RESEARCH & CONSULTING

SENIORS LIVING INSIGHT

SEPTEMBER 2017

A SNAPSHOT INTO SENIORS LIVING ACCOMMODATION IN AUSTRALIA

KEY FINDINGS

Underpinned by the baby boomer generation, the number of persons aged 65+ is set to almost double over the next two decades.

To ensure future demand is met, **the seniors living sector is experiencing significant policy reforms with the emphasis shifting towards home care.**

With a shortfall of seniors living accommodation across all industry subsectors, **developers and operators have responded through the construction of new facilities and aggressive investment mandates.**

To enable residents to age in place, **operators have been increasing their service offering through co-location and integrated care incorporating both retirement and aged care accommodation.**

As operators continue to search for scale to achieve operational efficiencies, **further industry consolidation is expected to occur.**

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STATE OF PLAY

In response to an ageing demographic, the need for age appropriate housing has grown significantly. Ranging from standard housing (supported by home care) through to aged care facilities, the offering of senior's accommodation in Australia has evolved markedly over the past decade, accentuated by regulatory reforms which have sought to develop a more consumer driven system.

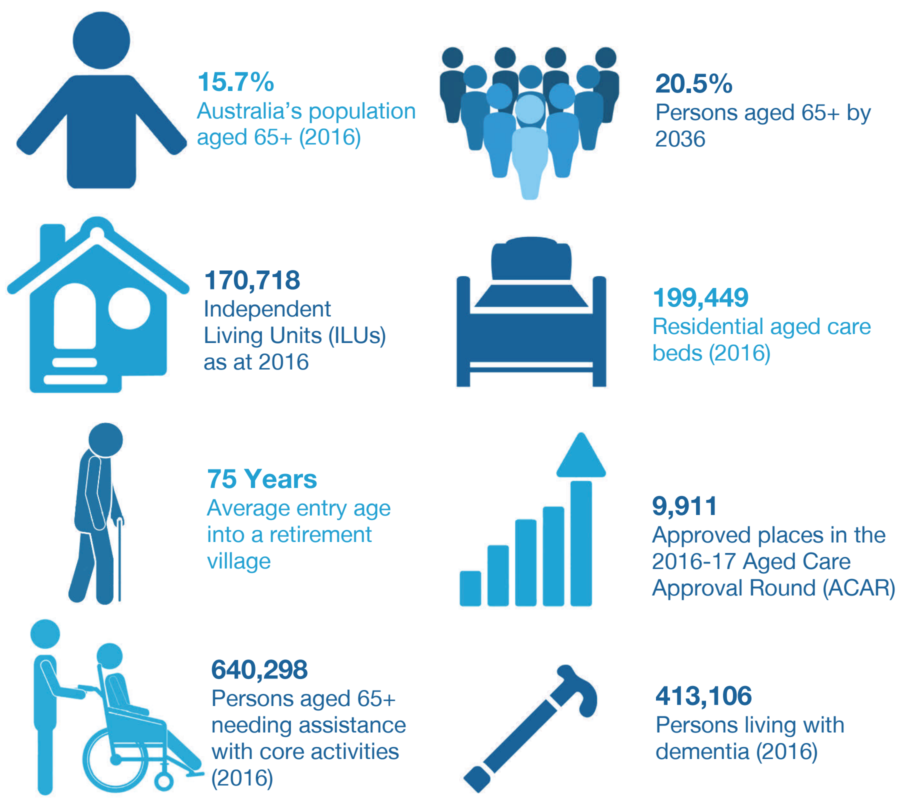
Unlike previous generations who had limited accommodation options, the housing preferences of seniors today has changed as both a greater accommodation variety and broader range of services are demanded. Subsequently, this is creating both challenges and opportunities to senior living providers.

Triggered by an ageing demographic and changing consumer preferences, all forms of seniors living are undergoing significant policy reforms. Most notably, there is a large emphasis on the provision of home care services, enabling aged persons to 'age in place'. The change in government funding from traditional aged care services to a user pays system will provide an advantage for larger operators which can demonstrate the desire, and have the capacity to deliver the required services. As a result, there has been significant industry consolidation over recent years as retirement and aged care operators look to build scale.

