Investment

Private equity bets big on seniors housing

Fund managers are drawn to build or buy seniors housing properties.

The first big investments by Kayne Anderson Real Estate Advisors in seniors housing include Aston Gardens, a portfolio of six mostly independent living properties including Aston Gardens at Pelican Marsh in Naples, Fla.

By Bendix Anderson

In just two years, private equity fund manager Kayne Anderson Real Estate Advisors (KAREA) has amassed a large seniors housing portfolio in the United States.

"We've been pleasantly surprised at how much we've been able to accomplish," says Max Newland, KAREA's managing director of healthcare real estate.

The private equity firm now owns 3,500 units of seniors housing, up from zero two years ago — plus deals in progress that should grow the portfolio to 5,000 units within the next 12 months. This has earned the firm a place among the top 50 owners of seniors housing in the United States, according to the American Seniors Housing Association.

Private equity funds are pouring money into seniors housing investments, drawn by the sector's proven track record, strong real estate fundamentals and new sources of information on supply and demand. Fund managers with a long history of investing in seniors housing are allocating more to the sector. New funds are also joining the bidding for existing seniors properties and developing new properties.

Private equity funds manage capital on behalf of investors ranging from pension funds to high-net-worth individuals. The first challenge of the private equity business is convincing investors to put money into their funds. "The fundraising market is more competitive than ever," says Andrew Moylan, head of real assets products for Preqin, a research firm that gathers information on private equity investments.

2014: Banner year for PE fundraising*

Private equity funds focused on niche property types, including seniors housing and student housing, raised $2.6 billion in 2014, more than any other year in the last decade.

Year	No. of funds	Aggregate capital raised
2004	1	$100 million
2005	4	$100 million
2006	6	$1 billion
2007	9	$1.4 billion
2008	5	$600 million
2009	10	$1.2 billion
2010	4	$200 million
2011	12	$900 million
2012	11	$1.5 billion
2013	9	$1.8 billion
2014	12	$2.6 billion
2015 YTD	1	$900 million

* When a PE firm announces the closure of a round of fundraising, the total amount raised is recorded in that year.

Source: Preqin

Largest North American real estate funds focused on alternative property sectors (funds closed 2012–2014)

Fund	Manager	Size	Sector Focus
Harrison Street Real Estate Partners IV	Harrison Street Real Estate Capital	$750 million	Medical/healthcare, self storage, seniors housing, student housing
Kayne Anderson Real Estate Partners III	Kayne Anderson Capital Advisors	$750 million	Seniors housing, student housing
Prudential Senior Housing Partners IV	Prudential Real Estate Investors	$568 million	Seniors housing
AEW Senior Housing Investors II	AEW Capital Management	$371 million	Seniors housing

Source: Preqin

Real estate in general, and seniors housing in particular, is attractive to these investors. Real estate funds managed by private equity firms held an all-time high of $742 billion in assets at the end of 2014. That figure takes into account all property types, ranging from trophy office properties to self storage, according to Preqin.

"There is a great deal of institutional confidence in the real estate asset class and its ability to meet portfolio objectives," says Moylan. "Institutional investors are receiving high levels of distributions from their existing commitments and strong returns on average." Annualized returns from private real estate investments averaged 16.7 percent over the last three years, according to Preqin.

In 2014, a dozen funds focused exclusively on niche properties types — from seniors housing to student housing — raised $2.6 billion from investors. That's up from $1.8 billion the year before, and the highest level of fundraising for niche property funds in the last 10 years.

KAREA's third real estate fund was its first to significantly invest in seniors housing. The fund raised $750 million. Fundraising is now well under way for the Boca Raton, Fla.-based firm's fourth real estate fund, which will invest in a number of niche property types, with 75 percent of investment activity split between seniors housing and medical office properties.

Prudential Real Estate Investors (PREI) has also found enthusiastic investors. It raised $568 million for its Senior Housing Partners Fund IV, which closed its final round of fundraising in 2012. That's significantly more than the $370 million that PREI's Senior Housing Partners Fund III raised in 2006.

"Each seniors housing fund tends to get a little bit larger with a few extra clients," says Noah Levy, managing director for PREI. "The interest in, and the knowledge of, seniors housing is growing."

