SENIOR HOUSING
SPECIAL REPORT

Q3 2020

ALEX. BROWN REALTY, INC.

EXECUTIVE SUMMARY

By all accounts, 2019 was a banner year for the senior housing industry. Driven by the longest economic expansion in U.S. history, favorable demographic trends, an abundance of cheap capital, unprecedented levels of private equity investment, and widespread optimism regarding its future, the industry either set, or came close to setting, numerous records during the year.

According to the senior housing research firm Irving Levin Associates, independent living, assisted living, and memory care assets sold at a record average price of $244,200 per unit in 2019. A record 450 publicly announced transactions at a disclosed value of $16.8 billion also occurred during the year, and after including confidential deals, 600 transactions at $25 billion in value took place in 2019. Cap rates also set a record, falling to an average low of 7.4%. In addition, absorption rates ticked up as the industry had 6.2% units of total inventory in the construction pipeline at the end of 2019 versus 7% in 2018. Higher absorption led to occupancy gains and the National Investment Center for Seniors Housing & Care (NIC) reported that senior housing occupancy increased from 87.8% in 2018 to 87.9% in 2019. With access to cheap capital, significant interest from private equity firms, less supply entering the market and encouraging demographic trends, senior housing investors and operators entered 2020 with a great deal of enthusiasm.

Positive industry expectations held to form in the first quarter of 2020 with NIC reporting strong occupancy rates in the assisted living, independent living, and nursing home segments; however, the situation changed dramatically when Covid-19 emerged in March. Covid-19 led to large declines in occupancy and significant increases in operating costs for personal protective equipment, labor costs, and other virus-related items. This resulted in substantial downward pressure on senior housing's operating margins. Government aid has helped support the industry to some extent, but occupancy and expense challenges still remain and are likely to continue for the time being. Nevertheless, in the long term investors remain bullish on senior housing because of the needs-based element of the product, favorable demographics that support elevated demand projections, and the opportunity to generate strong earnings in a low interest rate environment.

SENIOR HOUSING

FUELED BY A GROWING ECONOMY AND FAVORABLE DEMOGRAPHIC TRENDS, SENIOR HOUSING ENTERED 2020 IN A STRONG POSITION

At the start of 2020, the senior housing industry was benefiting from the long-running economic expansion, and with continued low interest rates, fewer construction projects adding to supply, increased interest from private equity firms, and favorable demographic trends, senior housing was well positioned to have another strong year.

This sentiment was reflected in a survey of investors and industry professionals that was conducted by Senior Housing News in December 2019 and January 2020. The survey found that most respondents expected occupancy to remain stable or increase across every segment of senior housing. A majority also expected new construction to remain stable or decrease during the year, which would result in higher occupancy rates; and a majority believed that private equity firms would be the biggest buyer of senior housing assets in 2020. The survey did reveal industry concerns about wage growth, but these concerns were generally outweighed by expectations of higher valuations and accelerated acquisition activity due to greater occupancy and increased interest in senior housing from private equity. And at the start of the year, these expectations appeared to be accurate as the National Investment Center for Seniors Housing & Care (NIC) reported solid first quarter occupancy rates for majority assisted living properties, majority independent living properties, and for nursing homes. However, the fortunes of both the economy and senior housing industry changed dramatically in March because of the Covid-19 global pandemic.

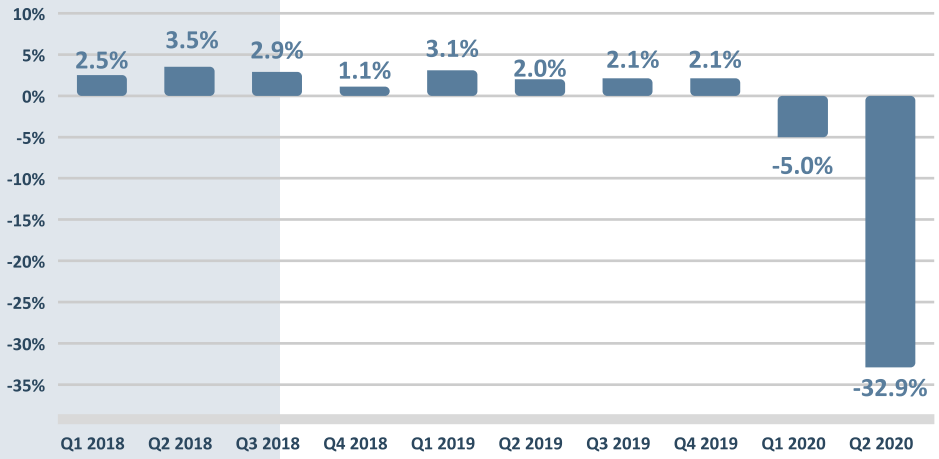
SENIOR HOUSING

COVID-19 DRAMATICALLY CHANGED 2020'S ECONOMIC LANDSCAPE

After the economy rebounded from the Great Financial Crisis of 2008 to 2009, it experienced the longest expansion on record as real GDP growth averaged over 2% annually and the unemployment rate fell to 3.5% in February 2020 - its lowest level in 50 years. But then the economy's upward trajectory was abruptly derailed in March by the Covid-19 global pandemic. In response to the novel coronavirus pandemic, federal, state, and local governments issued stay at home orders that dramatically reduced economic activity, millions of Americans were laid off from their jobs, the unemployment rate skyrocketed from 3.5% in February to 14.7% in April, and the economy entered a recession. The economic fallout continued as the year progressed with GDP falling by 32.9% on an annualized rate in the second quarter and consumer spending falling by 34.6% at an annualized rate during the quarter.

