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2018 Senior Living Trends

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WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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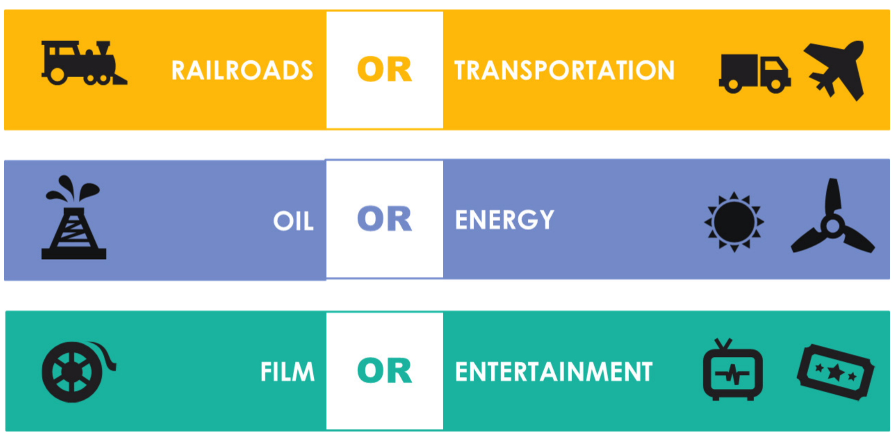
Disruption is the buzzword used when existing solutions can be disturbed by new, innovative solutions — sometimes quickly and violently, and often leading to obsolescence. An entire disruption ecosystem has emerged that includes disruption conferences and capital funds looking for disruptive ideas. All are seeking the novel disruptor that will create a competitive advantage and spur significant growth in the marketplace.

An environment is primed for disruption when existing market participants are unable to view themselves in a way that is distinct from their current industry. These service providers view themselves and the needs for their services as static and defendable and, as a result, underestimate the risk from disruptors seeking to displace them. In response to this risk of disruption, we are asking senior living organizations this simple question: What business are you really in?

According to the article "Marketing Myopia" by Theodore Levitt (2014 Harvard Business School Publishing), marketing myopia exists when market providers "focus too narrowly on selling products and services" and "miss the big picture of what consumers really want." The antidote to this, the author suggests, is to consider that:

- There is no such thing as a growth industry;
- Your product is not your business; and
- It is critical to focus on customers' needs, not your capabilities.



Source: 2014 Harvard Business School Publishing

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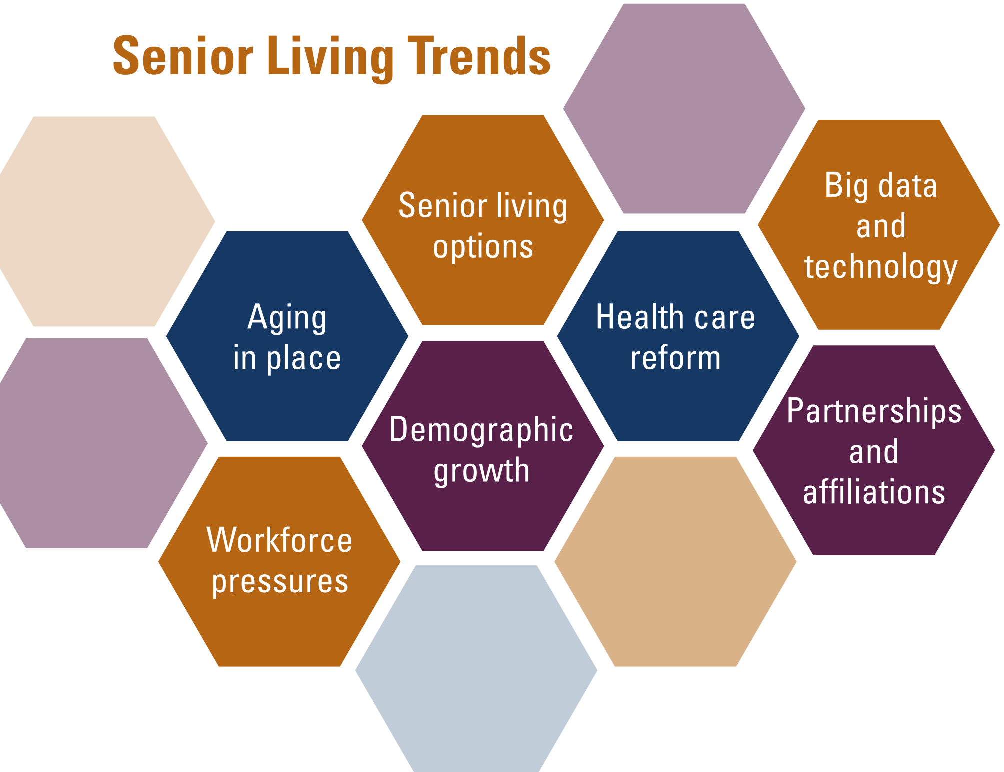
Similarly, in *The End of Competitive Advantage: How to Keep Your Strategy Moving as Fast as Your Business*, author Rita Gunther McGrath argues that companies gain advantage by viewing themselves as competing within arenas, which are defined by evolving customer needs, instead of static and narrow industries, which are defined by currently existing products and services.

