AEW RESEARCH

Seniors Housing Research Perspective

Q3 2023

AEW

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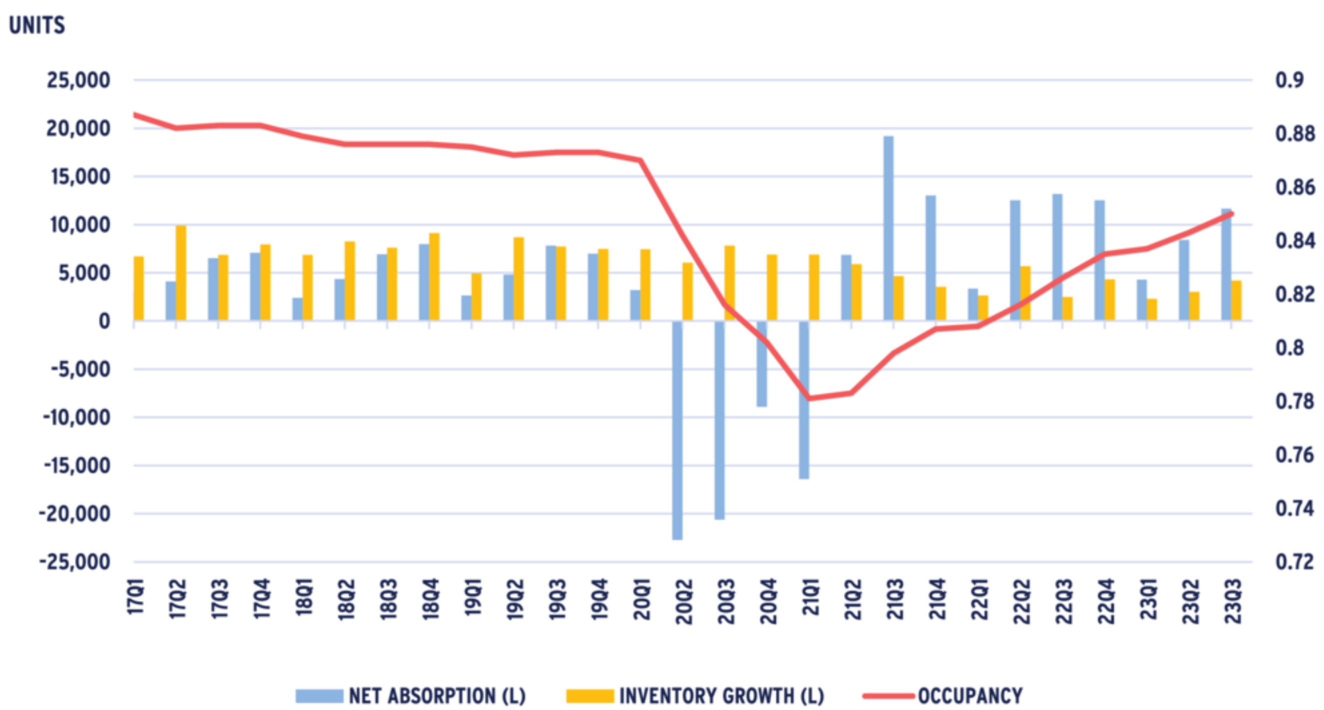
Seniors Housing 3Q Market Update

While capital market dynamics continue to weigh on valuations and liquidity across the broader CRE market including seniors housing, the positive trajectory of underlying fundamentals driving higher net operating income in seniors housing continues with absorption pacing well ahead of inventory growth. Occupancies improved for the ninth consecutive quarter with demand running well above pre-pandemic levels. After demonstrating the ability to pass through 8-10% and higher rent growth increases budgeted for 2023, operators expect continued strength in rent growth in the 6%-8% range in 2024 as the budgeting process gets underway. At the current pace, rent growth now represents real inflation adjusted increases benefitting top-line revenues as expense growth moderates in what has proven to be a persistent albeit moderating inflationary environment. Expense growth will likely remain the governor to driving NOI and margins with top-line revenue showing continued strength.

Overall, seniors housing occupancies increased 70 basis points (bps) in the third quarter to 85.0% 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 after minor revisions. Occupancies for majority assisted living properties increased 90 bps over the quarter to 83.2% while majority independent living assets rose a more modest 60 bps to 86.7%. While these trends clearly point to an improving macro environment, performance continues to vary widely at the property and market level. Nearly one-third (29) of the 99 primary and secondary markets tracked by NIC reported occupancies above pre-pandemic levels with secondary markets dominating the list. For majority assisted living assets, the number increases to 43 markets. 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, 45% of seniors housing assets were averaging occupancies of 90% or better, while 27% averaged occupancies of 80% or below, highlighting the disparity.

