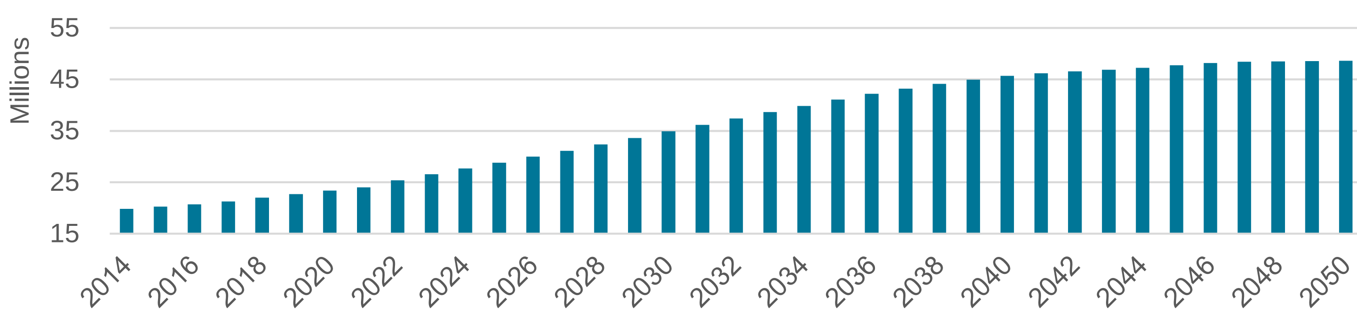
Multifamily Market Commentary – May 2017

Seniors Housing: Fundamentals Soften but Remain Healthy in First Quarter 2017

Seniors housing fundamentals softened modestly in the first quarter of 2017, with elevated levels of inventory additions moderately overwhelming otherwise healthy levels of absorption, based on data from the National Investment Center for Seniors Housing & Care (NIC), an industry provider of seniors housing data. The seniors housing industry experienced record levels of demand during 2016, which allowed occupancy to continue at near-term peak levels, despite significant additions to inventory. Those conditions eased in early 2017, which resulted in a minor slowdown in rent growth and a slight decline in occupancies, though both measures remain relatively healthy. High levels of new supply are likely to be an ongoing condition for seniors housing, though the number of units under construction has been declining over the past six months.

Seniors housing has been in the midst of a multi-year period of robust expansion. Since the end of the Great Recession, the nation's 100 largest metropolitan areas have added nearly 4,200 new units on average each quarter, while simultaneously experiencing a sufficient population increase to keep occupancies healthy and maintain steady levels of rent growth. As seen in the chart below, the growth of the population of people age 75 and older is an ongoing condition for the national economy, with this age group forecasted to double in size over the next 20 years, from around 21 million today to over 43 million in 2037.

Age 75+ Population, by Year (Projected)



Source: U.S. Census Bureau

All Primary Markets Have Positive Rent Growth - Secondary Markets Underperform Primary

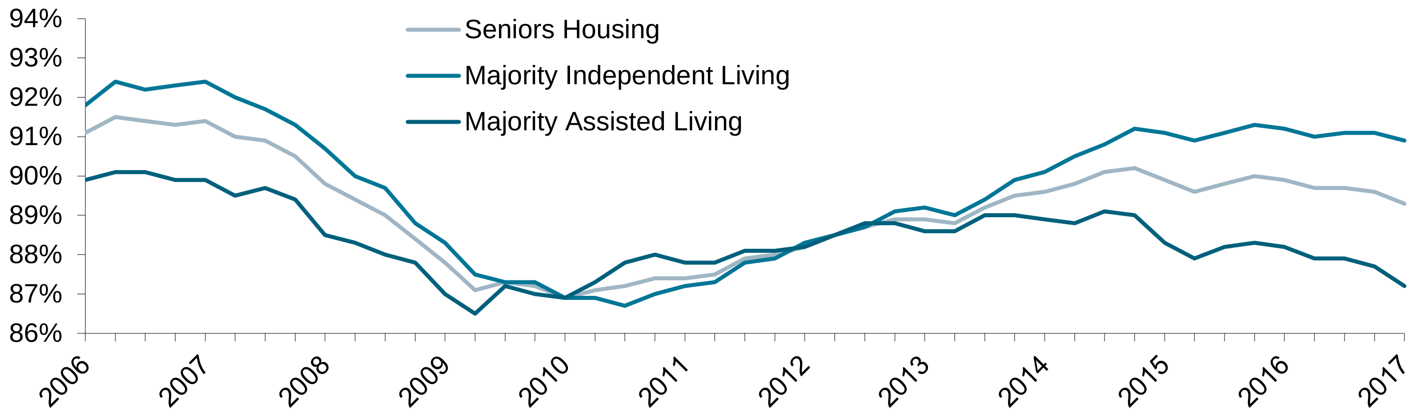
Rent growth was positive in all of NIC's Primary 31 Markets (1st to 31st in size by population) in the first quarter of 2017, for the eighth consecutive quarter. Overall, 15 of the 31 primary markets had lower rent growth in the first quarter than they did in the prior quarter, which is a slight improvement compared to the fourth quarter. Among the Primary 31 markets, most have steadily prospered over the past several years, though a mix of high levels of construction and unexpected interruptions in demand have resulted in Houston, Las Vegas, and San Antonio having the lowest occupancy rates among the large metros.