We see tremendous potential for disruption within the current senior living environment as the impending pace of change becomes overwhelming to those who are unprepared. While not all of the trends presented here will be applicable to all providers, our hope is that this edition of 2018 CLA Senior Living Trends will challenge the thinking of providers and their boards as they embark on their strategic journeys and position their organizations for future success.

Senior Living Trends



Senior living options

Consumers have expanding choices for senior living options. As one alternative, a Life Plan Community (formerly known as a continuing care retirement community [CCRC]) bundles a number of these options together to address the full spectrum of residents' long-term care needs. Other providers choose to offer only independent living, while many focus solely on assisted living or nursing care. Even market niches that are relatively well defined can be diluted. We recently noted a developer marketing a mini-Life Plan Community. What is a mini-Life Plan Community? A Life Plan Community without nursing. Current Life Plan Communities may say, "That's not a Life Plan Community." However, if the value proposition is ultimately attractive, consumers will readily embrace mini-Life Plan Communities and other alternatives.

Baby Boomers will further compound these challenges. Boomers are expected to bring increased demands for flexibility and choice, while expecting that their input will be valued and acted upon. Senior living organizations will need to adjust to meet the Boomers' desire to experience retirement on their own terms, including heightened focus on both purpose, engagement, and health. Boomers will seek out living, dining, and service accommodations that most closely align with their current lifestyles. We further expect boomers will want to remain integrated with their surrounding communities, presenting interesting opportunities for providers. And the influence of the adult child, usually the adult daughter, will be magnified — not only in impacting purchase decisions for parents, but also in evaluating future options for her own needs.

We believe that the consumer options impacting senior living providers fall into the broad categories of lifestyle and payment choice. We have purposefully not included quality because we believe that senior living has advanced beyond the focus on quality as a trend.

Lifestyle Choices

- Aging in place is the preferred option for the majority of seniors and represents the greatest market share for senior living services. With environmental modifications and technology-enabled solutions, home-based services (home care, home health, and continuing care at home [CCaH]) contribute to making home an increasingly viable alternative for successful aging.
- Whether in their private home or at a senior living provider, older adults increasingly prefer to maintain their current environment instead of moving to a new one. Within a Life Plan Community, delayed transition through the continuum will likely drive efforts to rebalance existing proportions of independent living, assisted living, and skilled nursing, as residents served by assisted living in the past can often be accommodated in independent living, and residents who would have transitioned to nursing care can often be cared for in assisted living. An unintended risk (or advantage, depending on how future consumers' needs are viewed) is that independent living residents of the future may seem more like assisted living residents of today.
- Senior living options without nursing level care (stand-alone independent living, independent living paired with assisted living, or assisted living) appeal to consumers who believe their needs can be met without dedicated skilled nursing or believe that time spent in nursing care will be minimal.
- Assisted living operators are embracing the combination of lifestyle with higher acuity care to realize strong growth of specialty programs. With continued policy and regulatory changes, assisted living facilities may soon be able to serve a wider range of consumers.

- After losing market share to assisted living operators providing more attractive “residential” environments, nursing facilities are adapting and reinventing themselves through the introduction of “household” and other models that bring residential elements into the institutional structure. At the same time, nursing operators are positioning themselves to be the value option (low cost, high quality) for specialized programs, sometimes through partnering with integrated networks to ensure better coordination of care.

Payment choice

For those providers that rely on third-party payment sources, changes are driven in part by third-party payers:

- Bundling is unfolding as a first step into what will be a slow, painful progression from cost reimbursement to very different models in the future.
- Capitation and risk sharing will ultimately prompt nursing providers to clearly define costs, quality, and programming to develop adequate contracts.

