

Welcome to season six of Bridge The Gap, a podcast dedicated to informing, educating, and influencing the future of housing and services for seniors. Powered by sponsors Accushield, Enquire, Connected Living, Hamilton CapTel, Refera, Service Master, The Bridge Group Construction and Solinity. The contributors are brought to you by Peak Senior Living and produced by Solinity Marketing.

Lucas 00:45

Welcome to Bridge The Gap podcast, the Senior living podcast with Josh and Lucas. We are in beautiful, well kind of gray San Diego today at the NIC Conference, spring NIC conference. We got a great guest on today. We want to welcome Aron Will, Vice Chairman and Co-Head of National Senior Housing at CBRE Capital Markets. Welcome Aron.

Aron 1:02

Thank y'all. Thank y'all for having me.

Lucas 1:04

Thank you. Well, you've been out here a couple days, you've been doing some wining and some dining and some golfing and you've avoided some of this rain.

Aron 1:10

Yep.

Lucas 1:10

Right? Pretty good start so far.

Aron 1:12

Pretty good start at the conference.

Lucas 1:13

Right? Not your first NIC?

Aron 1:14

Not my first NIC. I think it's my 16th or 17th NIC.

Lucas 1:18

Yeah, you've probably been like when you were one years old, did you come to NIC?

Aron 1:22

I soaked a little bit up by osmosis in the business, having a family in the business, but yeah, coming on my own account for about 16, 17 years. I did attend even prior to being in the industry though. So its a very different conference so far as attendance and so forth. A lot of maturation in the industry since then.

Lucas 1:38

Well, you know what, the industry in 2023, I think that there's still a lot of questions. What is this year going to look like? We know what happened in 2020, 2021 and 2022 and the effects on the interest rate, the economy, a lot of things that are in the works right now. What are you seeing on day-to-day? What's the biggest challenge facing the industry right now?

Aron 2:00

I think the biggest challenge, if you think about it, we're at a fascinating time in the industry right now. I would characterize the market as a juxtaposition vis-a-vis operations relative to capital markets. On the one hand, I mean very few real estate asset classes were more dramatically impacted than senior housing. I mean, arguably convention hotels plus eight lead certified office space and Manhattan and the Bay Area and certain asset classes were affected operationally worse but not many, right? And so it's not been a linear path, but operationally a lot of people see the light at the end of the tunnel, not just on the census side, which is now back to 83.5%. And I think in nine to 12 months we'll be more or less where we were pre Covid is my projection.

Lucas 2:44

Was that pre Covid?

Aron 2:46

86.5, 87 across acuity types. More importantly on the labor side, I think people were paid to sit on their tush for 18 months, right? Came back into the workforce with this euphoric, "I can do no wrong mentality" and would jump ship for 25 cents on the dollar. People think about it in the context of competing senior housing communities and actuality from a labor perspective, we've been competing with Amazon and Chick-fil-A and man on the moon employer, right? That have raised wages considerably and made it a really challenging labor environment. And so when people are willing to jump ship for 25 cents on the dollar and not even bothering to tell the employers, that's really significant in senior housing, right? Where you're taking care at the most basic level for elderly seniors. And so it necessitated a tremendous amount of temp labor, right? And that's really this single issue that has been the focal point I think in the industry in the last year, year and a half, is temp labor. It's crushed the PNLs of our space. And what we're seeing there is we head deeper into this recession that some people have been in a denial about and say, "We're soon to be in a recession." I mean people are dreaming, we've been in a recession. I think we'll continue to be in one for at least 12 to 18 months. I think that's a net positive though for the senior housing sector and quite frankly, hospitality, retail, bars, any heavily staffed real estate asset class because people will have trepidation about jumping ship. People will have allegiance to their employer for the first time in a long time. And we're already starting to see that in job applications in our space are at record levels and those with robust internal recruiting functions and operators that don't have a cookie cutter approach with respect to their recruiting efforts and do it in more bespoke fashion market by market and really are an employer of choice, if you will.

