The Winds of Change
Emerging Trends for Life Plan Communities

We are at a crossroads where there is tremendous change facing the Continuing Care Retirement Community (CCRC)/ Life Plan Community (LPC) industry. This change is being driven by a graying Baby Boom generation that is retiring at a rate of approximately 10,000 per day.[1] The living preferences of this generation are being shaped by an increasing focus on wellness, leisure and staying active for longer than previous generations.

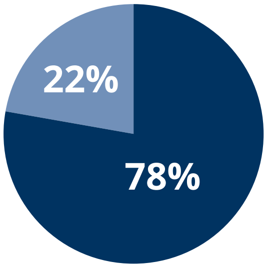
Today, active adults over 50 control more than 70% of all disposable income[2] and are poised to inherit $8.4 trillion by 2030.[3] As this generation ages, they will have different preferences about the lifestyles they want and how they would like to age, both pre- and post-retirement.

In this paper, we explore several trends in the CCRC industry that are influenced by the current generation of Baby Boomers. These changes present both challenges and opportunities for the management teams and boards of directors of CCRCs and LPCs.

TREND 1 – Tighter competition for not-for-profit providers

Historically, CCRCs and LPCs were dominated by not-for-profits due to their community-based and religious origins and emphasis on mission-based care. While the first CCRCs were exclusively not-for-profit, this is no longer the case. While not-for-profits still account for the majority of market share, they are facing a material decline in growth versus the for-profit sector.

Currently, approximately 78% of CCRCs are sponsored by a not-for-profit organization, with for-profits representing 22% of the mix.[4]



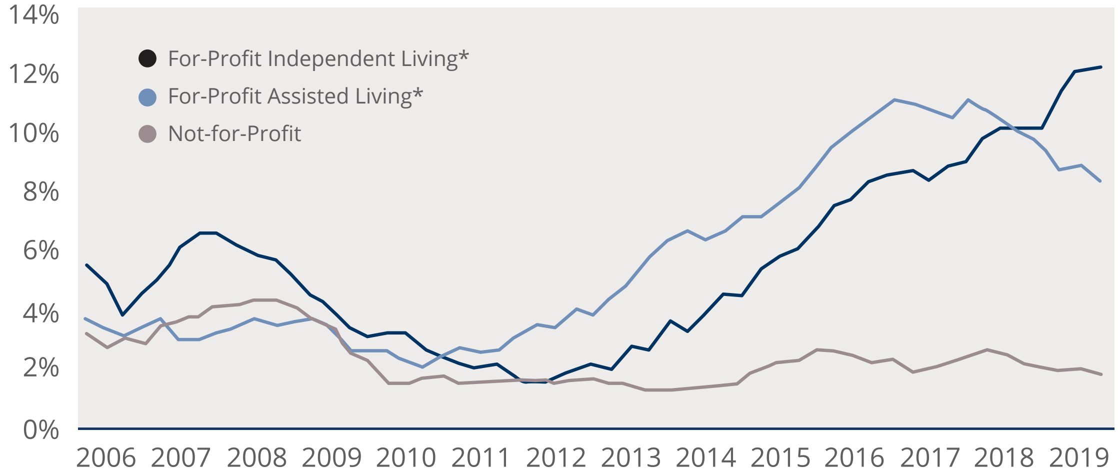
While this is still an emerging trend, the pace of growth of for-profits CCRCs is impressive. When looking at the amount of construction activity as an indicator, in recent quarters

[1]Source: U.S. Census Bureau
[2]Source: U.S. News
[3]Source: Center for Retirement Research at Boston College
[4]Source: Senior Housing News

Growing Pressure from For-Profit Competition

Construction vs. Inventory: MAP31

Seniors Housing 4Q05–2Q19



*Excludes CCRCs
Source: NIC MAP® Data Service
www.nic.org/nic-map

for-profits are outpacing not-for-profits by approximately threefold in assisted living and more than fivefold for independent living.[5] Between January and August of 2019, new developments from for-profits significantly outpaced not-for-profits by a factor of 17 times, with new for-profit sponsored expansions coming in at more than double the level of not-for-profit sponsored expansions.[6]

Significant New Development Coming from For-Profit/Private Sector[7]

	# of New Campuses	# of Expansions/ Repositionings
Non-For-Profit Sponsor	14	14
For-Profit Owner	243	27

Undoubtedly, the impetus for this trend is the opportunity presented by the lucrative Baby Boomer demographic, for whom retirement and long-term care are top of mind, and will become increasingly so.