SENIORS HOUSING FUNDAMENTALS TREND: PRIMARY AND SECONDARY MARKETS



Source: Bureau of Economic Analysis (BEA), Conference Board

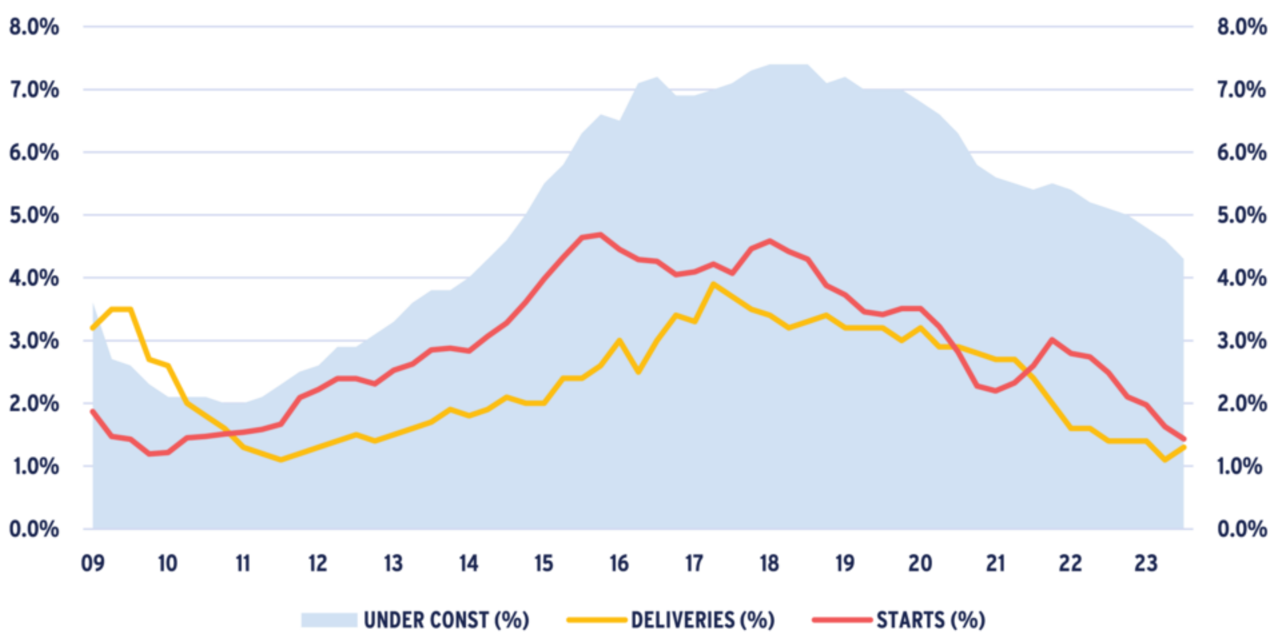
SENIORS HOUSING MARKET FUNDAMENTALS: PRIMARY AND SECONDARY MARKETS

	2023Q3	2023Q2	2022Q3
Properties	8,600	8,571	8,522
Units	1,074,930	1,070,751	1,061,137
Occupancy	85.0%	84.3%	82.6%
Stabilized Occupancy	86.0%	85.0%	84.0%
Absorption	11,666	8,416	13,178
Annual Absorption	4.8%	4.8%	5.1%
Inventory Growth	4,179	3,006	2,500
Annual Inventory Growth	1.3%	1.1%	1.4%
Properties Under Construction	420	453	530
Units Under Construction	46,439	49,423	54,582
Construction vs. Inventory	4.3%	4.6%	5.1%
Average Rent	$4,884	$4,841	$4,606
Annual Rent Growth	5.5%	5.9%	4.8%

Source: NIC Map Data Services

The positive trend in supply-side dynamics remains unchanged with the pipeline of new supply ratcheting down despite revisions that often impact the levels. Roughly 46,400 units, or 4.3% of existing inventory, were under construction through the third quarter with the pace of new projects breaking ground (new starts) at ~1.4%. It is difficult to see new construction maintaining a pace above current levels as the FOMC maintains its hawkish stance on inflation by keeping interest rates elevated. 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 on existing assets remain wide.