Aron 4:35

If they had for illustrated purposes, temp labor, let's say a portfolio of 30 assets and they had temp labor a year ago in 12 of the buildings, there may be two or three now, right? And certain labor markets are challenged to begin with. And also the proximity that people at the community can live relative to where the community is also in commute times also affects the labor environment. So what we're seeing there, and we try not to be so myopic, I mean we've got roughly 4 billion of transactions across our debt, business, sales business and equity capital markets business now that I oversee. If we look at that and

then stare at the data, we do a lot of the valuations and NAV work for the reeds and so forth on the valuation advisory side, different side of the house that have access to a lot of data in our industry. And what I would tell you is that, you know, there are winners and losers in your words, but it's largely very, very positive operationally. The pendulum is really swinging back and the only way to get out on the operations side of the degradation on the expense side next extraordinary expenses is with top line growth. And we are seeing that to the tune of seven to 11%. Now all that commentary aside, you juxtapose that with capital markets environment, which has been a real gut punch, right? Because the glimmer of hope that we saw now as we're turning a corner as an industry in a space, the capital markets have turned on their head and it's kind of the tail wagging the dog, so far as the lending climate deteriorating significantly. It applies to every real estate asset class, but obviously in senior living where people's portfolios were a bit battered for the last two and a half, three years to say the least, it's, I think it's exaggerated, right?

Aron 6:16

And how we got there on the lending side of the business was a lot of people don't really recognize, they understand if they're trying to secure a bridge loan, a construction loan, how difficult it is. And it's like they look around and go, geez, like these conditions are like GFC except the macro, despite the inflation, despite the geopolitical issues, despite the inverted yield curve, despite the labor challenges we've had in our nation, it's not as bad as a freeform meltdown in the financial system like we had during the gfc, right? But I would argue it's hard to secure a large bridge or construction loan from a commercial bank now as it is then with a lot better macro fundamentals. And the reason is it's kind of a sequence of events in the banking system. First, the regulators kind of came to the bulge brackets and effectively said we're not providing liquidity i.e. bailout capital to the extent it's a hard landing relative to a soft landing, right?

Aron 7:10

So that categorically took a lot of the nationals out of the market, national banks, right? Some of them have treasury management issues and other more discreet issues with their portfolios and certain real estate asset classes and generally speaking, but as a theme that was very impactful to the largest lending institutions. Subsequent to that there's been systematic, what we would characterize as like audits, where they're trying to independently verify banks risk ratings with the national banks, regional banks down to the community banks, right? Where they're coming in and reclassifying loans effectively and a lot of loans that they deem to be misclassified and non-conforming. And when you get a non-conforming risk rating, that just increases cash on hand relative, right? So it diminishes your ability to lend. So you have to have more cash on hand. The third sequence of events which has impacted commercial real estate in our space, specifically on the lending side, is there's been a mass exodus in particular when about now two months ago or so, when treasuries in short term treasuries peaked at five and a half percent on the two year, I think the 10 year peaked at 4.43 every FA in America were calling their clients saying, "Why are we in CDs that are yielding nothing - point, point and quarter point and a half - for a government backed risk-free debt instrument?" We need to be in short-term treasuries makes no sense. We get a five and a half percent yield, right? And so I was told by a pretty reliable source that roughly 700 billion, the B, was sucked out of the banking system. You throw that all into a pot coupled with market sediment coupled with the fact that when a lot of these lending institutions made the loans, SOFR was nothing for the longest time - it was free money. You've both had spreads that have gapped out, right spreads that were otherwise in the twos that are now in the threes for the most part on the part of commercial banks, but more importantly underlying term SOFR is it roughly 5%. So the cost of debt itself is exponentially more expensive even if assets or portfolios are performing at a nine, 10% debt

yield, pretty healthy cashflow level under ordinary circumstances ,you may not be covering now at a eight and a half 9% interest rate based on where we are in the world today.

Aron 9:28

And so all of that combined has really set into effect a kind of a ripple effect in the markets and it's very, very difficult. On the one hand, I think it's a net positive because it's extraordinarily difficult to secure construction financing. So people said for the longest time, first it was Basel 3, then it was the equity analyst being harsh on the space with respect to over building and as evidenced by some of the REIT portfolios and so forth. And somehow a lot of transient tourists were developing senior housing assets in our space where they may have been securing loans based on a depository relationship with the lending institution or their prowess and other real estate asset class. You had a lot of product quite frankly that shouldn't have been built in our space for a long time. Fast forward to the present for very, very top tier rarefied swath of the market on the construction side for large loans, we're getting 'em done.