At the same time, the design and development of new facilities has changed and more recently has led to the emergence of integrated care facilities. Incorporating both retirement and aged care living options, these facilities allow for a continuum of care, enabling residents to age in place as their needs change. In addition, a scarcity of sites in established areas and residents becoming more accustomed to higher density living has altered the configuration of seniors living facilities including the emergence of 'vertical villages'.

FIGURE 1

National Seniors Cohort Dashboard



Source: Knight Frank Research, ABS, Dept. of Health

DEMOGRAPHIC LED FORCES

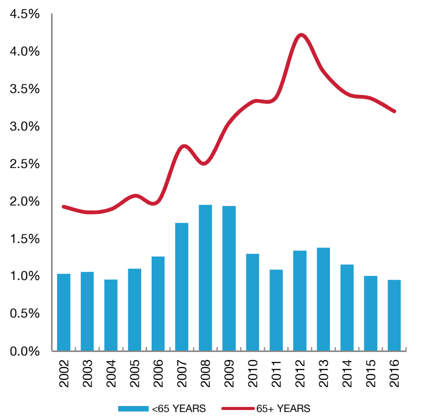
Following a significant pick-up in the birth rate between 1946 and 1964 as post war government policies promoted population growth, a significant structural shift in Australia's demographic make-up followed. Labelled 'baby boomers', this generation is today shaping the way accommodation is provided to older Australians. With baby boomers currently aged between 53 and 71 years of age, the demand for seniors accommodation is on the rise, further accentuated by medical advancements which has increased their average life expectancy.

As per the 2016 Census, there were almost 3.7 million Australians aged 65 and over, representing 15.7% of the Australian population, up from 13.0% a decade ago. The increased proportion of persons aged 65+ in the population is the result of the baby boomer generation flowing through to the 65+ age cohort. As highlighted in Figure 2, population growth for the 65+ age cohort has picked up significantly over the past decade, averaging 3.3% per annum from 2006, compared to 1.0% for persons aged less than 65 over the same period.

FIGURE 2

Historical Population Growth Rates

By Age Bracket, 2002-2016



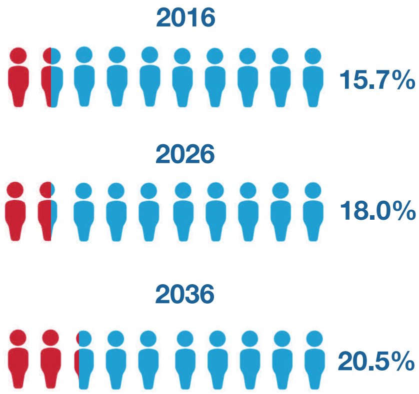
Source: Knight Frank Research, ABS

Looking ahead, population growth amongst the 65+ age cohort is projected to be significant. By 2036, it is expected that there will be almost 6.6 million persons aged 65+, at which point they will represent almost 21% of the Australian population.

