

# **2024 Annual Report Letter From The CEO**

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# LETTER FROM THE CEO

Dear Fellow Shareholders,

2024 marked another year of strong growth and satisfactory returns for our existing investors, as we continue to execute across all facets of our business. As I describe below, the fundamental backdrop remains healthy, as our population is rapidly aging with each passing day and, at the same time, new supply continues to dwindle. We also notched a record \$6 billion of acquisitions during the year - but we're more excited about the value which we achieved (30%+ discount to replacement cost) and their expected contribution to our growth over the next few years: *remember, today's capital allocation decisions will drive future operating performance*. Ultimately, our operational and capital deployment achievements last year resulted in 23% and 26% Adjusted revenue and EBITDA growth, respectively, and 19% Normalized FFO per diluted share growth<sup>®</sup>. This outsized level of cash flow growth coupled with prudent capitalization of our acquisitions, resulted in a 1.5x deleveraging of our balance sheet and culminated in an upgrade to our credit rating

earlier this year to A- from S&P and A3 from Moody's. While the outlook for the commercial real estate market and for the global economy has recently grown increasingly uncertain, we remain optimistic regarding the growth prospects of our business.

While these results have been satisfactory, we are perhaps more excited about the duration of our future growth trajectory, which now appears longer than it did 12 months ago. And not because we weren't optimistic enough at that time or because the longer-term fundamentals of the seniors housing business have improved further, but because of the progress made by John and his team on our end-to-end operating platform, the Welltower Business System ("WBS"). Notably, in the third quarter, we launched the tech platform of WBS at our first set of properties, marking the first step towards creating a modern digital experience for our residents, their families and site-level employees. We've continued to roll out

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the tech stack to additional communities in Q4 and Q1 with overwhelmingly positive feedback. Through this process, we've brought true operating expertise into our company and, combined with disciplined capital allocation and use of data science, we are creating real value and expanding our moat in a business which is ripe for disruption.

But to understand the conception and impact of our data science platform and WBS is to first understand the culture we have created at Welltower – my biggest source of pride as I enter my 10<sup>th</sup> year at the company. I firmly believe that our culture, which I'll describe in great detail below, is our greatest competitive advantage and the true source of our accomplishments to-date. The creation and successful deployment of our data science platform over the past decade – well before machine learning and AI entered mainstream vernacular – didn't occur by happenstance or without significant challenges. It required a massive shift in the mindset of the entire organization to embrace a data-driven and fact-based approach to investing as opposed to the "gut-feel" and "deal-shop" mentality which had been pervasive at the company for decades (and is still generally the case for most real estate entities). Similarly, our audacious vision to transform the seniors housing business through WBS has required buy-in and an open-mind from our team and our operating partners who, for decades, followed legacy practices around seniors housing operations. As I mentioned in my letter last year, our team has navigated multiple crises, fought side-by-side together from the trenches and, through it all, formed tremendous resilience which will allow us to tackle the macro and/or micro challenges we may face in the future. Needless to say, for most of us at Welltower, this is not work – this is our life's work, having re-founded this

company and building it by laying one airtight brick at a time. We have created a seamless web of DESERVED trust with all of our people and counterparties. Shared Sacrifice. Unity of Purpose. Mirrored Reciprocation. These seemingly mundane qualities in the right combination create a leaping emergent effect of a culture where everyone is fully committed – we go all in and stay all in. This is how we believe big money is made over long periods of time.

## Drivers of Long-Term Growth

First, I wanted to provide a quick update on the fundamentals of the seniors housing business. The fourth quarter of 2024 marked the ninth consecutive quarter in which same store net operating income growth for our seniors housing operating portfolio exceeded 20% – likely an unprecedented achievement in the public real estate industry. While we're pleased with our recent results, the backdrop for growth should continue to improve in the coming years. As you're aware, business fundamentals appear healthy through the end of this decade, as demand will continue to ramp driven by growth of the 80+ population, while new supply is at its lowest level since the Great Financial Crisis. After this period, though, is when we believe our growth trajectory may improve further: this is the time at which the 80+ population (i.e. those born in the post-WWII period, after 1945) really takes off. Given the higher-acuity tilt of our portfolio, demand for assisted living and memory care should take another leg higher around 2030.

From a supply perspective, we witnessed a fifth consecutive year of declining starts last year while 2025 is likely to be the sixth.

