CALIFORNIA SENIOR CARE MARKET | NOVEMBER 2022

EXPECT STEADY, SLOW RECOVERY

For those considering investing in senior care facilities in California in the next few years, specifically skilled nursing facilities (SNFs) and assisted living facilities (ALF), the advice is threefold.

1. Familiarize yourself with the markers, the things to look at when evaluating a facility.
2. This is a good time to start looking. In the wake of the pandemic, prices are depressed. There are some bargains out there, but don't wait too long, prices are rising.
3. The recovery for SNFs and ALFs has already begun and based on the demographics, it is expected to continue.

THE RECOVERY IS COMING

Before the pandemic, census rates in SNFs hovered at 80%. By January 2021, ten months into the pandemic, industry census rates dropped by more than 12 points to 67.5%.

The end of 2021 brought a turnaround, thanks to the development of vaccinations, weaker, less fatal strains of COVID-19, and a better understanding of how to control outbreaks. SNF census rates crept back to 74.5% by August 2022, making up more than half of the losses.

Mark Parkinson, president and CEO of the American Health Care Association, predicted that by 2024 or 2025 census would crawl above pre-pandemic levels. "I think the story in the mid-2020s will be, 'Wow, we have gone above where we were at pre-pandemic levels,' and we will get into the 82, 83, 84% range," he said.

A fact sheet from the Population Reference Bureau illustrates this post-pandemic growth. The number of Americans 65 and older will reach 98 million by 2060, comprising 25% of the population, up from 15% of the population in 2016. An April 2022 article in the Washington Post reports that the number of seniors over

Provided by

CALDLER CONRAD
Vice President
505.401.1211
calder.conrad@kidder.com
LIC N° 01987879
VCARD BIO LINKEDIN

Calder Conrad specializes in investment properties with a dedication to superior outcomes providing proven results in the commercial real estate arena. Calder has recently negotiated over $161.5M in transaction volume, representing private investors, institutions and non-profits.

KIDDER.COM

Kidder Mathews

85 (those most likely to need post-acute and senior care services) will more than quadruple in the next 20 years. care services, would more than quadruple in the next 20 years.

SNF: PRICE-PER-BED IS LINKED TO FACILITY AGE

The Senior Care Acquisition Report (developed by Irving Levin Associates LLC, referred to hereafter as the Levin Report), looks at senior care facilities sold in 2021. The study cites price-per-bed as an indicator of quality in an SNF. Newer facilities feature private rooms, preferred by private-pay and Medicare patients.

The average price per bed in 2021 was $84,000 for facilities 40 years or older. For those between 20 and 40 years, the average price per bed rose to $95,800. For those less than 20 years old, the price rises to $154,800.

Older facilities with smaller rooms or rooms for two or more people attract Medicaid residents, a less profitable operating model. Older facilities also require more capital expenditures for repairs and to keep them up to code.

The Levin study shows that the average price per bed in California was $111,300, putting the state in the top five in the US for per-bed prices of SNFs. Part of what drives the price in California is real estate. All the deals in the Levin study included both the facility and the real estate

Cap Rates

The cap rate is arrived at by dividing a facility's cash flow by the purchase price. This number is used to project the first year's cash flow. The standard cap for SNFs sold in 2020 was between 12.0% and 13.5%, but in 2021 that figure dropped to 11.3%, nationwide, which is what it was in California.

Cap rates are not the sole indicator of a facility's health, but they are useful for comparing similar facilities in a given area. They also do not take into consideration leverage or increased income from physical improvements or improvements to operations.

Operating Margins

Growing labor costs, a decrease in the average length of stay, a drop in census, and stagnant Medicaid reimbursement rates all place downward pressure on operating margins for SNFs. The operating margin for facilities sold in 2021 was 8.3%, a drop of 80 basis points over 2020, and down significantly from the high of 11.8% in 2014. Another cause for this drop in 2021 was that a number of the facilities sold recently are independents, often referred to as "mom and pops." The SNF space is getting more complex and regulated and these are the type of facilities that are more likely to underperform in that environment.