TREND 2 – The blurring of retirement and long-term care

Traditionally, retirement and long-term care were separated into different areas, but CCRC providers are under increased pressure to consider how to integrate the two.

The Challenge

How do you attract the relatively active 70 to 75-year-old into the CCRC community, as well as the octogenarians who were originally motivated by the continuum of care promised by CCRCs and LPCs? Who is leading the charge when it comes to solving this challenge?

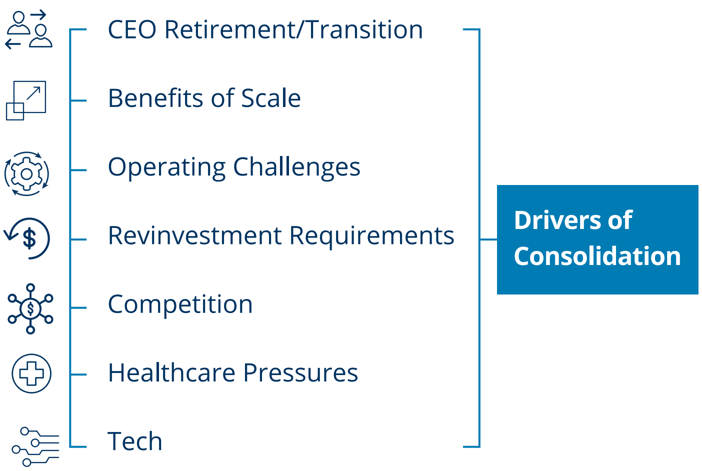
The continual blurring of retirement and long-term care explains, in part, the growing prominence of for-profits in the space due to their ability to develop product that specifically caters to Baby Boomers. They are selling the active lifestyle and high-end, lifestyle-oriented accommodations that Baby Boomers demand. Baby Boomers increasingly prize wellness, leisure, lifelong learning and longer careers and for-profits are tailoring communities that resonate with those needs.

[5]Source: NIC Map Data Service
[6]Source: Ziegler Investment Banking
[7]Publicly announced seniors housing and long-term care projects, January 2019 through August 2019

TREND 3 – Consolidation

In the future, we will likely see a wave of consolidation as not-for-profits increasingly compete with for-profits. We can expect to see the advent of larger and more integrated CCRC organizations, or at least parent organizations with deeper pockets and resources.

Larger organizations would have access to more capital at a cheaper cost and more resources to brand their lifestyle product. Another benefit: there would be obvious economies of scale and purchasing power across all categories. As with many large developers, larger CCRCs could hold greater sway and have influence with local officials and regulators. They may also enjoy advantages in hiring and developing employees.



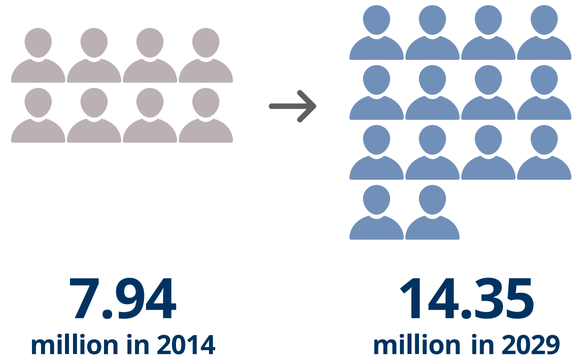
While there are a few non-profit organizations that are moving aggressively in this direction, the vast majority of not-for-profit CCRC/LPCs are community-based and likely averse to the kind of radical change and upheaval that comes with mergers and acquisitions. The strategy won't be right for all players.

On the other hand, larger CCRC/LPC organizations, with sizeable investment portfolios and a lower cost of capital, are better equipped to pursue the types of strategies that will more effectively compete with the for-profit entities that are actively pursuing the Baby Boomer market.

TREND 4 – Broadening the scope to middle income

Consistent with the theme of competition from for-profits, there is a lot of discussion about the market for middle-income retirees and pre-retirees, in addition to the mid-to-upper income client typically served by LPCs. By 2029, the number of middle-income seniors is projected to nearly double from 7.94 million to 14.35 million.[8]

The Number of Middle-Income Seniors will Nearly Double by 2029 (all 75+)



Given the rise of the lower-income and wealth demographic, it isn't inconceivable that rental properties may become more viable for CCRCs in the future. Many older, highly educated Baby Boomers have already expressed a desire to rent versus own. In fact, Baby Boomers and Millennials have been identified as the two fastest-growing groups of renters.[9]

Communities with lower occupancy rates may view rental properties as a way to improve census and increase revenue, while other communities may choose to build to meet that demand, being careful not to compromise existing entrance fee units. The development of rental units tends to be equity intensive, but can also have higher margins.