Strong performance under pressure

Private equity investors are drawn to seniors housing partly because the asset class performed quite well during the Great Recession. From 2008 to 2011, average rent growth for seniors housing properties never dipped below 1 percent a year, according to the National Investment Center for Seniors Housing & Care.

"Ours is the only property type that didn't experience negative rent growth," says Beth Mace, chief economist for NIC. In contrast, retail, office, and multifamily properties all suffered falling rents on average during and after the crash.

Many experts now believe that seniors housing is a countercyclical investment, meaning investments in seniors housing may keep their value even in tough economic times. "Seniors housing is driven by slightly different things than other property types," says Mace. "It acts differently than stocks and bonds."

Seniors housing can perform well in a downturn because the demand for seniors housing is not necessarily based on market cycles — particularly for seniors housing types like assisted living or memory care that serve people with acute medical needs. "Potential residents can try to postpone the decision to move into seniors housing, but often they can't," says Mace.

Some private equity funds that invest in seniors housing have experienced that resilience for themselves. PREI's Senior Housing Partners Fund III acquired properties in 2006, 2007 and 2008, some of the peak years of the real estate boom before the crash.

"The value of the portfolio was never down more than 10 percent," says Levy. "We never had distress and never breached a leverage target." In other words, the prices for seniors housing properties never dropped to the point that the debt equaled more than 60 percent of the value of the properties.

The assets continued to produce fairly steady income throughout the crisis, enabling them to maintain their value. "[Fund III] distributed income all the way," says Levy. "The fund provided its investors with an internal rate of return and multiple in excess of anything else they invested in commercial real estate over that time."

Seniors housing has also benefitted from rich data collected by organizations like NIC, which makes seniors housing investment more transparent to investors, including vacancy rates, property sales data, demographic trends and new construction figures.

So far, the balance between demand for seniors housing and the supply of new seniors projects looks positive for many private equity investors. "We are going to see our customer base grow pretty rapidly in the next 15 years," says Prudential's Levy.

The supply under construction now is likely to be absorbed, say industry experts, even though data from NIC counts a growing number of units under construction in many markets.

"The supply of new units does not even come close to the demand," says Matthew Whitlock, executive vice president for the CBRE National Senior Housing Group.

Private equity fund managers need to be armed with this kind of data to justify their strategies to investment committees.

The positive data on seniors housing is drawing managers of

KAREA + Discovery: A formidable partnership

Kayne Anderson Real Estate Advisors (KAREA) forged a strong relationship with Discovery Senior Living in October 2013 when it paid $404 million for a controlling interest in Aston Gardens, a portfolio of six seniors housing properties in Florida totaling 1,930 units. The properties are primarily independent living communities.

Before the sale, Discovery had kept the portfolio fully occupied with its old equity partner, GE Capital. Kayne Anderson replaced GE and also bought some of Discovery's equity in the property — returning some capital to the operator.

Because portfolios of fully occupied seniors housing properties like Aston Gardens are difficult to find, many private equity funds are investing in seniors housing projects that are not yet stabilized.

"Competition has skewed private equity more toward development and value-added projects than five year ago," says Alan Ursillo, senior vice president for JLL Capital Markets.

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In February 2014, KAREA and Discovery partnered to add value to a portfolio of 1,053 units in five properties in Texas that were 76 percent occupied, paying $290 million for the Conservatory Senior Living portfolio. The average occupancy across that portfolio has risen to 86 percent, says Max Newland, KAREA's managing director of healthcare real estate.

KAREA executed both of these giant deals via its third real estate fund, which by the second quarter of 2015 will have committed all of its $750 million to a mix of niche property types, including seniors housing, medical office and student housing. Together, KAREA and Discovery also plan to undertake ground-up development projects.

"Our pipeline is a mix of development and acquisitions of value-added and stabilized properties," says Newland. "As a firm, we have quite a bit of in-house development expertise."

— Bendix Anderson

real estate private equity funds to consider seniors housing investments, even if their funds aren't targeting niche properties. "We take those calls weekly," says CBRE's Whitlock.

A good yield is hard to find

About two-thirds of fund managers indicate it is more difficult to source attractive investment opportunities in the current environment compared to a year ago, according to Prequin's most recent annual fund manager's survey. Three-quarters of fund managers say there is more competition for core real estate assets than a year ago, with a similar percentage expressing the same sentiment toward value-added and opportunistic assets.