FIGURE 3

Share of 65+ Population**

Australia by Year



Source: Knight Frank Research, ABS

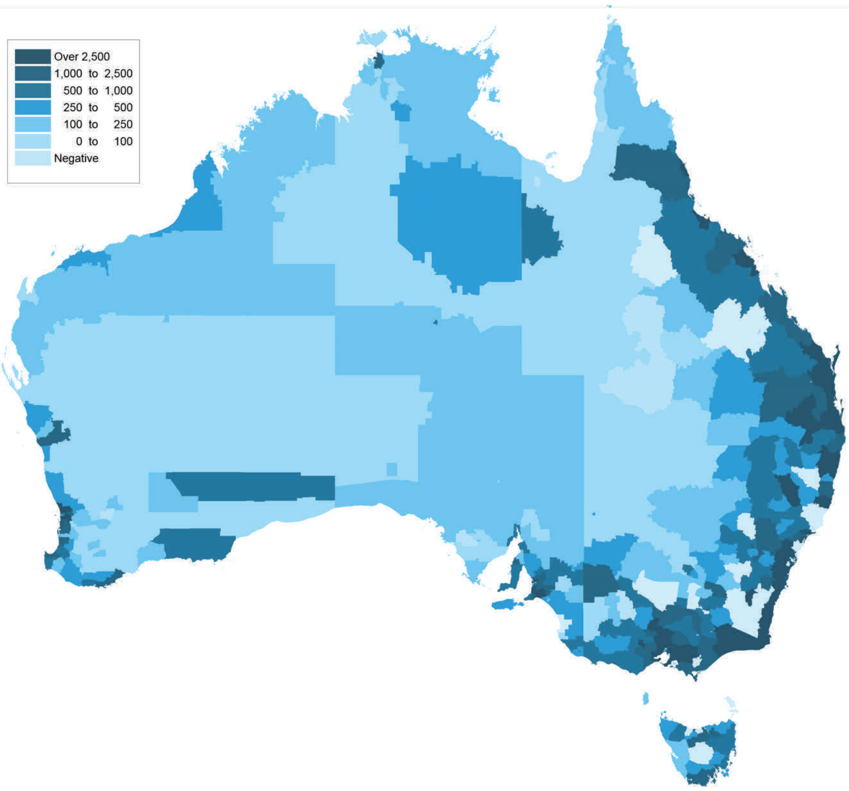
** each person represents 10%

Notably, this growth will underpin a large pick-up in retirement and aged care demand and highlights the opportunity to both existing operators and new market entrants.

MAP 1

Concentration of 65+ Population Growth

2006-2016, By Local Government Area (LGA)



Source: Knight Frank Research, ABS

Note - numbers indicate persons

City Vs Regional Population Growth

Coastal and lifestyle markets are widely considered to be the primary beneficiaries of an ageing population as a result of 'sea change' and 'tree change' migration patterns in addition to aged persons moving closer to family. Going forward, the need for age appropriate housing in these locations will be particularly important.

As per the 2016 Census, regional and coastal areas of Australia had a considerably larger skew towards persons aged 65+, representing 17.7% of all persons compared to 13.7% for the capital cities. Over the past decade, population growth in the 65+ age cohort totalled 3.1% per annum in the capital cities and 3.3% per annum in regional locations. We note however, much of the 65+ population growth in regional Australia has been focussed on the major centres. Notable areas include the Gold Coast, Newcastle, Central Coast (NSW) and the Mornington Peninsula where there is access to above average medical facilities and leisure activities.

RETIREMENT LIVING

Defined as a residential dwelling and lifestyle complex for persons aged 55 years and over who are self-sufficient, the sector has emerged as a key growth industry, supported by favourable demographic fundamentals. Operators and developers have responded to the anticipated surge in demand with a large increase in the number of Independent Living Units (ILUs) over the past five years.

As per the 2016 Census, there were approximately 170,700 ILUs within Australia, with NSW, Vic and Qld accounting for 74% of this total. In between the two most recent Census periods (2011 and 2016), there was an increase of 36,059 ILUs, representing a 27% increase over the period.

By state, the largest increase over the period occurred in NSW where 14,420 ILUs were added to the market. Important to note, 63% of new ILU supply in NSW stemmed from regional locations, underpinned by the Far North Coast, Central Coast and the Hunter region. In line with the concentration of 65+ population, Vic and Qld experienced the next largest increase in ILUs over the period, adding 7,540 and 6,896 ILUs respectively over the same period. Reflecting the sea change and tree change phenomenon, 42% of ILUs added to the market between 2011 and 2016 were in regional and coastal locations.

