

NIC INSIDER

Newsletter

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Skilled Nursing Transaction Pricing Continues to Edge Higher

by Bill Kauffman, Senior Principal, NIC

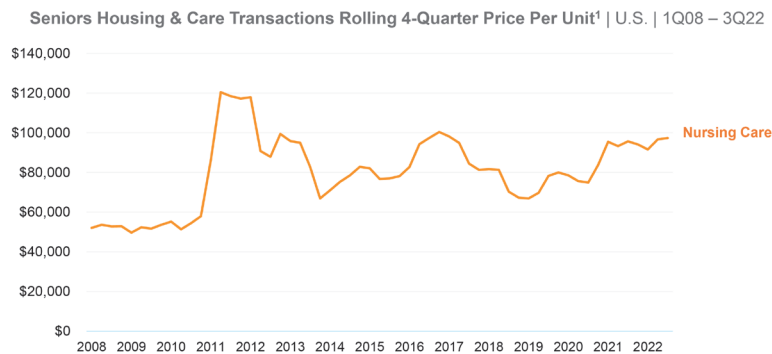


Bill Kauffman

Pricing for skilled nursing properties has held up in the past two years despite some negative headlines and weak, albeit improving, market fundamentals. Investor interest by private buyers has dominated the transaction landscape. This article delves into various reasons why this has been the case and why this could change in the months ahead.

For context, the chart below shows the historical trend of property pricing per nursing care bed. (Note: The data represents properties that have traded and does not include pricing of properties if they have not been transacted in the time periods shown. Hence, the mix of properties will impact the average prices reported). In late 2019, the price per nursing care bed averaged \$80,000 before slipping 1.8% to \$78,600 in the first quarter of 2020. Due to the pandemic, pricing declined another 4.6% to \$74,900 in the third quarter of 2020, its pandemic low. The decline made sense at the time because many properties were struggling during the pandemic due to low census counts, staffing challenges, regulatory requirements, and other factors.

Pricing Inched Up Again in the Third Quarter



1. Preliminary Data as of 10/4/2022

Source: NIC MAP® Data, powered by NIC MAP Vision, MSCI Real Capital Analytics

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However, the price per nursing care bed remarkably increased 27.4% to \$95,400 by the first quarter of 2021 during a period of very low occupancy levels. Since then, occupancy has partially increased from 74.0% to 79.3% but remains challenged with 7.1 percentage points of recovery required to get back to pre-pandemic levels. Nevertheless, the price per bed averaged \$97,300 as of the preliminary data for the third quarter. This was 21.6% above the level in the fourth quarter of 2019 before the beginning of the pandemic.

At the same time, there are headwinds against higher prices. These include the risk of Medicare reimbursement cuts, low occupancy rates, chronic underfunding



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of Medicaid reimbursement in many states, a staffing crisis, and ongoing elevated inflation including wage rate growth. Given the challenges that are present, why has the nursing care property price per bed increased?

There is not simply one answer as to the reason behind why skilled nursing price per bed is relatively high, especially considering the challenging operating fundamentals. There are likely many factors involved. These include strong private buyer interest, compelling demographic trends favoring the necessary care required for aging adults who have higher acuity needs as well as their more complex medical needs, changes in capital and debt markets, financial support from the federal government during COVID, and other factors and trends. Below, I discuss each of these conditions.

First, the low interest rate environment fostered by the Federal Reserve's monetary policy in the immediate aftermath of the pandemic created a tremendous amount of liquidity and pushed investors into a risk-taker environment. As a result, most asset prices including real estate and public equities, increased significantly during the height of the pandemic. Furthermore, the government made a commitment to financially support the skilled nursing industry during the pandemic. This was evident by many Paycheck Protection Program (PPP) loans, Medicare prepayments, Medicaid rate increases, and other forms of aid at the state levels. Second, the Patient Driven Payment Model (PDPM), implemented before the pandemic, can compensate for higher care levels unlike the previous model (RUG-IV). Thus, PDPM has the potential to create higher cash flow for operators of skilled nursing properties. Buyers can justify paying higher prices per bed if they are estimating higher cash flow.

Second, owners with more properties can benefit from scale in certain geographies and potentially experience other benefits like staffing flexibility. Therefore, some owners have planned to grow by acquisition and can justify higher prices paid if they own more properties in a defined geographic area. Another potential reason is the opportunity for growth in other ancillary businesses, such as in-house dialysis, contract therapy, wound care, pharmacy services or an on-site diagnostic lab. Also, there is the dynamic that there are more buyers than sellers of skilled nursing properties, at least for now.