In response to Covid-19's economic impact, Congress passed more than $3 trillion in economic stimulus legislation and the Federal Reserve lowered its target range for the federal funds rate to 0-.25%, created multiple lending programs, and purchased more than $2 trillion in Treasury, mortgage, and corporate securities to support lending activity and reinforce the capital markets. These unprecedented actions and the partial reopening of many state and local economies helped reduce the unemployment rate from 14.7% in April to 8.4% in August. In addition, the Purchasing Managers Index for the U.S. exceeded expectations and rose from 54.2 in July to 56 in August. This represents the largest expansion in the manufacturing sector since November 2018. Existing home sales also increased by a record 24.7% from June to July as people took advantage of historically low interest rates to purchase homes, and after falling to 2,192 in March, the S&P 500 rebounded to close August at a near-record high of 3,500. However, the economy is still in a precarious state and the recent expiration of enhanced unemployment benefits and other government stimulus programs are expected to exert downward pressure on consumer demand and economic growth in the coming months. Economists are generally of the view that the U.S. economy will not recover fully until Covid-19 infection rates are reduced further, and state and local economies can reopen more forcefully.

REAL GDP: PERCENT CHANGE FROM PRECEDING QUARTER



Source: U.S. Bureau of Economic Analysis

SENIOR HOUSING

COVID-19 DRAMATICALLY CHANGED SENIOR HOUSING'S SHORT-TERM OUTLOOK

In addition to the macroeconomic damage that Covid-19 caused, the virus also significantly impacted senior housing's short-term outlook by putting pressure on both occupancy and operating expenses. Senior housing communities responded aggressively to these challenges with a number of strong measures. In an effort to stem the infection rate, move-ins and tours were quickly suspended, access to properties was restricted, staff and residents were screened for the virus and were sent home or isolated in their rooms if they tested positive or had symptoms, group dining and other activities were curtailed, and large gatherings of any kind were prohibited. The moratorium on move-ins and tours that were caused by the virus, the typical turnover that occurs in senior housing, and an increase in residents leaving their communities because of concerns about Covid-19 all combined to reduce occupancy across every senior housing sector in the second quarter. According to NIC, assisted living occupancy decreased from 85.3% in 1Q20 to 82.1% in 2Q20 and independent living occupancy decreased from 89.9% in 1Q20 to 87.4% in 2Q20. Their combined occupancy decline from 87.7% in 1Q20 to 84.9% in 2Q20 is the largest decline that NIC has recorded since it began reporting this data 14 years ago, and 2Q20's 84.9% occupancy figure is also the lowest figure on record. NIC has continued to report occupancy declines in its primary markets as majority independent living communities ended August with 85.6% occupancy and majority assisted living communities closed the month with 79.5% occupancy. Covid-19 also had a significant impact on nursing homes, contributing to occupancy falling from 86.7% in 1Q20 to 80.2% in 2Q20. These occupancy declines have reduced revenues and are exerting significant downward pressure on operating margins.

In addition to the revenue disruptions caused by Covid-19, the virus also put pressure on senior housing's operating costs. At considerable expense, senior housing communities purchased generous amounts of personal protective equipment (PPE), enhanced their cleaning and sanitation efforts, and implemented "quarantine" or Covid-19 pay for employees who could not work because they had contracted Covid-19, had symptoms of the virus, had to stay home with their children because of school or daycare closures, or for other Covid-19 related reasons. Although the stimulus legislation that Congress passed to address Covid-19 has helped cover some of these costs by providing approximately $4.9 billion for nursing homes that accept Medicare or Medicaid, over $100 billion for other qualified healthcare providers, payroll tax relief, and access to federal Economic Injury Disaster and Paycheck Protection Program loans, even with this support, senior housing's margins continue to be challenged by lower revenues and higher expenses caused by the impact of the virus.

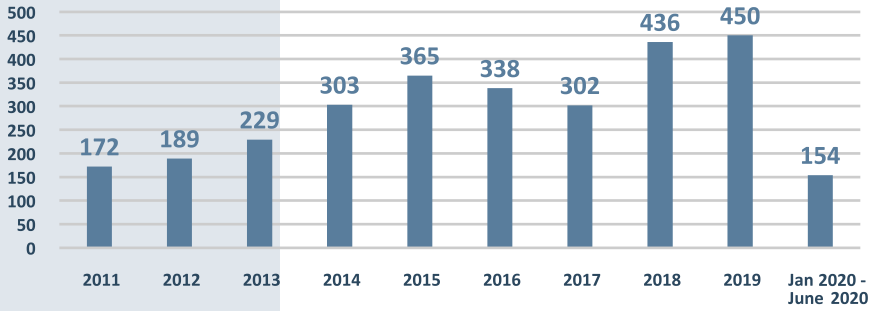
SENIOR HOUSING

COVID-19 HAS CAUSED A SHARP DROP IN TRANSACTION ACTIVITY

According to Irving Levin Associates, there were 95 publicly announced transactions in the first quarter of 2020 and 59 in the second quarter. The second quarter also included two large transactions involving the public REIT Welltower that accounted for nearly 60% of the quarter's total dollar volume. In the first transaction, the investment firm Kayne Anderson bought back its Astons Gardens portfolio, one other senior housing property and 19 medical office buildings from Welltower for approximately $1 billion; and in the second transaction, Welltower sold its majority interest in six Senior Star assets for approximately $300 million. However, these two large transactions failed to spark additional deals and M&A activity has declined precipitously from 2019 when there were over 100 publicly announced transactions in every quarter. In contrast to what happened during the Great Financial Crisis when capital markets slowed considerably, deal flow in 2020 has declined even though the government's stimulus measures have helped maintain liquidity in the system. This has occurred for several reasons. First, lenders are focusing on their existing portfolios and are not being as aggressive as they previously were in financing transactions. Second, while there are senior housing providers who are under financial strain, they are hesitant to sell their assets at a distressed price and remain hopeful that additional government assistance is forthcoming. The bid/ask spread is too large for these transactions to take place currently, but this may change if these distressed communities continue to experience significant financial losses going forward. Third, while well-capitalized providers with development projects that were already underway before Covid-19 are still pushing through with them, the rate of new projects has decreased significantly because of a lack of financing due to challenges in assessing land value, underwriting a budget, and being able to provide lenders and investors with accurate financial projections. In sum, the primary reason deal flow has slowed is because of the tremendous amount of uncertainty that lenders and investors have assigned to senior housing due to the Covid-19 pandemic.