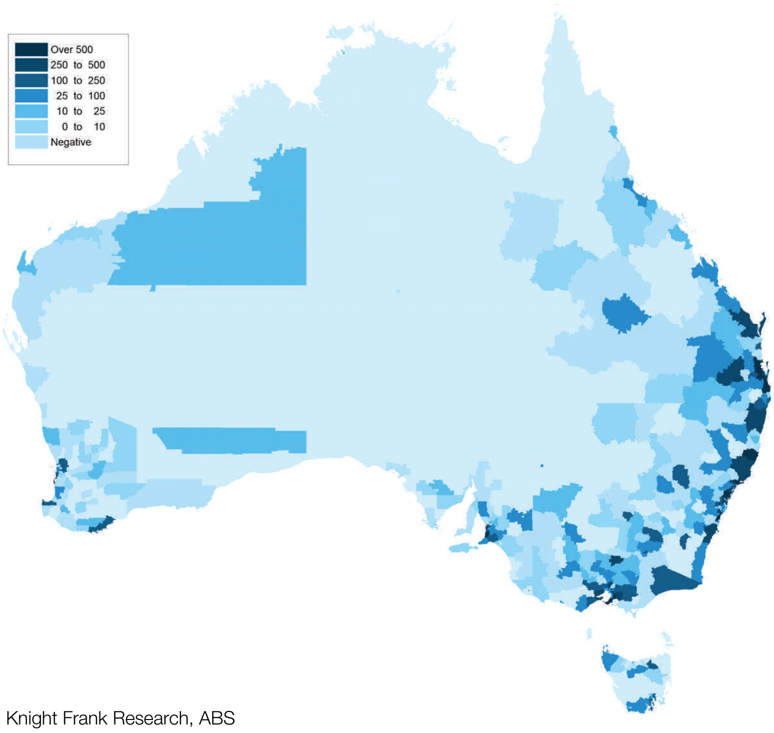
Industry Consolidation

Retirement village ownership is heavily fragmented with the four largest providers (Aveo, Stockland, Lendlease and Retire Australia) estimated to account for just 10% of industry revenue (IBIS World). Similarly, there are a large number of owner operator and not for profit providers who only operate a single village. As per the 2016 PwC/Property Council Retirement Census, 33% of retirement villages are run by not for profit providers while the remaining 67% are operated by for profit operators. However looking at the profile by ILUs, 84% of ILUs in the Retirement Census were owned by for profit providers, highlighting the link between for profit providers and scale.

MAP 2

2011-2016 ILU increase

By Local Government Area (LGA)



Source: Knight Frank Research, ABS

Over the past five years, consolidation in the sector has picked up as larger players such as Stockland, Lendlease and Aveo search for the operational efficiencies derived from scale. In recent years notable acquisitions included Lendlease's purchase of five villages from the Retirement Alliance Group in late 2014 and Stockland's acquisition of eight South Australian retirement villages from Masonic Homes SA in 2015.

More recently, Aveo acquired Freedom Aged Care in 2016, adding 1,000 ILUs, in addition to a large development pipeline, to their portfolio while Lendlease has flagged the potential 50% sale of their retirement business.

With demand in the sector set to rise significantly in the coming decades, further institutional investment through mergers and acquisitions is expected. However, there are limited portfolio opportunities remaining and as a result larger players have shifted their focus to quality individual villages, where available, to meet their expansion mandates. More recently this included the trophy asset sale of the Fraser Shores Retirement Villages to BlueCare in 2016.

Penetration Rates

With 170,700 ILUs nationally as per the 2016 Census and an average household density of 1.3 persons per ILU, this implies that there are approximately 221,910 persons living in a retirement village. With almost 3.7 million persons aged 65+ living in Australia, the retirement living penetration rate currently measures approximately 6.0%.

By state, penetration rates are greatest in Qld, SA and WA at 7.9%, 7.7% and 7.5% respectively. For Qld, the high penetration rate is underpinned by solid growth in Net Interstate Migration as persons aged 65+ from NSW and Vic head north. Despite NSW and Vic having the largest overall number of people living in retirement villages, penetration rates in these states are considerably lower at 5.4% and 4.7% for NSW and Vic respectively (see Figure 5).

Affordability

In comparison to the local housing market, the entry value of ILUs are typically priced well below both house and unit price metrics. As per the 2016 Retirement Census, ILUs were transacted at 67% of the median house price in the same postcode. For Sydney, the differential is even more pronounced with ILUs valued at just 45% of the median house price in the same postcode (average differential of $774,000).

Funding Model

The current payment model of retirement living in Australia is skewed towards the Deferred Management Fee ('DMF') which, as the name suggests, defers the payment until the resident leaves the village. In short, the resident pays an ingoing contribution to reside in the village and then this is repaid, minus the DMF, on exit and sale of the ILU. Subject to the contract, the resident may also receive a share of the capital gain which occurred over the period and can offset the DMF payment.

