

SENIOR HOUSING INVESTMENT

SURVEY

VOLUME 15

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

After a one year hiatus, the 15th annual *Senior Housing Investment Survey* was sent to 284 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 a June 10, 2009 cutoff date, 64 surveys or 23% of the total sent had been returned. Of the respondents, 51% represent market principals such as owner/operators or financial institutions/investors, a higher 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 43% of respondents this year identified themselves as having a national perspective, a similar percentage compared to previous years. The respondents indicated no difference between annual cash flow growth factors in revenue (2.8% average) and expense (2.8% average) projections. Both cash flow growth factors were near projections of overall inflation (2.6% average). 21% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (well below the 45% from 2007). 67% of respondents expect capitalization rates to increase up to 100 basis points in the next year (well above the 45% from 2007 and the highest in the 15 years of this survey). 8% of respondents expected capitalization rates to increase by over 100 basis points in the next year. Only a small minority (4%) of respondents expect capitalization rates to decrease in the next year. A large majority of respondents (75%) believe that market conditions will continue to deteriorate as reflected in increasing capitalization rates.

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 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 near the average range of the other categories of senior housing types.

Highlights of the 2009 survey results include a material upward trend in overall capitalization rates for all categories of senior housing from 2007 to 2009. However, the survey indicated increase in overall cap rates (a range of 20 to 90 basis points by property type) is less than the increases in the survey indicated internal rates of return (discount rate) and equity rates of return. Overall capitalization rates could be a lagging indicator of the market downturn as buyers emphasize internal rates of return instead of the overall capitalization rate (although they are strongly correlated measures of converting cash flows streams into value). It also may reflect a lack of confidence in applying an overall cap rate to any one year's uncertain (and often less than stabilized) cash flow stream. Finally, the decline in actual sale transactions has made gauging overall capitalization rates more tenuous. The difference between the overall capitalization rates of unlicensed congregate living projects (8.4%) and licensed assisted living projects (9.2%)

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2009 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>35%</u>	Owner/Operator	<u>27%</u>	Appraiser
<u>16%</u>	Financial Institution/Investor	<u>6%</u>	Consultant
<u>16%</u>	Broker/Mortgage Banker		

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

<u>13%</u>	East	<u>22%</u>	West
<u>7%</u>	South	<u>43%</u>	National
<u>15%</u>	Midwest		

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

Range	Average	
<u>0%-5%</u>	<u>2.8%</u>	Revenues
<u>-2%-4%</u>	<u>2.8%</u>	Expenses
<u>0%-4%</u>	<u>2.6%</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>2009</u>		<u>2007</u> ⁽²⁾	<u>2006</u>
<u>8%</u>	Increase more than 100 basis points	<u>2%</u>	<u>2%</u>
<u>67%</u>	Increase 0 to 100 basis points	<u>45%</u>	<u>44%</u>
<u>21%</u>	Flat, no significant change	<u>45%</u>	<u>47%</u>
<u>2%</u>	Decrease 0 to 100 basis points	<u>8%</u>	<u>7%</u>
<u>2%</u>	Decrease more than 100 basis points	<u>0%</u>	<u>0%</u>

Overall Capitalization Rate

	2009		2009		Basis Point Change from 2007 ⁽²⁾
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	5%-11.5%	7.9%	7%-8.3%	7.0%	+80
Unlicensed Congregate Living	6%-10%	8.4%	7.5%-10%	8.4%	+20
Licensed Assisted Living	7%-12%	9.2%	7.5%-11%	9.2%	+80
Licensed Alzheimer/Dementia Care	7%-14%	9.8%	8%-12%	9.8%	+50
Licensed Skilled Nursing-Long Term Care	9%-15%	12.5%	10%-14%	12.5%	+90
Licensed Skilled Nursing-Subacute Care	9%-15%	12.4%	10%-15%	12.4%	+30
Continuing Care Retirement Community	7%-12%	9.5%	8%-12%	9.4%	+70

Internal Rate of Return (Discount Rate)