Why? Because of the single most important question (or dare we say, the only question) developers should be asking before deciding to build: what is the value of the asset relative to replacement cost? In other words, can they sell an asset significantly above what it costs to build in order to make a profit. Otherwise, it simply makes no economic sense to do so. This model makes supply in real estate almost perfectly predictable. To understand where supply will be higher a few years from now, find those assets which are trading meaningfully above replacement cost. Irrespective of the strong fundamentals we're currently witnessing in the seniors housing space, why would a developer build when assets are trading at 60-70 cents on the dollar? That's a guaranteed recipe for losing money. The ramifications of this trend are likely to be pronounced. For example, take the single-family housing market: post-GFC, the spigot for development got turned off, and ~15 years later, supply still hasn't caught up, resulting in a massive housing shortage in the country (and single-family homes are amongst the lowest barrier to build). We could see a similar situation play out in seniors housing, keeping excess supply away for a long period of time. Additionally, while the recent tariff announcements have introduced significant economic uncertainty, what is a near certainty is that their potential implementation will drive construction costs higher (costs which have already remained elevated for several years), likely delaying any development even further.

While the beta of our business is unquestionably attractive, our enduring goal is to create meaningful operational and capital allocation alpha. Doing so in any business – particularly in seniors housing given its operational intensity – is not an easy one. It requires a culture of extreme excellence and partners who share this

mindset. Our team shows up every day with one question in mind: how do we improve customer and site-level employee satisfaction to drive compounding growth on a per share basis over a long period of time for our existing owners? As I mentioned above, this mindset is our greatest differentiating factor. We believe that our growth trajectory and the culture we have created aren't typical for a real estate entity – but, instead, more akin to those generated by an operating business.

And that is, at our core, who we are: an operating company in a real estate wrapper.

## Seniors Housing: A Product Business

The concept of advantageous divergence is perhaps best manifested in our view that real estate is not a levered finance business. As I described last year, ours is a product business. While we are extraordinarily proud of the unmatched portfolio of built environments we have curated over the course of many years, it isn't just our ownership of physical real estate or their locational attributes which creates value – it's what's taking place within those buildings that also creates true long-term value. How has Costco or Kiewit or Glenair achieved their success? By delivering a killer value proposition to their customers. Similarly, our goal is to work with our best-in-class operating partners to truly delight residents and their families while also improving the employee experience – all enhanced by WBS.

One of the biggest misconceptions about our company is that, like many other real estate companies, our growth will subside over time as we eventually succumb to the “law of large numbers.” However, as an operating company, the opposite trend is unfolding

- the network effect. As we've grown, and with more and more data capture, two of our key competitive advantages - our data science platform and WBS - continue to strengthen, further expanding our moat and driving a wider performance gap between ourselves and our competitors. Remember, the success achieved by companies like Amazon and Costco is because of their size - not in spite of their size. Or take Danaher which, for decades, has achieved incredible success through its principles of continuous improvement and operational efficiency. Seniors housing has historically been viewed by private equity and other institutional capital sources through the same "levered beta" lens as most other real estate sectors, usually to the detriment of their investors. However, in reality, it is unquestionably a product business and, as such, we are working shoulder-to-shoulder with our best-in-class operating partners to improve the experience provided to residents and their families while also enhancing the employee experience. Doing so has required us to rely on a form of bio-mimicry in the business world: bringing in the strongest talent from adjacent industries with higher standards. We obsessively study great operating businesses and great capital allocators. In all cases, we try to mimic their standards - not their style.

## Galilean Relativity

Simplistically, Galilean Relativity suggests that to understand a system, it must be viewed from outside the system. While our operators provide superior care to their residents, a transformation of the processes, systems, and technology used in the industry is critical to improving the overall value proposition they provide. Hence, why we are intent on bringing in talent from outside of the business. If people from within the seniors housing industry continue to be hired to solve

the inefficiencies which have long existed in the business, it will only lead to *incremental* change - not the *transformational* change that we are seeking. Think about the short-haul trucking executives who "fixed" the challenges of the railroad industry.

In our world, we are bringing in operating talent from multifamily, single-family rentals, hospitality, self-storage, logistics, the military, and many other operating businesses which view their product from the perspective of the customer. We are fortunate to partner with the strongest seniors housing operators in the industry and we have no desire to replicate the deep talent pool that resides within those partners. The talent we are attracting today is working with our operators to solve customers' and employees' pain points. Ultimately, the goal of WBS is to bring system level thinking to remove bottlenecks, streamline flow, and minimize friction from all human interactions and focus solely on areas where scalability creates a strategic advantage, while relying on our premier operating partners to solve the unremovable complexities that are inherent in our business. WBS will provide site-level employees with real-time actionable business insights and free up valuable time to provide a real human touch to our residents. If we can do this, we believe we will have a long runway for margin expansion in our business. Improving margins for us isn't about cutting corners; it's about removing excess and complexity, and improving service. This, in turn, will create a growing feedback loop as a superior product will generate goodwill with our customers today and create stronger pricing power in the years to come. This is what we are after - extending our revenue growth curve well into the future. We are always solving for long duration.



