

U.S. Municipal High Yield Market
2022 Senior Living Issuance

Debt issued to fund senior living projects was identified as a sector in which investors had significant concern in the HilltopSecurities [Hilltop High Yield 2022](#) and [2021 Surveys](#). Given the high labor costs associated with these projects, inflationary pressure on food and other operating costs, variability in occupancy exacerbated by the pandemic, competitiveness in many markets limiting the magnitude of rental increases, and the softening of the residential market affecting home sales and the decision to move into a senior community, operating margins at many communities will be compressed and an increase in technical and monetary defaults is likely in the immediate term for communities with more marginal operations.

Municipal Market Analytics reports that monetary defaults in the senior living sector exceeds 8% which is higher than any other sector in the municipal market. Of the defaults, 29% were original rated credits and 71% were unrated. In addition, according to Bloomberg data, it takes approximately 180 days from the time in which a senior living credit discloses a financial impairment to disclosure of a monetary default.

Despite challenges in the sector, the HilltopSecurities Debt Capital Markets team believes that highly liquid communities, with manageable amounts of well-structured debt, and good management teams will be best situated to weather these operating pressures. This assessment covers rated and non-rated debt. In order to better assess these factors, HilltopSecurities has calculated median credit information, including days cash on hand (median of 199), cash to debt (median of 13%), and debt per unit (median of \$248k), based off of approximately \$5 billion of nonrated debt issued over the last 18 months, providing important contextual data. We also believe that over the longer term, the continued aging of the American population will result in the increased need for congregate settings, which over time should introduce stability for well-structured senior living transactions. Therefore, investor focus in this sector is warranted.

Operating Revenues Driven by Occupancy and Competition

Senior living revenue is driven by occupancy and competition. Low occupancy coupled with significant competition in a market area, will suppress the ability of a community to raise rates to offset increases in operating expenses. Complicating this issue is that senior living occupancy, while somewhat improved from the 2021 troughs, has not yet returned to pre-covid levels according to 2Q 2022 [NIC MAP® Market Fundamentals Data, released by NIC MAP Vision](#). For instance, Independent Living occupancy approximated 90% from 2016 to 2020 and then declined to 80% as covid affected decisions to move to and ultimately stay in independent senior housing. However, as of 2Q 2022, NIC MAP Vision reports that Independent Living has increased to 83.9% occupancy which is an increase from Q1 occupancy of 83.2%. When looking at Nursing Care and Assisted Living occupancies, occupancies generally ranged in the 86-85% range in the pre-pandemic period for this need-based housing. However, in 2022 occupancy in these facilities declined to approximately 75% until climbing back to the Q2 2022 levels of 78.5% for nursing care and 78.8% for Assisted Living. The increase in quarterly housing in nursing care was 90 basis points from 77.6% to 78.5% reflecting the need for care and the loss of total nursing beds in the country as some communities providing skilled care needed to close for financial reasons.

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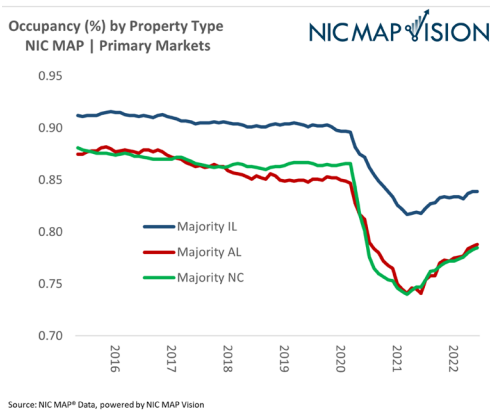
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Occupancy Has Not Yet Recovered From Pandemic Declines



Source: NIC MAP® Data, powered by NIC MAP Vision.

While the pressures on the revenue side derive from occupancy and competition, senior living communities are also affected by the labor market characteristics, which is the largest expense for most senior living communities.

Furthermore, recessionary pressures and a softening housing market, may result in the decision by some seniors to postpone home sales and moving into a community which could further dampen occupancy improvements particularly in the independent living sector. According to a report from Senior Housing News, average rates for assisted living increased by 4.6% in 2021 and reports by NIC MAP Vision, Senior Housing News, and CBRE, forecast increases in 2022 will range between 1% and 7%.

Occupancy Rates and Rents Impacted by Type of Housing

	Seniors Housing			Nursing Care
	Overall	Majority IL	Majority AL	Majority NC
Market Fundamentals 2Q 2022				
Occupancy	81.4%	83.9%	78.8%	78.5%
Annual Rent Growth	3.7%	3.0%	4.6%	2.6%

Source: NIC MAP® Data, powered by NIC MAP Vision.