Lenders and investors have tightened their underwriting standards and are holding off on financing transactions until there is greater certainty in the industry and in the broader economy. Lenders need this certainty to accurately evaluate and price risk. In the meantime, they are struggling to find answers to the following questions: When will a vaccine or effective treatment become widely available for senior housing residents? How long will negative perceptions of nursing homes and other senior housing properties last because of the number of Covid-19 nursing home deaths? How long will it take for occupancy to recover from its current slide? How long will expense increases caused by Covid-19 weigh on operating margins? Can rising costs be offset by higher rents or greater occupancy in the future? Will wages fall because the supply of labor has increased due to business closures that were caused by Covid-19, or will a potential change in administrations in Washington D.C. after the presidential election lead to an increase in the minimum wage instead? How much will insurance premiums increase in the future because of Covid-19? Will the senior housing industry receive legal protection from Covid-19 related lawsuits? Until lenders and investors have some answers to these questions and gain the certainty that comes with them, they will continue to take a conservative approach to financing by extending lease-up periods, reducing net operating income, rent and margin growth projections, and factoring in higher costs and cap rates.

PUBLICLY ANNOUNCED SENIOR HOUSING & CARE ACQUISITIONS



Source: Irving Levin Associates, 2020 SCA Report, Volume One

SENIOR HOUSING

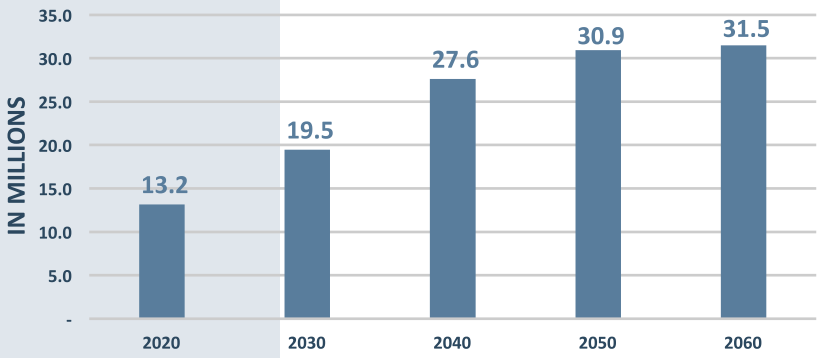
SENIOR HOUSING'S LONG-TERM OUTLOOK REMAINS POSITIVE

Although Covid-19 has had a dramatic impact on senior housing this year, in the long-term, investors remain bullish on senior housing for several reasons. The most cited reason is the aging of the nation's population.

According to NIC, in 2018 there were roughly 23,500 senior housing and nursing care communities with 25 or more units or beds in the U.S. This equates to approximately three million units/beds at a combined value of close to $420.4 billion. And while senior housing targets a wide range of ages based upon the property type, the average age that someone transitions into senior housing is generally between 82 and 84. The oldest baby boomers will reach 82 in 2028 and the youngest baby boomers will not become 82 until 2046. This portends a long period of reliable demand for senior housing communities. This is supported by additional data from NIC that indicates that depending upon penetration rates and other factors, 638,000 new units to 1.1 million new units of senior housing will be needed between 2019 and 2030 in order to satisfy future demand for the product. Furthermore, during the Great Financial Crisis, senior housing's YOY rent growth never went negative and levered IRRs outperformed other commercial real estate asset classes by 500 to 700 basis points. This is largely attributed to senior housing's needs-based component, which will grow in importance as the nation's population gets older.

The results of a recent Jones Lang LaSalle survey also indicate optimism regarding senior housing's long-term prospects. This survey of senior housing professionals found that although Covid-19 could increase operating costs by 4% to 12% in the short-term, in the long-term, operating costs are likely to stabilize at 1% to 2% above pre-Covid-19 levels as communities trim costs in non-essential areas and draw on their experiences from earlier this year to better prepare for future expenses. Furthermore, a majority of the survey's respondents also noted that while they expect capitalization rates to increase in the short-term because of the virus, in the long-term, capitalization rates should mostly return to the levels that prevailed before the emergence of Covid-19 as occupancy rates increase due to favorable demographics, expenses normalize at lower amounts, and investors seek higher yields in a low interest rate environment.

THE PROJECTED POPULATION OF U.S. RESIDENTS AGED 80+



Source: U.S. Census Bureau

SENIOR HOUSING

FUTURE OPPORTUNITIES IN SENIOR HOUSING

In addition to being optimistic about senior housing's long-term prospects, because Covid-19 has lowered senior housing valuations this year, there are likely to be opportunities to purchase assets at discounts, while at the same time, the fallout from the pandemic is spurring new ideas in technology, architecture and design, and healthcare partnerships.

With respect to senior housing transactions, investor sentiment is growing that the decline in valuations caused by Covid-19 will most likely create an opportunity to acquire senior housing assets with solid fundamentals at healthy discounts and to acquire distressed hotel assets at significant discounts as well - these hotels can then be repurposed into senior housing. If the economic downturn continues for a prolonged period, REITs may also decide to generate additional working capital by selling their older properties at a discount instead of investing capex dollars in them that they would prefer to invest in newer assets. Widespread transactions of distressed senior housing assets have not occurred yet as significant government stimulus has helped support many senior housing communities and limit the level of distress; nevertheless, the sheer magnitude of the economic downturn may eventually result in a number of assets being returned to lenders and sold into the market at deep discounts.