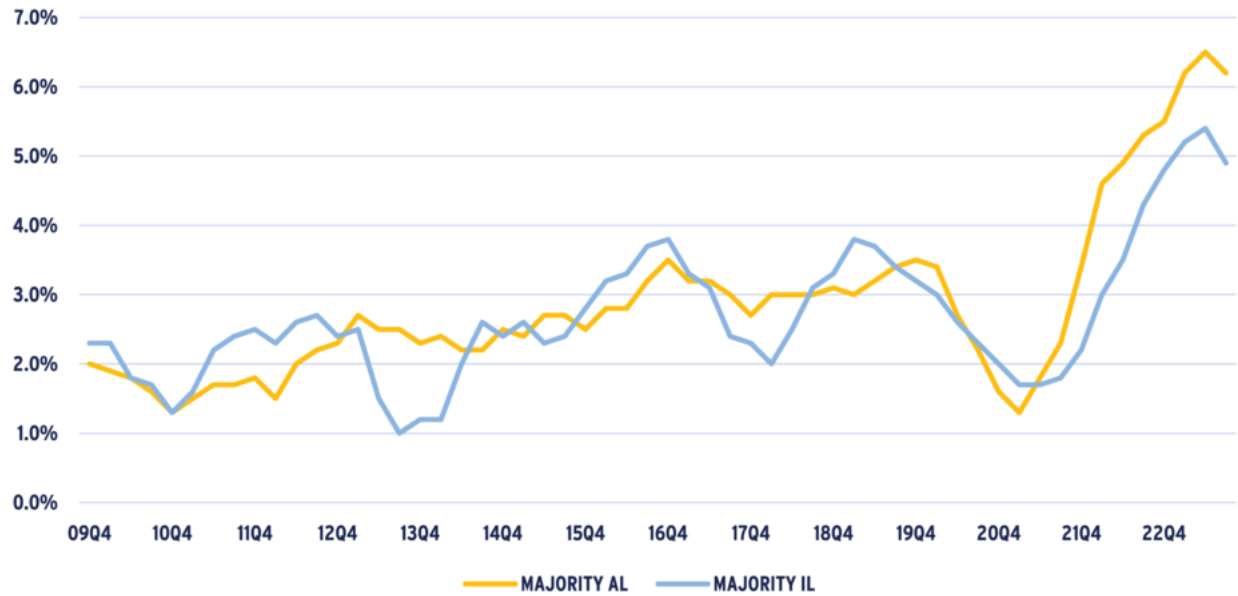
SENIORS HOUSING SUPPLY PIPELINE (% of Inventory)



Source: NIC Map Data Services; Primary and Secondary Markets
As of Q3 2023

Operationally, labor availability has improved with operators reporting the ability to fill full-time roles with labor cost growth moderating, adding stability to managing expenses. Across AEW's portfolio, agency usage has fallen closer to pre-pandemic levels which, combined with the ability to push rents, is helping drive higher NOIs and margins. This is especially true for communities where occupancies are approaching or have moved above previously stabilized levels. AEW's portfolio of stabilized assets has seen average occupancy move above 90%, adding to the ability to move rents and drive NOIs.