How would this change the ability to raise capital? Could this model work in concert with the traditional entrance fee model? Questions remain, but traditional models will face increasing pressure as retirement communities broaden their scope and business models to capture a wider and more inclusive membership.

[8]Source: National Investment Center for Senior Housing and Care
[9]*Washington Post*, "Forget Owning, Rental is Becoming the Endgame for Many Millennials and Baby Boomers," Robert Pinnegar, May 8, 2018

Top 5 Reasons Baby Boomers Are Choosing Rentals

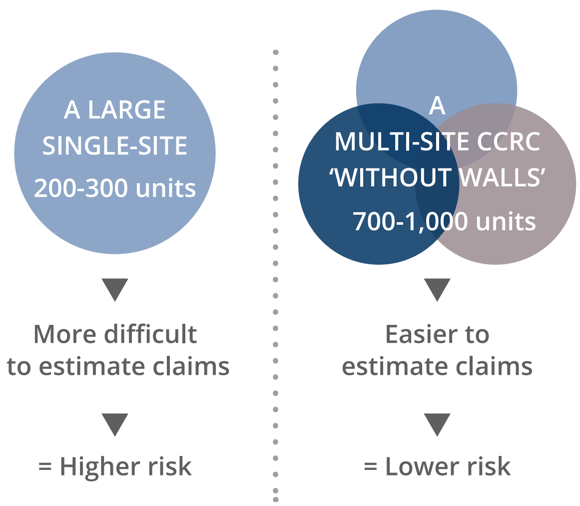
- Affordability and walkability
- Amenities and services often included
- Low/no property maintenance
- Convenience to shopping
- Convenience to medical

TREND 5 – CCRC without walls

The idea of a CCRC without walls continues to gain momentum. This model supports the concept of aging in place by allowing seniors to remain in their current homes and communities for as long as they are able. In this new model, the community, amenities, and services would be mobile, supporting a member's ability to stay within their current environment, until such point as they might take advantage of the CCRC/LPCs other senior living solutions.

This is still a relatively new concept, and many questions need to be answered. For example: How does this offering work with the traditional model? Does this make the organization look increasingly like an insurance company from a business model standpoint? For instance, this type of model might involve an entrance or membership fee that is a small fraction of typical CCRC/LPC entrance fees, as well as a monthly charge. This model would resemble health insurance, with the entrance fee equating to an up-front premium.

If a CCRC/LPC decides to adopt this model, how much capital would be needed to fund these new and untested liabilities? As with all insurance-like models, this would probably play out better when executed on a larger scale.



What are the implications? With change comes opportunity.

There are many factors disrupting the CCRC/LPC space as we know it: Competition, consolidation, changing target markets, new products and supply coming on the market, and the significant opportunity provided by the Baby Boomers. There is much to consider as CCRC/LPC models come of age and reach an inflection point. But change is inevitable. Will more organizations begin to change their long-term strategic plans to adapt to this change? And if so, how will this impact how they manage their investments?

*Source: The World Bank (https://data.worldbank.org/indicator/SP.DYN.LE00.IN?locations=US)

Rejuvenating business models will require capital

If part of a CCRC/LPC's strategic plan is to appeal more to the younger "active adult" Baby Boomer segment with the accompanying bump-up in services and amenities, capital will be needed. Older campuses will need to be "repositioned" and marketed to look more like active lifestyle-oriented real estate and less like a traditional retirement home. Amenities must be added, upgraded and improved. Larger units with guest bedrooms may be in demand to accommodate the rise of intergenerational-focused amenities.

Proximity to social, cultural and entertainment venues is also an attractive feature to many Baby Boomers. There has also been talk within the industry about establishing satellite campuses. As many CCRCs and LPCs exist just outside of urban areas, a satellite campus in the city may be a selling point, for example.

On the upside: More amenities, a longer runway for revenue

Merging an active lifestyle with retirement amenities for people with another 15 to 20 years to live could potentially create a longer stream of revenues for communities. This also creates the opportunity to explore different "entrance fee" options, including an option for cooperative ownership or even a hybrid model that accommodates rentals.