Covid-19 has also generated discussion about how future communities should be built and designed in order to avoid community-wide disruptions caused by viral outbreaks or bacteria. Future designs may emphasize separate or pocket neighborhoods that are built on small campuses where residents can live, dine, and socialize in small groups. Because of this layout, an infected area could easily be cordoned off without closing the entire community if an outbreak occurs. This is referred to as the "small house" or "compartmentalization" model and these communities can be built horizontally or vertically. The challenge with these communities will be to ensure that they are small enough to close off infected sections if there is a viral outbreak or other health emergency, while still remaining inviting and warm instead of projecting an institutional feel. Future communities may also include more outdoor space to allow for socially distanced gatherings and they may make greater use of furniture, flooring, kitchen equipment and other materials that are antimicrobial and easy to clean. In addition to these enhancements, future communities may include specialized ultraviolet lighting that can kill germs, enhanced air filtration and purification systems, dedicated clean rooms with partitions and intercoms for communication, and dedicated rooms for virtual medical appointments with videoconferencing technology. In certain markets, many of these features might be required by law someday.

Because Covid-19 has highlighted the important role that healthcare providers play in keeping residents safe and healthy, senior housing providers may participate in more partnerships with other members of the healthcare continuum. For example, in Coral Gables, Florida; Belmont Village Senior Living is developing a $100 million mixed-use senior housing community with Baptist Health South Florida, the largest nonprofit healthcare organization in the region. Partnerships such as these or other relationships that encourage greater collaboration between senior housing providers and healthcare networks may accelerate in the future because of Covid-19.

Lastly, over the past few years, new senior housing developers have focused on high-end communities that can charge premium rents, attract high-quality employees, require little capex, and generate large returns. However, a NIC sponsored 2019 study on senior housing illustrated that the focus on high-end communities has left a large hole in the supply of middle-market communities. The study found that the number of middle-income seniors in the U.S. will nearly double from 7.9 million in 2014 to 14.4 million in 2029 and that 54% of these 14.4 million middle-income seniors will not be eligible for Medicaid or be able to afford private pay senior housing. The study also estimates that at today's utilization rates, more than 700,000 new senior housing units will be needed by 2029 to satisfy demand from middle-income seniors. This presents an opportunity for operators and investors who wish to focus on the middle-market. Possible ways to satisfy demand for middle-market properties include developing new communities with smaller units to lower construction costs, developing new communities in opportunity zones to take advantage of tax incentives, developing mixed-use communities that can generate revenue from multiple sources, repositioning existing market rate assets, redeploying capital into existing middle-market assets, repurposing older senior housing stock and other existing real estate, and outsourcing operations such as meal service and transportation to lower expenses and make communities more affordable.

SENIOR HOUSING

ACTIVE ADULT OUTLOOK

Entering 2020, active adult communities were regarded as one of the best opportunities for investments in senior housing. This enthusiasm was demonstrated in a Jones Lang LaSalle survey in which active adult ranked second only to assisted living as the biggest opportunity for senior housing investment during the year.

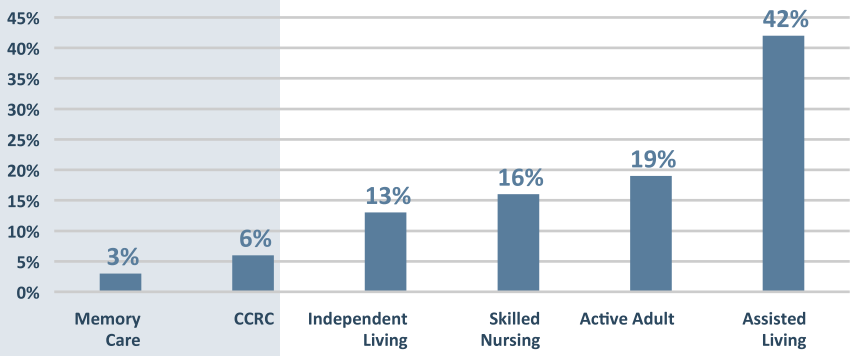
Active adult is an emerging class of senior housing assets that closely resembles traditional multifamily properties. They require minimal staff, only accept private pay residents and are either age-restricted to the 55+ cohort, or age-targeted to the 55+ cohort. Because active adult residents are younger and generally in better health than older seniors, they require a different product than traditional senior housing. Active adult communities may have relationships with healthcare providers, but they do not offer healthcare services. Instead, they emphasize activities and amenities. These amenities can include retail outlets, indoor pools, golf courses, access to private beaches, vineyards, entertainment centers, fitness centers, and even horse stables in some communities. Marketing for these communities focuses on experiences, as residents are effectively choosing a community based upon a group of friends and lifestyle, instead of choosing a community for healthcare reasons. Since many active adult residents still work, home offices are sometimes included in these residences. The average age for active adult move-ins is generally mid-60s to early-70s and the average age of an active adult resident is 74. The typical active adult community seems to be around 120 to 160 units, which provides for a range of different rates and design options; but active adult communities exist in many different sizes and can range from 20-unit buildings to large communities with hundreds of privately owned homes and thousands of residents. These communities may also have "common homes" with game rooms and other amenities that everyone can use. Designs often include specific features for aging residents, such as few, if any, stairs and wider doors to accommodate wheelchairs that residents may need as they age. Residents may pay an additional fee for garbage collection, maintenance of shared spaces and facilities, security, cable or satellite television, the internet, shuttle buses, and other features. Some communities also include insurance and property taxes in their monthly HOA fees, but they are mindful that high fees can suppress demand for these properties. Research has shown that HOA fees that are greater than $300 are not affordable in some markets. When building these communities, developers have discovered that prospective residents are focused on safety and security, weather, proximity to places of worship, doctors, friends and family. Several active adult developers have reported that most of their residents come from within 10 to 15 miles of their old homes. Active adult communities tend to have longer lease-up periods than other senior housing properties, but the length of stay is also longer with some communities reporting that residents stay for 6 to 10 years.

