continued, expense growth normalized and transaction activity showed renewed signs of life.

Resident demand maintained its healthy recovery for the tenth consecutive quarter with occupancies adding 90 basis points (bps) in the fourth quarter to 85.9%, rising to within 140 basis points of pre-pandemic levels across the primary and secondary markets tracked by the National Investment Center for Seniors Housing & Care (NIC). Tightening conditions provided operators the ability to pass through 8%-10% rental increases in 2023 and to budget for additional increase in the 6%-8% range for 2024. With inflation and expense growth moderating to the 3%–4% range, real rent increases are being achieved with NOI growth well into the double digits leading to margin compression. Expense growth will likely remain the governor to driving NOI and margins with top-line revenue showing continued strength.

SENIORS HOUSING FUNDAMENTALS TREND: PRIMARY AND SECONDARY MARKETS



Source: NIC Map Data Services
As of Q4 2023

[1]*Source: NORC at the University of Chicago; National Investment Center for Seniors Housing and Care (NIC). "Vulnerability to Adverse Health Outcomes Amongst Senior Housing Residents", September 2023*

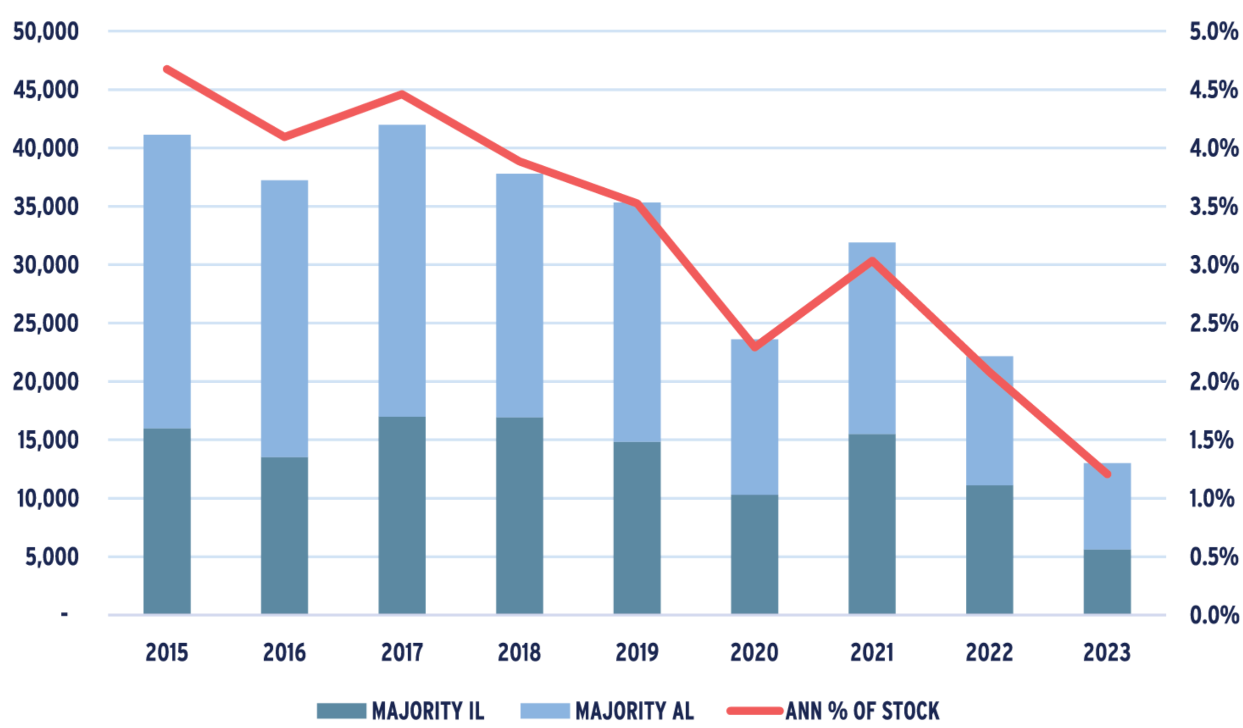
SENIORS HOUSING MARKET FUNDAMENTALS: PRIMARY AND SECONDARY MARKETS

	2023Q4	2023Q3	2022Q2
Properties	8,634	8,606	8,546
Units	1,079,878	1,076,364	1,065,914
Occupancy	85.8%	84.9%	83.4%
Stabilized Occupancy	87.0%	86.0%	85.0%
Absorption	12,702	11,421	12,453
Annual Absorption	3.6%	4.2%	5.1%
Inventory Growth	3,514	4,680	4,154
Annual Inventory Growth	1.3%	1.4%	1.4%
Properties Under Construction	384	408	496
Units Under Construction	43,088	45,924	53,149
Construction vs. Inventory	4.0%	4.3%	5.0%
Average Rent	$4,932	$4,900	$4,671
Annual Rent Growth	5.0%	5.7%	5.2%

