ISSN: 1648-715X/eISSN: 1648-9179

VILNIUS TECH
Vilnius Gediminas Technical University

INTERNATIONAL JOURNAL OF STRATEGIC PROPERTY MANAGEMENT

2024
Volume 28
Issue 1
Pages 64–75
https://doi.org/10.3846/ijspm.2024.21095

BUSINESS MODEL TRANSFORMATION OF REITs IN THE SENIOR HOUSING SECTOR

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Article History:
- received 15 September 2023
- accepted 27 February 2024

Abstract. This study examines the transformative impact of the REIT Investment Diversification and Empowerment Act (RIDEA) of 2007 on Real Estate Investment Trusts (REITs) and their partnerships with operating entities in the U.S. senior housing industry. We explore how REITs, functioning as both asset owners and managers, adapt their business strategies in response to the evolving business landscape. Employing a case study approach rooted in Zott and Amit's (2010) conceptualization of business models, the study identifies and analyzes notable shifts in market participants' recognition of value-enhancing approaches, encompassing not only traditional rental income but also the operational performance of property managers. The findings reveal an expanded risk and profit-sharing mechanism propelled by the newly implemented business framework based on RIDEA, fostering enhanced alignment of interests between REITs and operators compared to the traditional business framework. While this effect under the new model holds the potential for significant enhancements in operational efficiency for asset managers, it concurrently introduces complexities arising from heightened financial and market risks, as well as challenges related to workforce management. Our findings offer valuable insights to industry experts, including REITs, operators, investors, and policymakers, enriching their comprehension of the evolving business models within the senior housing sector.

Keywords: REITs, healthcare, senior housing, business model, RIDEA.

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1. Introduction

The senior housing industry, a dynamic and evolving sector within the broader real estate landscape, provides essential living spaces and care services tailored to the unique needs of aging populations. Traditionally, there are two ways to finance rental housing for seniors in the U.S. First, it can be funded directly through an integrated healthcare company (can be equivalent to a "service provider" or an "operator"), which owns, leases, and/or manages senior housing properties. Second, senior housing real estate can be funded through specialized property ownership companies, of which healthcare REITs, (Real Estate Investment Trusts) are the most predominant (Eichholtz et al., 2007). By 2019 healthcare REITs–specializing in acquiring and managing healthcare-related real estate properties, including senior housing, medical offices, and hospitals–held over 18% of the nation's real estate assets associated with senior housing (National Investment Center for Senior Housing and Care [NIC], 2020). Their ownership covered a wide spectrum of services, ranging from independent living options to nursing facilities. In 2021 these healthcare REITs comprised more than 9.4% of all publicly listed equity REITs in the U.S. market, amounting to a total market value of around $127 billion (National Association of Real Estate Investment Trusts [Nareit], 2022). As a financial entity, a REIT is presumed to aim for maximizing returns for its investors. In the case of healthcare REITs, this objective is realized through the leasing or renting of properties to healthcare operators, who utilize these spaces to offer care services to their clients. While this approach allows healthcare REITs to secure rental income and potentially capitalize on the growth of the healthcare industry, it enables healthcare operators to focus on delivering high-quality care and services for their residents or patients.

Over time, U.S. REIT regulations have progressively evolved to allow a broader spectrum of activities, enhancing REITs' ability to operate akin to corporate property owners. Such development has resulted in attracting a wider investor base while preserving their tax-advantaged status (Mueller et al., 2013). In the context of healthcare REITs, a significant legislative transformation occurred with the introduction of the REIT Investment Diversification and Empowerment Act (RIDEA) of 2007. The enactment of this act allowed healthcare REITs to modify their revenue structure, incorporating participation in operating cash flow alongside rental income. Such departure from the traditional revenue structure, reliant on contractual rent from third-party tenant operators, marked a revolutionary shift in how REITs manage asset income and cultivate

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relationships with operating companies, which ultimately influenced their overall business models.

Although understanding the resulting changes in REITs' business models is crucial for improving the efficiency of financing and managing senior housing real estate assets, such a topic has received limited attention in the scholarly literature. To address this research gap, our study investigates the influence of the novel revenue structure introduced by RIDEA on the business strategies of asset managers. We focus on the asset operation phase where interactions between the REIT and its operator are most active. Given the constraints of employing a conventional applied econometric approach based on limited data, we opt for a case study approach. Drawing on the conceptualization of business models as activity systems by Zott and Amit (2010), our research explores how a REIT, acting as both owner and manager, adopts distinct business strategies and partnership dynamics driven by different revenue models resulting from the enactment of RIDEA. The results of this study highlight significant shifts in how market participants perceive value-enhancing methods. Furthermore, our findings underscore that while the new model based on RIDEA has the capacity to substantially improve operational efficiency for asset managers, it also amplifies complexities stemming from heightened financial and market risks, along with challenges in workforce management. This research holds significance for REIT companies, operators, investors, and policymakers, offering insights into the ramifications of the changed business environment catalyzed by the enactment of RIDEA.

The remainder of the paper is organized as follows: The following section reviews the existing literature regarding legislative changes and the evolution of business models within the healthcare REITs and senior housing sector. Subsequently, we will delve into our conceptual framework, research questions, and the methodologies employed. The remainder of this paper will offer an in-depth analysis of the research results, culminating in a discussion that highlights the key findings and their consequential implications.

2. Literature review

2.1. Legislative background of RIDEA

According to the National Association of Real Estate Investment Trusts, a Real Estate Investment Trust (REIT) is a company engaged in owning, operating, or financing income-producing real estate (Nareit, 2023). However, their core distinction from other entities or companies involved in real estate investment resides in their tax structure and distribution requirements. Enacted through the REIT Act of 1960, REITs were established as an investment instrument to promote long-term investment and broad ownership of commercial real estate assets (Feng et al., 2022). From an investor's standpoint, a primary advantage of this vehicle lies in the use of tax-efficient framework within the corporate structure, as outlined by the U.S. Internal Revenue Code (Feng et al., 2011). However, to maintain such tax-exempt status, REITs must fulfill certain requirements, including having at least 75% of assets in real estate assets or cash equivalents; deriving at least 75% of gross income from real estate activity; ensuring that 95% of income comes from designated passive sources; and most notably, distributing at least 90% of taxable income to shareholders (Nareit, 2023). Such regulations position REITs as tax "pass-through" entities with similarities to mutual funds, albeit with trading restrictions (Ambrose & Linneman, 2001). In this context, REITs are designed to be passive investment vehicles that are prohibited from directly providing "non-customary" services outside traditional real-estate activities, and doing so would trigger a 100% penalty tax and loss of REIT status.