Different types of active adult communities are being developed across the country, at different price points. Developers have found that seniors have different tastes and are working to accommodate them. Units can be purchased or rented, and current developments vary from single-family homes in gated communities, to townhomes, custom-built and manufactured homes, and active adult condominiums in urban and suburban locations. There are active adult cottages in Daytona Beach, Florida with 1,200 sf of space that start in the low $200,000s and grow to 2,310 sf and $354,990; and there are active adult communities that are being developed in Palm Desert, California with monthly rates between $1,850 and $2,200. Some operators have also begun developing joint active adult and independent living communities for transitioning residents. Lenders have underwritten active adult properties similar to apartment homes and their cap rates have been similar to those found in the multifamily sector.

Active adult communities are not expected to feel Covid-19's impact as much as traditional senior housing because they have fewer labor costs and other virus-related expenses, including PPE purchases, but because these communities do not have a long history and are not needs-based, there is some uncertainty regarding long-term demand. Conversely, also because of their short history, there is little concern about oversupply in the sector and the same demographic trends that are driving the demand for other senior housing assets are expected to boost the demand for active adult properties as well. This view is supported by comments such as those made by Margaret Wylde, the CEO of the senior housing research firm ProMatura Group. In late 2019 when she was asked about active adult's prospects, Ms. Wylde responded that "It's going to be a great market for the next 10 to 15 years and even beyond that."

SENIOR HOUSING

BIGGEST OPPORTUNITY FOR SENIOR HOUSING INVESTMENT IN 2020



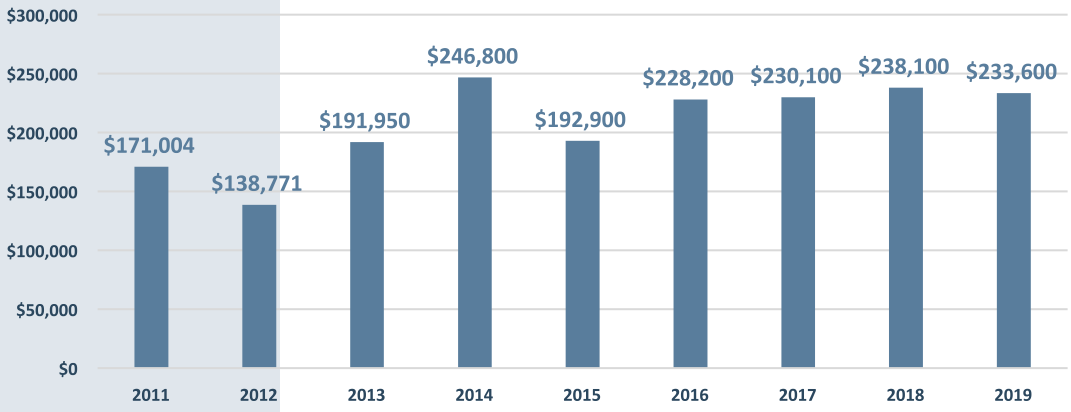
Source: JLL Research Report Spring 2020

INDEPENDENT LIVING OUTLOOK

Independent living is typically the only senior housing segment that sells below a 6% cap rate because it is not as operationally intensive as other senior housing segments, its residents acuity levels are lower, and its resident turnover rates are also lower. According to Irving Levin Associates, after peaking at 8.3% in 2013, independent living cap rates dropped to a record low 6.7% in 2019. Values have also been strong and consistent for the past five years. They peaked at $246,800 per unit in 2014, fell to $192,900 per unit in 2015, subsequently stabilized around $230,000 in the following years and finished 2019 at $233,600 per unit. And although 11,000 new units were delivered in 2019, according to NIC, occupancy only fell by 20 basis points YOY from 90.2% in 4Q18 to 90% in 4Q19. Lastly, 52% of the nation's independent living inventory is over 20 years old and while these communities are still usable, they may become less attractive in the future as new supply enters the market.

While independent living properties have been hurt by Covid-19, due to the lighter acuity in these properties, the impact has not been as pronounced as in higher acuity senior housing assets. Independent living properties also performed better than multifamily apartments during the last economic downturn and this experience will likely encourage existing owners to hold their assets through the current downturn. In addition, despite thousands of new units being delivered over the past few years, independent living's occupancy has consistently remained around 90% and annual rent growth decreased only slightly from 3.2% in 4Q18 to 3% in 4Q19, indicating strong demand for the product. This demand will be tested in some markets as independent living entered 2020 with 27,000 units under construction, representing 10% of existing inventory. Most of these units are in the Sunbelt region where occupancy is below the market average and new construction represents 13% of inventory. However, long-term demand for independent living should help address the supply/demand imbalance as all 10 markets with the largest projected increase in the 65+ cohort over the next five years are also in the Sunbelt.