Source: NIC Map Data Services

The positive trend in supply-side dynamics continues to improve with the pipeline of new supply ratcheting lower. Roughly 43,000 units, or 4.0% of existing inventory, were under construction at year end with the pace of new projects breaking ground (new starts) at ~1.2%. Thus far, there has been little indication of a reversal in this trend as the FOMC maintains its hawkish stance on inflation by keeping interest rates at current levels at least through 2024 Q2. Financing for new construction remains scarce with tight lending standards adding another governor to new projects breaking ground. From an investment perspective, it remains difficult to justify the return-on-cost to build relative to buying existing product. AEW is experiencing the ability to access quality assets at below replacement cost.

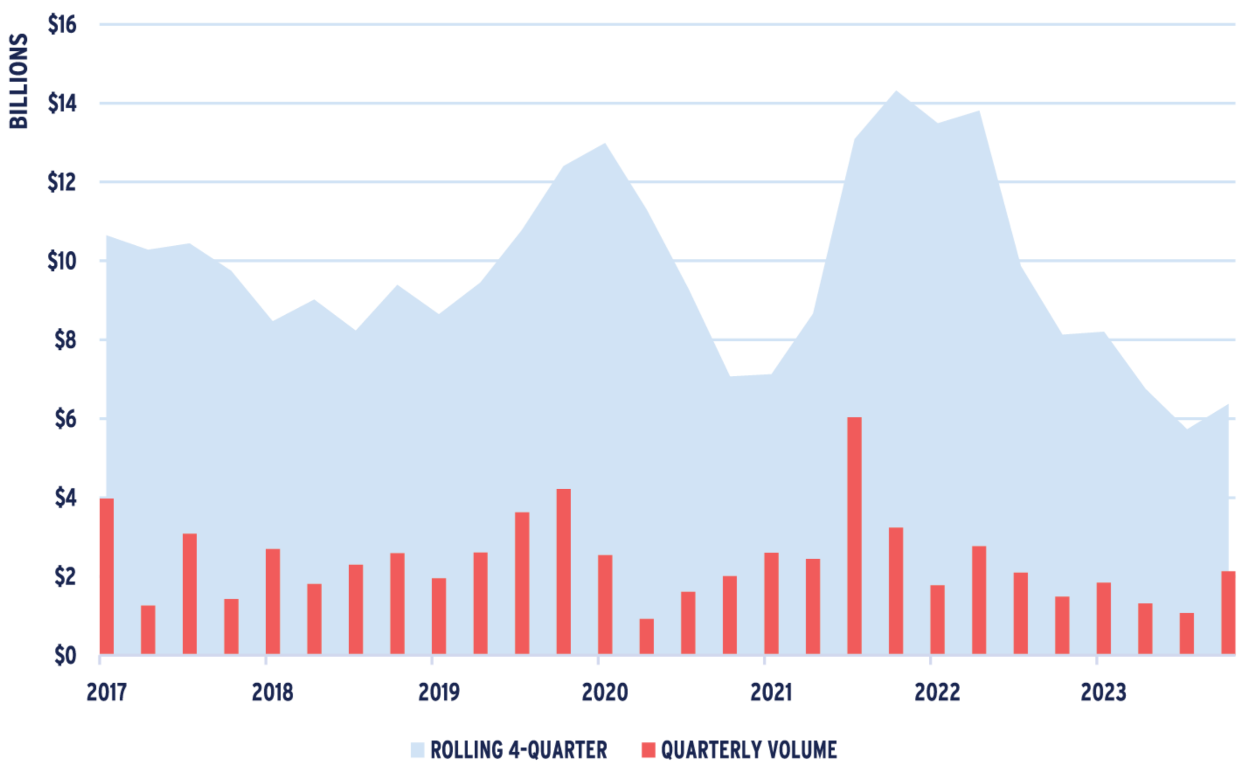
SENIORS HOUSING CONSTRUCTION STARTS



Source: NIC Map Data Services
As of Q4 2023

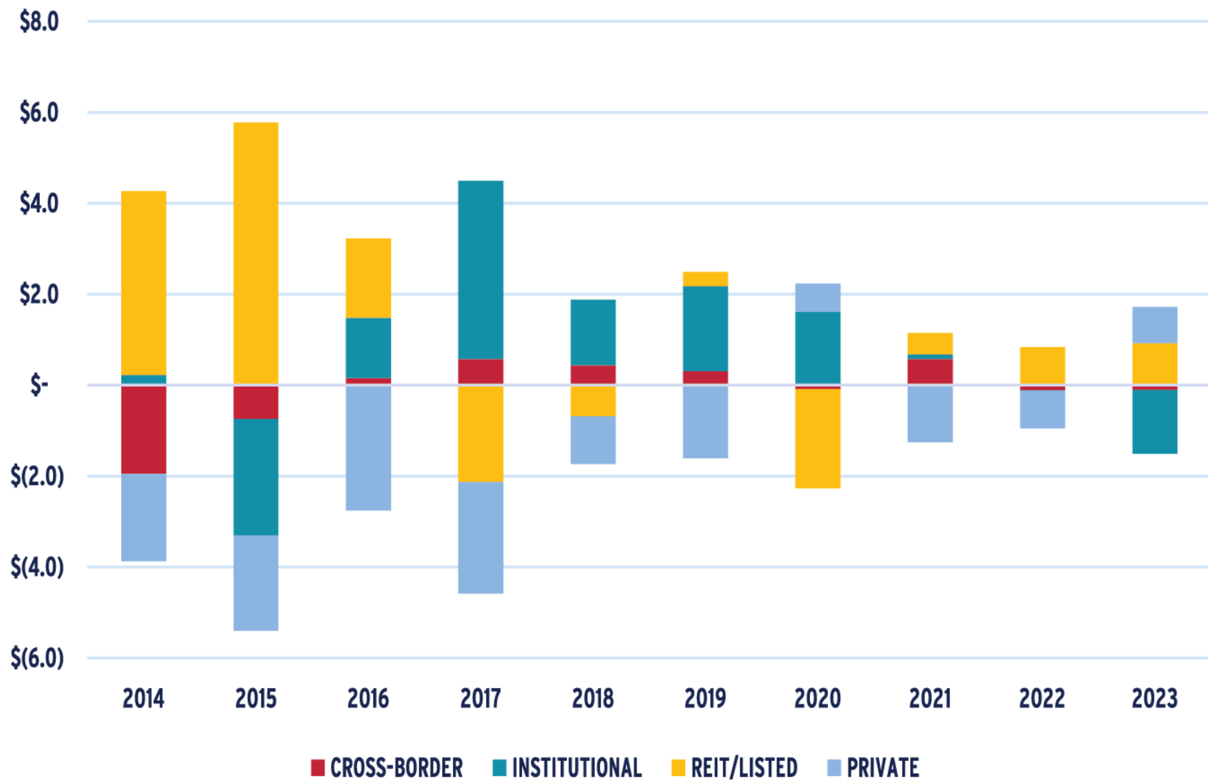
Aggregate transaction volume was $6.4 billion in 2023, down ~22% for the year although roughly the same number of assets changed hands. That said, the fourth quarter registered a notable uptick in momentum both in terms of dollars and number of deals. Public REITs were the most active net buyers along with private owners while institutional capital remained a net seller. Smaller portfolio trades (2+ assets) accounted for most of the increase driven by maturing debt, fund life pressures and transient owners reducing their exposure. Covenant defaults remain prevalent on existing loans and, while lenders have been flexible in return for credit support, the extended recovery and evolving bank stress is adding a layer of difficulty to modifying loans that often require some level of paydown or credit support from borrowers. Select deals are transacting typically on an all-cash basis or with assumable financing. Top sponsors working with quality operators remain in the pole position in the eyes of banks and insurance companies, while bridge financing from the debt funds remains costly.