In response to competitive pressures, the real estate sector has pursued greater flexibility in REIT operations, leading to adjustments in regulations. Mueller and Anikeef (2001) suggested such a trend mirrors REITs' need for new strategies as they mature and encounter earning growth limitations, aligning with the life cycle model conceptualization. Indeed, these changes have allowed REITs to operate more flexibly while maintaining their tax-exempt status, thereby attracting a larger investor base (Batt et al., 2022). Key legislative milestones include the "Tax Reform Act of 1986", which expanded the role of REITs beyond investment vehicles. The "REIT Modernization Act (RMA)" in 1999 introduced the concept of Taxable REIT Subsidiaries (TRS), which are taxable subsidiaries wholly owned by REITs, capable of engaging in activities typically considered "non-qualifying income" for traditional REITs. This initiative enabled certain REITs to provide services and capture additional cash flow that was previously allocated to third-party lessees (Beals & Singh, 2002). Subsequently, the enactment of "REIT Investment and Diversification Act (RIDEA)" of 2007 expanded the TRS provisions to cover healthcare REITs, allowing healthcare REITs to incorporate operating income into their total revenue through the establishment of TRS. In this arrangement, the REITs are required to hire licensed healthcare operators legally termed "Eligible Independent Contractors (EIC)" to oversee property management and provision of services specific to senior housing and care. The "non-qualifying" income generated from the operations within this framework is then subject to regular corporate tax rates (Edwards & Bernstein, 2008).

In such context, RIDEA offered a viable option for REITs to incorporate extra cash flow from business operations through intricate partnerships with operating entities, all while maintaining tax benefits for their core real estate holdings. RIDEA significantly fueled a surge in seniors housing and care property transactions, making REITs dominant players in the industry within a few years. The momentum resulted in a record-breaking $27.4 billion in closed seniors housing and care property sales, propelling the top three healthcare REITs with seniors housing portfolios to secure positions among the world's 10 largest REITs, as well as S&P 500 companies in 2011 (Mueller

et al., 2013). This marked a significant change from 2008 when only one healthcare REIT was among the 20 largest REITs. Currently, two healthcare REITs–Welltower, Inc. and Ventas, Inc.–hold the S&P 500 status, each boasting total assets surpassing 20 billion dollars by 2022.

2.2. Business model of healthcare REITs

While there is a dearth of literature analyzing the effects of the RIDEA-based business model, numerous studies have investigated the conventional business model of healthcare REITs before the implementation of RIDEA. Healthcare REITs, a subset of the broader REIT category, initially gained popularity among investors in 1986 due to the Tax Reform Act of 1986 (Lutz, 1989). Simultaneously, these REITs were being explored as a financing alternative for healthcare providers. At that time, most REITs originated from spin-offs by large, for-profit healthcare companies, which often secured capital for expansion by selling portions of their assets. Equity REITs, in particular, proved attractive by providing funds equivalent to a facility's fair market value and offering an off-balance sheet financing avenue (Terris & Myer, 1995). Meanwhile, REITs benefited by negotiating long-term leases with entities that previously owned the properties, thereby managing a portfolio of these income-generating properties.

Batt et al. (2022) discussed that business models embraced by healthcare REITs were primarily built upon the sales-leaseback mechanism, which remains active today. Sales-leaseback is a financial arrangement where an entity sells a property to another party and then immediately leases it back, allowing the seller to continue using the property while unlocking capital tied up in the property's ownership. Terris and Myer (1995) elaborated on key aspects of this arrangement, describing it as a standard method for a healthcare company to obtain equity financing through a REIT, wherein the company sells a property to a REIT–generally for 100% fair market value–and leases the property from the REIT. Such an arrangement allows property owners, often healthcare operators, to realize the complete value of their real estate assets during the transaction. Nevertheless, it subsequently designates them as tenants for the previously owned property under long-term leases, usually ten to fifteen years, with options every five years after the initial lease period to renew the lease or repurchase the facility at the current market price. Under this agreement, the healthcare operator is still responsible for and has control of all operations of a facility. However, once significant capital improvements are sought and financed by the REIT, the associated property commonly becomes the property of the REIT upon termination of the lease.

Another significant feature of the standard business model of healthcare REITs is a triple-net lease (NNN), which is a type of lease agreement requiring the tenant's responsibilities for covering various property-related expenses in addition to the base rent, including property maintenance, taxes, and insurance costs. Batt et al. (2022) argued that such lease agreement based on the "OpCo/PropCo model", which advocates for separating real property from productive enterprises, enables investors to calculate the returns more precisely to capital based on the risk-reward features of the asset class. It seemed to be a rational choice for investors, as previous studies have established that care services increase business risk, which affects real estate valuation and performance (Mullen, 1999). Mueller and Anikeeff (2001) also mentioned the use of triple-net leases as a core investment strategy adopted by healthcare REITs. Through the empirical analysis, they argued that the use of a triple-net lease, which effectively separated the connection between operation variations and property returns, could account for the relative outperformance of healthcare REITs concerning comparable commercial sectors. The study further concluded that connecting operation income to real estate rental income in REITs may cause more return volatility and potentially decrease the risk-adjusted returns to investors. Furthermore, a recent study investigated the optimal ownership of senior housing property, a fundamental query to be addressed in the discourse of the business model. By comparing the performance of healthcare REITs to the performance of the real estate component of integrated healthcare companies, Eichholtz et al. (2007) concluded that healthcare REITs achieved superior returns on independent living properties due to the division of real estate and care services.