The DMF fee structure varies greatly by village and operator, however, as an example can be calculated as 3% per year, up to a maximum of 10 years (i.e. 30% is the maximum percentage). Note that a minimum departure fee can also apply in the first couple of years.

Currently, one of the largest barriers to entry into a retirement village is the current mindset of the DMF structure and how it's perceived. Instead of viewing the DMF as a lump sum payment at the end of a resident's tenancy, it should be viewed as a monthly lease payment. For example, if a resident pays $400,000 upon entry into the village, being the loan to the owner (to secure the DMF payment in the future), they stay for 12 years and the DMF is calculated as 3% per year, up to a maximum of 10 years, an exit fee of $120,000 would be payable. Notably, this equates to a monthly payment of just $833, which is likely to be well under the rent for comparable properties in the local area. In addition to this, the resident would need to pay general service fees which could be in the order of $650 per month.

By converting the DMF to a monthly payment, it becomes a lot more palatable for potential residents and given the growth in DMF is capped, the longer a resident stays in the village, the lower the average monthly hypothetical lease payment during their tenure becomes.

Design Factors

Traditionally, retirement village developments were lower in density, featuring individual villas arranged around a community centre on large sites. However, changing household preferences (more lifestyle focused), a scarcity of sites in established residential areas and residents becoming more accustomed to higher-density living, have all started to alter the design of retirement village formats.

The growing demand for healthcare in both industry subsectors (aged care and retirement living), has influenced the design of such facilities with operators looking to incorporate both subsectors in conjunction with mobile health care to form one integrated service. Essentially, this enables economies of scale, allowing each subsector to leverage off one another while reflecting contemporary consumer demand and accommodation priorities.

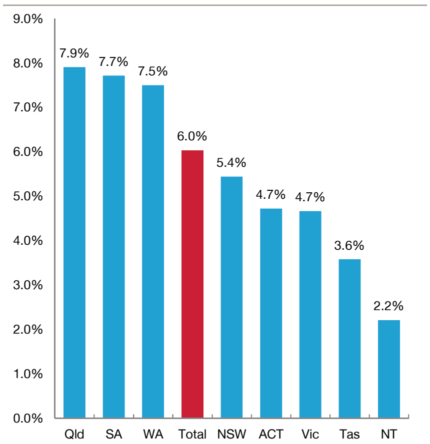
Similarly, following sharp increases in the price of land (particularly in Sydney and Melbourne), the construction of higher density or 'vertical' village formats has become more prevalent.

Future Demand

As highlighted earlier, there are currently 170,700 ILUs across Australia housing approximately 221,910 persons. Using ABS population projections (medium series) we are able to determine the future demand of retirement living. Based on the current penetration rate of 6.0%, Knight Frank Research forecasts market demand for an additional 133,947 ILUs by 2036.

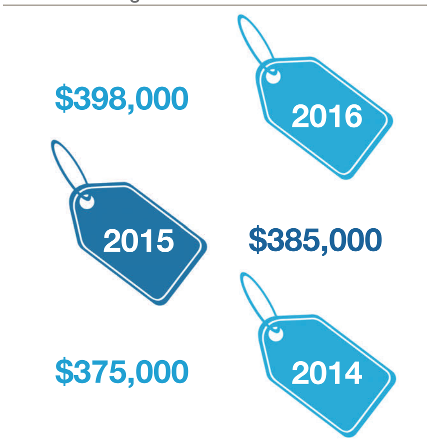
However, as more and more residents age, it is likely that penetration rates will increase which will result in a greater number of ILUs required to satisfy demand. Using a penetration rate of 7.5%, an additional 207,835 ILUs are projected to be required by 2036, highlighting a significant opportunity for both current and future operators.