Prices continue to rise for seniors housing properties. "Real estate investment trusts (REITs) are driving yields so low that it is difficult to compete on acquisition," says Alan Ursillo, senior vice president for JLL Capital Markets. REITs have such a low cost of capital, they can often afford to pay more for real estate properties than private equity buyers.

The aggressiveness of REITs on the acquisitions front has worked to the advantage of private equity. Once a fund reaches the end of its approximate five-year hold period and it's time to sell properties and return funds to investors, the REITs are ready and willing buyers.

However, private equity has had a more difficult time finding properties to buy. "With so much transaction volume, a lot of the high-quality stuff has been gobbled up," says Ursillo. "It's so frothy on the acquisition side. Buyers compete heavily for properties that have a lot of cash flow."

All about the operator

To get access to properties, private equity firms are forming long-term partnerships with operating companies. These relationships can sometimes lead to opportunities to buy properties that have not already turned into bidding wars.

Private equity funds like KAREA typically spend a great deal of time selecting their operating partners, who often become equity partners for a long series of deals over many years.

"We never had distress and never breached a leverage target," **says Noah Levy, managing director, PREI.**

"It's a lot of work to put together one of these partnerships. Neither party wants to do that for just one deal," says Richard Swartz, executive managing director and national head of senior housing for Cushman & Wakefield. "It's rarely a one-off."

Private equity encourages its operating partners to hold an equity stake in seniors housing properties to help motivate the operator to succeed.

Appetite for development

Private equity funds are becoming much more comfortable plowing capital into new development projects. "There are more groups today that will do ground-up development," says Cushman & Wakefield's Swartz. "Money is stretching out to find yield."

Prudential is also investing significant capital in new seniors housing development through PREI's Senior Housing Partners Fund IV, which made approximately $500 million in new investments in 2014.

About 10 percent of the fund is allocated to development. The rest of the fund's investments will be focused on stabilized and value-added investments in relatively new assets that can be upgraded to include better exercise rooms or other amenities.

Other private equity funds add value to seniors housing properties by converting some of the units to a different type of seniors housing. For example, a private equity fund might buy an independent living property and add licensed assisted living and memory care units to the property.

"The continuum of care model has resonated within the investment community, as well as with residents and their adult children by allowing residents to age in place within the same campus," says Aron Will, executive vice president for CBRE's Capital Markets Debt & Structured Finance Group. "Communities with a continuum of care trade at the tightest cap rates."

A number of private equity funds now spend about 25 percent of their capital on development projects. A few years ago, Prudential's 10 percent target was much more common.

Kayne Anderson Real Estate Advisors partnered with operating company Discovery Senior Living to invest hundreds of millions of dollars in seniors housing properties, including Aston Gardens at Tampa Bay, located in Tampa, Fla.

Several private equity firms have expressed an interest in entering into a joint venture with Boston-based developer and operator LCB Senior Living to develop four new seniors housing properties, according to Cushman & Wakefield's Swartz.

LCB has partnered with PREI and Virtus separately in the past to develop seniors housing. "We attracted far more interest in these four new development projects than the first two rounds of development," says Swartz.

Other private equity fund managers have separated value-added investments and investments in stabilized properties into different opportunistic and core real estate funds.

In August, Harrison Street Real Estate Capital partnered with The Shelter Group's Brightview Senior Living entity to buy an ownership stake in 11 seniors housing communities for $520 million. Harrison Street Real Estate Partners IV, a $750 million opportunistic closed-ended fund, owns three of the communities. The strategy is to significantly boost the average occupancy rate, which currently stands at 82 percent.

Harrison Street Core Property Partners, which acquires properties that are well stabilized, will own the other eight properties, which have an average occupancy rate of 96 percent.

Typically, a fund with "core property" in its name focuses on properties such as office buildings in Boston or apartment complexes in New York.

Seniors housing properties are increasingly accepted by these funds as appropriate investments, says NIC's Mace. "Seniors housing is emerging as a new core property type." ■

About the writer

Bendix Anderson, a New York-based freelance writer, has covered the commercial real estate industry for more than a dozen years.