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## **TIPS FOR FIRST-TIME SENIORS HOUSING INVESTORS**

*Unlike many other commercial property types, seniors housing is heavily dependent on operations and licensure. Here's what to keep in mind.*

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Historically, the seniors housing market consisted primarily of non-profit organizations, small owners and operators and a finite list of private equity firms, REITs and institutional investors that dabbled in the seniors housing space. In recent

years, however, investors of all types, including new private equity firms, REITS and institutional investors, as well as family offices, foreign capital and other equity sources, have begun pouring capital into the seniors housing industry, and the sector has evolved from a niche real estate asset type to a sophisticated real estate class of its own. Although there has been some tightening of the seniors housing market of late, investment returns as tracked by the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index consistently show seniors housing properties outperforming commercial properties generally, with only the industrial sector outpacing the seniors housing sector. NCREIF also reported the first quarter of 2019 as the first quarter that market value of NCREIF-indexed seniors housing properties exceeded \$6 billion.

There are a variety of reasons for the recent boom in the seniors housing industry. One is that the U.S., like the rest of the world, is rapidly aging. By 2030, all members of the baby boom

generation will be older than 65 and, according to the Census Bureau, about one-fifth of the U.S. population will be of traditional retirement age. This rapid surge in the older population is increasing demand for seniors housing and attracting new investors to the sector. Another reason for the growing demand is that this asset class is generally viewed as less cyclical than other classes of real estate, as evidenced by the sector's comparatively strong performance during the 2008 global financial crisis.

As we get deeper into the current business cycle, many new investors are moving into the seniors housing space in an effort to diversify their portfolios with more recession-proof investments. In addition, as the seniors housing industry has grown, industry data, including property sales, financial metrics, investment performance, occupancy rates and demographic trends, has become more readily available. Given this wealth of new information, first-time investors have a better understanding of the sector's historically strong performance, particularly during economic downturns, as well as its unique risk profile. However, these first-time investors should be aware of a few key differences between seniors housing assets and other types of real estate.

First, seniors housing assets are heavily operational. Vetting and selecting the right operator or manager is crucial to success, and waiting too long to bring an experienced operator into a seniors housing deal can be a critical and costly mistake. There are many factors to consider in selecting an operator, including community size, geography, experience, areas of focus, operational strategy, growth trends, historical performance and culture, so it is important to identify an operator that is the right fit for the particular seniors housing community and investor. A seasoned and sophisticated operator will provide valuable feedback on the community's historical performance, current operations and areas for improvement, as well as participate in business planning that identifies targeted investment goals and strategies to improve the performance of the community. On development deals, it is never too early to identify and secure the right operator. The operator can help identify the right location, guide the development through the entitlement phase, advise on a community design that will appeal to potential residents and their families and assist with pre-opening start-up and marketing efforts.

Second, certain types of seniors housing communities (e.g., assisted living, memory care, and skilled nursing) are subject to licensure requirements that vary from state to state. This regulatory overlay impacts property diligence, the transaction documents and overall deal timing, based on the particular state's requirements and timeline for new licensure applications. Identifying knowledgeable attorneys and consultants, as well as partnering with an experienced operator, is critical to the successful navigation of these issues.

Third, many seniors housing communities participate in payment and reimbursement programs such as Medicare, Medicaid, HMOs, PPOs, state government insurers, private insurers and other programs. These payment structures need to be scrutinized during underwriting, with the understanding that payment and reimbursement under government sponsored programs are subject to legislative change. Seniors housing communities that market primarily to private pay residents are less risky in this regard, since payment streams will not be susceptible to such changes in law.

Finally, from a transactional perspective, it is important to find attorneys who are familiar with the seniors housing industry and well-versed in the types of issues that arise in the course of these transactions. Many issues that come up in the documentation of seniors housing transactions differ from other real estate transactions, and the concept of "market" can be distinctly different, so it is critical to work with attorneys who specialize in this area. For example, in purchase and sale agreements, issues which differ from other asset classes include the transfer of operational assets, documentation relating to state licensure requirements, representations and warranties, as well as indemnities relating to operations and licensure and allocations of risk between the parties. Similarly, with respect to the negotiation of joint venture agreements, property management agreements and loan documents, the operational issues associated with a seniors housing investment (including, among other things, licensing and compliance issues, employment issues, and operational risk allocation issues) permeate the entirety of the documents, including the representations and warranties, indemnities, covenants, and default and cure rights.

With all of this in mind, first-time investors should be cognizant of the unique characteristics of this asset type and plan accordingly. A critical first step is to work with consultants and partners who are experienced with seniors housing investments and operations. More so than with other asset classes, it is imperative to build the right team to successfully identify and underwrite a

potential investment, form a competitive business plan and structure and to negotiate the transaction.

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