SENIOR HOUSING INVESTMENT

S U R V E Y

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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 13th annual *Senior Housing Investment Survey* was sent to 323 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 20, 2006 cutoff date, 65 surveys or 20% of the total sent had been returned. Of the respondents, 45% 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 42% of respondents this year identified themselves as having a national perspective, a higher percentage compared to previous years. The respondents indicated a material difference between annual cash flow growth factors in revenue (3.8% average) and expense (3.4% average) projections. Both cash flow growth factors were above projections of overall inflation (3.2% average). 47% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (lower than the 56% from last year). 44% of respondents expected capitalization rates to increase up to 100 basis points in the next year (up substantially from 21% last year). 7% of respondents expected capitalization rates to decrease up to 100 points in the next year (down substantially from 23% last year). A few (2%) respondents expected capitalization rates to increase by more than 100 basis points in the next year. It appears a majority of respondents believe the market has most likely peaked and that the recent downward trend of lower capitalization rates will not continue and may possibly increase.

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

Highlights of the 2006 results include a continuing downward trend in overall capitalization rates for all categories of senior housing to the lowest levels in the 13 years of this survey. Capitalization rates declined for each category of senior housing. The sharpest declines in overall capitalization rates were noted for licensed assisted living facilities (110 basis points), licensed alzheimer/dementia care facilities (120 basis points) and continuing care retirement communities (120 basis points). The spread between the overall capitalization rates of assisted living projects and alzheimer/dementia care projects changed only slightly, to an 80 basis point difference. The 90 basis point difference between capitalization rates for unlicensed congregate living facilities and licensed assisted living facilities represents a slight narrowing of the spread between 2005 and 2006.

Oddly, reported discount rates for many senior housing property types increased from 2005 to 2006, with the exceptions of age restricted apartments, subacute nursing

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2006 SENIOR HOUSING INVESTMENT SURVEY

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

29%	Owner/Operator
16%	Financial Institution/Investor
20%	Broker/Mortgage Banker
31%	Appraiser
4%	Consultant

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

11%	East
4%	South
16%	Midwest
27%	West
42%	National

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	
2%-6%	3.8%	Revenues
2%-5%	3.4%	Expenses
2%-5%	3.2%	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):

2006		2005	2004
2%	Increase more than 100 basis points	0%	0%
44%	Increase 0 to 100 basis points	21%	12%
47%	Flat, no significant change	56%	46%
7%	Decrease 0 to 100 basis points	23%	40%
0%	Decrease more than 100 basis points	0%	2%

Overall Capitalization Rate

	2006 All Responses		2006 Adjusted Responses[1]		Basis Point Change from 2005
	Range	Average	Range	Average	
Age Restricted Apartments	6%-10%	7.4%	6%-8.5%	7.4%	-60
Unlicensed Congregate Living	6%-11%	8.1%	6.5%-10%	8.1%	-90
Licensed Assisted Living	6.5%-11%	9.0%	7.5%-11%	9.0%	-110
Licensed Alzheimer/Dementia Care	7%-12%	9.8%	8%-12%	9.8%	-120
Licensed Skilled Nursing-Long Term Care	10%-14.5%	12.1%	10.5%-14%	12.1%	-50
Licensed Skilled Nursing-Subacute Care	8%-17%	12.6%	10.5%-14.5%	12.6%	-70
Continuing Care Retirement Community	7%-12%	9.3%	8%-11%	9.3%	-120

Internal Rate of Return (Discount Rate)

	2006 All Responses		2006 Adjusted Responses[1]		Basis Point Change from 2005
	Range	Average	Range	Average	
Age Restricted Apartments	8.8%-14%	10.7%	9%-12%	10.4%	-20
Unlicensed Congregate Living	9.3%-20%	13.3%	10%-20%	12.9%	+120
Licensed Assisted Living	9.5%-22%	14.6%	11%-20%	14.2%	+100
Licensed Alzheimer/Dementia Care	10.5%-25%	14.6%	11.5%-20%	14.0%	+10
Licensed Skilled Nursing-Long Term Care	12%-35%	16.4%	13%-20%	15.3%	+10
Licensed Skilled Nursing-Subacute Care	12%-35%	16.7%	13%-17.5%	15.2%	-100
Continuing Care Retirement Community	10.5%-25%	13.9%	11%-20%	13.3%	-60

Equity Dividend Rate (Cash on Cash Return)

	2006 All Responses		2006 Adjusted Responses[1]		Basis Point Change from 2005
	Range	Average	Range	Average	
Age Restricted Apartments	5%-14%	9.0%	7%-12%	8.9%	-210
Unlicensed Congregate Living	6%-25%	12.0%	7.5%-15%	11.5%	-360
Licensed Assisted Living	6%-27%	12.4%	7%-16%	11.9%	-290
Licensed Alzheimer/Dementia Care	7%-17%	12.0%	8%-15%	12.0%	-450
Licensed Skilled Nursing-Long Term Care	7.5%-30%	15.6%	10%-20%	15.0%	-410
Licensed Skilled Nursing-Subacute Care	7.5%-32%	15.9%	11%-20%	15.2%	-540
Continuing Care Retirement Community	7%-17%	12.1%	8%-17%	12.1%	-390

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

homes and continuing care retirement communities, which saw declines in discount rates. The spread between overall capitalization and discount rates reflect a wide range of 2.6% and 5.2% by property type, larger than suggested by the indicated average annual growth factors. It appears that a widely used formula defining the relationship of cap rates and discount rates (overall cap rate plus annual cash flow growth factor less 100 basis points) is not recognized by many participants in the survey. In other words, given the indicated average cap rates and average annual growth factors, it appears that the indicated discount rates are too high (or less likely, that the cap rates are too low). The discount rate is a difficult financial concept that is subject to varying interpretations.

One of the most striking results of the 2006 survey is the substantial decline in equity dividend rates for all senior housing property types. The decline in equity dividend rates ranged from 210 to an eye-popping 540 basis points. As suggested by the indicated historically low cap rates, this may reflect an imbalance of macro market demand and market supply. Demand for all senior housing property types seems to be well in excess of the available supply. This imbalance has led investors and buyers to expect and accept lower returns to build portfolios and market share. Equity dividend rates ranged from approximately 11% to 15%.

Survey Relevance

2005/2006 has seen a full manifestation 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 surprising relative lack of new development have created an imbalance of market demand, especially for larger, higher end and healthy facilities, and the market supply of senior 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 (although we incorrectly made the same conclusion in 2005). This conclusion is supported by greater expectations of upward pressure on capitalization rates from historic lows.

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 costs (and recent material increases in building costs), 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.

Inquiries, comments or requests of interested parties wanting to participate in the 2007 survey can be directed to:

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