NIC's Smaller Markets (32nd to 100th in size by population) continued to have lower occupancy than the Primary 31 markets, which happened only once before, in the first quarter of 2016. Occupancy levels in these secondary markets fell for the ninth consecutive quarter, falling to 88.8 percent, the lowest level since 2011. Rent growth in these secondary markets in the first quarter of 2017 followed the decelerating trend in the primary markets, falling 0.4 percent to 2.5 percent. Rent growth again remained slower in the secondary markets compared to the primary markets, which has been the case in every quarter since the second quarter of 2013.

Absorption Levels Ease in Early 2017 but Have Been Strong for Several Years

Total absorption for seniors housing declined from the recent record levels, with 2,349 total units absorbed in the first quarter of 2017. The results were driven by divergent underlying trends: Majority Assisted Living (AL) absorption was down 29 percent compared to a year ago, but Majority Independent Living (IL) absorption was up 92 percent from the first quarter of 2016. Throughout 2016, and generally since 2010, absorption levels for overall seniors housing have been robust and steadily increasing, albeit with brief interruptions, as seen in the chart below.

Occupancy by Property Type

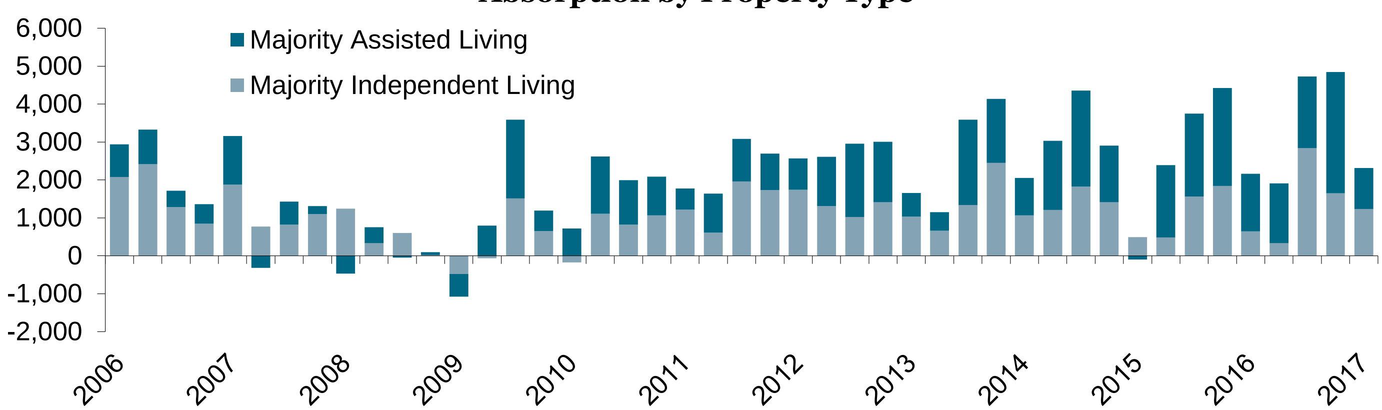


Source: NIC MAP Data & Analysis Service

Occupancy Remains High After Easing in First Quarter

Under the weight of high levels of inventory additions, overall occupancy for seniors housing properties fell slightly, to 89.3 percent in the first quarter of 2017, down 0.6 percentage points from year-ago levels. This result possibly marked the end of a multi-year plateau that was likely the peak level achieved by the industry in this business cycle. As seen in the chart below, Majority IL was down a modest 0.2 percentage points in the first quarter of 2017 to 90.9 percent, while majority AL decreased slightly more, falling 0.5 percentage points to 87.2 percent. Both segments remain above the trough that was observed in the aftermath of the Great Recession, although Majority AL is approaching that level. Given the robust supply that segment has seen in in the past five years, this level of occupancy is likely just a result of slightly too much supply in a short period.