As previously discussed, earlier research on the business model of healthcare REITs has confirmed the strategic effectiveness of separating real estate and operational functions from the perspectives of both REITs and investors. However, the current trend suggests a deviation from theoretical expectations, illustrated by the expanding operational engagements of REITs that are dominating the market share. Further examination of this topic reveals that while previous studies may question the fundamental rationale of RIDEA supporting integration of operational and real estate components, they lack a direct counterargument. This can be attributed to inadequate attention given to RIDEA legislation and a predominant emphasis on quantitative analysis in the study's methodology. Such considerations highlight the need for research to holistically investigate the implications of RIDEA legislation and additional factors beyond investment performance that could influence the effectiveness of recent business models employed by healthcare REITs.

2.3. Senior housing: Ownership and management

Senior housing is a management-intensive operating business closely entwined with real estate (Zaner, 1997). The industry provides a wide range of real estate and care services under many different names, generally to those over the age of 75 (NIC, 2020). According to the National Investment Center for Seniors Housing and Care (NIC), senior housing can be divided into four main care segments: independent living, assisted living, memory care,

and nursing care. In the United States, it is categorized as a continuing care retirement community (CCRC) when senior housing offers at least two care segments–independent living and nursing care–in a single community. Besides housing, including both shelter and amenities, senior housing and care properties offer residents multiple services, including hospitality services (meals, transportation, housekeeping, entertainment, and concierge services), care services (assistance with bathing, grooming, dressing, eating, medication management, and other activities of daily living), and medical services (skilled nursing, rehab therapy, and chronic care). These services are offered at different types of senior living facilities (see Figure 1). Eichholtz et al. (2007) state that such classification manifests the increasing contribution of business (care) value and the declining real estate (housing) value as one moves further up the continuum of care.

Senior housing and care properties are frequently owned by entities such as publicly traded healthcare REITs and institutional investors separate from senior housing business operators. The nature of the relationships between owners and operators varies by ownership. While institutional investors often opt for joint venture ownership alongside operators, REITs employ either a triple net lease (NNN) or a RIDEA-based structure that was established in 2007 (NIC, 2020). Nonetheless, as many owners lack operational expertise in this specialized real estate domain, it becomes imperative for them to partner with skilled operators to manage the facility's day-to-day operations. Desirable operators are leading senior housing operating companies with financial strength and at least five years of experience in the senior housing industry (Lynn & Wang, 2008).

The specific duties, responsibilities, and legal liabilities of both the owner and operator are typically outlined in a property management agreement. It imposes a broad mandate on the operator to manage and operate all aspects of the facility in a manner comparable with other similar facilities in the applicable geographical area and compliance with all laws (CREJ, 2018). Specific tasks assigned to the manager or the operator under the agreement encompass preopening responsibilities (e.g. marketing and procuring residents) and operational duties (e.g. property maintenance, financial operations, record-keeping, and reporting to the owner). In addition to addressing budget preparation, fund management, cost allocation, bank account maintenance, and insurance upkeep, the manager's responsibilities often extend to assisting in obtaining and maintaining the facility's license. The agreement also stipulates the manager's fee structure, typically based on a percentage of the gross revenue of the facility. Unique considerations, including branding and intellectual property owned by operators, must also be addressed in the agreement, which is critical for establishing facility quality and attracting residents. Moreover, provisions for temporary trademark use upon termination of the agreement can facilitate smooth transitions, while some agreements can restrict the operator's operation of nearby facilities to protect revenue and brand integrity of the service.

Another vital aspect of the agreement required for the operation and management of senior living communities pertains to the manager's responsibility to recruit, train, hire, and oversee skilled personnel as required for the facility's operation. Required roles include executive directors, operational staff, maintenance workers, food services directors and staff, resident aides, and other essential roles for community service (CREJ, 2018). Mueller and Anikeeff (2001) highlighted the need for ongoing supervision, extended resident stays, and substantial leisure time, which emphasize the need to secure well-trained and motivated employees to provide satisfactory services, especially for roles requiring continuous interactions with the residents. Young and Brewer (2002) also underscored the significance of staff oversight, hiring, and discipline in CCRCs. They argue that the prevalent service evaluation model "SERVQUAL" developed by Parasuraman et al. (1985) lacks in capturing CCRC-specific elements such as interpersonal relationships, provider effort, emotion, social support, and individualized service. To address this, the researchers proposed an alternative model rooted in CCRC residents' perceptions, acknowledging the constraints and coping mechanisms resulting from residents' powerlessness. Further, they advocated for a meticulous hiring and training process prioritizing non-stereotyping and attentive staff, coupled with wellness programs, which is critical to enhance overall satisfaction and empower CCRC residents.

Despite the previously highlighted significance, the crucial role of staff in shaping residents' experiences is often

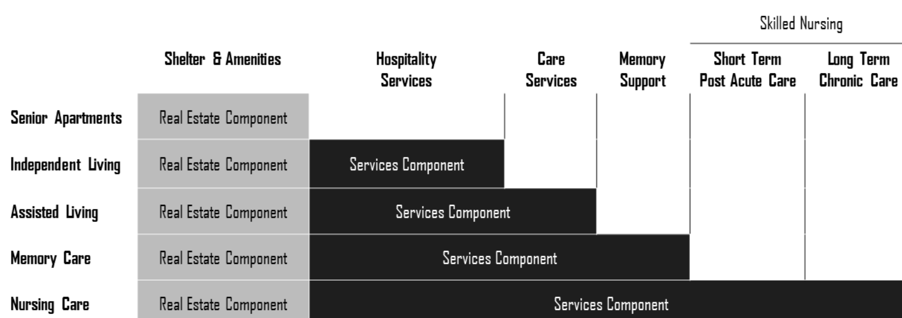

Figure 1. Property types of senior housing by services provided. Adapted from NIC (2020)

disregarded or undervalued within the industry (Young & Brewer, 2002). Scholars widely recognize this as a phenomenon intensified by the "financialization" of the sector, wherein investors integrate non-financial corporations more deeply into liberalized capital markets, extending financial logics of investment to a broader range of actors (Froud et al., 2006; Krippner, 2011; Martin, 2002). Numerous studies have expressed concerns about the impact of fiscal and competitive pressures specifically on the cost of care, affecting the well-beings of both workers and residents (Appelbaum & Batt, 2014; Cox, 2013; Cushen & Thompson, 2016; Duffy, 2005; Horton, 2022). Horton contends that the process of financialization exacerbates the crisis of care by escalating costs through high rent and debt bills under the sale-leaseback mechanism. This, in consequence, erodes working conditions, leading to staff shortages and a redirection of resources away from residents (Horton, 2022). Hence, the study emphasizes the need to consider the implications of labor-intensive service work–including particular workforces, client bases, and forms of work–in the context of the financialization process.