# Culture

Ours is a unique culture. And we are obsessed with it. Defining, refining, fine tuning, and living our culture – EVERY DAY. EVERY STEP. EVERY ACTION. But before I delve into our culture, I want to first define what culture means to us. After spending thousands of hours in books related to business, psychology, philosophy, biographies, anthropology, and culture itself, we found the definition of culture that resonates with us in an unusual place – in a book of science essays – “The Lives of a Cell – Notes of a Biology Watcher” by Lewis Thomas. In this 1974 book, Thomas writes:

“It is instinctive behavior, in my view, and I do not understand how it works. It cannot be prearranged in any precise way; the minds cannot be lined in tidy rows and given directions from printed sheets. You cannot get it done by instructing each mind to make this or that piece, for central committees to fit with the pieces made by other instructed minds. It does not work this way.” And he continues, “What it needs is for the air to be made right. If you want a bee to make honey, you do not issue protocols on solar navigation or carbohydrate chemistry, you put him together with other bees (and you’d better do this quickly, for solitary bees do not stay alive) and you do what you can to arrange the general environment around the hive. If the air is right, the science will come in its own season, like pure honey.”

At a macro level, we believe this to be the very definition of culture – getting the air just right around the hive (aka our organization). And it is our belief, if we get the air right, the honey (“compounding of per share growth for existing owners”) will come.

At a micro level, we once again borrow from science to help define our culture. We are decisive disrupters who believe we can reinvent real estate as an asset class. We founded a unique culture of owners – not managers with agency problems – and bring the view of an “outsider” driven by Galilean Relativity in which distance provides perspective.

## Tenets of Incentive Design

Nowhere is “culture” more important than with “incentive systems.” At Welltower, we truly believe that what you honor, measure, and reward is what you tend to get. In other words, few concepts are more important than designing the right incentive structure to achieve optimal norms and behaviors. This is as much of an external design criteria (e.g. the contracts with our operating partners) as it is an internal one (compensation design of our employees/executives). We have discussed the external design criteria at length over the past decade as our contracts evolved from RIDEA 1.0 (minimal alignment with our operators) to 5.0 today (highly aligned, win-win, with appropriate long-term incentives in place). And from an internal perspective, we have touched on our compensation philosophy in our Ground Rule Document, conveying that we eat our own cooking and only eat after creating substantial value for you, our owners. However, the philosophical underpinning of both external and internal design systems, whether for executives or for front-line workers, stems from five principles. Importantly, we believe that each of these five principles is necessary but not sufficient – they must work in unison to drive impact. They consist of the following:

1. Simple – An easy to understand system that all participants can explain.
2. Significant – Offering a truly meaningful potential payoff, big enough to get the attention of all participants.
3. Duration matched – Depending on the level at the organization, incentives need to be duration matched with the immediacy of an individual's impact. For example, an executive should be paid on performance based on multiple years of value creation while a line level employee should receive monthly or quarterly incentives. The “Goal Gradient Effect” – the human tendency to sprint when spotting a finish line – should always be kept in mind.
4. Non-Gameable by Payee or the Payors – A certain plan in which neither party can alter afterwards or cheat to reach the goal is a must.
5. Territoriality – The reward must be earned as a group with graduated payments to individuals as appropriate. No individual should be allowed to win while the rest of the group is losing. At the same time, it's incumbent upon groups themselves to monitor and prevent free rider problems.

## Growth Leader's Power Law Trifecta – From Culture to Growth

As critical as incentive systems are, we also believe that a company's success is driven not just by having skin in the game, it's about having *soul in the game*. Regardless of the type of business in which a company operates, but especially for a growth company, success over the long-term is largely a function of a leader's ability to harness three

basic power laws of nature: unity, vector, and constancy. And, in doing so, that culture ultimately manifests itself in the durability of the company's growth resulting in shareholder value creation.

1. Getting the team right (Unity of purpose) guided by Newton's Law of Gravitational Attraction. The attraction between two particles is inversely proportional to the square of the distance between them:

$$F = G \frac{m_1 m_2}{r^2}$$

The tightness amongst members of the team (i.e. less distance), more unified, closely-knit version shows up in a squared way in their attraction. We believe this is the most important task of leadership – getting and keeping the team all-in and keeping their souls on fire.