On the flipside, this pivot would certainly require additional long-term financing. How might this impact the management of investment portfolios?

How will investment portfolios be impacted?

What are the implications of these forces of change on a CCRC/LPC's investment portfolio? As we advocate looking at an organization's assets and liabilities as an integral part of its strategic plan, our examination of trends would be incomplete without it.

As a result of these disruptive forces, the operational risk of the organization would clearly be heightened. And the probability of portfolio withdrawals – used as seed capital or to smooth out the bumps – would be higher. As such, management teams and consultants should look at asset allocation with care and creativity.

Investment committees will almost certainly play a large role in any form of transition. Change and uncertainty represent risk and may require liquidity, all of which should sharpen the focus of investment committees charged with being good stewards of capital.

The CCRC without walls, as we noted earlier, may be an appealing option for seniors who don't want to move out of the family home. However, what are the implications for an investment portfolio if a CCRC were to adopt this model?

Collecting the health-insurance-like premiums without having to build units may sound great, but how do you forecast the need for future services? Insurance companies use data from large groups of people to assess these risks. How will a single campus organization do that? As would seem prudent, only the largest and financially robust senior living groups are currently pursuing this strategy. Given the lack of data to asses risk, it is once again clear that this emerging trend will also require greater liquidity and less risk in investment portfolios. At Procyon, we believe in asset allocations that accurately take liabilities into account.

Case Study – Repositioning a CCRC (and its liabilities)

The situation

A **mature Life Plan Community** has seen its census **decline moderately** and has recognized the **need to re-position** the community to better compete with newer offerings in the marketplace. The census decline has pressured margins and the timing of refunds relative to new deposits and has resulted in modest draws on the investment portfolio.

The repositioning envisions the **upgrade of vacant units,** the **modernization and re-purposing of some common areas** and the addition of **new amenities**, such as a clubhouse and a fitness and wellness center.

In the near term, the additional debt service will further pressure margins and the unit upgrades will take inventory off the market for a period. Ultimately, the repositioning should **benefit the community**, making it more **appealing to a new generation** of members, but clearly operational risk has increased.

The portfolio allocation

In terms of **portfolio allocation**, the investment committee may want to take this additional risk into account. In most LPC investment portfolios, prudent allocators **recognize the role of the portfolio in supporting the operations of the organization**. At the same time, investment committees are interested in long-term growth of the portfolio to support the long-term mission of the organization.

In effect, there are two time horizons that are relevant to the community. Both of these time horizons are linked to a liability. The **shorter time horizon** relates to the ability of the organization to maintain its **financial strength** and its ability to meet **debt covenants** over the short term.

The **longer horizon**, on the other hand, reflects the desire for the community to **optimally grow its capital base** over a long period of time. In terms of actual time, the short horizon may be 3 to 5 years, after which time things are back to "normal" for the community.

The **short horizon** allocation will necessarily be less risky than the long horizon allocation, and will include a modest amount of **equities,** a reasonable dose of **income-oriented risk assets** and a meaningful share of **fixed income.** The **longer horizon** will likely be tilted towards risk assets with some allocation to **fixed income** categories as a buffer. **Both are built for withstanding volatility, but over different time periods.**

During a re-positioning the investment committee will want to look at how the relative size of these two horizons – short and long term – should shift to reflect heightened risk in the portfolio. If in "normal" times the short-term horizon allocation is **25%** of the portfolio, perhaps it moves to **40%** during the project. Stress tests on various financial ratios would be instructive in determining the size of the shift between horizon buckets.

Now more than ever, LPCs should be looking at the range of challenges ahead of them with an eye towards a dynamic and proactive asset allocation.

Dynamic times ahead times ahead

- The CCRC/LPC industry is a dynamic arena where growth through developing emerging new markets and consolidation could be a recipe for success, and perhaps survival.
- While the trends of mergers and acquisitions among the not-for-profits, rental unit opportunities in the middle market, and the CCRC without walls are all relatively new, they can be expected to converge in coming years as not-for-profit competition with for-profits intensifies in the bid for Baby Boomer dollars.
- Communities that are prepared to evolve in order to manage these risks and think beyond traditional models will be well equipped to survive and thrive.

Call (844) PROCYON today

Is your organization prepared for these trends? Contact Jim Jeffery at Procyon Partners for a complimentary holistic assessment of your organization's assets and liabilities.

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One Corporate Drive • Suite 225 • Shelton, CT 06484 | (844) PROCYON | www.procyonpartners.net