All providers will need to tackle how to reduce pricing:

- Market pricing advantages through economies of scale may very well tip the scale in favor of very large organizations that are better positioned to help bring the total cost of care down in the system.

Are the options you offer aligned with what the consumer wants?

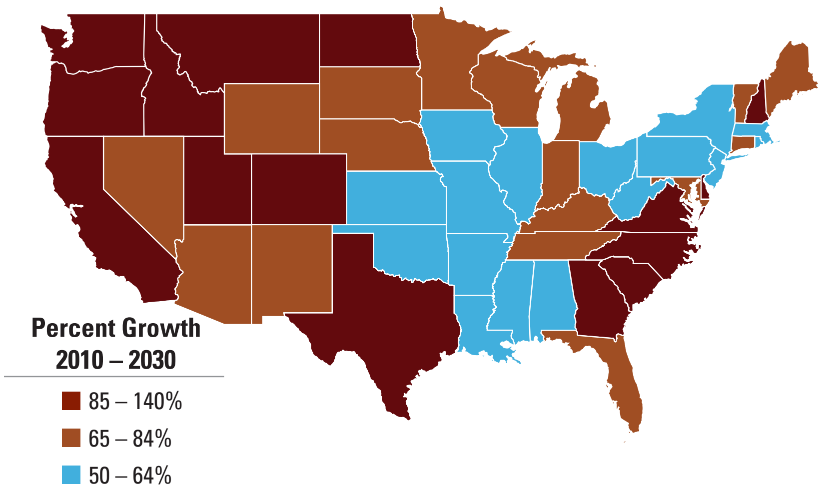
What should your organization do differently?

How entrepreneurial is your board?

Demographic growth: senior cohort

The long anticipated impact of the Boomers is almost upon us as the leading edge of the Baby Boomer generation turns 72 in 2018. The U.S. Census Bureau (May 2014) estimates the 65+ population will almost double to 83.7 million and will be more racially and ethnically diverse. Persons 65+ will also make up an increasing portion of the total U.S. population — from 13 percent in 2010 to over 20 percent in 2030.

The following presents the percent population growth by state from 2010 – 2030:

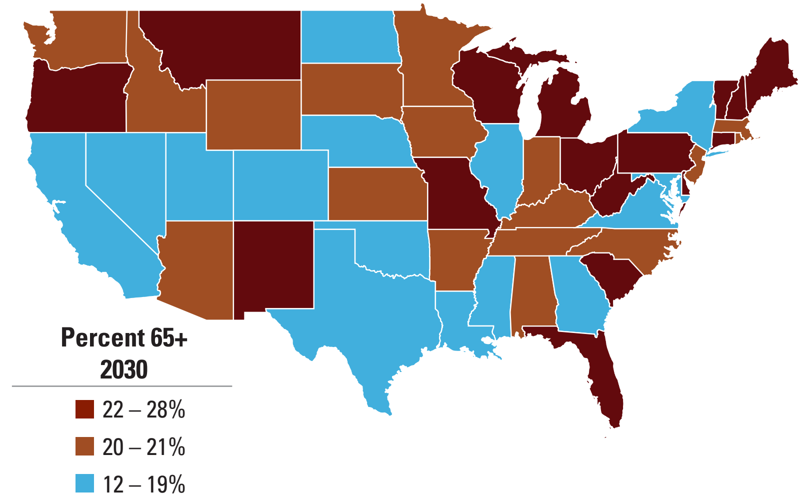


Sources: 2010 – U.S. Census, 2030 - University of Virginia, Weldon Cooper Center for Public Service

How well do you understand the demographics of your local market?

Are you growing?

The following presents the proportion of persons aged 65+ by state from 2010 – 2030:



Source: University of Virginia, Weldon Cooper Center for Public Service

The sheer magnitude of growth in the number of older adults (the “Silver Tsunami”) represents a tremendous opportunity and is attracting massive levels of capital. We are already seeing entrepreneurs and investor-owned enterprises dominate stand-alone independent living, assisted living, and nursing environments. We believe that technology-based solutions will also come primarily from agile, entrepreneurial organizations.