While the existing body of literature has underscored the fundamental attributes inherent to senior housing as mentioned above, a dearth of research addresses alterations in these attributes prompted specifically by the change of the REIT's structure induced by RIDEA. Our research strives to mitigate this scholarly void by subjecting these pivotal attributes of senior housing enterprises to a comprehensive reassessment. Moreover, we aim to explore how these aspects contribute to the business models adopted by key stakeholders in the operating partnership within the senior housing industry.

3. Research design

3.1. Conceptual framework

Our analysis began by recalling that REIT is, by definition, a "company" with a corporate organizational form (Ambrose & Linneman, 2001; Nareit, 2023). In this context, we conducted a cross-analysis of the business models employed by REITs and their operating partners, considering the distinct revenue structures of REITs. Our analysis utilized the business model framework developed by Zott and Amit (2010), which conceptualized business models as activity systems. According to this framework, the activity system represents the collaboration of resources from various parties to fulfill a specific purpose within the overall objective. The activity-based business model framework comprises design elements–content, structure, governance–that delineate the architecture of the activity system, and design themes–novelty, lock-in, complementarities, efficiency–that describe the sources of value creation within the activity system. Zott and Amit (2010) suggested that the design elements encompass the selection of activities, how they are linked (sequencing), and who performs them (governance). The activity system's architecture captures the focal firm's integration within its ecosystem, including networks of suppliers, partners, and customers. The design themes describe how the business model elements (activities) are orchestrated and connected by distinct value drivers. These drivers affect the cost incurred or value delivered by an activity and can counteract or have different impacts across different activities.

A subsequent study conducted by Rajakallio et al. (2017) modified the aforementioned framework to characterize business models in the real estate sector. This adaptation involved the addition of "risk" to the existing design themes, which originally included novelty, lock-in, complementarities, and efficiency. Novelty involves adopting new activities or ways of linking and governing them, while efficiency aims to reduce costs and optimize system content and structure. Complementarities occur when bundling activities generate more value than separate execution. Lock-in strategies aim to retain participants through switching costs or network effects. Additionally, risk plays a significant role in the cost and value of activities as firms employ various risk management strategies based on their risk appetites. These concepts provide a framework for comprehending the business model and financial logic of activity systems in strategic management literature. By employing this conceptual framework on business model, our study diverges from the mainstream literature on healthcare REITs, which largely relies on quantitative methods to analyze investment characteristics as a subset of REITs (Eichholtz et al., 2007; Mueller & Anikeeff, 2001; Terris & Myer, 1995; Zietz et al., 2003). Recognizing the unique challenges posed by healthcare REITs, including data sampling and measurement issues stemming from limited sample sizes, frequent mergers and acquisitions, and variations in asset classification and reporting standards across firms, quantitative analysis was deemed inadequate for addressing the research topic. Therefore, we take a qualitative approach to capture the intricate nature of inter-company relationships, which are fundamental elements of the examined business models.

3.2. Use of case study analysis

To overcome the limitations inherent in the predominantly quantitative methods found in the majority of REIT literature, we opted for a case study analysis. This approach facilitates a comprehensive examination of contextual factors, providing insights into informal structures (Yin, 2003). This is essential for addressing our research question concerning the evolution of business model factors in response to the adoption of a new revenue structure based on RIDEA. To investigate the impact of changes in income streams within REITs, our case selection prioritized identifying REITs with polar types of revenue models in which the process of interest is transparently observable (Eisenhardt, 1989; Pettigrew, 1990; Yin, 2003). Hence, we decided to select two REITs with distinct revenue structures–one that heavily uses the RIDEA-based income model (hereafter referred to as the "operating model") and the other that does not employ the RIDEA-based income model at

all (hereafter "non-operating model")–for a comparative case analysis.

In terms of the analysis scope, our decision was to scrutinize the business models of each REIT and its operating partner specifically during the asset operation phase. This phase marks a pivotal point of convergence in activities between the REIT and the operator within the partnership structure for both REITs, potentially resulting in distinct and observable outcomes. The operation phase of the asset, in this context, initiates with the execution of a sales-leaseback agreement in the non-operating model or the establishment of a third-party management agreement in the operating model. By examining pertinent case examples illustrating their engagements with operating partners under each model, our objective was to identify changes, similarities, and differences in the business models of both the REITs and their operating partners, who actively participate in managing the REITs' assets. Our analysis aims to offer insights into the consequences resulting from structural changes within REITs and their influence on the dynamics of partnerships with operating entities.

3.3. Case selection

A key step in our case selection process entailed identifying one REIT that opts out of the RIDEA option while strictly conforming to a traditional business model, and another REIT that actively utilizes the RIDEA-based operating income model. To ensure comparability, we anticipated that the ideal candidates would showcase contrasting income structures despite some similarities in other crucial aspects. This includes company size, marked by total assets exceeding one billion USD, as well as the portfolio structure implied by the percentage allocation to senior housing as part of their total investments. Additionally, for a meaningful comparison of partnership dynamics, both REITs must be actively involved in partnerships with multiple healthcare service providers.