FIGURE 5
Estimated Penetration Rate by State
2016 Census



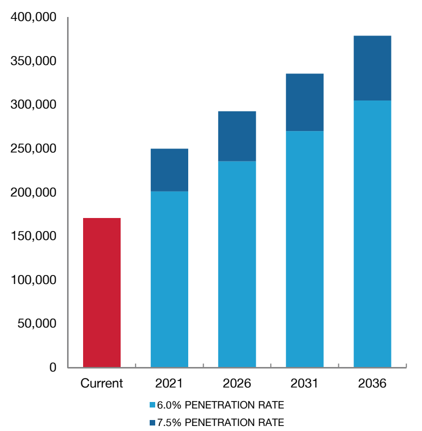
Source: Knight Frank Research, ABS
Assumes a household density of 1.3 persons

FIGURE 6
Two Bedroom ILU Price
National Average Price



Source: Knight Frank Research, PwC/PCA

FIGURE 7
National Projected ILU Demand
2016-2036



Source: Knight Frank Research, ABS

AGED CARE

The need for age specific housing and care has led to significant policy reforms within the aged care sector over the past five years. These policy reforms have been centred on the desire for aged residents to 'age in place', enabling them to remain in their current home and thus delaying their entry into residential aged care. With this in mind, recent policy reforms have been geared towards developing a more cost effective home care model and driving consumer directed outcomes.

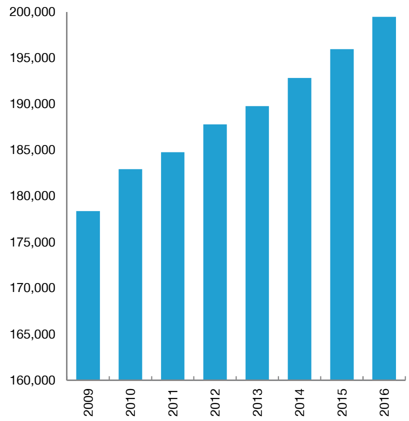
As at June 2016, there were 199,449 operational residential aged care places in Australia, 60% of which are located in the states of NSW and Vic. Between 2009 and 2016, just 21,070 new places have become operational reflecting an increase of just 12% over the period. In contrast, population growth amongst the 70+ age cohort measured 23% over the same period.

By state, the largest increase in operational places since 2009 has occurred in NSW, (+6,946 places) followed by Vic (+5,729 places) and Qld (+4,169 places). Through the Aged Care Approval Round (ACAR), the Australian government currently regulates the supply of residential aged care beds. Previously, home care packages were also allocated through the ACAR however the recent 2016-17 release was the first year home care was not allocated through ACAR as they are now consumer directed.

FIGURE 9

Residential Care Beds

By Year

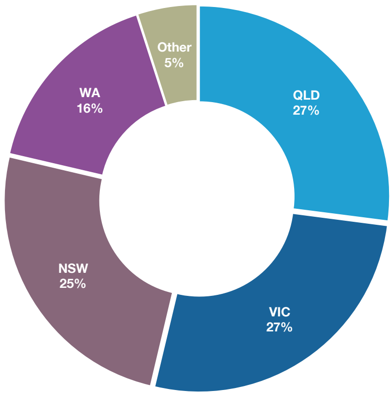


Source: Knight Frank Research, Dept. of Health

FIGURE 10

2016-17 ACAR Results

By State



Source: Knight Frank Research, Dept. of Health

In the 2016-17 ACAR results, 9,911 new residential aged care places were allocated across Australia, with Qld and Vic granted the largest number of places at 2,680 and 2,645 respectively. The Federal Government received 45,053 applications for the 2016-17 ACAR, up 16% from last year and means that for every 4.5 applications received, only one was given an allocation. Importantly, not all ACAR allocations from previous years have been used and still represent potential new supply going forward.

Aged Care Reform

As discussed earlier, the aged care sector in Australia is currently undergoing significant policy reforms to meet the needs of both the current and future aged population. Initially, alterations to the aged care model were prompted by the Productivity Commission's Caring for Older Australian's report released in 2011.

The Government's response to this was the 2012 release of the Living Longer Living Better reform package which was designed to create an integrated and

FIGURE 8

Types of Housing for Seniors

Source: Knight Frank Research

consumer centered aged care system to meet the needs of Australia's ageing population. The reform package adopted a staged approach to be delivered over a 10 year period which began in 2012.

While there are a number of significant changes as part of the package, the key reforms included the establishment of the Aged Care Financing Authority, removing the distinction between high and low residential aged care, more extensive means testing and a Consumer Directed Care (CDC) model, changes to payment arrangements and a move towards consumer driven accommodation payments. In addition to the above, perhaps the biggest change has been an increased focus on home care services, thus enabling people to remain in their current home for longer with aged care being increasingly used for palliative care.