The economic disparity among the senior population is another important consideration. In contrast to the wealthiest members of the coming Silver Tsunami, who will be able to afford a wide array of appealing options, the vast majority of less affluent members face a much less positive outlook. In addition to having insufficient assets, many sources report that this group is generally unprepared for the cost of retirement and aging. The resulting societal impact will be a huge strain on safety net resources and the inability of governmental funds to support those without means.

Aging in place

The majority of older adults report a desire to age at home[1]. In a sense, all other senior living settings are intended to disrupt staying at home. Conversely, the greatest potential to disrupt senior living is to keep people at home as long as possible.

An environment well-suited for aging in place solutions can be created by combining three elements:

- Affordable technology (iPhone, Android)
- Access to the internet (cable, satellite, LTE networks)
- Comfort with technology

Without relying on physically building brick and mortar solutions, joint ventures and other partnerships will be leveraged to enhance the lives of those who are aging and living at home. Telehealth services and technology applications offering on-demand assistance will become increasingly important, as will advancements in self-driving car technologies that can reduce isolation and allow individuals to live at home longer. In fact, the availability of transportation independence and social interaction may erase what previously were primary factors motivating older adults to move out of their homes.

Senior living providers have an opportunity to embrace these changes by positioning their communities as hubs for social interactions and by delivering services to those at home. Alternatives include CCaH contracts, wellness contracts, or other models serving larger markets through networks of community centers. Instead of cannibalizing markets, we see these as avenues for providers to exert broader influence over a larger pool of potential future consumers.

Do you have plans to expand beyond your bricks and mortar?

How can you develop services that help individuals age independently at home?

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[1]*Primary consumer research (focus group and telephone surveys) conducted by CLA between 2014 and 2017 found that 77 – 80 percent of the survey population planned to remain in their residence.*

Workforce

Undoubtedly, all industries will be challenged by the lack of qualified workers; however, the impact may be more severe within the senior living sector. Satisfying the tremendous need at all levels of an organization will require deep commitment to the distinct but highly inter-related workforce issues of recruiting and retention.

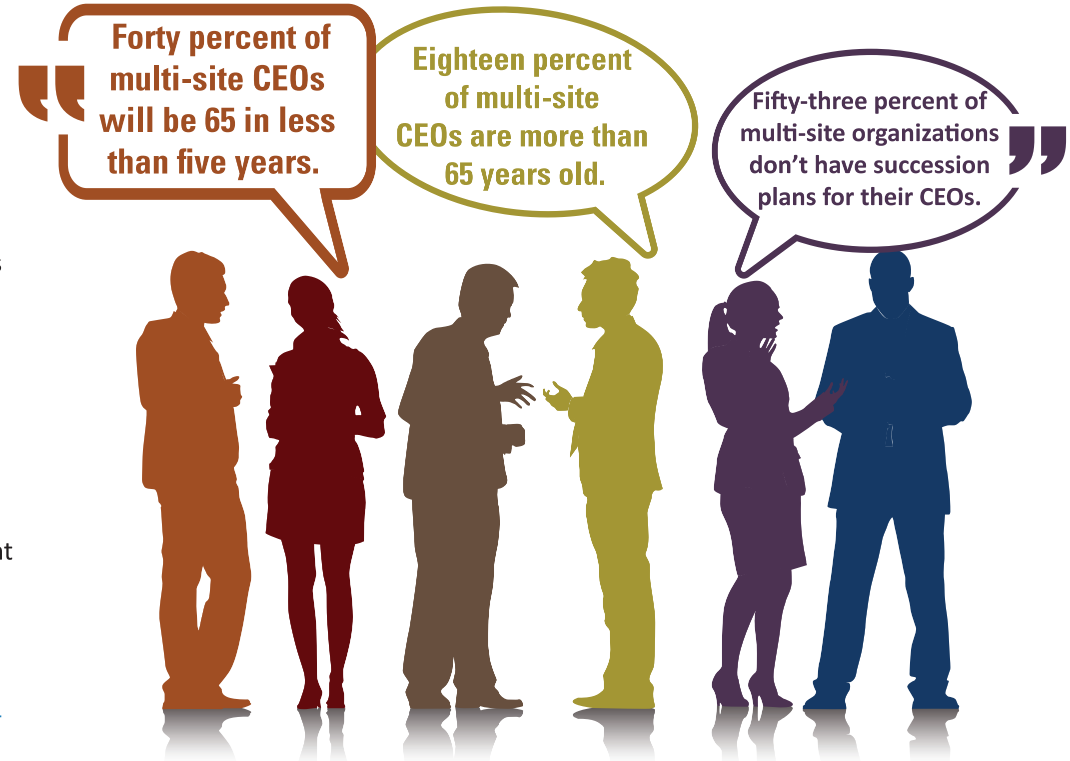
Recruitment issues focus most directly on pay levels (dictated by local market forces for labor) and access to labor (shortages that are driven by other factors such as retirements and nursing school output). Retention issues are also impacted by pay, but focus more on employee engagement.

