Thoughts From NIC’s Chief Economist

Breaking A Record

In July, a significant record is likely to be broken. The U.S. economy officially will be in the longest expansion recorded since 1854, beating out the 10-year or 120-month expansion of the 1991 to 2001 period. In addition, this growth period is now more than twice as long as the average expansion of 58 months enjoyed in the post war period. Wow! It’s a remarkable time in which we live.

The question now is how much longer will this growth continue? What factors could cause a slowdown or even a reversal of fortune? The business cycle has not disappeared. Are we around the corner from a recession? What are the indicators we can be watching?

Recession Triggers

As has been repeated often of late, an expansion does not die of old age in and of itself. Other factors come into play. This could include an unexpected shock to the economy as has often occurred in the past, such as an oil price spike (1973-75 recession as OPEC quadrupled oil prices). Often related to an oil price shock is a sudden run-up in inflation which generates a sharp retraction in spending behavior, slower economic growth, and an increase in joblessness. Possibly adding fuel to a slowing economy are rising interest rates caused at least in part by the Federal Reserve trying to slow inflation (1980-82 recession). Consumer and business confidence are also significant contributors to exacerbating or reversing broad economic strength. And lastly, financial shocks—busts following a boom or the popping of an asset bubble—can lead to serious setbacks such as the subprime mortgage crisis in 2007 and the dot-com bust in 2001 (exacerbated by the 9/11 attack).

Until January, it was widely speculated that the U.S. economy would slip into recession by 2020 as (a) the short-term positive effects of the 2017 deficit-financed tax cuts and fiscal stimulus faded near year-end 2019 and (b) the Federal Reserve continued its policy of rate normalization by raising interest rates. The sentiment held by many was that this would tip the scales into a recession. However, as Federal Reserve chairman Jerome Powell indicated in the early part of this year, his previously announced intentions of raising interest rates in 2019 have likely gone on hold as the Fed pledged to take a “patient” approach to future policy changes. As a result, the fear of the Fed stepping too heavily on the brakes by raising interest rates and tipping the economy into a sharp downturn have now dissipated to at least some degree. In fact, many prognosticators believe the Fed’s next move may be to cut interest rates to stimulate further growth in the economy.

All in all, it is now likely that the U.S. economy will slow in 2019 due to the waning effects of the tax cuts and fiscal stimulus as well as an overall slowdown in the global economy, a potential escalation of the Trump administration’s tariffs on China (and other countries), and slowing growth in the automotive and housing industries.
For 2020, and barring any significant exogenous shock to the economy, it is also not likely that a severe recession will take place, which, combined with moderate growth in 2019, would clearly cement this recovery as the longest one in U.S. history.

**Yield Curve Warning Sign**

One indicator to watch as an early warning indicator of a recession though is the shape of the yield curve. The yield curve plots bond yields from the shortest maturity to the highest and is considered a barometer of economic sentiment. Normally, the yield on a shorter-dated 3-month Treasury bill is less than a longer-dated 10-year bond. That’s because the perceived risk for holding a bond for a longer period of time is higher. In “normal” market conditions, the yield curve is upward sloping as bond investors require higher rates for a longer-hold period than a shorter-hold period.

When the longer yield is lower than the shorter-term instrument, it creates an inverted yield curve, and it is typically an indicator of concerns about the long-term growth potential of the overall economy. When the yield curve inverts, it is a leading indicator that a recession may be on the horizon. Historically, the yield curve has inverted 7 to 24 months ahead of a recession. An inverted yield curve does not guarantee a recession, but since 1956, every recession has been preceded by an inverted yield curve.

On March 22, the yield curve inverted for the first time since mid-2007, i.e., the yield on the U.S. 10-year Treasury note dipped below the yield on the 3-month paper. Time will tell if this was a harbinger of a recession next year.

**Is Seniors Housing Recession-Resilient?**

While an economic recession does not appear to be on the immediate time horizon, it may be prudent to consider the seniors housing sector’s recession-resiliency. For this, we can look back at how the sector fared during the Great Recession from December 2007 to June 2009.

During that period, a difference was observed in the occupancy performance of assisted living properties versus independent living properties. For assisted living, the occupancy rate fell 3.1 percentage points from 89.5% in the third quarter of 2007 to 86.4% in the second quarter of 2009, a near-record low rate of occupancy (the subsequent nadir was 85.2% in the second quarter of 2018). Once the recession officially ended, occupancy for assisted living began to improve.

Independent living lost 4.3 percentage points of occupancy during this same time period (91.7% in the third quarter of 2007 to 87.4% in the second quarter of 2009) and continued to slip further until the third quarter or 2010 when it hit a low of 86.8% (for a total decline of 4.9 percentage points). Independent living occupancy declined for a longer period, and the decline was more significant than that of assisted living.

The difference may be that, because assisted living is more need-based and less
choice based, it is less sensitive to the economic cycle. When an older adult has significant mobility limitations or significant activities of daily living care, it is difficult to not respond. Independent living is perceived as less need-based and more choice-based, so it may be more easily postponed. This may have been particularly the case during the Great Recession, since that recession was largely housing related and significant amounts of home equity were eroded, reducing the dollars available to move into a preferred housing option.

Unlike other property types, asking rent did not go negative for either independent or assisted living properties during the Great Recession or in the months thereafter, but they did decelerate during this period. For assisted living, year-over-year asking rents shifted from a 3.7% annual pace just prior to the recession starting to 1.9% by the end of the recession in mid-2009, and then continued to decelerate to 1.1% in the fourth quarter of 2010. For independent living, asking rent growth decelerated from 3.9% before the recession to 2.9% at the end of the recession, and then decelerated to 1.2% by late 2010.

In terms of investment returns, for the seniors housing properties that are tracked by National Council of Real Estate Investment Fiduciaries (NCREIF), there were two quarters of negative total investment returns during the recession for a cumulative decline of 6.1%. This compares favorably with the overall NCREIF Property Index (NPI), which had six quarters of negative total investment returns for a peak-to-trough decline of 26%.

Taken in its entirety, seniors housing is not recession resistant, but it did show resiliency during the last economic recession. This was particularly the case for assisted living. Looking ahead, the need-based component of assisted living (including memory care) does suggest that, when (not a question of if) the next recession occurs, investors would be wise to have assisted living in their portfolios, especially in those markets where today’s market fundamentals are strong.

As always, I welcome your comments and feedback.

Beth
Seniors Housing & Care Industry Calendar

May 2019

5/1-3  AHCA/NCAL Spring Conference for Multifacility CEOs and Senior Executive Leaders  Bluffton, SC
5/3   6th Annual Brain Ball – Alzheimer’s Association  Washington, DC
5/5-8  LTC 100 Leadership Conference  Naples, FL
5/8-9  Real Estate Research Institute (RERI) Conference  Chicago, IL
5/8   Build – the Future of Senior Living Development  Chicago, IL

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