HEALTHCARE & SENIOR HOUSING REPORT

NAVIGATING NEW NORMALS

By: Vic Cremeens, MAI, Managing Director
IRR's Healthcare & Senior Housing Practice Group

The healthcare and senior housing sector is emerging from the pandemic's challenges with a renewed focus on recovery and adaptation. These markets, vital for an aging population, are experiencing shifts in operational dynamics, occupancy rates, and financial structures. IRR's extensive analysis highlights how increased construction costs, evolving Medicaid policies, and changing interest rates are influencing the landscape. Despite these pressures, there are positive signs of recovery, with occupancy rates gradually improving and the market adapting to new operational norms. Dive into our detailed report for a comprehensive understanding of how these sectors are reshaping in response to current economic and demographic trends.

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Overview

The senior housing and healthcare markets have moved past the abyss of the pandemic, an era of great uncertainty and weak operating performance. Operations are recovering in conjunction with improvements in occupancy and stabilization of the industry's workforce. Higher interest rates are limiting construction and setting the stage for further recovery. Sales activity has slowed with the higher rates, which seem likely to ratchet back down as inflation decreases.

Construction

In general commercial construction costs have risen dramatically in the last couple of years. Per Marshall Valuation Service, construction costs are generally 15% to 30% higher now than they were in mid-2021, with wood frame construction in the lower portion of that range and steel frame construction in the higher portion.

In most segments, senior housing construction starts have slowed since 2022. In general, they remain well below pre-pandemic levels because construction and borrowing costs are higher. ess construction will benefit future net absorption, helping many existing facilities reach their pre-pandemic occupancy.

Absorption and Occupancy Recovery

NIC MAP data from the third quarter of 2023 reveals ongoing occupancy gains in senior housing as absorption outpaces new additions to the supply. Senior housing occupancy rates rose to 84.4% over nine quarters, rebounding from a low of 77.8% in the second quarter of 2021 and approaching the pre-pandemic first-quarter 2020 rate of 87.1%. The occupancy rate for majority IL facilities is 86.1%, compared to 82.6% for majority AL facilities. Occupancy in majority SNFs is reportedly 82.4%, which remains below the pre-pandemic occupancy of 86.6% recorded in the first quarter of Q1 2020, but well above the pandemic low of 74.0% from the first quarter of 2021. At the recent pace of net absorption, senior housing occupancy levels are expected to reach or exceed pre-pandemic levels in 2024.

Inflation and Interest Rates

Inflation spiked in 2021 and 2022 due to various pandemic-related factors, including disruption in the supply chain, record numbers of people leaving the workforce and a tightened labor market, and loose monetary policy. In its effort to combat inflation, the Federal Reserve has raised interest rates multiple times since March 16, 2022. The Fed funds rate is now in the 5.25% to 5.5% range, its highest level in over 20 years. Consensus forecasts for inflation in 2024 are under 3.0%. Lower inflation would allow the Fed to reduce interest rates; thus, borrowing costs would decline, making healthcare and senior housing acquisitions more affordable and new construction more financially feasible.

Medicaid SNF Reimbursement

The Keiser Family Foundation (KFF) conducts an annual state survey of Medicaid reimbursement policy for fee-for-service activity –– States Reporting Provider Rate Increases. Per that survey, for SFY 2023, 43 states raised nursing facility rates. This compares with 44 states in SFY 2022.

During the pandemic, the federal match for Medicaid funding was enhanced by 6.2%, which helped replace state spending on the program. In 2023, the enhancement was being phased out, ending December 31. States will need to spend more to maintain the nursing facility rate increases made in 2022 and 2023, and provider rates could be a target to hold down spending.

CMS Proposes Minimum Staffing Standards for SNFs

In September 2023, in an effort to improve resident safety and promote high-quality care, the Centers for Medicare & Medicaid Services (CMS) issued a proposed rule for national minimum staffing standards for nursing homes participating in the Medicare and Medicaid programs. The proposed standards include "hours per resident day" for registered nurses (RN) and nurse aides, plus a requirement to have an RN onsite 24 hours a day, seven days a week. A subsequent report from CliftonLarsonAllen suggests that a large majority of facilities do not presently meet the proposed staffing mandate criteria.

The nurse shortage that was greatly exacerbated by the pandemic remains a hardship for health care providers Needless to say, there will be challenges to meeting these requirements, which seem likely to take effect in the not-to-distant future. There is concern that the staffing mandate and nurse shortage will contribute to higher wage rates and tighter operating margins. Ultimately, higher Medicare and Medicaid reimbursement rates would likely reflect the rise in workforce costs.

Prices per the SeniorCare Investor

Higher interest rates and less aggressive lending terms are holding down prices for properties. Operating margins are still under pressure due to inflation, modest unemployment, and the aforementioned nurse shortage, but most facilities have been able to implement rate increases to offset much of their higher operating costs. The pandemic-era grants that eased the financial operating burden during the pandemic have also ended. Until operating margins restabilize and borrowing costs decline, senior housing values are likely to remain below pre-pandemic levels.

Generally, the market is active but somewhat slower than 2022 due to the current operating and lending environments. Owner-operators have the greatest buying presence, while institutional and private equity interest is more muted. Struggling facilities have been a larger slice of the available properties for sale. SNF values were particularly strong in 2022, declining somewhat in 2023, although capitalization rates remain low by historical standards. While SNF values have remained high, this segment provides notably greater yield opportunities than senior housing.

In Closing

Senior housing capitalization rates increased modestly in 2023 from the relatively low rates in 2022. SNF cap rates have been trending lower than any time in recent history. There has been some compression of the capitalization rate-spread for different classes of property, with higher interest rates having the greatest impact on the low cap rate (aggressive) purchases. Higher operating costs have been offset by higher private pay rates of 3.0% to 7.0% generally, and by higher Medicaid rates in most states. Among industry participants, there tends to be more optimism for assisted living, active adult, and SNF investments, and less for independent living and memory care.

SOURCES & REFERENCES

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