Rising CRE Lending Opportunities in Senior Housing

lending CRE

Summary: Due to an aging population, demand for senior housing is expected to grow. As occupancy rates rise and margins improve following a pandemic slump, investment in the sector should rebound. We consider the lending environment, the size of the opportunity, and what it takes for a CFI to succeed in this market.

Life expectancy across the globe has increased dramatically over the past couple of centuries. In 2021, the world average was 70Ys, while in 1800, no region recorded a life expectancy higher than 40. Improvements in medicine, nutrition, public health, sanitation, and economic conditions are at the heart of this staggering change. Here in the US, upon reaching the age of 65, men can look forward to an average of 17 more years of life, while women can expect to live for another 19.7Ys on average. That adds up to a growing elderly population, many of whom will seek out housing specifically for seniors, especially as the populous baby boomer generation enters their retirement phase.

The senior housing market has had a rocky couple of years, with depressed occupancy rates, inflated staffing costs, and high interest rates hampering investment. However, there are signs of a recovery. Occupancy rates are on the rise — though still not back to the pre-pandemic national average of 87.3%, they increased from a low of 77.7% in Q2 2021 to 83.7% in Q2 2023. A demand-supply imbalance should further boost occupancy rates. Meanwhile, labor costs, which suffered from the need to resort to temporary agency staffing during the pandemic and beyond, are easing. One operator noted that its use of agency labor declined by 50% in the last year. Interest rates have also stabilized, restoring some confidence in capital markets. We consider what these trends might mean for community financial institutions (CFIs).

A Growing Market

The National Investment Centers for Seniors Housing & Care (NIC) estimates there are currently 24.5K investment-grade senior housing and care properties comprising 3.1MM units in the US, a market worth around $475B. Welltower, the largest REIT owner of senior housing, expects the 80+ population to grow at a CAGR of 4.4% until 2030.

An aging population, combined with a low net inventory growth of 1.1%, will lead to a property shortage: NIC estimates a shortfall of approximately 806K new units by 2030, requiring an industry-wide investment of $400B. Demand is likely to be sharpest near metropolitan areas, hospitals, and other medical facilities. Coincidentally, 2030 is the year when baby boomers will all officially be at least 65.

The Lending Landscape

High interest rates, increased regulatory scrutiny, and enhanced capital requirements have led to lenders and borrowers in this market exhibiting some caution and a subsequent decline in new loan originations. The latest data from Q2 2023 showed that issuance of new permanent loans for senior housing hit a new low, reflecting an 8% decline from Q1 2023. In contrast, loan volume for nursing care increased by 75%.

Although delinquency rates increased by 36% in Q2, they remain lower than those seen in 2020 and do not seem to be unduly worrying bankers. Several key players have commented that despite having to watch some loans more closely, they remain cautiously optimistic about their performance, citing the operators' ability to positively impact margins by raising rents and cutting costs without reducing occupancy.

3 Key Success Factors for CFIs

Many CFIs have navigated these challenges well. Three factors appear key to succeed in capitalizing on the growing long-term opportunities available in the senior housing market.

1. **Market expertise.** An understanding of this market and how it operates is crucial to identifying reliable borrowers. Whether it is an acquisition, renovation, or refinancing of an existing facility, having in-depth knowledge of all aspects of senior housing — including independent living, assisted living, memory care, and skilled nursing — ensures the best debt solution can be found.
2. **Careful risk assessment.** It's essential to carefully scrutinize an operator's financial position as well as their experience in the sector. Strong performers will typically have the expertise to navigate cost issues, solid staff programs to support recruitment and retention and avoid the need for contract workers, and high care ratings to protect occupancy rates.
3. **Continuous monitoring.** Once a loan has been underwritten, careful and regular monitoring of key internal and external metrics is essential to ensure a CFI is able to take corrective action, should the loan be at risk. Adjustments to loan terms and pricing to reflect changing circumstances can prove critical in preventing an adverse outcome.

With an aging population and a growing shortage of appropriate facilities, the senior housing market looks to be an interesting long-term opportunity. As lending conditions ease and billions of dollars of loans are due for refinancing, this sector might be of interest to CFIs. Market expertise, careful risk assessment, and monitoring remain key to securing and protecting their investment.

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ECONOMY & RATES

Rates As Of: 02/12/2024 05:49AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.44	0.02	0.04
6M	5.26	0.08	0.00
1Y	4.83	0.13	0.07
2Y	4.46	0.26	0.22
5Y	4.12	0.29	0.28
10Y	4.17	0.25	0.28
30Y	4.37	0.20	0.34

FF Market	FF Disc	IORB
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**

5.31	8.50	5.32