Increases to minimum wage, adoption of living wage thresholds, and competition for qualified staff will intensify pressure on wage rates, which are expected to outpace potential service rate increases. Additionally, in a tight labor market, employees are always contemplating their next opportunity, which magnifies the importance of creating an engaged and loyal workforce. Providers that are able to connect fulfilling work with an attractive employment environment will gain a strategic advantage.

Concurrent with the demographic shifts facing our nation, many members of the senior living workforce are approaching retirement, which adds urgency to plans for replacing aging leadership and long-tenured caregivers. A recent CLA executive compensation study (commissioned by LeadingAge) found that 40 percent of 105 CEOs of multi-site organizations will turn 65 (assumed age of retirement) within the next five years.

Considered together, these factors mean that the senior living industry will need to attract and retain a younger, more multicultural workforce. This workforce will bring different expectations from those of previous generations. Most notably, current, accessible, and integrated technology will be a minimum requirement, and flexibility in work arrangements will be highly valued. Organizations will need to determine how to best leverage their human resources for high touch, high impact consumer interactions as they stretch their service capacity through artificial intelligence and robotics. Operators can also benefit by recognizing the resource potential of older adults interested in remaining part of the workforce.

Workforce issues will continue to dominate the focus of organizational leadership and boards as they work to attract, leverage, and retain the talent needed to navigate the challenging environment.



Source: CLA/LeadingAge Multi-Site Compensation Study

Do you have market data regarding labor, pay, and employment conditions in your market area?

How are you planning to focus on employee engagement?

Health care reform

Nursing operations are subject to pressures on all fronts, including higher acuity patients, reduced lengths of stay, and the increased admissions necessary to maintain census volume. Risk-sharing is expected to become the norm, accentuating the direct correlation between future payment streams and the value delivered to consumers by providers. Organizations will need robust reporting and measurement systems to contract within a capitated environment and prove their merit within increasingly narrow referral networks of post-acute providers.

A number of factors are expected to contribute to decreased reimbursement for nursing services. For fiscal year (FY) 2018, the Quality Reporting Program (QRP) penalizes providers for incomplete minimum data set submissions. For FY 2019, the Value-Based Program for Readmissions includes a 2 percent Medicare withholding with less potential redistribution of withheld amounts based on readmission rates.

We expect low occupancies, eroding margins, and elevated regulatory burdens will create opportunities for "consolidators" to benefit from economies of scale, allowing the "super large" to absorb these cuts and remain profitable. At the same time, regional providers may be well positioned to benefit from their deep understanding of their local markets and strong relationships with local referral sources.

CLA Clarity Provides Vast Data Set

CLA created a resource called CLA Clarity, which organizes nearly 1 billion financial and quality measures from every Medicare certified skilled nursing facility in the country. The data set is vast but organized in a way that allows providers to explore how their facility compares to specific peers. Clarity pairs the data CLA has acquired with our industry experience, allowing us to deliver unmatched insights to assist operators to better understand their business and determine specific areas to focus on for performance improvements.

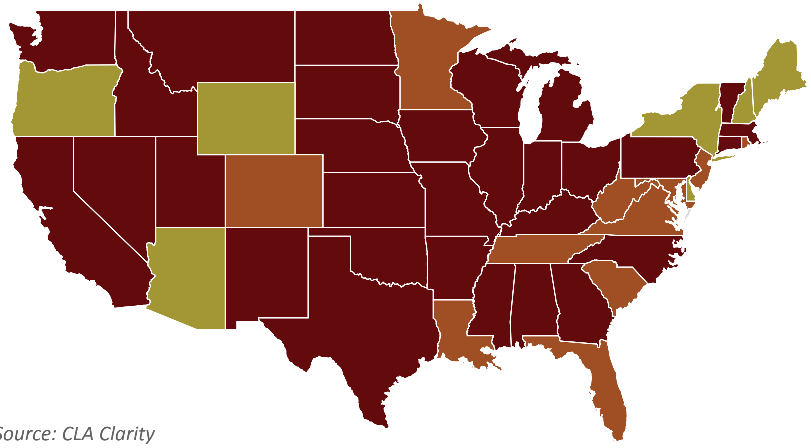
Using our proprietary modeling tool, CLA Clarity, we analyzed the four-year trend in the weighted average operating margins for nursing facilities by state. (For the purpose of this analysis, operating margin is defined as earnings before interest, depreciation, and amortization as a percentage of revenue.) The following map illustrates the results of this analysis. The rate of change (defined as high, medium, and low) illustrate the overall direction of change nationwide.