AVERAGE INDEPENDENT LIVING PRICE PER UNIT



Source: Irving Levin Associates, 2020 SCA Report, Volume One

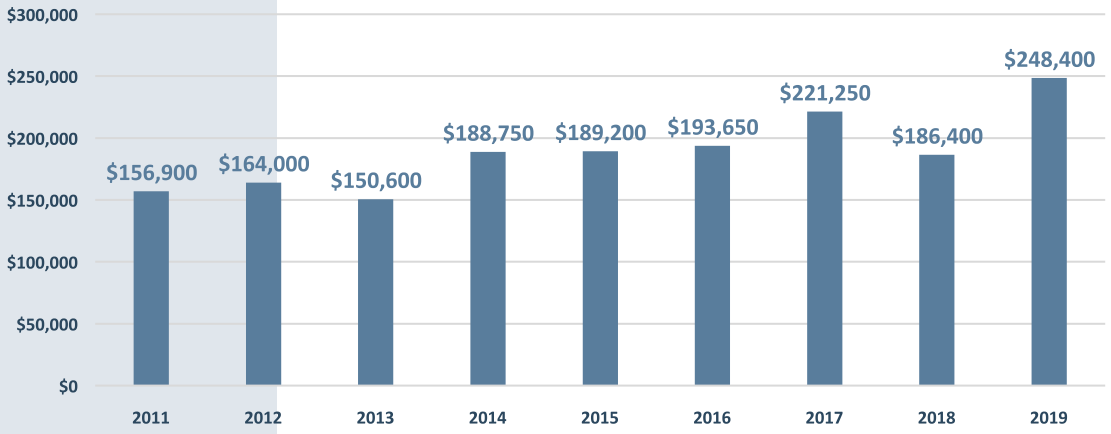
SENIOR HOUSING

ASSISTED LIVING OUTLOOK

According to Irving Levin Associates, the average cap rate for assisted living communities fell 60 basis points YOY from 8.2% in 2018 to 7.6% in 2019, and the price of assisted living units increased from $186,400 per unit in 2018 to a record $248,400 in 2019, which is 12% higher than the previous record of $221,250 in 2017. Buyers prioritized stabilized communities (those with 85%+ occupancy) in 2019 and paid $336,200 per unit for those properties, while non-stabilized communities sold at an average of $182,900 per unit. After years of aggressive development dating back to 2013 and absorption rates that struggled to keep up with increased inventory, construction in the sector slowed down in 2019 as only 13,600 units were delivered during the year, which was down from 17,100 in 2018. Also, the number of units under construction at the end of 2019 represented 6.1% of existing inventory, which is the lowest it has been since the end of 2016 when it was 8.8%. The slowdown in construction was reflected in assisted living's occupancy rate as NIC reported 85.7% occupancy in majority assisted living communities in 4Q19, an increase of 30 basis points from 4Q18's 85.4% figure.

Entering 2020, 2019's increased occupancy rate and the slowdown in construction pointed to a strong year for assisted living, but then a few months into the year, assisted living was severely upended by Covid-19 as its higher acuity population made it more vulnerable to the virus. According to NIC, majority assisted living communities closed 2Q20 with just 82.1% occupancy and 2% rent growth. Occupancy declines continued into the third quarter with NIC reporting only 79.5% occupancy in its primary markets for majority assisted living communities at the end of August. In the short-term, the virus is expected to continue exerting downward pressure on occupancy and revenue, while also increasing expenses. Assisted living has also experienced increased competition from home healthcare as some prospective residents have held off on moving into assisted living communities because of virus concerns and are taking advantage of new offerings that make it easier for seniors to live at home longer. These include advances in technology, such as telehealth and remote monitoring devices; new meal delivery systems, such as DoorDash and Uber Eats; and easy to use rideshare services, such as Uber and Lyft. But in the long-term, investors remain positive about assisted living because of strong demographic trends, reduced construction, and the belief that home healthcare cannot replace the level of care that assisted living communities provide, or the socialization activities that they offer.

AVERAGE ASSISTED LIVING PRICE PER UNIT



Source: Irving Levin Associates, 2020 SCA Report, Volume One

SENIOR HOUSING

MEMORY CARE OUTLOOK

In 2019, the occupancy rate for memory care communities decreased from 86.5% in 4Q18 to 86.2% in 4Q19. Rent growth also fell during the year, dropping from 2.4% in 4Q18 to 2% in 4Q19. 2019's occupancy and rent growth figures declined from 2018's even though 1,200 fewer units were delivered in 2019 than in 2018. The declines in occupancy and rent growth may indicate that memory care pricing has become prohibitive for a larger segment of the population than in the past. At the end of 2019, the average monthly rate for a memory care facility was $6,709. Many families may simply be unable to afford this price and are opting to provide care out of their home instead.

Similar to assisted living, Covid-19 will hurt memory care communities in the short-term; however, investors are still encouraged by the sector's long-term prospects because of the slowdown in construction and favorable demographic trends. The Chicago-based non-profit Alzheimer's Association estimates that if there are no medical breakthroughs, the number of Americans who are 65 and older and suffer from Alzheimer's will increase from an estimated 5 million in 2013 to 13.8 million by 2050. Moreover, this growth does not capture the total need for memory care because Alzheimer's is just one cause of dementia. Parkinson's disease and other health ailments also cause dementia. Demographic trends are especially important for memory care communities because lengths of stay can be short for their residents, so a consistent inflow is needed to maintain a healthy census. According to the American Seniors Housing Association, the average length of stay at a memory care community is 11 months to just over 2 years. For this reason, investors may gravitate towards memory care communities with an additional care component whose staffing and equipment resources can be leveraged to provide synergies for the entire community, such as assisted living or skilled nursing.