Operating Expenses Affected by Labor and Supply Costs

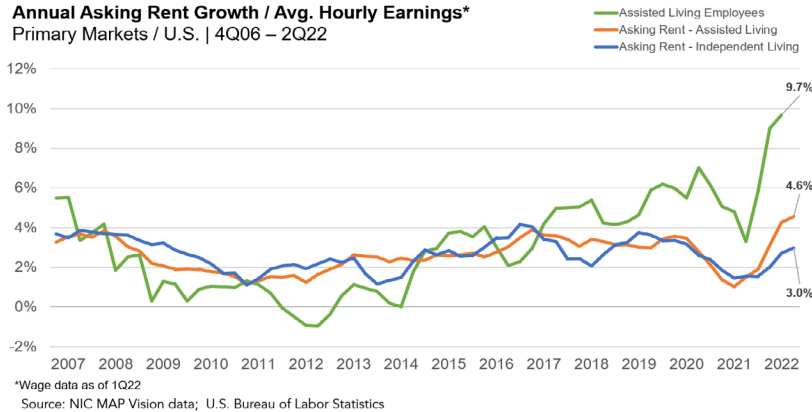
While the pressures on the revenue side derive from occupancy and competition, senior living communities are also affected by the labor market characteristics, which is the largest expense for most senior living communities. Given the vacancy rate in senior care employment, coupled with the overall tight labor market, there is significant pressure on the largest operating expense of a community. In fact, NIC published a historical comparison of labor to rent increases from 2007 – 2022, which graphically depict the relationship between rents and salary increases—a relationship that’s been exacerbated in 2022 for many communities.

As demonstrated in the chart below, the average hourly earnings for an assisted living employee has outpaced annual rent increases since 2017. However, this increase grew to almost 10% in 2022, well outpacing the average increases recorded, underscoring the likely margin compression through the medium term.

Health care job vacancies coupled with tight labor supply and the year over year growth of hourly earnings within life plan communities provide the framework that underscores the perpetuation of the labor cost paradigm.

Labor Cost Increases Continue to Outpace Rental Increases

Annual Asking Rent Growth / Avg. Hourly Earnings*
Primary Markets / U.S. | 4Q06 – 2Q22



When you combine revenue and expense pressures that are evident in the senior living sector, communities with strong liquidity, manageable debt, good management, and solid operations, are well positioned to weather the medium-term operating environment.

The Bureau of Labor Statistics posted updated information for job openings, hires and separations in the health care and social assistance sectors. As of June 2022, there are more than 2 million vacancies in health care related jobs equivalent to a 9.1% vacancy rate. Turnover is further compounding the challenge. For every person that is hired, 91% of the position replaces positions that have turned over. As a result, scarce financial and human capital resources also have to be devoted to training new personnel and retaining current talent supporting our belief that labor cost pressures are not going to subside soon. However, it is important to note that well positioned management teams at various communities nationwide are focusing on innovative methods to attain and retain employees that do not always include significant salary increases.

Health Care Related Job Openings Far Exceed Monthly Hires

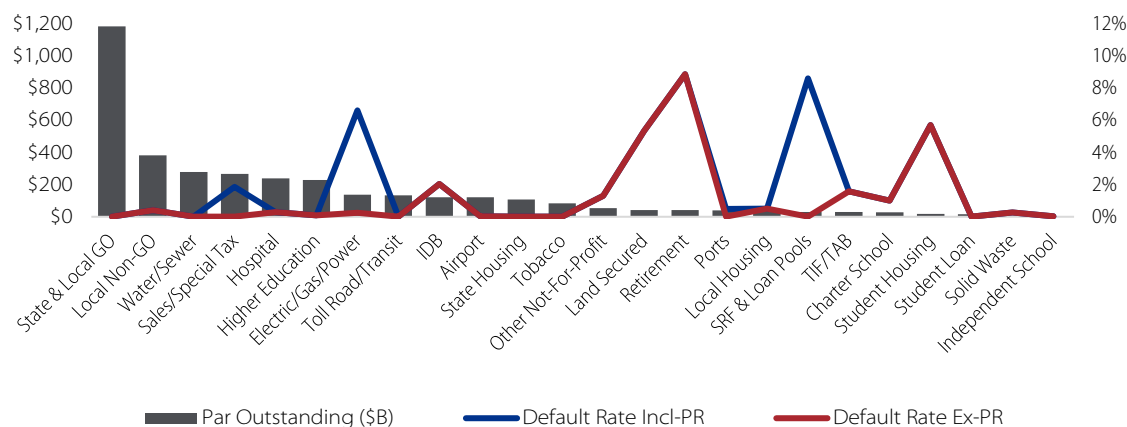
Health Care and Social Assistance	June 2021		May 2022		June 2022	
	Rate	Total (Thousands)	Rate	Total (Thousands)	Rate	Total (Thousands)
Job Openings	7.2%	1,554	8.8%	1,967	9.1%	2,046
Hires	3.3%	672	3.8%	773	3.9%	796
Separations	3.4%	673	3.6%	728	3.5%	728

Source: Bureau of Labor Statistics and HilltopSecurities.