High – Change in operating margin in excess of 3 percent

Medium – Change in operating margin greater than 0 percent and less than 3 percent

Low – Change in operating margin less than 0 percent

Rate of Change in Operating Margins for Nursing Facilities



Source: CLA Clarity

As noted in CLA's 32nd SNF Cost Comparison Report, CLA believes that, as health reform proceeds, referral sources will narrow their post-acute network, and there will be a larger standard deviation in the financial results of high performing facilities and their low performing counterparts. Referral sources will continue to guide a greater percentage of their referrals to high quality, low cost providers with a proven track record of producing good outcomes for their residents. Our findings further support these observations and the sustained weakening of operating margins.

What is your role in the local health care market?

How do you compare to your competitors?

How are you ensuring operating margin pressures are addressed?

Big Data and technology

Big Data

We are in the age of exponential knowledge growth. Pundits and academics alike have suggested that data will be among our most valuable resources. To progress from data that is interesting but not actionable, providers must be able to draw insight from abundant data and then use it to drive informed, effective decisions and actions.

The current use of Big Data is predictive analytics. From a population health perspective, the goal is to intervene before an event cascades out of control. From contact lenses that measure glucose, to algorithms that capture gait and evaluate the risk of falling, the opportunity for intervention and prevention before an event occurs is tangibly close. The recently announced plans of Amazon, Berkshire, and JP Morgan — three organizations that are quite advanced in terms of Big Data — to jointly offer a new type of health plan will be interesting and informative to watch. We fully expect Google, Apple, Verizon, Amazon, and many others will be similarly working to turn their data into solutions for delivering services to seniors.

Technology

Because of their natural focus on their brick and mortar locations, providers may not understand what the consumer wants and values in terms of technology. The vast size of the longevity economy presents opportunities attractive to nimble and creative intermediaries who can harness technology to provide services that may ultimately negate or lessen the influence of senior living organizations.

Although some dismiss the power of technology in health care because it lacks the human touch, we encourage providers to consider the ways in which technology can create a barrier between organizations and their consumers. Technology-based apps may be the first contact with the consumer and help steer the flow of purchases. Once established as the connector between the provider and the consumer, the app supplants the providers' influence and differentiation.

Uber, Tesla, Blue Apron, and Amazon are examples of disruptors offering consumers alternatives for traditional services. Due to the significant amount of capital being invested in creating these types of alternatives, providers are well served to consider what combination of activities, marketing, and outreach will allow them to influence consumers.

Providers should be considering the investments that will allow them to remain connected to consumers. A simple example is the upgrading of bandwidth infrastructure to prepare the organization for data intensive solutions. Providers also need to ensure that data is protected, and that systems are safe from hacking and disruption. Cloud storage and platforms will be standard. Many organizations must recognize that the required technology skillsets may be beyond their internal capabilities, and therefore need to explore their partnerships and outsourced staffing and security options.

Have you created an app that is offered for free? What assistance or resource would help you in this pursuit?

Are you building the right infrastructure to support the use of data-intensive technologies?

Can you quantify or identify the impact of preventive activities on outcomes?

Can you effectively communicate your value to other health care participants (providers or payers)?

Partnerships, mergers, and acquisitions

As evident in the trends discussed thus far, sustainability and viability come through access to a wide range of resources. In addition to financial assets, organizations need human and intellectual capital, economies of scale, and other strategic resources — many of which represent significant challenges to smaller, single-site providers. Joining forces — whether through partnership, affiliation, or related structures — then becomes an increasingly important tactic for securing strategic capital resources and enhancing market position.