In selecting our REITs based on the revenue structure, a suitable candidate for a non-operating model must conform to a traditional business approach in the industry. This involves acquiring senior housing properties through sale-leaseback transactions with operators who, in turn, assume tenancy responsibilities while covering general property-related expenses under the associated triple-net leases. It is essential to highlight that these lease arrangements are formalized between a Qualified REIT Subsidiary (QRS), serving as the lessor on behalf of the parent REIT, and the respective operator or the lessee. Figure 2 presents a visual representation delineating the standard ownership structure of a REIT with a conventional revenue model, which should correspond to the non-operating REIT selected for our analysis.

Conversely, the alternative REIT selected for comparison must be among the most active users of the RIDEA-based operating model within the market. Adoption of the RIDEA-based income model can be construed as grounded in a vertical integration strategy, wherein the REIT engages in senior housing operations by procuring a share in the service provider (Buzzell, 1983; Buzzell & Gale, 1987; Mueller & Anikeeff, 2001). This strategic approach empowers the REIT to exercise heightened control throughout the senior housing value chain, encompassing property ownership through to service provision, all with the overarching objective of optimizing operational efficiency and elevating overall performance. It also entails a complex tax structure based on RIDEA, under which the senior housing assets owned by the REIT or QRS are typically leased to a partnered operator represented by a Taxable REIT Subsidiary (TRS) of the REIT. The TRS indirectly operates the property and pays taxes on the net income generated after deducting rents and other expenses paid to the QRS. It is important to note that the asset subject to the TRS must be managed by a qualified "Eligible Independent Contractor" under the IRS Tax code, a role generally performed by an operator. Figure 3 illustrates a typical

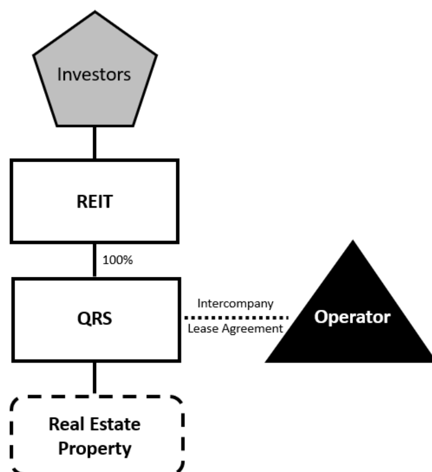

Figure 2. A sample ownership structure of a "Non-operating (Conventional)" REIT

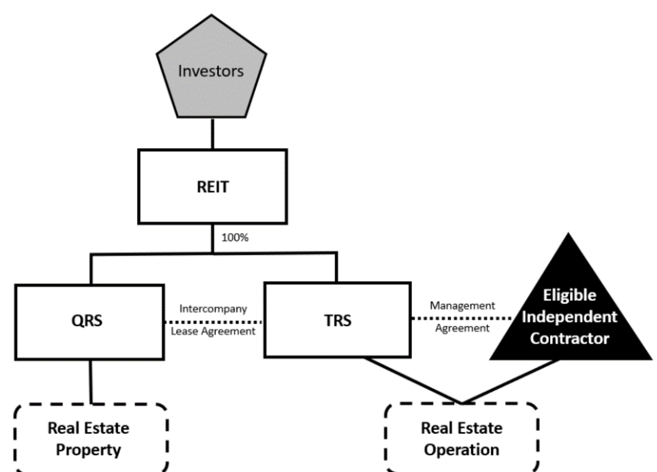

Figure 3. A sample ownership structure of an "Operating (RIDEA-based)" REIT

ownership structure of the REIT with an RIDEA-based revenue model, which should characterize the operating REIT selected for our analysis.

3.4. Data collection and validation procedures

The process of selecting cases involved various stages of data collection and filtering. First, drawing upon data from 2009 and 2022, we compiled a list of the U.S. healthcare REITs listed on the FTSE Nareit US Real Estate Indexes, which included fifteen REITs as of the end of 2022 (Nareit, 2022). Secondly, recognizing that not all healthcare REITs were involved in senior living facilities, we established a distinct category of "senior housing REITs". This compilation comprised companies with a total asset size of at least one billion USD, primarily concentrating their investments in senior housing properties as of December 2022. This refinement resulted in a narrowed list of seven senior housing REITs. Next, we gathered information on the revenue model, portfolio structure, key business strategies, and other investment characteristics from a combination of publicly available data from 2021 to 2023, including recent 10K reports released by EDGAR and other investment reports available from the official company website (LTC Properties, 2023a, 2023b; Welltower, 2023a, 2023b, 2023c). Upon analyzing the provided data, we found that three companies, which constituted part of the top five largest REITs–Welltower, Inc., Ventas, Inc., and National Health Investors, Inc.–stated the use of the RIDEA structure in their annual reports. All these companies reported financial data under a distinct account, denoted as "Senior Housing Operating Portfolio (SHOP)", specifically reflecting the use of the RIDEA structure. While the other four companies have not mentioned the use of RIDEA in their business reports as of December 2022, LTC Properties, Inc. distinguished itself as an entity strictly dedicated to the traditional business model as a primary strategy. Notably, LTC Properties, Inc. has never employed the RIDEA structure in the past, setting it apart from other REITs that have previously implemented RIDEA since its enactment.

After a thorough review of the mentioned company data and the specified criteria, we have selected two REITs for comparative analysis: Welltower, Inc. (hereafter referred to as "Welltower"), a prominent advocate of the RIDEA-based operating model, and LTC Properties, Inc. (hereafter referred to as "LTC"), a contrasting REIT that has not embraced this approach. Welltower has established itself as the largest investor in the U.S. senior housing operating business within the REITs market since its initial adoption of RIDEA in 2010. Welltower has experienced significant expansion in its investment in the "Senior Housing Operating Portfolio (SHOP)", surpassing $20.1 billion in gross value as of December 31, 2022. The Seniors Housing Operating segment's portion of total revenue has steadily increased, representing 67%, 68%, and 72% for the years ending 2020, 2021, and 2022, respectively (Welltower, 2022c). In contrast, LTC does not engage in operating activities but instead focuses on collecting contractual rents from senior housing properties through triple-net leases acquired via sale-leaseback transactions. Despite the notable difference in the company size, LTC has allocated approximately 53% of its total investment to senior housing, closely aligning with Welltower's real estate portfolio exposure of 59% to senior housing (LTC Properties, 2023b; Welltower, 2022c). In terms of partnership dynamics, LTC partnered with 32 operators (LTC Properties, 2023b), meanwhile, Welltower collaborated with 43 operators for its senior housing operating properties through a TRS structure, wherein each operator delivered management services under an incentive-based contract (Welltower, 2023c). Since both companies concentrate their investments in the senior housing sector through collaborations with multiple operators while maintaining distinct revenue models, LTC and Welltower were deemed suitable for comparison. In addition to reviewing financial and business reports (LTC Properties, 2023a, 2023b; Welltower, 2023a, 2023b, 2023c), we also reviewed news articles (Montgomery, 2023; Mullaney, 2021) for data validation. Subsequently, the data from both cases was individually analyzed to comprehensively examine their business model elements, activities, and design themes during the asset operation/management phase. Finally, an industry expert, who remains anonymous and is associated with one of the companies under analysis, validated the accuracy of our data and findings.