Net Operating Income (NOI)

NOI is down in 2021 over 2020, even as the price per bed rose over the same period. This is the inverse of how the market typically performs. NOI usually rises with the price-per-bed figure. The Levin study did not speculate as to the reason for this incongruity. One explanation is that NOI is suffering from the pandemic, and staffing wages have increased, but knowledgeable buyers are purchasing facilities in anticipation of an industry recovery.

ASSISTED LIVING FACILITIES: GROWTH DRIVEN BY AGING POPULATION

A market analysis of the assisted living facilities (ALF) by Grandview Research anticipates expansion for this sector at a compound annual growth rate (CAGR) of 5.48% from 2022 to 2030. These facilities serve developmentally disabled adults, individuals with disabilities, and those with dementia, as well as seniors who maintain their cognitive abilities but need long-term help with daily activities because they are recovering from a stroke or other health challenge. These latter two categories, dementia patients and the senior population in general drive the majority of growth in this sector.

Kidder Mathews

These facilities range in size from 100-plus units to those as small as four to seven units. More than 40% of ALFs in the US are in the western states, including California.

Price Per Unit

The average price per unit sold for ALF facilities reached an industry high of $248,400 in 2019, a unit is defined as a room that may house one individual or perhaps two. Prices plummeted in 2021, down 30% to $174,700. They recovered slightly in 2021 to $186,800 per unit. As with SNFs, the information on these sales includes both the physical facility and the real estate, which again means buyers can expect higher prices in California.

California ALF Prices

The Levin study considers ALFs and Independent Living as one category. For the four-year period between 2017 and 2021, the average sales price for these facilities in California was $296,100 per unit, with an average cap rate of 7.3%.

Operating Margins

Operating margins in ALFs are higher than those in SNFs, but they experienced the same downward pressures from declining census because of the pandemic, staffing issues, and overdevelopment. Operating margins in ALFs dropped nominally from 2019 to 2020, from 21.6% to 20.7%, respectively. The bigger hit came in 2021 when operating margins dropped to 17.3%.

Net Operating Income

The average net operating income for ALFs and independent living also fell. The average NOI per unit annually for properties sold in 2019 was $12,700. That fell in 2020 to $11,550, and fell again in 2021 to $10,100. There is a direct correlation between the age of the facility and the NOI. Overdevelopment also plays a role in this downward trend.

The age of the facility also affects NOI. ALFs less than five years old had a per unit NOI of $17,300 in 2021. Those facilities five to 15 years old had an NOI of a little more than $13,000. Those older than 15 years had the lowest NOI, coming in at a little over $7,000 per unit.

SINGLE FACILITY SALES VS. PORTFOLIO SALES

The Levin study looked at sales of single facilities as opposed to portfolio sales (sales of three or more facilities). Portfolio sales in 2021 averaged $205,900 per unit, whereas sales of single facilities averaged $158,500 per unit. There are two reasons for this. First, the facilities in a portfolio sale were likely corporately owned and have more stringent management. Second, single-facility sales were more likely independently owned (again referred to as "mom and pop" operations) and were more likely to be older facilities.

MEMORY CARE ALFS CONTINUE TO COMMAND HIGHER PRICES

Another trend that continues through 2021 is that buyers are willing to pay more for ALFs that are 100% memory care, or independent living facilities that have a memory care component. In 2021, the Levin study valued the average memory care facility sale at $207,100 per unit as opposed to a facility without memory care, which sold for $150,700 per unit, a difference of $66,400. The demographics of an aging population (more likely to need memory care) and higher rents make them attractive investments.

This price differential is on a downward slope. In 2018, the difference between memory care and ALFs without memory care was $94,700, or $219,200 and $124,500, respectively. The Levin study attributes this to the overdevelopment of memory care facilities in many markets. ALFs that were 100% memory care or had a memory care component comprised 80% of sales in 2019 but fell to 70% in 2020 and only 61% in 2021.

CONCLUSION

As the US emerges from the pandemic, an aging population points to opportunities in SNFs and ALFs. Buyers need to be diligent and examine the indicators when evaluating a facility for purchase. One factor that is less likely to play a role in these sectors for the next few years is overdevelopment. Scarcity of developable land in core markets, higher construction cost and increased interest rates are discouraging new construction.