We see healthy interest among our diverse client base in exploring possible collaboration and cooperation. While working to create their path to a successful future, we encourage organizations of all types to consider not only the potential benefits, but also the substantial effort involved in developing relationships with entities that are both similar and dissimilar.

For nonprofit entities, affiliations were often saddled with the expectation that a "weaker, unviable" entity needed to "affiliate" with a stronger entity for survival. The competitive landscape and market opportunities have created a strategic view of affiliations and mergers in which strong entities join to create more advantageous platforms with which to tackle pressing issues.

The significant growth in the "longevity economy" (composed of 106 million people responsible for at least $7.1 trillion in annual economic activity — a figure that is expected to reach more than $13.5 trillion in real terms by 2032 according to AARP) will attract capital investment, innovation, and investment opportunities.

The confluence of capital and opportunity will continue to drive growth and merger opportunities in the broader health care market place while offering new or increased sources of capital to fund new and existing growth opportunities while fostering innovative approaches to care.

Would you affiliate with a larger organization?

How would growth impact your ability to offer solutions in your market place?

Have you modeled a ten year financial plan that incorporates significant growth in your market space?

How we can help

The dynamic senior living environment calls for urgent and decisive action on many fronts. Senior living operators are confronting significant pressures as a result of this year's trends — and they need to move fast to stay ahead of the competition.

> **"Every morning in Africa, a gazelle wakes up, it knows it must outrun the fastest lion, or it will be killed. Every morning in Africa, a lion wakes up. It knows it must run faster than the slowest gazelle, or it will starve. It doesn't matter whether you're the lion or a gazelle — when the sun comes up, you'd better be running."**
>
> — Christopher McDougall, *Born to Run*

The way organizations address our rapidly changing world influences the opportunities we create. We understand the challenges you need to overcome and build on to be successful. You shouldn't have to do it alone.

CLA provides comprehensive strategic, advisory, and outsourcing services to help you decide on the opportunities you want to pursue. We offer the full spectrum of strategic tools combined with strong guidance that can make a profound difference in your organization and in the lives of your clients.

- Comprehensive strategic planning assistance
- Financial analysis and modeling of strategies via CLA Intuition
- Master planning facilitation services
- Outsourced solutions
- CCaH advisory services
- Health reform resources
- Information security services

CLA serves clients across the aging services continuum, including Life Plan Communities (formerly known as continuing care retirement communities [CCRCs]), home health agencies, community-based care providers, and hospitals and health systems. Our resources help clients stay ahead of the changing issues of the senior services industry. Our insight and advice come from many years of working with health care clients. At CLA, we believe our close, professional relationships can last for generations.

Mario Mckenzie is a principal specializing in assurance and advisory services. He has experience in strategic planning, master planning, executive compensation planning, operational assessments, and feasibility studies (financial and market) for senior living organizations.

Cathy Schweiger is a health care director specializing in market research including survey and focus group facilitation, strategic planning, and program development for Life Plan Communities, continuing care at home programs, home and community-based services, and a wide array of senior housing and services.

Download the *2018 Senior Living Trends* whitepaper at CLAconnect.com/2018trends.

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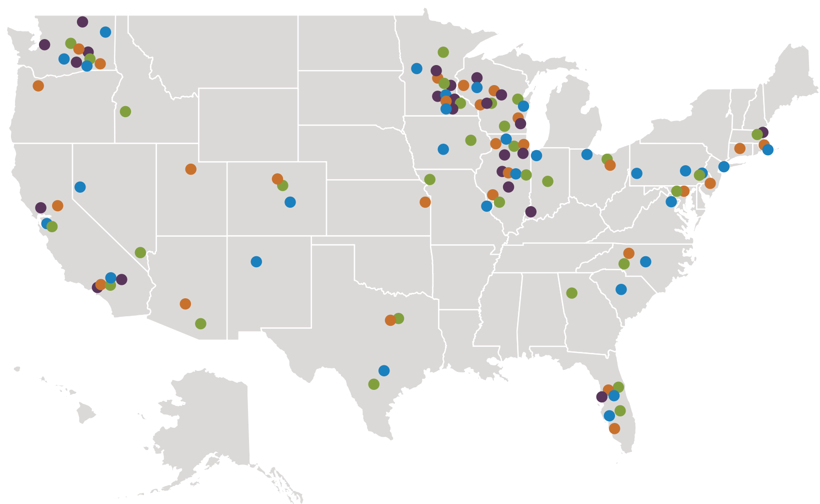

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