4. Results

We present the findings of a comparative analysis that explores the impact of using a RIDEA-based income structure on the business models of the REITs and their operating partners. Detailed results are summarized in Table 1 below, where the business model design elements–activity content, structure, and governance–are mapped against the design themes or value drivers for each company in both case settings. Using a similar approach by Rajakallio et al. (2017), the cross-case comparison is conducted separately for each pair of companies (a REIT and its operating partner), focusing on the triple-net lease contractors under the non-operating model versus the RIDEA contractors under the operating model. Table 1 also outlines the findings of the cross-case analysis about each design theme along with the identified value appropriation mechanisms for each value driver.

During the operational stage of the asset, both cases show consistent governance: REITs and operators collaborate within a network to engage in specific activities aimed at maximizing property value for their clients, who are investors and tenants. Healthcare REITs typically act as property landlords, occasionally providing financial resources to tenants for property operation, and operators serve as tenants based on the terms of sales-leaseback transactions or even become responsible for day-to-day property management on behalf of the REITs, causing a symbiotic relationship. While operators share similar business elements across the cases, we have identified some

Table 1. Comparison of value drivers and value appropriation mechanisms

	REITs		Operator	
	Non-operating	Operating	Non-operating	Operating
Novelty	▪ Creating real estate (healthcare-related) investment opportunities for investors by distributing cashflow from rent collection, sales and development projects ▪ Providing financial capital for operators ▪ Creating value-enhancement opportunities for the holding asset via financing for occasional property improvements	▪ Creating real estate (health-care-related) investment opportunities for investors by distributing cashflow from rent collection, sales and development projects ▪ Securing additional revenue stream from operating cash flow for investors ▪ Providing financial resources to operators ▪ Creating value-enhancement opportunities for the holding asset by investing in recurring property improvements and other related services	▪ Creating value for users (individual tenants/residents) i.e. providing residential and care services ▪ Creating business opportunities for REITs usually by transferring real-estate ownership to REITs based on sale-leaseback transaction and providing rental income	▪ Creating value for users (individual tenants/residents) i.e. providing residential and care services ▪ Creating business opportunities for REITs by providing rental income, providing operating and management services for the holding assets
Efficiency	▪ Maintaining the margin of the investment ▪ Transferring general property-related costs to the tenant	▪ Maintaining the margin of the investment ▪ Leveraging operational capabilities and market knowledge via operating partnership ▪ Maintaining the margin of the life-cycle management ▪ Targeted asset management and data analytics platform to identify operational issues	▪ Maintaining the margin of the life-cycle operations ▪ Paying below-market rate rent based on triple-net leases	▪ Maintaining the margin of the management operations for the contract period ▪ Sharing financial burden (capex, operating expense) burden with REITs
Comple-mentarities	▪ Transferring operational risks to a tenant	▪ Capturing operational upside ▪ Maintaining the margin of the life-cycle management ▪ Providing financial resources to operators needed for sustainable management and operation of the property	▪ Maintaining the margin of the life-cycle operation	▪ Maintaining the margin of operations for the contract period
*Lock-in	Investors: ▪ Maximizing cashflow from rent collection and value appreciation ▪ Managing key financial and operating performance metrics Operator: ▪ Providing operators with financial resources for operation and management of property ▪ Managing and monitoring financial metrics for investors (debt ratio, high FFO, payout ratio)	Investors: ▪ Maximizing cashflow from rent collection and value appreciation ▪ Managing key financial and operating performance metrics Operator: ▪ Providing operators with financial resources for operation and management of property ▪ Providing attractive performance-based incentives for operators achieving target revenues ▪ Sharing operating risks with operators	REIT: ▪ Providing stable, predictable cashflow ▪ Sharing market/business knowledge ▪ Building regional network and reputation in the industry Users: ▪ Property maintenance and development ▪ Improving core and related services	REIT: ▪ Optimizing operational performance to maximize stakeholders' share in operating cashflow ▪ Providing operating expertise ▪ Building regional network and reputation in the industry Users: ▪ Property maintenance and development ▪ Improving core and related services
Risk	▪ Transferring property-related risks to the tenant ▪ Conducting a diligent credit assessment on the tenant ▪ Investing in market research to identify profitable business opportunities	▪ In-depth market research and sophisticated underwriting ▪ Ensuring goal alignment in promoting operational efficiency with the operator Monitoring key performance/financial metrics for investors), ▪ Flexible tenant/operator replacement under revenue-based incentive structure	▪ Maintaining the margin of the life-cycle management operation ▪ Strategic product offerings and investment given market supply and demand ▪ Structuring lease terms based on long-term market prediction and company growth prospects	▪ Maintaining the margin of the management operations for the contract period ▪ Strategic product offerings and investment given market supply and demand ▪ Setting reasonable target revenue with REITs

Note: * To establish a lock-in strategy, the company utilizes various value appropriation mechanisms tailored to its key stakeholders, which can be classified as investors (clients) and the operator (partner) for the REIT, and the REIT (partner) and users (client) for the operator.

differences from the perspective of REITs in terms of content and structure. Historically, REITs have relied on rental income from triple-net leases as their primary source of revenue, as exemplified by LTC (LTC Properties, 2023b). However, Welltower has gradually shifted its focus from the traditional triple-net-lease business to the senior housing operating portfolio, known as "SHOP", causing a change in both content and structure. This shift is evident in the REIT's portfolio structure, with SHOP representing the largest number of properties, the largest capital invested, and the highest percentage of total net operating income within the firm's overall real estate portfolio as of December 2022 (Welltower, 2023c).