Aron 10:21

But it's really by hook or by crook and it's not really national banks, it's regional banks and so forth, but what that does to the supply demand imbalance is it's really difficult. I was talking about it with Beth Macy the other day, but I don't think that there's always a lag in data that we've fully picked it up as an industry yet and how much construction is dwindling down. But that's going be a very, again, positive for the operating fundamentals. Oh by the way, as we're finally delivering into a different baby boomer demographic, come 2026, 2027, people have been about talking about for a long time. But in actuality those were the adult children in some instances, many instances influencing, some instances partially subsidizing their parents in private pay, senior housing. But we're gonna be at a place where they're actually the target resident in 3, 4, 5 years, right?

Aron 11:13

So all those things are incredibly positive in our industry. I would also tell you that so far as weight of capital is concerned, there were winners and losers during Covid, but obviously multi-family and all of its offshoots, student housing, affordable housing and student housing were enormously profitable and outside of a couple months of forbearance and things of that nature at the beginning of Covid. We had significant cap rate compression - we didn't - how could you have cap rate compression in senior housing when your fundamentals are suppressed, right? In what underlying and why are you capping? The beginning of covid where you have a self posed ban on emissions for six months, right? And so multi-family, industrial student housing, affordable housing, manufactured housing, medical office, life science, huge winners during Covid, right? Senior housing was not have entered into a recession.

Aron 12:06

And if you look at the NCREIF and the NIC data during the last recession, senior housing tends to outperform the rest of commercial real estate based on the needs driven. It's not completely recession resistant, but it's more recession resilient than the rest of commercial real estate. And so into alternatives that tend to perform and be more counter cyclical including senior housing, but specific to senior housing, I think there'll be a way to capital as the operating fundamentals improve in the next 12 to 18 months into alternatives away from some of the asset classes that were stars during Covid but now are starting to see chinks in the armor. So that's a net positive. But in the interim it's really tough because anybody with a significant size senior housing portfolio in particular that's experienced a lot of issues on the labor side are somewhat jaded on the space. And then you see this juxtaposition where people are

having a hard time seeing the forest through the trees, so to speak, when I'm very bullish on the next, it was rough, the last, especially being on the capital market side of the business last two or three years was really more so for the operators. For Ben and Sears there's a light at the end of the tunnel, but it's a very challenging capital markets environment.

Lucas & Josh 13:22

Senior living is arguably one of the most vulnerable environments on the planet and knowing who is in your community has never been more important. Accushield replaces the paper and pen visitor logbooks with a kiosk based solution designed by senior housing operators. By definition Accushield is a healthcare technology company. The onsite hardware and software provides staff agency and visitor management solutions, infection prevention and control workflows and a health and safety compliance via data insights, automation and reporting.

Aron 14:02

What I would tell you is that there's going to be a lot of transaction volume second half of 2023 because the lending community was very accommodative by and large for people that were committed to our sector. We didn't cause it, it was caused by covid, right? That kind of thing. But now they have more global issues and a lot of these banks are asking for major payoffs. You also have a lot of institutional owners, particular private equity funds working around finite life funds that may have been in year seven in 2020 and now they're in their second extension in a seven year finite life fund in year nine, which by the way required majority LP consent and they got nowhere to go. That is gonna precipitate a lot of transactions. And then the debt markets also good precipitating a lot of transactions. So there's going to be on a relative basis, virtually no transaction volume comparatively, our size relative to say multi-family per capita transactions was very, very low for the longest time and now we're gonna see a lot of trades, not necessarily because it's a great time to be transacting any piece of commercial property, but because people have to, there'll be a lot going on in in our industry and a lot of interesting buying opportunities that have come about through the passage of time.

Josh 15:18

That is a lot of insight for our listeners and I like makes me feel good to hear you say about the positive side of what you see caused by some compression in the industry to true things up. But for the remainder of the year you said there would be some transactions in the latter part, but deals that are getting done on the new development side, if you could categorize deals that are going to get done and who's doing them, who would you say that's going to be able to get deals done through the rest of this year?