Similarly, in response to a redirection of funding towards home care and a user pay model, the Federal Government has reduced baseline funding to the Aged Care Funding Instrument (ACFI). The ACFI is the main funding tool in providing government subsidies to aged care residents and is determined by a dependency based assessment. Following these reforms, aged care providers have adapted by providing a greater level of user pay services across the aged care spectrum, ultimately allowing an easier transition through different care stages.

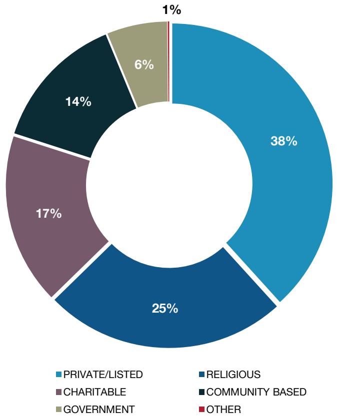
Further regulatory reforms are expected to occur over the next five years, centered on the Aged Care Legislated Review which commenced in September 2016. Parallel to this was a report by the University of Wollongong on the recommended alternative funding options to the current funding system including a blended activity based funding model.

Industry Consolidation

Regulatory reforms which have led to a reduction in funding levels into residential aged care has led to industry consolidation over the past three years as smaller players struggle to compete in the face of increased cost pressures. With estimates suggesting 63% of aged care providers operate a single facility, there remains significant scope for larger players to increase their footprint through acquisitions, developments, mergers and partnerships with other operators.

In light of recent cost pressures, aged care operators are increasingly needing in the order of 1,000+ beds across their portfolio to achieve optimal efficiencies. Subsequently, larger providers have been in pursuit of scale, highlighted by the recent emergence of listed players Japara, Regis and Estia. Notably, government funding cuts coupled with the aggressive expansion mandates of larger players has come at the expense of smaller providers who struggle to provide the same level of service due to efficiencies. However there are always exceptions to this with a number of single operated facilities performing extremely well.

FIGURE 11
Residential Care by Company Type
2016



Source: Knight Frank Research, Dept. of Health

FIGURE 12
2016 Demand Vs Supply
Residential Care by State

Source: Knight Frank Research, Dept. of Health, ABS

Funding Model

Funding within the sector is underpinned by both Government funding and a resident contribution. When a resident enters an aged care home, they are required to pay for their accommodation in one of three ways - a refundable accommodation deposit (RAD), a daily accommodation payment (DAP) or a combination of both - all of which are means tested. In addition to the above, residents are required to pay a basic daily fee to cover care and living expenses and depending on the facility an additional services fee for extra services.

A RAD requires the incoming resident to pay a lump sum payment upon entry which is then refundable once the resident leaves the facility. Higher service standards in recent years has allowed operators to command higher RADs. Alternatively, a DAP is a daily payment equivalent to the lump sum RAD. The DAP is calculated by multiplying the face value of the RAD by the Maximum Permissible Interest Rate (MPIR) and divided by 365.

Future Demand

The Department of Health and Ageing have set national benchmarks for the provision of aged care places, with the ratio currently set at 113 operational places for every 1,000 people aged 70+ (88 residential places and 25 home care places). By 2021-22, the ratio will rise to 125 operational places per 1,000 people aged 70+ (80 residential places and 45 home care places) to reflect the increase in the number of people requiring aged care and a shift towards home care.

Looking specifically at residential care, under the current ratio there is demand for 218,449 places, indicating a current undersupply of 19,474 places across Australia. By State, the largest shortfall is estimated to exist in Qld and NSW at 5,943 and 5,092 places respectively. Alternatively, a moderate oversupply of 110 places is estimated to exist in SA.

Using ABS population projections (medium series) and the Government benchmark of 80 residential places by 2021-22, an additional 86,856 residential places are required by 2026 across Australia.

MANUFACTURED HOME ESTATES

Manufactured Home Estates (MHEs) or Land Lease Communities have emerged as a viable housing option for not only low income senior households but the broader retiree population. Once utilised as holiday accommodation featuring caravans, MHEs have become an affordable alternative to traditional seniors living accommodation and in turn has attracted significant investor interest over the past five years.