REITs and operators engage in a cooperative interplay driven by shared design themes in their activities and value appropriation mechanisms. Although the specific impact of these themes may vary depending on the case or party involved, there is a general increase in the activities performed by the REIT under the operating case. This can be attributed to the introduction of new business dynamics, characterized by the creation of an additional income stream, which adds considerations and complexities to the REIT's operations. Novelty is the collaborative dynamics between REITs and operators from a business creation standpoint. The cooperative network is embodied by transactions where the REITs provide the operators with capital access, whether through sales-leaseback transactions under the non-operating model or through the sharing of operating expenses under the operating model. In turn, the operators remit rent payments, generating a rental cash flow for the REITs. This relationship not only fosters value enhancement but also unlocks new business opportunities for both parties, facilitating a mutual exchange of novelty within their respective operations.

Yet, the impact of novelty varies, particularly for the REIT, depending on its revenue structure, whereas the effect on the operator side remains marginal. Under the operating case, the REIT's further involvement in operating activities, in addition to its core rental business, amplifies the impact of novelty and complementarities on value creation. More specifically, the REIT's active involvement in operating activities generates an additional income stream derived from the operating cash flow (novelty), which enables the REIT to capitalize on significant upside potential through enhanced operational performance and broadens its investment horizons (complementarities). For example, instead of the fixed 2–3% rent escalations in a triple-net lease structure as usually arranged by LTC, Welltower can benefit from the market rent increases, occupancy increases, and overall operational efficiencies (LTC Properties, 2023b; Welltower, 2023a). Moreover, with the active use of the RIDEA-based income model, Welltower has much more actively ventured into investments in non-stable assets through various means, including joint ventures, in anticipation of realizing significant operational improvement as the property becomes stabilized.

Furthermore, efficiency emerges as a primary value driver for the REIT in the operating case, showing greater importance when compared to the REIT in the non-operating case and the operators in all scenarios. Under the non-operating case, the REIT cares about the operational efficiency of the operator only to the extent that it influences the operator's ability to generate sufficient income for rent payment. Under the operating case, however, the REIT becomes a direct stakeholder of the property's operating cash flow and actively seeks measures to capture operational upside to maximize cash flow for investors. In this context, efficiency emerges as a crucial value driver that leads to cost savings in main activities, which entails pressuring operators to reduce major operational expenses, such as labor costs. For example, Welltower, as reported by its 2023 February business update, has effectively addressed outsized agency labor utilization with the specific operator whose labor usage cost substantially exceeded the average in their SHOP portfolio. This was an issue that the REIT was better positioned to discern compared to the operator itself, given its investment in the specialized asset management and data analytics platform in collaboration with a broader group of operators within the same geographic area. Since introducing the agency reduction initiatives in August 2022, Welltower has verified a 54% reduction in monthly agency expenses as of January 2023 (Welltower, 2023a).

Risk or risk management is a pivotal factor that can govern the income structures and business models within the industry network. Engaging in activities aimed at effectively managing and mitigating risk contributes to a more sustainable business environment, fostering confidence among stakeholders and creating opportunities for growth and value creation. In the non-operating model, the triple-net lease structure entails a complete transfer of operational responsibilities from the REIT to the operator. Thus, the operator assumes full accountability for the risks associated with the day-to-day operation of the property. Moreover, in the case of LTC, these triple-net leases are commonly structured as master leases or multiple master leases with a single operator and are typically cross-defaulted (LTC Properties, 2023b). This implies that if one lease defaults, it may trigger a cross-default situation, placing other leases with the same operator in default as well. Such interconnected arrangement serves to safeguard the interests of the property owner (LTC) by enabling them to take appropriate action in the event of default under any of the leases with the same operator.

On the contrary, the operating model introduces a more collaborative approach to managing operational and financial responsibilities from the operator's perspective. In this model, a REIT is obliged to share the cost burden that was once solely carried by operators, encompassing regular operational expenses and meeting capital expenditure requirements throughout the asset's lifecycle. As a result, the financial risk for the REIT increases, potentially resulting in a higher debt ratio. Additionally, with shorter lease terms and market-based rental rates, REITs under the operating model have greater exposure to unfavorable economic situations or decline in market

occupancy compared to the conventional non-operating model. While this risk-sharing mechanism creates a lock-in effect for the operator, it also necessitates greater efforts from REITs in terms of risk management, such as carefully scrutinizing the tenant's credit history as a part of due diligence process; conducting a diligent assessment of the tenant's operational and financial performances; conducting in-depth market research and employing sophisticated underwriting practices before acquiring the asset; and most notably, implementing a revenue-based incentive framework designed to promote alignment of interests while facilitating timely replacement of underperforming operators. In the case of Welltower, each operator involved in the SHOP portfolio is obligated to management services under a contingent, incentive-based management contract. This empowers the REIT to terminate management agreements in defined circumstances, including manager insolvency and the failure to attain designated NOI targets (Welltower, 2023c). For instance, the case study of Welltower demonstrated the substantial improvement of over 75% in EBITDAR in 4Q22, following the re-tenancy of senior housing facilities to Complete Care Management, underlining the effectiveness of a profit-based incentive contract (Welltower, 2023b). Consequently, operating partners face a heightened responsibility to establish realistic revenue objectives with the REIT and must rigorously uphold operating margins to ensure the continuity of their contractual relationship. Such dynamics place operators in a more competitive environment, as REITs taking a greater share of profits from operations means tighter lease coverage for operators, which may or may not be adequately compensated by REITs depending on the perceived value of the operator's skills.