Aron 15:47

The bar is very high for development and it's very hard to secure development financing, cost to capital is high and so the bar is much higher. It's hard to make deals pencil because construction costs have gone through the roof now they're baiting a bit. It's interesting, it's always subs and land sellers that are last ones to get the memo in a recession. The subs are not as busy because the GCs are on the front line and pricing more aggressively now on account of inactivity, certainly relative to where we were a couple years ago, land costs are starting to go down. I mean you've had degradation of value in commercial real estate to the tune of 20, 25% in the last six, nine months. We're starting to see construction costs go down, but a lot of deals are not penciling the deals that do pencil. It's very hard to time long lead time high barrier to entry 2, 3, 4, 5, 6 year entitlement deals perfectly in every capital market cycle. The deals

that are getting done by and large have precious real estate attached with consummate, for the most part, vertically integrated developer owner operators that have built a lot of this on time and on budget through cycles. That's the type of stuff that's getting done today. Again, it's difficult, especially when you're dealing with loans. We've got construction loans we're working on ranging at 55, 60% loan to cost ranging from, call it 50 million to as large as 135 million big projects in large markets. And it's very difficult to get those get done. You have to cobble together a lot of regional banks to do so. But I think the sponsorship in the markets themselves win the day still and we've been able to again and thankfully knock on wood, get those deals done.

Aron 17:39

A lot of the commodity product in IL, AL memory care than the traditional senior housing spectrum, especially suburban stuff, it's just harder to get done today. A lot of those markets were oversupplied and still working through the existing stock to begin with. The other thing that's getting done is active adult on the development side and, and the reason being within the active adult space, you've seen a massive cap rate compression to the tune of they're trading at parody and some instances tighter than multi-family deals. If you can build in the high sixes trended or low sevens for great deals yield on cost relative to let's say eight and a half percent or so for seniors, you still have even with debt costs where they are a fair bit of spread when I think about that asset class, active adult, relative to when I got smart in the space through a client making it big in that investment about a decade or so ago who we were worked closely with kind of along the way, the penetration rates agent income qualified seniors that are taking the product in this instance, the 70 something year old lifestyle renter relative to a needs based consumer, which is what we have in traditional senior housing relative to those that can afford the product, is night and day.

Aron 18:52

An educated consumer knows what it is, understands that it's multi-family that's age restricted with an amenity package where they have a sense of community, where they have more robust health and wellness, where they have more robust resident councils and lecture series and things of that nature, right? Where they wake up with a real sense of purpose living there and identify with the community as their community and not just apartment building. That space has finally resonated in the eyes of baby boomer, 70 something year old renter, at entry point. There's just not enough of it. For the longest time that was an asset class that was new, it was hit or miss, it was flailing, some deals achieved the 20% rent premium they set out to some deals didn't achieve any. It's really matured tremendously. There's a dearth of high quality product within the middle market segment of the market all the way through the upper middle market and even into the upper market and active adults. So to answer your question, it's got to be merited and market's got to make sense and the numbers have to make sense, but we are seeing active adult deals on the development side get done as well.

Josh 19:58

Well that's an exciting sector to talk more about, Lucas, I feel like we've just got a masterclass by Aron here.

Lucas 20:06

Drinking from a financial fire hose with Aaron Will, that's going to be the title of this episode.

Lucas 20:12

What a great opportunity. This is why we love coming to these big high profile events like NIC. We get to pick brains like Aron's and many others, so entrenched in the day-to-day and really have a great grasp and knowledge of this space, not just around the fringes. Guys like Aron and so many others are so dedicated to this industry, been learners of this industry and really care about good outcomes for this industry. And so it's a pleasure to speak with you today. I really, really appreciate you taking time with us.

Aron 20:39

Of course, yeah. Thank y'all for having me.

Lucas 20:41

And so to our listeners, we'll make sure that we connect with Aron in the show notes. You can go to btgvoice.com, download this episode and many, many more. You can connect with Aron on LinkedIn and then connect with Bridge The Gap on LinkedIn too. We'd love to hear from you. Let's continue that conversation. Maybe you have questions about what you heard today. Let's hear from you there. Thanks for listening to another great episode of Bridge The Gap.

Speaker 21:01

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