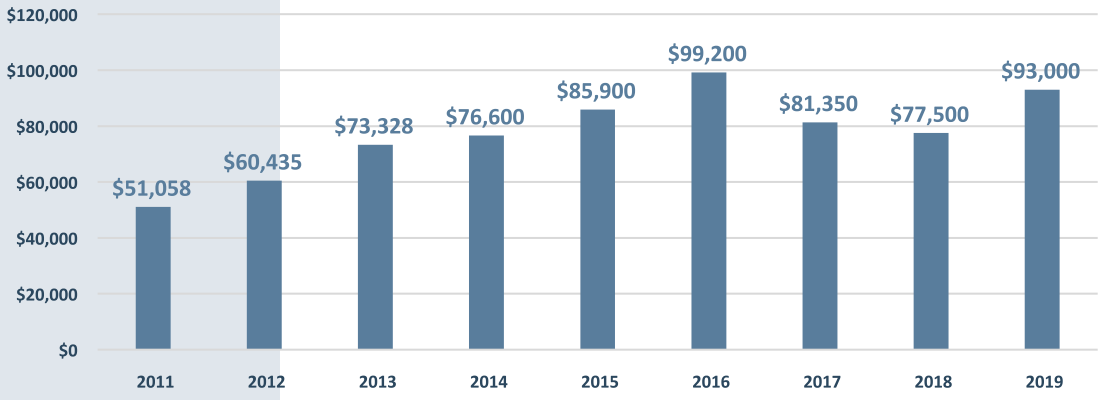
SENIOR HOUSING

SKILLED NURSING OUTLOOK

In 2019, occupancy at skilled nursing facilities increased from 86.1% in 2018 to 86.3% in 2019. Construction also slowed as there were only 3,600 beds in the pipeline at the end of 2019. This is roughly 70% less than the record high that was recorded in 2012. The average cap rate rose slightly from 12% in 2018 to 12.2% in 2019 and the average price paid per bed for acquisitions increased from $77,500 in 2018 to $93,000 in 2019. This was partly due to investors expecting increased revenue from the federal government replacing the patient classification system it uses for skilled nursing reimbursements from the Resource Utilization Group (RUG-IV) to the Patient Driven Payment Model (PDPM). PDPM is supposed to better account for the care that nursing homes that accept Medicare provide to higher acuity residents while also being "budget neutral." It was implemented across skilled nursing facilities in October 2019 and while it is too early to draw any hard conclusions from its implementation, it does appear to have generated higher reimbursement rates for nursing homes. According to CORE Analytics, the PDPM average realized per diem rate was $615 in October 2019, which is nearly 10% greater than the RUG-IV average of $563. However, the Centers for Medicare and Medicaid Services (CMS) can reduce PDPM's rates and may do this in the future if it determines that the current rates are not "budget neutral." Another impact of PDPM is that some smaller mom-and-pop nursing homes are expected to be sold to more sophisticated operators due to the complexity of the PDPM system and the resources that are needed to manage it.

Covid-19 has had a tremendous impact on skilled nursing facilities across the country. According to CMS, over 43,000 Covid-19 deaths have occurred in nursing homes and this has greatly impacted occupancy and revenue in the sector. Expenses have also increased significantly as nursing homes have spent large sums on PPE, cleaning supplies, labor costs, and other Covid-19 related items. The federal government has infused roughly $5 billion into nursing homes to help support the sector, but it is still facing tremendous headwinds from continued occupancy declines and Covid-19 related expenses. Because nursing homes are a needs-based product and are heavily dependent on referral networks, the long-term outlook for the nursing home sector is not as dire as its current pandemic driven challenges may suggest. Nevertheless, the immediate situation is serious, and it is possible that a number of nursing homes will either go out of business or be consolidated in order to survive Covid-19's impact.

AVERAGE SKILLED NURSING PRICE PER BED



Source: Irving Levin Associates, 2020 SCA Report, Volume Two

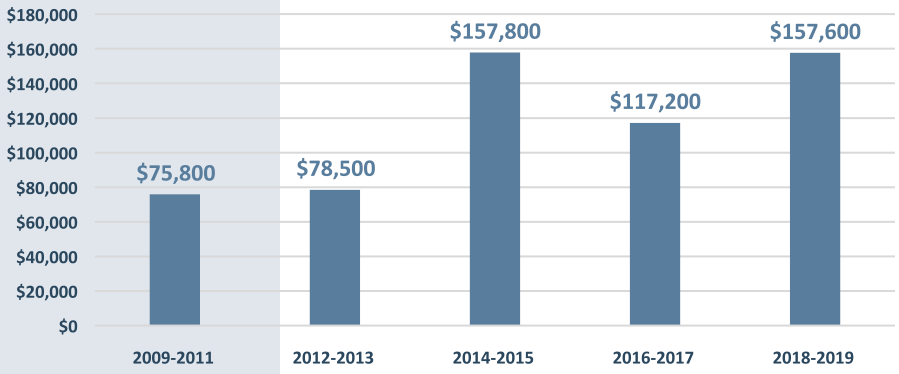
SENIOR HOUSING

CONTINUING CARE RETIREMENT COMMUNITIES OUTLOOK

Continuing Care Retirement Communities (CCRCs) are distinct from other senior housing properties because the majority of these communities use an entrance fee model, with the remaining communities opting to charge rental fees. Many CCRCs are also non-profits and their owners tend to retain them for the long-term unless they are under financial duress. In addition, entrance fee CCRCs are sold subject to refund obligations. Accordingly, the transaction volume is limited relative to other types of communities and this helps explain why the per-unit average value for CCRC transactions is routinely below the average value for senior housing overall. This is also why Irving Levin Associates reports CCRC figures on a two-year basis instead of a single-year basis, and according to Irving Levin, the average price per unit for CCRCs during the two-year period 2018 to 2019 was $157,600, which nearly bested the record high of $157,800 that was set during the two-year period 2014 to 2015. Also, occupancy at CCRCs increased YOY from 91.3% in 4Q18 to 91.6% in 4Q19, with entrance fee CCRCs averaging roughly 380 basis points more in occupancy than rental CCRCs. Average rents also increased by 2.9% in 2019 to $3,353 and the average entrance fee rose 3% to $367,000 during the year. The combination of these figures helped to make CCRCs arguably senior housing's strongest performer in 2019.

