Thoughts from NIC’s Chief Economist
By Beth Burnham Mace

Shifting attitudes toward interest rates

The generally accepted view on interest rates has shifted since my last commentary in the NIC Insider. As this year began, there had been general consensus about both the direction and speed of change in short term interest rates. Supported by the Federal Reserve’s comments, many pundits believed there would be at least two and possibly three more 25-basis point rate increases in 2019, moving the fed funds rate toward a range of 2.75% to 3.00%. In December, the Federal Reserve raised the fed funds rate by 25 basis points to a range of 2.25% to 2.50%, an 11-year high. That marked the fourth increase in 2018 and the ninth increase since late 2015, after the rate was kept near zero for seven years. The increases were part of an on-going normalization of interest rates, initiated by former Federal Reserve Chairwoman Janet Yellen and continued by current Chairman Jerome Powell.

However, in January, Chairman Powell signaled a pause to rate increases when he eliminated a reference to “further rate hikes” in his policy statements. In his statements, he also indicated that the Fed’s strategy to shrink its $4 trillion balance sheet would likely slow. Since early 2018, the Fed has been gradually reversing its Quantitative Easing policy (QE) with Quantitative Tightening (QT) by allowing the bond holdings held on its balance sheet to steadily mature without re-investing them, a policy that could potentially put upward pressure on interest rates. In making these statements, Mr. Powell cited concerns about global economic growth and limited inflation. But some analysts viewed these comments as a capitulation to the stock market, which swooned in late December after the Fed raised rates a fourth time in 2018.

For us in the seniors housing and care industry, this means that the cost of debt may be somewhat lower than anticipated a few months ago. It may also slow the shift of borrowing from fixed rate to variable rate debt, and it puts less downward pressure on valuations, which can be affected by higher interest rates. It could also suggest a slower pace of distressed deals coming to market, increasing the patience of investors with capital on the sidelines.

The residential housing market and seniors housing

Among the macroeconomic factors that generally influence demand for seniors housing are interest rates, expectations of future interest rate changes, broad economic growth, the job market, consumer confidence, the stock market, and residential housing activity. Indeed, the ability to sell one’s home and use the proceeds to pay for the costs of seniors housing often contributes to the timing decision of when to move into seniors housing, especially for independent living. And of late, the housing market and price growth have shown weakness.
The housing market has started to feel the effects of higher mortgage interest rates and the 2017 tax law that reduced tax deductibility for homeowners. Taken together, these two factors make it more expensive to purchase a home.

In November, the Federal Housing Finance Agency effective composite rate was 4.9%, up from 3.7% in mid-2016. Combined with still-increasing (albeit decelerating) home price growth, affordability is being affected, which in turn is having an impact on the pace of both new and existing home sales. Also in November, new home sales were 7.7% lower than year-earlier levels, while existing single-family home sales fell 10.0% to a seasonally adjusted annual rate of 4.45 million in December, the lowest reading since November 2015. The median single-family house price fell to $261,200 from $264,330, as well, but was up 3.0% from year-earlier levels.

The change in Fed policy this year could help limit further increases in near-term mortgage interest rates, which in turn could support stronger demand for home sales and price appreciation in the months ahead. Indeed, the 30-year mortgage rate fell last December in response to lower Treasury yields amid indications of looser Fed policy.

If sentiment shifts to the idea that no further significant mortgage rate increases are in the queue, homebuyer expectations could stabilize and sales could return to their very slow upward trend. Should this happen, another leg in the stool for strong seniors housing demand would strengthen. In the fourth quarter, NIC MAP® data showed that demand was strong—in fact, the strongest on record—but not enough to offset robust inventory growth.

Is seniors housing construction plateauing?

Data from the fourth quarter of 2018 suggests that seniors housing construction activity may be slowing. Indeed, construction starts for both independent living and assisted living (units in properties that have broken ground during the respective quarter) are trending lower. In the fourth quarter, assisted living starts clocked in with the fewest units since the first quarter of 2012 for the NIC MAP 31 Primary Markets (an estimated 1,500 units). On a rolling four-quarter basis, starts totaled less than 9,400 units, the fewest since 2014. As a share of inventory, this amounted to 3.3%. The last time it was below 4% was 2012. For independent living, starts on a rolling four-quarter basis totaled approximately 7,300 units in the fourth quarter. As a share of inventory, this equaled 2.2%. The last time it was below 2% was 2014.

In addition to fewer units breaking ground, there are also fewer units in total under construction (measured from start to completion). In the fourth quarter, there were roughly 37,000 seniors housing units under construction (independent living and assisted living) for the NIC MAP 31 Primary Markets. That figure is down from the record high of 43,800 in the fourth quarter of 2017, or by nearly 6,500 units. Moreover, construction as a share of inventory slipped back to 6.0% of open inventory in the fourth quarter of 2018, down from the recorded high of 7.3% in the fourth quarter of 2017.

It is important to note, however, that construction data is often restated—both up and down. Construction starts are the most commonly restated data points
because they are particularly difficult to capture, so these numbers are likely to be modified. NIC occasionally finds out that a project has broken ground after the fact or that a property indicated ground-breaking pre-maturely. Part way through a project, a property manager may adjust their plans for unit totals or unit mix based on pre-leasing patterns, unforeseen challenges, or other factors. Changes to unit mix can also mean changes to a property’s majority property-type designation.

As always, I welcome your feedback, thoughts, and comments. Let’s keep the conversation going.

Beth
Seniors Housing & Care Industry Calendar

March 2019

3/13-14  AHIP National Health Policy Conference  Washington, DC
3/14-15  2019 PREA Spring Conference  Dallas, TX
3/17-20  LeadingAge PEAK Leadership Summit & Great Minds Gala  Washington, DC
3/18-20  Nineteenth Population Health Colloquium  Philadelphia, PA
3/27-28  Health Datapalooza  Washington, DC
3/28  McKnight’s Expo Webinar

NIC Partners

We gratefully acknowledge our following partners:

Premier Partners

[List of logos for Premier Partners]

Official Partners

[List of logos for Official Partners]