2. Getting the pace/direction right (Vector) guided by kinetic energy ( $KE = \frac{1}{2} mv^2$ ). As I described in my letter last year regarding velocity, the direction and the “punch” are crucial here. Potential energy is what an organization could do. Kinetic energy is what it is doing. Its punch refers to the force it presently exerts in its competitive niche.
3. Keep it going (Constancy) guided by the law of compounding interest (growth). We got everyone all in – unity of purpose (#1). We sent them off with the right pace and direction – velocity (#2). Now, the third applicable law of nature is compounding. The momentum we have established – right pace, right direction – we want to keep it going continuously. Compounding is the most powerful force in the universe. Why should we harness it and never lose it? Because it is the only power law that does not have a fixed numeral in the exponent slot. It has “n” in the exponent slot.  $A = P(1 + r/100)^n$

It has been n=60 for Berkshire Hathaway (and still going). This is why we are so obsessed with duration and keeping the counter (n) going (duration). Again, duration is how the big money will be made for our owners.

## Team Chemistry, Latency and Network Effects – A Use Case of Machine Learning and AI

Over the past few years, many of you have mentioned to me that while you are intrigued by the humanity changing power of AI, you are also struggling with real life use cases of this amazing technological advancement. Machine learning is, in a sense, the tree from which AI sprouts. And our own experience essentially follows that path. We believe our Data Science platform (an umbrella term we use for Machine Learning/Deep Learning/AI), which we developed over the past decade, provides a fascinating and practical use of the power of this technological advancement.

Consider the following steps in a typical process for a marketed real estate asset transaction:

1. Hiring a broker:
  - a. Receive broker opinion of value (BOV) from multiple brokers, then interview brokers, and negotiate brokerage contract – 30-60 days
  - b. Provide financial information to brokers, back and forth between broker and seller to refine data and create an Offering Memorandum – 60 days

2. Launch sales process:
  - a. Negotiate an NDA with each potential buyer – 2 weeks
  - b. First round data room review period – 30 days
  - c. Second round best and final process with investor tours – 15 days
  - d. Select Buyer
3. Negotiation and close process:
  - a. Negotiate Purchase and Sale Agreement (PSA) – 30-45 days
  - b. Due Diligence (DD) period – 30-60 days
  - c. Closing – 30-60 days

Total time = **5-10 months** assuming the buyer doesn't drop out during PSA negotiation or DD period

On the other hand, Welltower's advanced data science platform offers unparalleled speed and certainty in approaching the same transaction. Unlike other market participants who rely on standardized and broad industry and MSA-level data (often across fewer than 100 markets in the US), our proprietary platform analyzes 10 million+ micro-markets nationwide, leveraging a unique and non-replicable dataset accumulated from 100+ seniors housing operators over 20 years. This granular, machine learning based approach, powered by a long time series of data across diverse properties and operators, enables Welltower to take a neighborhood-level view of any asset and provide initial interest within **a few minutes**. It determines a narrow range of predicted operating performance within **one day** allowing us to provide preliminary pricing feedback within **one week**, subsequently tour the asset(s), have a handshake on definitive terms within **two weeks**, and ultimately close deals in **45-60 days** from start to finish. So, if you are a seller, what do you do? You call us and, if within a



week if you are not happy with our answer, you hire a broker and you've lost nothing. This is why most opportunities hit our desk first and how we are able to complete most of our new investments off-market. This "velocity to market" makes Welltower the first call for most sellers (along with our reputation that we never walk from a handshake) and has fundamentally upended the status quo in an industry (Real Estate) that has not changed in decades.

While the tightness of a closely knit team is incredibly important from a culture standpoint (described above), it also manifests itself in another way while thinking about an organization like ours as a complex adaptive system. And that is through latency. Latency is a particularly important concept when studying network effects. In most industries, change occurs at a glacial pace which is no different in our industry. That is the very thing we disrupted by reducing latency in the system by completely turning speed to market ("velocity to market") on its head. And, as latency shrinks materially as described above, the network effect kicks into high gear, creating a new paradigm of maximum growth and maximum gain that simply doesn't occur in an industry that moves at a glacial pace. Having achieved this on the investment side, this is exactly what we seek to accomplish with the Welltower Business System on the operating side: reducing latency and accelerating the network effect. I hope we will have more to say next year on this topic.

## Gratitude

I continue to be deeply grateful for the counsel provided by our Chairman, Ken Bacon, and the dedication and support of the entire Welltower Board of Directors. Our accomplishments would not be possible without their commitment to our company and our shareholders. I am also humbled every day by the unrelenting efforts of the Welltower team and our operating partners. Our journey hasn't been an easy one (nor will it ever be), but we've managed to create an unmatched "hive" in which everyone is all-in for our long-term pursuit of dogged, incremental, continuous progress. And, most importantly, to you - our fellow shareholders, I remain deeply appreciative of the trust you have placed in our team. We will always be fiercely protective of your interests before anything else; being an extreme fiduciary is our pride - not just our responsibility.

We remain singularly focused on the compounding of per share growth for our existing owners, our true North Star. We cannot be dissuaded, discouraged, or distracted. And we're just getting started.

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