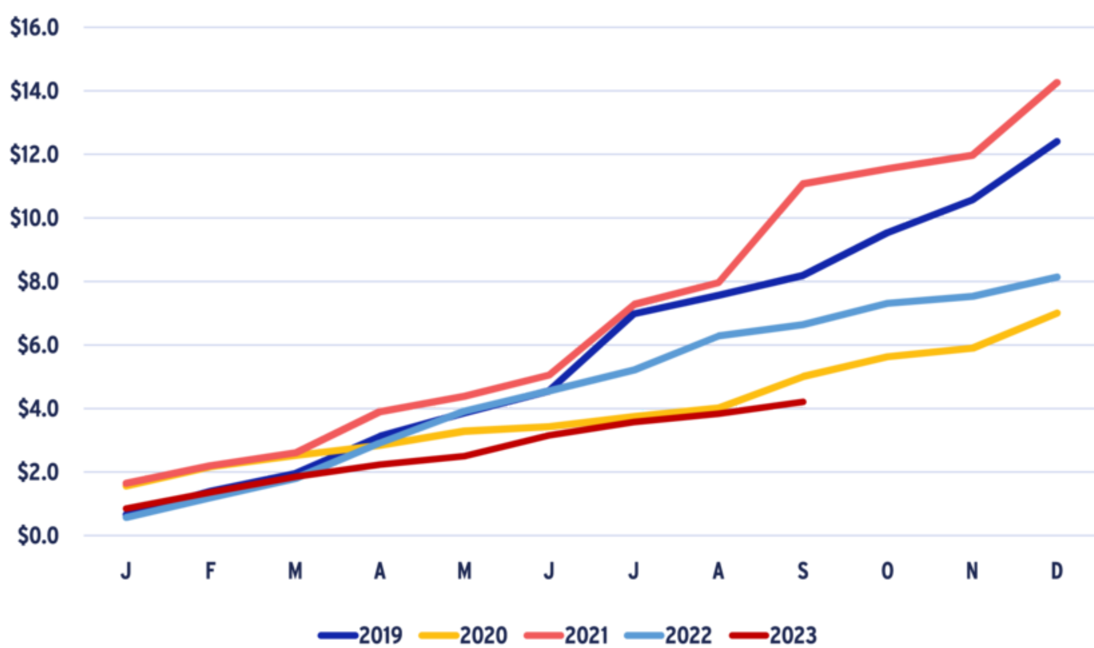
ANNUAL RENT GROWTH - NATIONAL



Source: NIC Map CBSA Property Trends
As of Q3 2023

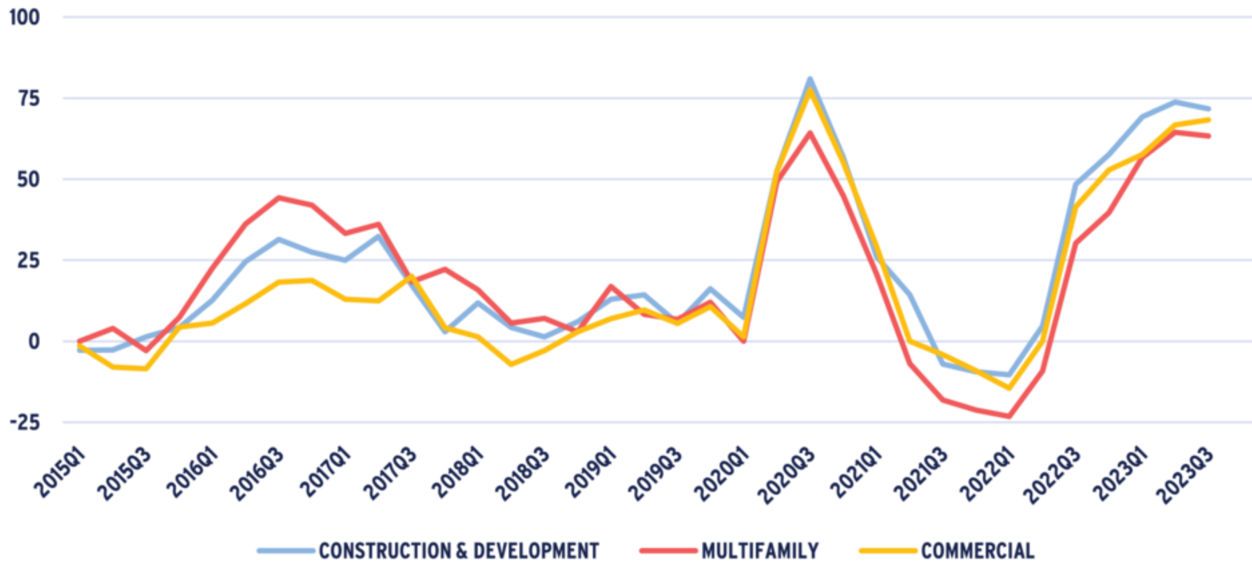
Aggregate transaction activity continued to slow through the third quarter of 2023 with $1.1 billion changing hands and year-to-date pacing at about two-thirds of last year's already depressed volume. Individual assets accounted for ~80% of the volume as select deals are closing in the absence of any sizable portfolio trades. Private buyers are most active, accounting for approximately two-thirds of the activity, while REITs, institutional capital and leveraged buyers took a step back as borrowing costs rose and lenders tightened lending standards by requiring additional recourse and covenants. Covenant defaults are 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 additional cash or credit support from borrowers. Select deals are transacting typically on an all-cash basis or with assumable financing. Lenders continue to tighten underwriting metrics with availability coming at a higher cost, especially as it relates to bridge financing.

CUMULATIVE SENIORS HOUSING TRANSACTION VOLUME ($BILLIONS)



Source: Real Capital Analytics
As of 10/27/23

PERCENT OF LOAN OFFICERS REPORTING TIGHTENING CONDITIONS



Source: Federal Reserve Board

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 margins still under pressure as NOIs work their way back toward 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. Signs of distress are becoming more evident across the sector. Leveraged assets with misaligned capital structures remain the biggest challenge for owners in the current environment but will likely represent the most attractive opportunities in 2024 for new capital as values and margins adjust.