

SENIOR HOUSING INVESTMENT

SURVEY

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SENIOR LIVING VALUATION SERVICES, INC.

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The *Senior Housing Investment Survey* provides information concerning the investment criteria currently used or perceived to be used in the evaluation of senior housing properties. Survey participants included owners/operators, financial institutions/investors, brokers/mortgage bankers, appraisers and consultants.

Survey Methodology

The 12th annual *Senior Housing Investment Survey* was sent to 305 potential respondents including those with membership in various national senior housing associations, parties responding to the survey in previous years and others involved in the senior housing industry and known to the editor. As of an April 22, 2005 cutoff date, 70 surveys or 23% of the total sent had been returned. Of the respondents, 42% represent market principals such as owner/operators or financial institutions/investors, a lower percentage compared with previous years.

Survey Results

Survey respondents were geographically dispersed throughout the country with a slight weighting toward the West. Geographic location did not appear to bias the survey results as responses were not materially different between differing portions of the country. Approximately 39% of respondents this year identified themselves as having a national perspective, a lower percentage compared to previous years. The respondents indicated no material difference between annual cash flow growth factors in revenue (3.4% average) and expense (3.3% average) projections. Both cash flow growth factors were slightly above projections of overall inflation (3.0% average). 56% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (higher than the 46% from last year). 21% of respondents expected capitalization rates to increase up to 100 basis points in the next year (up from 12% from last year). 23% of respondents expected capitalization rates to decrease up to 100 points in the next year (down from 40% from last year). No respondents expected capitalization rates to increase or decrease by more than 100 basis points in the next year. It appears that a majority of respondents believe that the market has most likely peaked and that the recent downward trend of capitalization rates will not continue.

The specific overall capitalization rates, discount rates (internal rate of return) and equity dividend rates (cash on cash return) used or perceived to be used by respondents is presented on the following pages. The range and average of all responses and the range and average of all responses less the 5% highest and 5% lowest responses are shown.

The rate averages range from the lowest for age restricted apartments to the highest for licensed subacute skilled nursing facilities. These results are not surprising given the higher degree of management specialization, smaller profit margins and higher degree of licensing as one moves up the continuum of senior housing from age restricted apartments to unlicensed congregate facilities to licensed assisted living and alzheimer/dementia care facilities to licensed conventional and subacute skilled nursing facilities. Rates for continuing care retirement communities which are typically combinations of each of the above categories of senior projects, fell slightly below the average range of the other categories of senior housing types.

Highlights of the 2005 results include a decreasing trend in overall capitalization rates for all categories of senior housing to the lowest levels in the 12 years of this survey. The sharpest declines in overall capitalization rates were noted for age restricted apartments (90 basis points), unlicensed congregate living facilities (70 basis points), licensed assisted living facilities (70 basis points) and continuing care retirement communities (80 basis points). The gap between the overall capitalization rates of assisted living projects and alzheimer/dementia care projects increased slightly by 20 basis points, to a 90 basis point difference. The 110 basis point difference between capitalization rates for unlicensed congregate living facilities and licensed assisted living facilities remained unchanged between 2004 and 2005.

Reported discount rates for most property types also declined from 2004 to 2005, with the exceptions of age restricted apartments, subacute nursing homes and continuing care retirement communities, which saw slight

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2005 SENIOR HOUSING INVESTMENT SURVEY**

Indicate the classification that best describes your company or profession (% of total responses):

<u>23%</u>	Owner/Operator	<u>33%</u>	Appraiser
<u>19%</u>	Financial Institution/Investor	<u>6%</u>	Consultant
<u>19%</u>	Broker/Mortgage Banker		

Indicate the region with which you are involved with/knowledgeable of (% of total responses):

<u>15%</u>	East	<u>28%</u>	West
<u>5%</u>	South	<u>39%</u>	National
<u>13%</u>	Midwest		

What annual growth factors are you using (or perceive to be used by others) for cash flow projections of senior housing properties in general:

Range	Average	
<u>2%-7%</u>	<u>3.4%</u>	Revenues
<u>2.5%-7%</u>	<u>3.3%</u>	Expenses
<u>2%-5%</u>	<u>3.0%</u>	General Inflation

What are your expectations of overall capitalization rate changes for senior housing properties in general over the next 12 months (% of total responses):

<u>2005</u>		<u>2004</u>	<u>2003</u>
<u>0%</u>	Increase more than 100 basis points	<u>0%</u>	<u>2%</u>
<u>21%</u>	Increase 0 to 100 basis points	<u>12%</u>	<u>13%</u>
<u>56%</u>	Flat, no significant change	<u>46%</u>	<u>66%</u>
<u>23%</u>	Decrease 0 to 100 basis points	<u>40%</u>	<u>19%</u>
<u>0%</u>	Decrease more than 100 basis points	<u>2%</u>	<u>0%</u>