Finally, the concept of lock-in emerges as a significant value driver, catering to two essential stakeholders: investors and partners. The symbiotic nature of the relationship between REITs and operators, underpinned by the exchange of financial resources and operational capabilities, highlights the significance of the mutual lock-in effect on both parties across the cases. Lock-in can act as a catalyst in enhancing other pivotal themes within the partnership, including novelty, efficiency, and risk management. It promotes collaboration between REITs and operators, creating an environment conducive to identifying and pursuing novel avenues for collective growth. More specifically, lock-in plays a crucial role in enhancing operational efficiency under the operating model, fostering a joint effort by the REITs and operators to minimize operational costs, share excess profits, and optimize the allocation of resources. By establishing lock-in through shared goals reinforced by well-designed incentive structures in addition to risk-sharing mechanisms, REITs and operators can effectively leverage their collective expertise and capabilities, resulting in enhanced operational efficiency and financial performance. Should such enhanced financial performance materializes, it could yield positive implications for investors, further reinforcing a lock-in effect on their clients.

5. Conclusions

Traditionally, business models of Healthcare REITs revolved around the passive strategy, characterized by a sale-leaseback model coupled with triple-net leases (Batt et al., 2022; Terris & Myer, 1995). Conventional wisdom indicated that such an approach proved effective for both the owner and the operator of the property, as it enabled operators to focus on core business by conserving capital while REITs managed the assets (Eichholtz et al., 2007). From the REIT's standpoint, this strategy was grounded in the rationale that isolating business activities from real estate facilitated accurate assessment of capital returns, aligning with the inherent risk-reward attributes of the asset class (Batt et al., 2022). While a REIT remains exposed to the financial risk of the operator (LTC Properties, 2023a, 2023b), a closer examination of this framework reveals a significant transfer of financial responsibilities from the REIT to the operator under the traditional business model (Batt et al., 2022; Bruch et al., 2022; Gupta et al., 2021; Horton, 2022; LTC Properties, 2023a, 2023b). Although the sales-leaseback arrangement may initially appeal to financially distressed operators seeking swift asset liquidation, the extended lease term and the transferred responsibilities, requiring the lessee to manage property maintenance, tax, and insurance expenses within the triple net lease structure, could compromise the operator's financial resilience. The presence of information asymmetry may exacerbate this situation, as the owner lacks comprehensive insights into their operational activities, particularly regarding areas such as labor utilization and daily cost management. Consequently, this may lead to further deterioration in service quality and the overall condition of the property.

Therefore, it is crucial to reevaluate the effectiveness of this framework from the perspective of efficient property management, especially in sectors where property and services are closely interwoven and mutually supportive. Given the capital-intensive nature of the industry, operators often look to REITs for institutional capital to fund property management and enhancements. They may also seek guidance on effective real estate management, capitalizing on REITs' expertise in asset management and extensive database through their diversified portfolios. Meanwhile, REITs must rely on operators with professional licenses and required experience to oversee and address operational complexities (Lynn & Wang, 2008). Operational responsibilities encompass a wide range of healthcare management aspects, such as staffing, insurance-related concerns, protection of intellectual property, cost control, medical service oversight, resident attraction, and the improvement of service quality for elderly clients (CREJ, 2018). Facilitating the exchange of knowledge and establishing a robust partnership between the REIT, serving as the financial resource provider, and the operator in charge of daily operations is crucial for their shared success and sustainability of the business.

In this context, embracing the RIDEA-based operational model could be a viable substitute for the traditional approach. Integrating operating income into real estate cash

flow via the TRS structure has compelled REITs to jointly shoulder profits and risks that were previously borne exclusively by operators under the traditional model. As illustrated by Welltower's cases, this approach has proven successful in fostering a cooperative relationship between the REIT and the operator, consequently yielding enhancements in operational efficiency for the managed properties (Montgomery, 2023; Mullaney, 2021; Welltower, 2023c). Such gains have been realized through collaborative management duties, performance-based incentive systems, and intensified information sharing. Meanwhile, it is important to acknowledge that the RIDEA framework comes with notable risks for REITs and their investors, encompassing escalated operating costs, heightened market volatility, and increased financial liabilities (Welltower, 2023c). These factors call for careful consideration for asset managers and investors when contemplating the adoption of RIDEA. It is worth noting that the current primary proponents of RIDEA are the leading entities in the senior housing REIT sector. In this context, it can be argued that REITs with higher risk tolerance, substantial asset portfolios, and strong financial backing are better positioned to effectively capitalize on the advantages offered by the RIDEA-based framework.

While RIDEA may provide benefits for asset managers and operators, earlier research and the Welltower case study suggest potential negative implications for workforce in the care service. Researchers have demonstrated how the expectations of more influential investors have heightened workloads and job insecurity among employees, aiming to meet performance metrics or targets for reducing headcount, which often resulted in productivity gains benefiting capital rather than translating into increased wages (Appelbaum & Batt, 2014; Cushen & Thompson, 2016; Horton, 2022). Welltower's case exemplified this when the company exerted pressure on the operator to achieve a target reduction in monthly agency expenses, referred to as the 'normalization of agency labor usage', which was realized within a year. This was accomplished through weekly calls with the operator's executive team, benchmarking labor cost data against the broader Welltower portfolio, and utilizing output from Welltower's predictive analytics tools (Welltower, 2023a). Such initiatives find justification in the contractual terms delineated in the standard management agreement between the REIT and the operator (CREJ, 2018). In such context, REITs' pursuit of heightened operational efficiency through labor cost control may inadvertently compromise interpersonal relationships between care providers and residents, which is vital to the well-beings of users (Young & Brewer, 2002). It can be assumed that RIDEA might amplify the impacts of financialization, causing adverse effects on working conditions of the staff while diverting resources from residents (Horton, 2022). While our analysis does not definitively ascertain RIDEA's impact on service quality and resident satisfaction, further research is imperative to investigate the effects of the business model transformation on the user side. Such research will shed light on achieving balanced benefits for REITs, operators, investors, and users within the prevailing business model framework.

Acknowledgements

This paper was supported by Konkuk University in 2020 (2020-A019-0097).

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