Private buyer interest in skilled nursing properties has dominated the transaction market for the past few years. Specifically, over the past three years the industry has not only seen the private buyers dominate the transaction market, but the percentage of closed transactions attributed to these buyers has steadily increased. Through the third quarter of 2022 private buyers represented 94% of buying activity, in 2021 they were 90% of activity, and in 2020 closed transaction dollar volume attributed to the private buyers was 82%. This activity has contributed to higher prices as these buyers bid up prices to win the deals.



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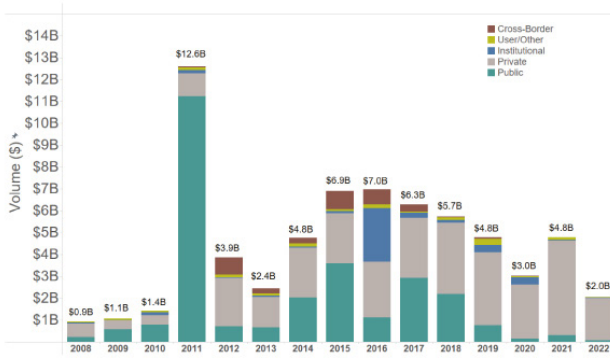
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Private Buyers Dominated Nursing Care Transactions

Closed Transactions Nursing Care Volume by Buyer Type¹ | U.S. | 1Q08 – 3Q22



1. Preliminary Data as of 10/4/2022

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Furthermore, many investors view higher acuity patients as an opportunity for their business model. As mentioned earlier in this article, the Patient Driven Payment Model (PDDM) creates the potential for operators to receive additional payment for higher acuity patients, and perhaps higher cash flow of which many investors/owners find attractive. Particularly, PDDM reimburses skilled nursing facilities based on the medical complexity of patients rather than the RUG-IV model based on volume of services provided. This model may impact the resident profile as many operators could move toward a higher-acuity patient profile. Investor interest is likely to continue given the favorable demographics regarding the growth of the older adult population and the expected need of many within this population to require 24-hour care because of multiple chronic illnesses as they age.

Lastly, there is a yield spread differential in nursing care properties compared with other real estate property types. For example, if skilled nursing properties are selling at 12% cap rates, there is still positive leverage and there historically has been significant cushion if the cost of debt capital is, for example, in the 6% range and combined loan-to-value ratios were in the 85-90% range for a stabilized property. In many other real estate property types, leverage has turned negative with the cost of debt exceeding cap rates, which are rising in today's economic environment. In addition, from an overall real estate investment perspective when measured against other real estate asset types, 12% cap rates look very attractive. Cap rates for office have been in the range of 6-7%, for example, and in the range of 4% for multifamily. However, this specific appeal could certainly change if interest rates continue to increase rapidly and stay elevated for longer.

Skilled nursing property pricing has been stronger than many would have expected during these challenging times for various reasons. However, the risk of higher interest rates and labor market challenges could provide additional reasons for sellers to bring properties to market. If more sellers do come to market and the cost of capital increases as inflation and interest rates continue to stay elevated, the pace of increases in the price per bed for skilled nursing properties may be limited in the near-term.

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- 11/02..... Seniors Housing Business Interface Multifamily (Salt Lake City, UT)
- 11/2-3..... ASHA Chairman’s Circle (Sarasota, FL)
- 11/6-8..... Senior Living Innovation Forum (SLIF) Conference (Nassau, Bahamas)
- 11/7-9..... California Assisted Living Association (CALA) Conference (Palm Springs, CA)
- 11/8-10..... ICAA Conference, Leadership Summit and Expo 2022 (Orlando, FL)
- 11/9-10..... Senior Housing News BUILD Conference (Chicago, IL)
- 11/13-16..... California Association of Health Facilities (CAHF) Annual Convention (Palm Spring, CA)
- 11/13-16..... HLTH Create Health’s Future (Las Vegas, NV)
- 11/14-16..... Argentum Senior Living Leadership Summit (Las Vegas, NV)
- 11/15-17..... REITworld: 2022 Annual Conference (San Francisco, CA)
- 11/15-17..... AHCA/NCAL 2022 Fall CEO & Senior Executive Conference (Scottsdale, AZ)
- 11/15-16..... Seniors Housing Business Interface Southeast (Nashville, TN)
- 11/16-17..... Skilled Nursing News RISK Summit (Virtual)

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