Overall Capitalization Rate

	2005		2005		Basis Point Change from 2004
	<u>All Responses</u>		<u>Adjusted Responses⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	6%-10%	8.0%	6.5%-9%	8.0%	-90
Unlicensed Congregate Living	7%-12%	9.0%	7%-10.5%	9.0%	-70
Licensed Assisted Living	7.5%-12%	10.0%	8%-12%	10.1%	-70
Licensed Alzheimer/Dementia Care	8.5%-14%	11.0%	9%-13%	11.0%	-50
Licensed Skilled Nursing-Long Term Care	10%-18%	12.7%	11%-15%	12.6%	-30
Licensed Skilled Nursing-Subacute Care	10.5%-20%	13.5%	11%-17.5%	13.3%	-10
Continuing Care Retirement Community	8%-13%	10.5%	9%-12%	10.5%	-80

Internal Rate of Return (Discount Rate)

	2005		2005		Basis Point Change from 2004
	<u>All Responses</u>		<u>Adjusted Responses⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	9%-20%	11.0%	9%-12.5%	10.6%	+30
Unlicensed Congregate Living	9%-20%	11.9%	10%-14.5%	11.7%	-80
Licensed Assisted Living	10%-20%	13.4%	10.5%-16%	13.2%	-90
Licensed Alzheimer/Dementia Care	10%-24%	14.2%	11.5%-19.5%	13.9%	-110
Licensed Skilled Nursing-Long Term Care	11%-25%	15.5%	11.5%-20%	15.2%	-30
Licensed Skilled Nursing-Subacute Care	12.5%-20%	16.2%	13%-20%	16.2%	+40
Continuing Care Retirement Community	10%-20%	14.0%	11%-15.5%	13.9%	+20

Equity Dividend Rate (Cash on Cash Return)

	2005		2005		Basic Point Change from 2004
	<u>All Responses</u>		<u>Adjusted Responses⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	3%-20%	11.0%	8%-15.5%	11.0%	-180
Unlicensed Congregate Living	8%-22%	15.1%	10%-20%	15.1%	+90
Licensed Assisted Living	9%-25%	15.1%	10%-20%	14.8%	-10
Licensed Alzheimer/Dementia Care	10.5%-25%	16.7%	12%-20%	16.5%	+80
Licensed Skilled Nursing-Long Term Care	14%-40%	20.0%	14%-25%	19.1%	-150
Licensed Skilled Nursing-Subacute Care	14%-30%	20.9%	15%-30%	20.6%	+40
Continuing Care Retirement Community	11%-25%	16.3%	12%-20%	16.0%	+30

(1) Minus 5% Highest and 5% Lowest Responses

increases in discount rates. The spread between overall capitalization and discount rates reflected a relative tight range of 2.6% and 3.4% by property type, suggesting that participants are aware that discount rates are overall capitalization rates with inflation built in.

Changes in equity dividend rates were varied, increasing for congregate projects, subacute nursing homes and continuing care retirement communities and decreasing for age restricted apartments, assisted living projects and conventional nursing homes. With the exception of age restricted apartments, equity dividend rates ranged from approximately 15% to 20%.

Survey Relevance

2004/2005 has seen a full incorporation of recent industry trends that began in 2003. A large pool of adequately financed buyers looking to expand their portfolios, a larger number of portfolio purchases, still historically low interest rates, more creative financing structures, industry consolidation and a relative lack of new development have created an imbalance of demand for projects, especially for larger and healthy facilities, and the supply of projects available for sale. This may suggest a market cycle near a tipping point of new construction although only the age restricted apartment and continuing care retirement community property types are experiencing widespread new development around the country.

Given the recent increases in interest rates, it appears that capitalization rates have probably bottomed out. However, there are minimal expectations of upward pressure on capitalization rates in the short run.

The results of this survey can be an asset in the evaluation of new development or acquisitions by lenders and investors. However, market illiquidity and the specialized management driven characteristics of the industry overall and on individual properties specifically, mute the impact of more traditional measures of analyzing real estate such as capitalization, discount and return on equity analysis. Other limiting factors include a lack of confidence in the uniform application and understanding of these criteria - especially for non-stabilized or more complicated properties, the difficulty in quantifying general and specific property risk and illiquidity, concerns over reliable future cash flow projections and their unproven relevance for not-for-profit owners/investors.

Other investment criteria used including the terms and availability of debt and equity financing, debt coverage ratios, exposure to health care liability costs, relationships to replacement cost, market share, portfolio effect and geographic concentration value surcharges and opportunities for significant cash flow gains in distressed or underutilized properties. These criteria have their own significant limitations such as the inability to objectively account for property specific risk and to comprehensively assess the impact of a potential default and resale of a property.

The *Senior Housing Investment Survey* is compiled and produced by Senior Living Valuation Services, Inc., a San Francisco based firm that specializes in the appraisal of all forms of senior housing. Readers are advised that Senior Living Valuation Services, Inc. does not represent the data contained herein to be definitive. The contents of this publication should also not be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to Senior Living Valuation Services, Inc.

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