SENIORS HOUSING TRANSACTION VOLUME



Source: MSCI/RCA
As of Q4 2023

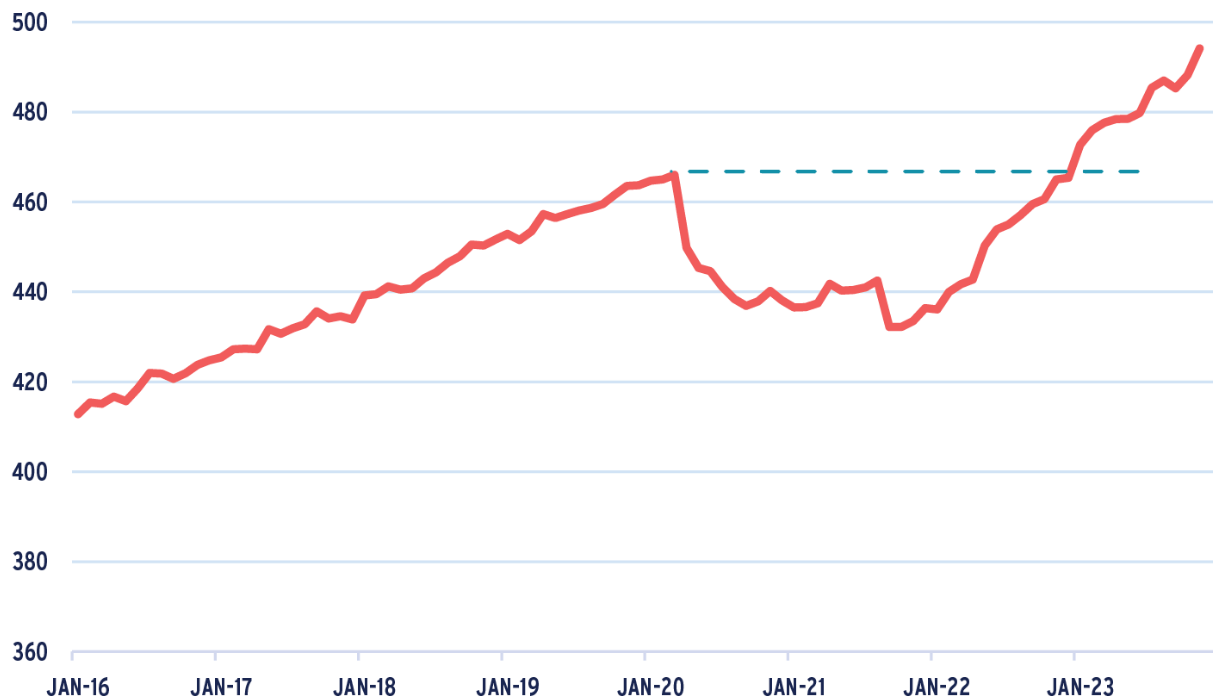
NET TRANSACTION VOLUME BY TYPE ($BILLIONS)



Source: MSCI/RCA
As of Q4 2023

Operationally, both labor availability and cost dynamics continue to improve with operators reporting limited need for contract labor that is in-line with pre-pandemic levels outside of select situations, adding stability to managing expenses. Combined with the ability to push rents, this is allowing operators to drive higher NOIs and margins. This is especially true for communities where occupancies are approaching or have moved above previously stabilized levels.

ASSISTED LIVING FACILITIES EMPLOYMENT (THS.)



Source: Bureau of Labor Statistics
As of Q4 2023

Overall, the underlying fundamentals continue to improve with solid demand, rising occupancies and a reduced supply pipeline all benefitting rents and top-line revenue growth. The sector remains in recovery mode with margins still under pressure as NOIs work their way back toward previously stabilized levels. That said, with each passing quarter the income picture improves. Those without the luxury of time or the ability to manage their capital stack face a higher level of urgency. The FOMC's posture of holding firm on rates, especially with the economy surprising to the upside remains one of the biggest disruptors for seniors housing and CRE more broadly. That said, seniors housing continues to differentiate itself with measured improvement in fundamentals and healthy demand tailwinds. Leveraged assets with misaligned capital structures remain the biggest challenge for owners in the current environment, but we believe these dynamics can also present the most attractive opportunities to place for new capital as values and margins adjust.

Additional Notes

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