AEW RESEARCH

Seniors Housing Research Perspective

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AEW

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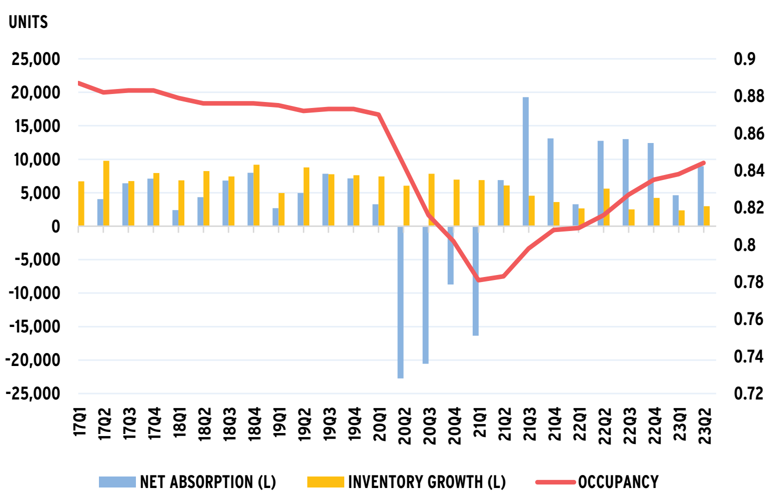
Seniors Housing 2Q Market Update

The positive trajectory of seniors housing continued through the first half of 2023 with absorption pacing well ahead of inventory growth. Occupancies improved for the eighth consecutive quarter with demand running at more than twice the pace of the typical second quarter prior to the pandemic. While rising interest rates and misaligned capital structures present the most pressing challenges for seniors housing and real estate investors more broadly, underlying operating conditions continue to improve. Operators are reporting the ability to pass through healthy rent increases both for new and existing residents, benefitting top-line revenues as expense growth moderates in what has proven to be a persistent inflationary environment. Expense growth remains the bigger challenge to driving NOI and margins. Budgeted rent increases for 2023 are in the 8%–10% range and evidence through the first two quarters indicates that these numbers are being achieved.

Overall, seniors housing occupancies increased 60 basis points (bps) in the second quarter to 84.4% across the primary and secondary markets tracked by the National Investment Center for Seniors Housing & Care (NIC). The needs-based sectors have demonstrated the most improvement although gains were recorded across all unit types. Occupancies for majority assisted living properties increased 90 bps over the quarter to 82.5% while majority independent living assets rose a more modest 30 bps to 86.1%. While these trends clearly point to an improving macro environment, performance continues to vary widely at the property and market level. The most challenged local markets remain those that experienced the most supply growth or experienced a delayed demand recovery due to stiffer COVID restrictions put in place by state and/or local municipalities. According to NIC, 41% of seniors housing assets were averaging occupancies of 90% or better while 31% were 80% or below, highlighting the disparity.

SENIORS HOUSING FUNDAMENTALS TREND*



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

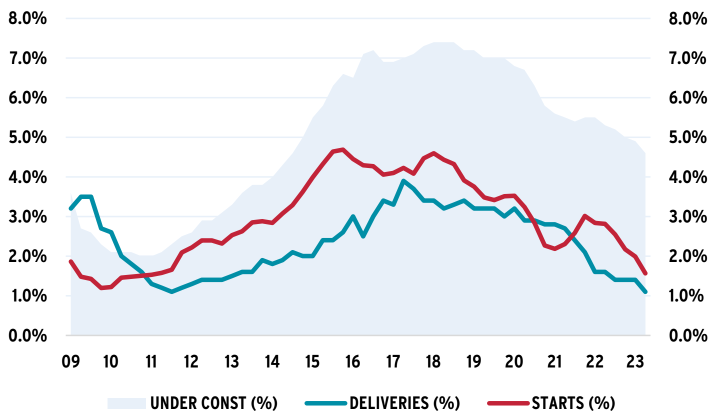
SENIORS HOUSING MARKET FUNDAMENTALS
PRIMARY AND SECONDARY MARKETS

	2023Q2	2023Q1	2022Q2
PROPERTIES	8,569	8,551	8,505
UNITS	1,070,051	1,067,044	1,057,926
OCCUPANCY	84.4%	83.8%	81.6%
STABILIZED OCCUPANCY	85.0%	85.0%	83.0%
ABSORPTION	8,973	4,638	12,767
ANNUAL ABSORPTION	5.0%	4.9%	5.2%
INVENTORY GROWTH	3,007	2,382	5,620
ANNUAL INVENTORY GROWTH	1.1%	1.4%	1.6%
PROPERTIES UNDER CONSTRUCTION	454	475	546
UNITS UNDER CONSTRUCTION	49,476	52,266	55,716
CONSTRUCTION VS. INVENTORY	4.6%	4.9%	5.3%
AVERAGE RENT	$4,828	$4,776	$4,540
ANNUAL RENT GROWTH	5.7%	5.6%	4.1%

