

## Key Factors to Consider When Investing in Senior Housing Real Estate

The senior housing industry has recently become the center of attention for many investors due to a variety of key market factors, some examples include the aging baby boomer population and increasing longevity. Becoming educated in senior housing, knowing the questions to ask, and knowing what to look for when investing in senior housing real estate have become common topics for discussion. Below we will address a few of the common questions and provide insight into senior housing.

### Who are Operators, and what do they do?

Operators are management companies that handle the “day to day operations” of a senior housing facility. The responsibilities of an operator include management and hiring of all staff, ensuring the residents are receiving the care that goes above and beyond what is needed, organizing fun activities and events, providing quality food, marketing the facility for new residents and making sure the facility is compliant with licensing regulations. The operator and their staff are truly the face of the facility and the ones that interact with residents daily. Thus, it is extremely critical as an investor to partner with a high quality operator.

### What makes for a good senior housing real estate site?

We believe a good location for a senior housing facility is one that has complimenting nearby uses, has few competitors and is located in an infill location.

#### Complementing Uses:

Amenities in the locale surrounding a facility that the residents deem important and desirable.

Examples:

1

Residents at Independent Living facilities tend to prefer a vibrant surrounding community with lots of activities. Independent Living residents are typically very active and seek an environment to enjoy with friends.

2

Residents of assisted living facilities and memory care facilities typically value having medical offices and a hospital nearby, as residents in these facilities tend to have more significant and chronic medical needs.

Ultimately, regardless of whether a senior resides in an independent living facility, assisted living facility or memory care facility, usually the most important factor for seniors is their desire to live near family members. Sites with ample single-family homes and apartments nearby, as well as family-oriented communities, may serve well for senior housing facility locations.

In regards to competition, an investor should ensure there is excess demand for that type of senior housing facility and not an oversupply of competition in the local market. Additionally, the more infill the location the better, as it prevents the possibility for future competitors developing nearby senior housing facilities.

## How do you know if you have the right operator and right location?

To ensure an investor is investing in a senior housing facility that is managed by a quality operator and located in a great location, an investor should partner with an investment management team that will properly underwrite the senior housing investment from both an operational perspective and a real estate perspective.

### Operational Perspective

The investment management team needs to get to know the operator objectively and subjectively. That means the investment management team should be observing the quality of care that is being provided by the operator by visiting the operator's facilities. It is also important to see how staff is interacting with each other and with the residents. From a corporate standpoint, the investment management team should understand what the corporate culture is like, what employee turnover is like, and should review the corporate financials and the financials of the facilities that are currently being managed by the operator. It is also imperative that the investment management team get to know the reputation of the operator in the market place.

### Real Estate Perspective

The investment management team should be reviewing the historical and forecasted financials of the facility that is the potential investment. The investment management team should hire experts to conduct an appraisal, a market study, a property condition assessment and an environmental report. Additionally, it is important for the team to visit and survey the competitors within a five-mile radius and understand how the competing facilities compare to the potential investment in terms of condition, pricing, and amenities. The investment management team should also reach out to the local planning and zoning department to understand potential for future development by competitors. If the investment includes any renovations or developments, understanding any construction and zoning restrictions is essential.

After underwriting and performing due diligence on the operator and the real estate, it is key to make sure that the operator, the investment management team and the investors have a strong alignment of interest.

## How do you keep investor and operator interests aligned?

In our opinion, the best way to make sure there is a strong alignment of interest between the operator, the investment management team, and the investors is to use a single tenant net lease approach. With this type of agreement, the investors own the real estate and the operator leases the entire senior housing facility. The Operator is responsible for managing the entire senior housing facility. The investors are better sheltered from operational volatility and, assuming the business remains profitable, simply collect a rent check from the operator.

## How is a triple net lease structured?

From a high level, a single tenant net lease is structured just as it sounds. The entire facility is leased to a single tenant or operator. That operator is not only responsible for managing the senior housing facility, but the operator is also responsible for the real estate expenses, including taxes, insurance and maintenance expenses.

A typical single tenant lease:

- ✓ Long in term
- ✓ Has a triple net expense basis (the tenant is responsible for the real estate expenses)
- ✓ Provides for annual escalations to rent (typically in the range of 2.0% to 3.0%)
- ✓ Most leases have a corporate and/or personal rent guaranty

### **Corporate/Personal Rent Guaranty<sup>1</sup>:**

This is a very important element in aligning the interests of the operator and the investors. The tenant/operator is putting their corporate balance sheet on the line and/or their personal balance sheet on the line to ensure that the monthly rent payments will be made. Additionally, a strong single tenant net lease ensures that the rent payment will be made before the tenant/operator receives a single dollar of profit. The Operator is incentivized to make sure that the senior housing facility is profitable, since after their rent payment, all the upside is theirs to keep. Furthermore, the investor has assurance that the Operator is doing their due diligence and underwriting of the property since the Operator is committing a corporate and/or personal rent guaranty on the lease and signing a long term lease.

From an investor perspective, the advantage of having a single tenant net lease is that the investor is not exposed to any lease up risk, and fluctuations in occupancy do not affect the investors' cash flow. The investor is simply collecting a monthly rent check, which typically is priority over the tenant/operator making a profit on the facility. If there was any delay or issue with the rent payment, the investor's risk is somewhat mitigated by the corporate and/or personal rent guaranty. Another key characteristic that a strong single tenant net lease has is the ability for the investor to review the financials of the facility so that the investor may keep track of how the facility is performing. If the facility is not performing well, the lease should allow the investors to replace the operator and terminate the lease. If properly structured, the single tenant net lease is a great way to align interests of the operator and the investors of a senior housing facility.

In conclusion, when you have a high quality operator, a great location for a senior housing facility, an experienced investment management team that can thoroughly underwrite the operator and the investment, and a single tenant net lease agreement, this typically provides a great foundation for a potentially successful investment.

<sup>1</sup>Any guarantees are subject to the claims paying ability of the guarantor. This is NOT a guarantee of performance. All investing involves risk of loss of some or all of the principal invested.



A Single Tenant, Net Lease  
Senior Housing Real Estate  
Reg D Fund

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