Technological advancements in manufacturing have been a catalyst behind demand growth. The distinction between a MHE home and a traditional home is increasingly becoming blurred from a design perspective with modern MHEs being designed to replicate trends in the broader housing market.

With a growing number of retiree households favouring the simplified cost structure of MHEs, operators have responded by offering high quality homes, targeting aged persons of all income levels. Notably, this has seen the inclusion of community facilitates normally found at retirement villages including swimming pools, bowling greens, tennis courts and community centres.

Unlike traditional seniors living accommodation, MHEs operate under a different funding structure in that a resident purchases and owns the relocatable home and leases the land on which the home sits on (see Figure 13). The site fee that the resident pays provides use of facilities and covers general park operating costs. There are instances where residents can obtain rental assistance to cover site fees through Federal Government subsidies.

Like other forms of seniors living housing, operators of MHEs are increasingly expanding their services, adding to the overall appeal of such housing provisions. More recently, this has included the co-location of aged care facilities through forming strategic alliances with aged care providers, allowing residents to remain in the one community as they age.

Rising Demand

With the average retiree income in Australia being very low, the reality is that a large share of senior households cannot afford traditional seniors living accommodation. Given a large number of retirees have had their superannuation balances eroded post the GFC in 2008, the demand for more affordable seniors housing has picked up markedly.

Research by the Association of Superannuation Funds of Australia (ASFA) indicates that there are a significant proportion of persons aged 55+ with no superannuation. For persons aged 55-59 years, 22% have no superannuation while the proportion jumps to 81% for persons aged 75+ (see Figure 14). Similarly, as per the 2016 Census, 65% of persons aged 65+ receive an income less than $33,800 per year, well below the $43,665 threshold for what is considered to provide a comfortable lifestyle for a single person in retirement. With the maximum pension being $437 per week, a large proportion of the population have insufficient funds for retirement living.

Alternatively, a large share of 65+ households own their own home outright. The purchase of a MHE unit would provide an affordable alternative by allowing retirees to trade down, release the capital gains from the sale of the family home and use the remaining funds for retirement.

Investment Market

Given their defensive nature, offering a long term income stream in addition to a rapidly growing demand pool, investment into the MHE sector has grown significantly. While traditional players have continued to grow their portfolios, there has also been the emergence of new operators into the sector.

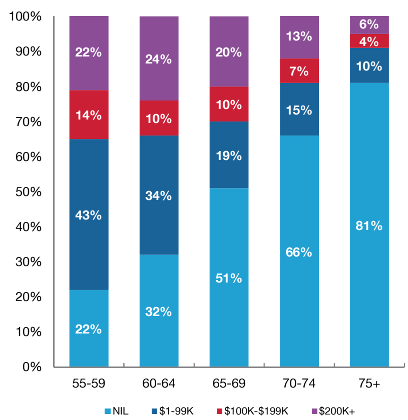
Investment into the sector has been led by the aggressive investment mandates of local A-REIT groups such as Ingenia Communities, Gateway Lifestyle and Lifestyle Communities who have been actively land banking future development sites and re-positioning existing parks. In addition, offshore interest in the sector has grown significantly, highlighted by Blackstone's joint venture with National Lifestyle Villages in 2014 and the more recent Boyuan Holdings acquisition of Broadland Gardens in 2017. With there being similarities between the Australian and US MHE markets, international enquiry has been underpinned by interest from US groups.

Unlike other accommodation options for seniors living, scale within the MHE sector can be achieved relatively quickly as older style existing caravan parks offering short term accommodation can be converted in a short space of time, subject to existing site agreements, to offer long term accommodation. This trend has already begun to occur as the likes of Ingenia Communities and Gateway Lifestyle actively target reposition opportunities.

FIGURE 13
MHE Funding Model

Source: Knight Frank Research

FIGURE 14
Superannuation Account Balances
By Age Group



Source: Knight Frank Research, ASFA Research

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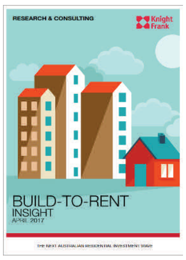

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