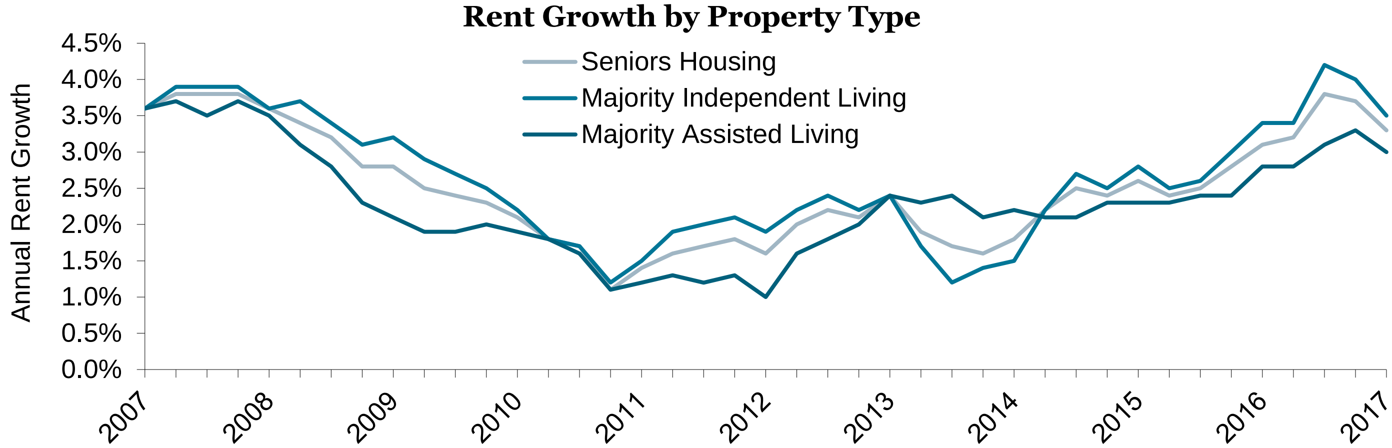
Absorption by Property Type



Source: NIC MAP Data & Analysis Service

Rent Growth Eases from Recent Record Levels

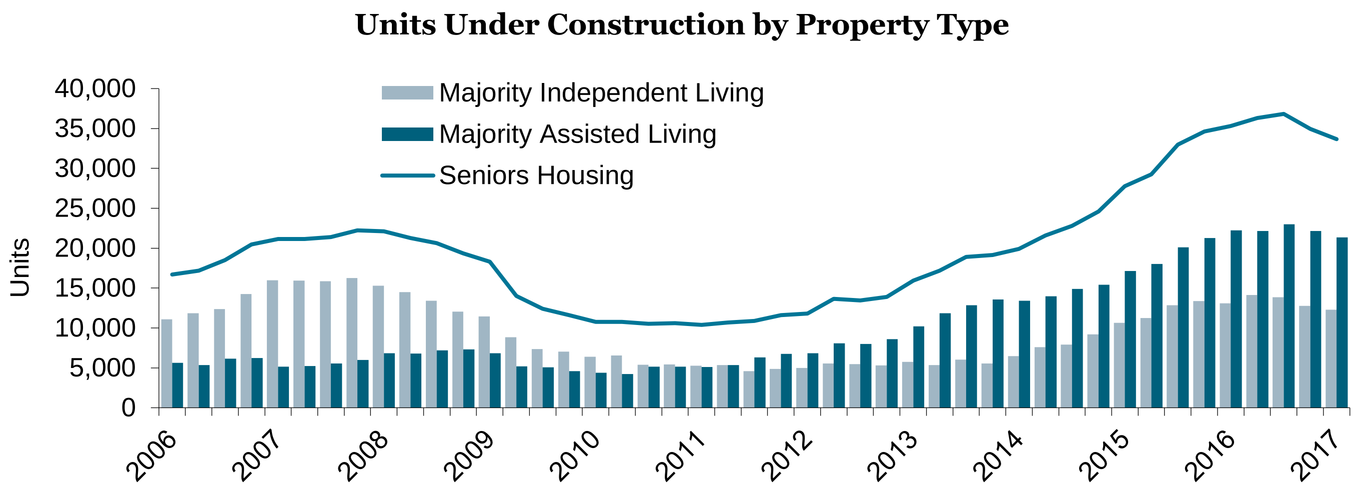
Annual rent growth for seniors housing declined from its recent peak, slowing 0.4 percentage points during the quarter to 3.3 percent in first quarter 2017. The underlying trends for IL and AL were similar during the quarter as they have been for the past several years. Compared to the prior quarter, Majority IL slowed 0.5 percentage points to 3.5 percent in first quarter 2017, while Majority AL slowed 0.3 percentage points to 3.0 percent. As seen in the chart below, rent growth rates for both segments have been generally increasing since 2013, having matched or achieved record quarterly rates during that period.