	2009		2009		Basis Point Change from 2007 ⁽²⁾
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-20%	12.7%	9%-18%	12.5%	+300
Unlicensed Congregate Living	8%-20%	13.1%	8%-20%	12.9%	+160
Licensed Assisted Living	10%-22%	14.2%	10%-20%	14.0%	+210
Licensed Alzheimer/Dementia Care	9%-26%	14.7%	10%-20%	14.3%	+180
Licensed Skilled Nursing-Long Term Care	9%-20%	15.1%	10%-20%	15.2%	+220
Licensed Skilled Nursing-Subacute Care	9%-20%	15.3%	10%-20%	15.4%	+200
Continuing Care Retirement Community	8%-20%	14.0%	10%-20%	13.7%	+290

Equity Dividend Rate (Cash on Cash Return)

	2009		2009		Basis Point Change from 2007 ⁽²⁾
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	6%-45%	15.4%	8%-20%	13.8%	+580
Unlicensed Congregate Living	6%-45%	14.8%	8%-20%	13.6%	+240
Licensed Assisted Living	7%-45%	15.8%	9%-23%	14.2%	+280
Licensed Alzheimer/Dementia Care	8%-45%	16.7%	9%-23%	14.8%	+240
Licensed Skilled Nursing-Long Term Care	9%-25%	15.7%	10%-20%	15.6%	+40
Licensed Skilled Nursing-Subacute Care	9%-25%	16.3%	10%-20%	16.0%	+20
Continuing Care Retirement Community	7%-45%	15.9%	10%-22%	14.1%	+150

(1) Minus 5% Highest and 5% Lowest Responses; (2) No Survey Conducted in 2008.

increased substantially to 80 basis points. Oddly, the survey indicated overall cap rate for subacute nursing homes (12.4%) was slightly below the indicated overall cap rate for conventional nursing homes (12.5%).

One of the more significant results of the 2009 survey was the sharp increase in discount rates for all senior housing property types, ranging from 160 to 300 basis points. The discount rate increase was much more pronounced than the cap rate increase. The indicated survey result spread between cap rates and discount rates is less indicative of a market relationship in 2009 compared to the results of previous years of this survey. In other words, the spread is too large given the survey indicated forecast of cash flow growth rates. This relationship is typically expressed by appraisers as: discount rate = overall capitalization plus annual cash flow growth rate and less about 100 basis points. It is possible that some survey respondents have incorporated increases in the cost of debt into their perceptions of discount rates/internal rates of return but not into overall capitalization rates. The discount rate (also known as the yield rate or the internal rate of return rate) is a difficult financial concept that is subject to varying interpretations.

Equity dividend rates in 2009 increased for all types of senior housing, most significantly for age restricted apartments. The indicated equity dividend rate range of increase from 2007 to 2009 was 20 to 580 basis points. It is interesting to note that the range of equity dividend rates between the various types of senior housing is fairly narrow (13.6% to 16%), the smallest difference in the 15 years of this survey. The increase in equity dividend rates reflects a market environment of greater uncertainty, greater risk and an increasing supply of properties available for sale being pursued by a smaller pool of financially able buyers.

Survey Relevance

2008/2009 has seen the unequivocal reversal of the historically low cap rate era (2004-2007), with most indications suggesting that things will get worse before they

get better. Seller expectations have yet to match buyer demands, leading to fewer actual sale transactions. Less than stabilized properties are being particularly punished with deep discounts, if they are sold at all. These trends will be exacerbated by lenders reluctantly and slowly either forcing or actually selling through foreclosure, an increasing pool of senior housing properties. In short, it's a buyer's market and likely to remain so for at least the next year and probably longer. On a positive note, the senior housing industry is more mature and sophisticated than during the previous severe market downturn of the early 1990's, although it is still relatively small and illiquid. Though still about 15 years away from the prime senior housing target market, the oldest baby boomers turned 65 years old in 2008.

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 include the terms and availability of debt and equity financing, debt coverage ratios, exposure to entry fee refund liabilities or health care liability costs, relationships to replacement cost, portfolio effect, 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.

Inquiries, comments or requests of interested parties wanting to participate in the 2010 survey can be directed to:

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