Sector Defaults

When you combine revenue and expense pressures that are evident in the senior living sector, communities with strong liquidity, manageable debt, good management, and solid operations, are well positioned to weather the medium-term operating environment. However, communities with less liquidity and more challenged operations are facing operating difficulties. Municipal Market Analytics reports that in the \$4 trillion municipal market, the senior living sector has the greatest number of defaults and impairments with defaults equivalent to over 8% of outstanding senior living municipal debt and 29% of defaults on senior living communities were on initially rated credits.

Sector Default Rates vs Par Outstanding, as of July 1, 2022



Source: Municipal Market Analytics.

In addition, Bloomberg has calculated the median time from the posting of a technical default until a monetary default in the senior living sector. This period approximates 180 days which corresponds to the median liquidity of a nonrated credit as calculated by HilltopSecurities.

Despite the operating and revenue challenges within the senior living sector, rated and nonrated deals have been completed in both 2022 and 2021. When assessing a senior living credit, there is a mix of quantitative and qualitative factors that go into the analysis. From a numbers perspective, factors that measure liquidity (days cash on hand and cash to debt), factors that measure leverage (debt per unit), and factors that purely measure operations (debt service coverage and operating margin), to name a few, are critical to an assessment. However, these factors represent a snapshot in time and the qualitative elements such as management, community occupancy, competitiveness, and attractiveness (relative to peers) directly affects the ability to raise monthly charges and are fundamental inputs to the analysis.

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Medians on Non-Rated Senior Living Communities

Fitch Ratings has the predominant market share of ratings in the sector. As of August 2021, the agency has ratings on 161 life plan communities with a median rating of BBB on 51% of the portfolio and an almost equal number of A rated and Below Investment Grade communities. Fitch publishes an annual median report by rating level which is an important analytic tool. This section of the article analyzes medians created by HilltopSecurities reflecting \$5 billion of non-rated issuance in 2022 and 2021.

Senior Living Debt Medians

Medians	Fitch	Fitch	HilltopSecurities	NIC MAP Vision
Rating Level	BBB	Speculative Grade	Non-Rated	NA
Days Cash on Hand	527	365.2	199	NA
Cash to Debt	67%	36%	13%	NA
Debt Service Coverage	1.7X	1.0X	1.47	NA
Debt Per Unit	Not Provided	Not Provided	\$247,830	NA
Debt or Price per unit IL AL combined	Not Provided	Not Provided	NA	\$166,864
Debt or Price per unit SNF	Not Provided	Not Provided	NA	\$91,515

Source: Bloomberg, NIC MAP® Data, powered by NIC MAP Vision, Fitch Ratings, and HilltopSecurities.

Based on non-rated deals issued in 2021 and year to date 2022, the median DCOH of a non-rated credit is 199 and cash to debt is 13% with pro-forma DSC at issuance of 1.47x. The important takeaway here is that although the liquidity measures are not equivalent to their rated peers BBB and Speculative Grade peers, for many of the non-rated bond issues over the last 18 months, liquidity provided approximately 54% of annual operations, which in many cases should be sufficient to provide cushion during this challenging period. The higher debt service coverage that is calculated in HilltopSecurities' Medians reflects the fact that many 2021 issues took advantage of the historically low rates and refunded debt as well as the lack of adjustment made by many issuers regarding the receipt of federal pandemic relief funds.

HilltopSecurities also calculated the median debt per unit. In our assessment, this is an important number because it provides a barometer for community leverage and potential recovery modeling if the community has to be sold because of financial conditions. These numbers are helpful when put into context with NIC calculated numbers for the price per unit of an Independent or Assisted Living Facility of \$166k and \$91k per skilled nursing facility (SNF) unit. When compared to the indebtedness, it is clear that the municipal market generally provides more leverage as compared to actual sales with a median nonrated value of \$247,000 as calculated by HilltopSecurities.

Concluding Thoughts

There is no doubt that the next year will present challenges for many senior living communities as they seek to grow occupancy and monthly revenues while simultaneously trying to control labor, food, and other expenses.

Communities with solid liquidity positions, good operating matrices, innovative management teams and manageable debt positions should weather the current operating environment albeit with potentially reduced margins. Conversely, communities with weak liquidity, heavy debt loads, dated properties, or weak management will be more challenged resulting in more defaults and challenges in the immediate term. Ultimately demographic trends, including the need for congregate care for an aging population coupled with the absorption of new properties, could result in greater stability in the senior living sector.

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