Source: NIC MAP Data & Analysis Service

Construction Activity Remains High but Signs of Easing Emerging

The number of seniors housing units under construction declined for the second consecutive quarter, decreasing to 33,641 units in the first quarter of 2017. The total number of units under construction is down 4.7 percent from a year ago. Compared to the first quarter of 2016, the number of AL units under construction is down 3.8 percent, while IL units are down 6.3 percent. Prior to the recent decline, construction activity had been steadily increasing since 2011, as seen in the chart below. While the level of construction might initially appear concerning, put in the context of the growing population of Baby Boomer retirees and their older cohorts, this level of construction was probably an appropriate response to growing demand.



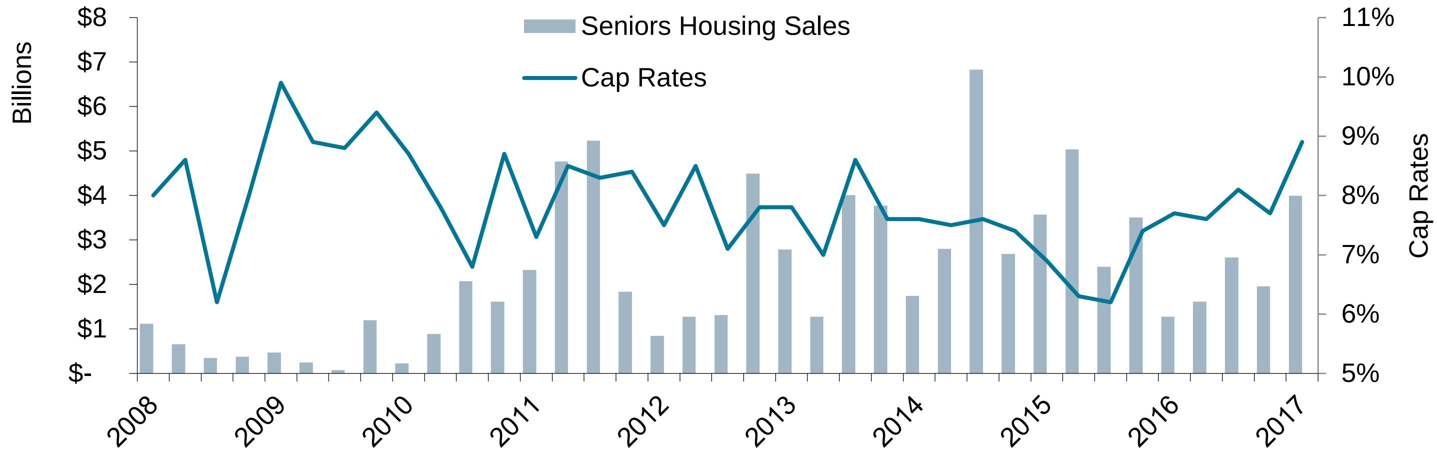
Source: NIC MAP Data & Analysis Service

Seniors Housing Sales Jump in First Quarter

In total, seniors housing sales volume in the first quarter of 2017 was up 104 percent from the prior quarter, jumping to $4.0 billion, the highest quarterly sales total since the second quarter of 2015. The sales involved 421 properties, the largest number since the third quarter of 2013. Cap rates were also up sharply from the prior quarter at 8.9 percent, the highest quarterly cap rate since late 2009.

Total 2016 sales volume was at the lowest level since 2010 at $7.4 billion, down 49 percent from 2015. As seen in the chart below, quarterly sales volumes have been quite volatile from quarter to quarter for the past several years, often the result of spikes in sales volume due to large portfolio transactions. Cap rates have also seen significant volatility, especially when compared to the steady decline in multifamily cap rates during the same period. Seniors housing experienced a declining trend in cap rates from 2013 into 2015 but has seen a steady increase since then.

Seniors Housing Sales and Cap Rates



Source: NIC MAP Data & Analysis Service and Real Capital Analytics

Near Term Easing Likely but Long Term Should be Healthy

High levels of new seniors rental housing negatively impacted fundamentals in the first quarter of 2017, but market conditions remain generally healthy in most markets. While occupancy again saw a slight decline in the first quarter, and rent growth slowed from its recent pace, a slowdown was nearly inevitable after many quarters of remarkably strong performance. Inventory growth and absorption should continue to be balanced over the next year, with occupancy remaining near its current plateau. The sector might experience some easing pressures in 2017, but the solid performance under similar conditions in 2015 and 2016 indicates steady underlying demand. The overarching caveat for this sector is economic conditions: As long as there is a generally healthy economy and an improving housing market, we expect seniors housing demand to remain steady over the near term.

Continued elevated new supply is likely a long-term condition for the seniors housing sector, serving the needs of the nation’s growing elderly population. The solid results in the past three years have shown that positive rent growth can be attained even when new supply results in rising levels of inventory and softening occupancies. Supply growth may prevent further occupancy tightening in the long term, but continued rent growth appears to be reliably sustainable, again, as long as the national economy remains stable.

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May 2017

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