Although deal flow for CCRCs is light when compared to other senior housing segments, these assets do attract investors on a consistent basis. In 2019, transactions were spread across the country, private investors acquired more CCRCs than REITs, and rentals were involved in more transactions than entrance fee CCRCs, but this could have been due to availability and is not necessarily the start of a trend. Entering 2020, CCRCs were poised to build on their strong 2019 as construction was at its lowest level since 2014 despite consistent demand for the continuum care of that CCRCs provide. Approximately 9,250 units were being developed, representing just 2.5% of inventory; but then Covid-19 emerged and began to impact CCRCs. Similar to other senior housing assets, Covid-19 has put downward pressure on CCRC's net operating income and margins by causing occupancy declines and higher expenses in the sector. In addition, because the majority of CCRCs use an entrance fee model, they are affected by home sales more than other communities. So far this year, because of historically low interest rates, widespread stimulus from the federal government and moratoriums on evictions and foreclosures, the housing market has not experienced the dramatic crash that it did during the Great Financial Crisis. But this is something that investors are keeping an eye on in case the housing market does take a turn for the worst and CCRCs are significantly impacted as a result.

AVERAGE CCRC PRICE PER UNIT



Source: Irving Levin Associates, 2020 SCA Report, Volume One

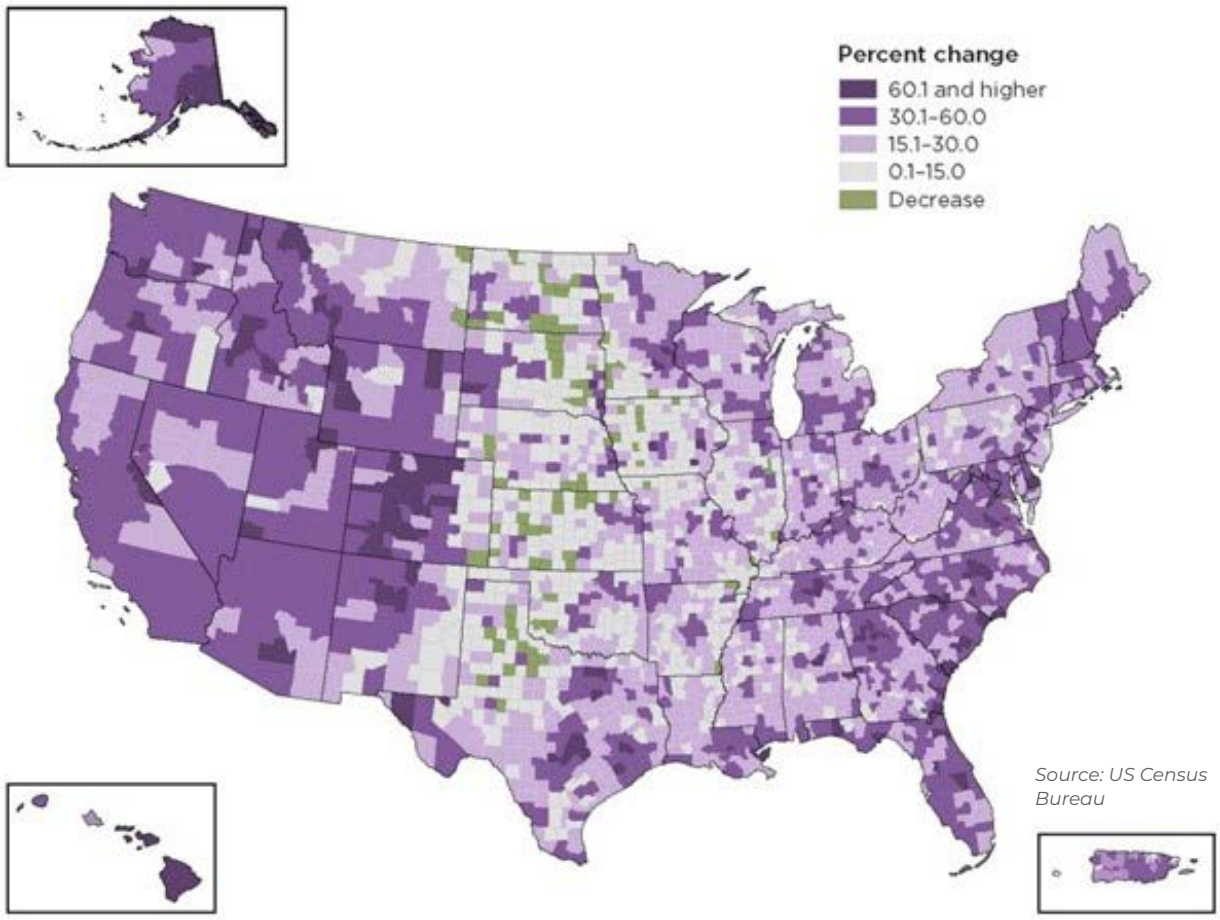
SENIOR HOUSING

CONCLUSION

After having a successful year in 2019, senior housing experienced significant dislocation in 2020 because of the Covid-19 global pandemic. While this dislocation has been disruptive and costly, it has also created opportunities for well-seasoned, experienced investors to acquire fundamentally sound assets at discounted prices and to provide rescue capital to distressed operators. Because lending standards have tightened during this period, in the near-term, transactions may require additional equity and less leverage in order to close; however, even with tighter lending standards, there will still be opportunities to purchase distressed assets and effectively deploy investor capital with the potential for attractive returns. Perceptive investors will take advantage of these opportunities to enhance their senior housing portfolios and will retain the benefits of these investments as Covid-19's impact on the industry recedes in the future.

APPENDIX

PERCENT CHANGE - THE 65 AND OLDER POPULATION - 2010 TO 2019



Source: US Census Bureau

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guaranty, express or implied, may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.

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