Guest Column

Roadblocks and alternative paths to a healthy senior housing market

By Ken Y. Chen and Helen Chen

Many of us have seen the superlatives touting the great potential of China's senior care and senior housing market: the huge elderly population, increased incomes, and that foreign and domestic investors salivating at the promise of serving this huge market. Some have acted, investing large amounts to build housing targeted at seniors, forming companies to provide services, and setting up JVs with funds or insurance companies to hunt for opportunities.

Behind this buzz though is a lack of real success stories, especially in senior housing. Cherish-Yearn in Shanghai is so often bandied about as the example to look to that one starts to wonder whether it's the only project out there. In fact it's not, but many are still in the start-up stages or have met with mixed success.

Thus, we would like to examine two reasons that the senior housing market is not as developed as it could be.

On-trend in every way

Before that though, it is worthwhile to review why people are so enthusiastic about the senior housing market potential. China is already home to over 167 million people over the age of 60, more than the total population of Germany and France combined. And this segment of China's population is only increasing, expected to rise by another eight million a year over the next five years.

The speed of aging in China is unique, considered one of the fastest growing in the world thanks to a rapidly falling mortality rate coupled with a low birth rate—a result of the country's infamous one-child policy. This aging citizenry has led to a '4-2-1 paradigm', where a growing number of couples are responsible for just one child but four parents. As a result, nearly half of the country's elderly population lives alone.

With an increasing level of household wealth, it is projected that over one fifth of China's senior population will be able to afford high-end senior housing and care by 2020, establishing this as a truly lucrative market segment. Based on L.E.K. analysis, Shanghai in particular appears to face a supply gap when it comes to high-end eldercare institutions.

The government is also encouraging this market to develop. After the policies encouraging this sector were passed during the 18th National People's Congress in 2013, recent developments at the provincial level NPC and CPPCC which just wrapped up also bode favorably, with most provinces detailing out specifics of how they will encourage the market.

Against this tailwind, however, are two fundamental issues hampering the full development of a robust senior housing market in China.

Ramp up in real estate prices

First is the state of the real estate industry. Despite prices reaching stratospheric levels and government attempts to cool them down, housing prices continue to reach new heights, especially in first-tier cities. Prices in Shanghai have increase at an average of nearly 10% each year over the last decade. Just using averages, the typical home in Shanghai costs a family 20 times their annual income, versus 3-4 times in the United States. However to many families, owning a home is a necessity (for marrying off a son, for security, etc.) rather than strictly a utilitarian good that can be weighed against renting.

Against this backdrop, developers are able to sell what inventory they have easily at an ever-rising price. The need to differentiate and appeal to niche demand, such as senior housing, is diminished. In fact, the competitive edge for developers is as much in getting access to land as it is in developing a distinctive property, if not more. This is especially true in situations where land is not sold through an open auction process. In these situations, developers sometimes try to differentiate themselves by promising sellers of land (who are for the large part local governments) that they will develop the land into something the state is encouraging, such as senior housing. However, there is currently a lack of overall accountability for what promises have been made, and no standards against which to hold the developers. Thus developers are in essence building conventional residential buildings with minimal "senior housing" features. They may be marketed as senior housing, but with such minimal features this perpetuates the impression to consumers that all senior housing is undistinguished.

Consumer bias towards ownership

The second obstacle has to do with the consumer himself. Chinese consumers have a bias towards ownership. There may be many reasons for this, cultural as well as economic. As alluded to above many brides' families will demand that their daughter and future son-in-law have a home to call their own before agreeing to the match. It's oftentimes not a burden solely placed on the groom's family, as the bride's family will often chip in with the down payment as well. In many cities, the annual rental cost may only be 2% or even 1.5% of the purchase price of the same home, but people still opt for the seemingly economically illogical choice of buying. A related tendency is fee aversion. There are many stories of people who own multi-million dollar apartments who refuse to pay monthly maintenance fees until legal action is threatened. A common explanation is that the owners feel that they own the property already and should not have to pay any additional fees for services.

Both of these consumer preferences hinder the development of senior housing that provides adequate services. Senior housing is not just providing a customized box in the form of an apartment, but should also include services ranging from the simple such as administering medication to the complex such as changing colostomy bags to the social such as organizing activities. In China, L.E.K. research also shows that nutritious meals are also high on the list of requirements. Of course, not every resident will require or want the same set of services either. This flexible range of services lends itself more suitable to a rental as well as a fee-for-service business model. However operators are finding consumers resistant to this model for the reasons stated above.

Thus from both a supply and a demand point of view, the status quo does not favor the development of a senior housing market. Is there a way to break through this logjam? While we do not claim to have a definite answer, we believe some solutions are more likely to occur than others.

Alternatives to break the logjam

Some industry participants are discussing using financial engineering to give developers, operators, and consumers what they want. Specifically, if the price of an annuity were to be built into the price of a senior apartment, then after the developer gets his capital out, the operator can rely on the income stream from the annuity to fund ongoing services, and the consumer both owns the property and doesn't have to monthly service fees either. Win-win-win.

This might be a creative solution, but L.E.K.'s view is that the real solution will be more evolutionary and prosaic. Our view is that rather than a sudden change in consumer or developer behavior spurred on by a deus ex-machina financial instrument, it will be gradual shifts in the market and consumer that lead to faster development of the senior housing market. It is likely that housing markets will begin to cool, in select cities first, which will lead to more rational consumption and higher standards demanded by homebuyers, as well as real efforts from developers to innovate, including by partnering with operators to provide quality senior services. Consumers will also evolve: when the generation of Chinese currently in their forties and fifties who have worked in its modern economy and have enjoyed material prosperity begin to retire in a decade or so, our bet is that they will be much more open to paying a reasonable monthly fee to continue to be taken care of. ■

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