Source: NIC MAP Data Services

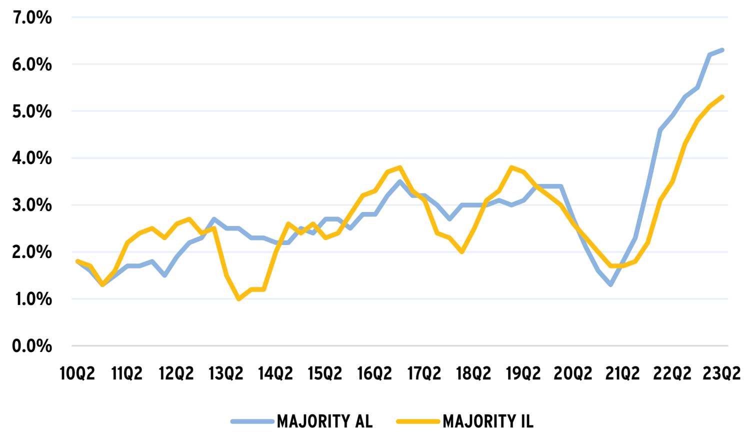
The trend in supply-side dynamics remains unchanged with the pipeline of new supply ratcheting down despite revisions that often impact the levels. Roughly 49,500 units, or 4.6% of existing inventory, were under construction through the second quarter with the pace of new projects breaking ground (new starts) at ~1.6%. It is difficult to see new construction maintaining a pace above current levels as the FOMC maintains its hawkish stance on inflation by raising interest rates. Financing for new construction also remains scarce with tight lending standards adding another governor to building additional product. From an investment perspective, it remains very difficult to justify the return on cost-to-build relative to buying existing product even in the current environment where bid-ask spreads remain wide.

SENIORS HOUSING SUPPLY PIPELINE (% OF INVENTORY)



Source: NIC MAP Data Services; Primary and Secondary Markets

ANNUAL RENT GROWTH - NATIONAL

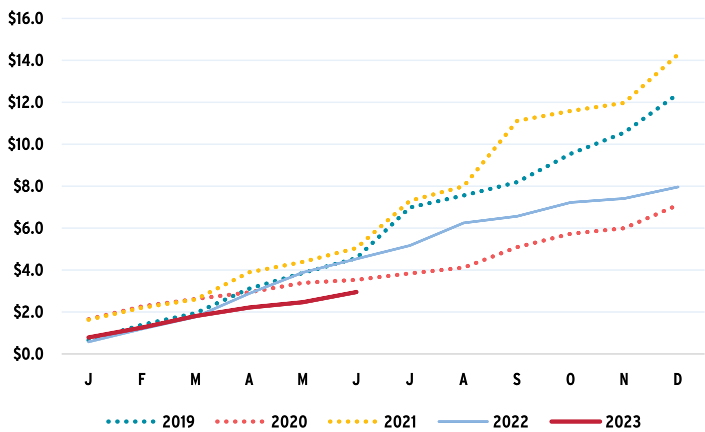


Source: NIC MAP Data Service

Operationally, availability of labor has improved with operators reporting more success in filling full-time roles and labor cost growth showing some moderation, helping to bring expenses more in focus. Across AEW's portfolio, agency usage fell to less than half year-ago levels, which combined with the ability to push rents is helping support higher NOIs and margins. This is especially true for communities where occupancies are approaching previously stabilized levels. NIC data reflects a similar pattern of strengthening rent growth supporting topline revenue growth with needs-based communities at the forefront.

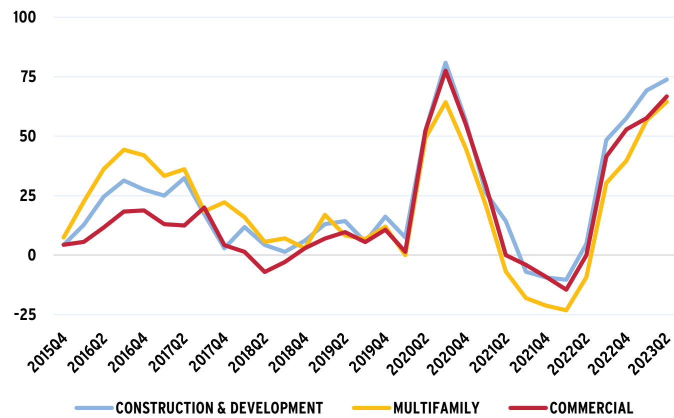
Transaction activity has slowed materially through the second quarter of 2023 and is pacing behind the lows of 2020. Slightly more than $1.1 billion changed hands during the quarter with select deals getting done in the absence of any sizable portfolio trades. Institutional buyers have been quiet with REITs and private investors responsible for the limited activity taking place. Leveraged buyers have clearly been impacted most by elevated borrowing costs and tighter lending standards that require additional recourse and covenants. Seller financing presents one of the best avenues for generating liquidity along with selectively selling assets with assumable loans. Properties that are trading tend to be high-quality stabilized assets, assets with challenged capital structures, or underperforming newer assets that entered lease-up as the pandemic began. In many instances, these deals are being done on an all-cash basis with the expectation of adding leverage when capital market conditions improve.

CUMULATIVE SENIORS HOUSING TRANSACTION VOLUME ($BILLIONS)



Source: Real Capital Analytics (RCA); As of 7/26/23

PERCENT OF LOAN OFFICERS REPORTING TIGHTENING CONDITIONS



Source: Federal Reserve Board (FRB)

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. Despite the strong momentum, the sector remains in recovery mode with a way to go before occupancies and NOIs are back to previously stabilized levels. The FOMC's posture on reining in inflation by pushing interest rates higher continues to be the biggest disruptor for seniors housing and CRE more broadly, adding uncertainty to the capital markets and constraining liquidity. Stressed capital structures will likely remain the biggest challenge for existing investments and owners as 2023 progresses, while also creating attractive opportunities for new capital as values and margins adjust.