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 eighth annual *Senior Housing Investment Survey* was sent to 249 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, 2001 cutoff date, 67 surveys or 26.9% of the total sent had been returned. Of the respondents, 62% represent market principals such as owner/operators or financial institutions/ investors, a slightly 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. A similar percentage of respondents this year identified themselves as having a national perspective compared to previous years. The respondents indicated a fairly tight range of annual cash flow growth factors in revenue (3.2% average) and expense (3.4% average) projections. These cash flow growth factors were slightly above projections of overall inflation (3.1% average). 31% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (up from 24% from last year). 64% of respondents expected capitalization rates to increase up to 100 basis points in the next year (down from 74% from last year, but still a prominent majority). No respondents expected capitalization rates to decrease up to 100 points in the next year; a small 1% of respondents expected capitalization rates to increase by over 100 basis points. Unlike previous years, respondents split their opinions by property type, noting a greater likelihood of higher capitalization rates for assisted living and alzheimer/dementia care facilities compared to the other senior housing property types, most notably unlicensed congregate projects.

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 2001 results include a material upward trend in capitalization rates for most senior housing property types except for noncongregate senior apartments and unlicensed congregate living projects, which each showed no material change in capitalization rates. The gap in overall capitalization rates between unlicensed congregate projects and assisted living facilities widened from 70 basis points to 120 basis points from 2000 to 2001. This change confirms the difficult past year within the assisted living and alzheimer/dementia care market segments caused by the paucity of available financing, the visible financial and operating difficulties of some assisted living companies, some sales of assisted living projects be-

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2001 SENIOR HOUSING INVESTMENT SURVEY

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

40%	Owner/Operator	24%	Appraiser
22%	Financial/Institution/Investor	0%	Consultant
14%	Broker/Mortgage Banker		

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

12%	East	25%	West
12%	South	42%	National
10%	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**	
0%-5%	3.2%	Revenues
0%-5%	3.4%	Expenses
0%-5%	3.1%	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):

2001		**2000**	**1999**
2%	Increase more than 100 basis points	2%	6%
64%	Increase 0 to 100 basis points	74%	38%
31%	Flat, no significant change	24%	46%
3%	Decrease 0 to 100 basis points	0%	8%
0%	Decrease more than 100 basis points	0%	2%

Overall Capitalization Rate

	2001 All Responses		2001 Adjusted Responses[1]		Basis Point Change from 2000
	Range	Average	Range	Average	
Age Restricted Apartments	8%-11%	9.2%	8%-11%	9.2%	-10
Unlicensed Congregate Living	8.5%-13%	10.2%	9%-12%	10.1%	0
Licensed Assisted Living	9%-14%	11.4%	9.5%-13%	11.3%	+50
Licensed Alzheimer/Dementia Care	10%-15%	11.9%	10.5%-14%	11.8%	+30
Licensed Skilled Nursing-Long Term Care	10%-18%	13.6%	11%-17%	13.4%	+70
Licensed Skilled Nursing-Subacute Care	12%-18%	14.0%	12%-17%	13.9%	+80
Continuing Care Retirement Community	9%-14%	11.2%	9.5%-13%	11.2%	0

Internal Rate of Return (Discount Rate)

	2001 All Responses		2001 Adjusted Responses[1]		Basis Point Change from 2000
	Range	Average	Range	Average	
Age Restricted Apartments	10%-25%	12.6%	10.5%-13%	12.3%	+100
Unlicensed Congregate Living	10%-30%	14.8%	11%-20%	14.1%	+30
Licensed Assisted Living	12%-50%	17.2%	12.5%-30%	16.4%	+210
Licensed Alzheimer/Dementia Care	8%-25%	17.7%	12%-25%	16.6%	+260
Licensed Skilled Nursing-Long Term Care	14%-24%	16.4%	14%-20%	16.0%	-80
Licensed Skilled Nursing-Subacute Care	14%-30%	16.8%	14%-24%	16.5%	+20
Continuing Care Retirement Community	10%-20%	13.0%	12%-18%	13.1%	-150

Equity Dividend Rate (Cash on Cash Return)

	2001 All Responses		2001 Adjusted Responses[1]		Basis Point Change from 2000
	Range	Average	Range	Average	
Age Restricted Apartments	8%-16%	11.2%	10%-15%	11.0%	+100
Unlicensed Congregate Living	9%-45%	13.8%	10%-20%	13.2%	+160
Licensed Assisted Living	9.5%-40%	16.9%	10%-20%	16.1%	+260
Licensed Alzheimer/Dementia Care	10%-20%	16.4%	12%-20%	16.6%	+80
Licensed Skilled Nursing-Long Term Care	12%-30%	17.5%	12%-25%	17.3%	+50
Licensed Skilled Nursing-Subacute Care	12%-30%	17.8%	12%-25%	17.5%	+70
Continuing Care Retirement Community	10%-25%	15.5%	12%-22%	15.0%	+120

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

low replacement cost and some overbuilt specific market areas. Respondents still seem relatively bullish (or at least content) with prospects within the unlicensed congregate living and continuing care retirement community market segments. Though many skilled nursing companies have had relatively successful years during 2000/2001, uncertainties caused by litigation, rising insurance costs and stiff competition from modern assisted living and alzheimer/dementia care projects, have led to material increases in the skilled nursing and subacute care facilities capitalization rates.

Equity dividend rates increased for all senior housing property types as equity sources have become more scarce. Changes in discount rates were positively correlated to and even generally larger than increases in capitalization rates.

Survey Relevance

2000/2001 has been a transitional period in the senior housing industry as the mid to late 1990's development cycle of new senior housing projects has slowed to a trickle of new development projects. Many markets in the country are still in the process of consolidating and absorbing the recent large increases in supply of mostly assisted living and alzheimer/dementia care facilities. Most, but not all, proposed projects planned in the late 1990's have been withdrawn. New proposed projects tend to be located in markets with higher barriers to entry, or those with lower potential for overbuilding. Development of continuing care retirement communities has remained relatively strong in 2001 due to their longer development periods and atypical ability to attract below market rate, tax exempt financing.

Absorption rates of new projects opened in the last 12 months have been highly variable, but trending toward sluggish, with some rent concessions in crowded competitive markets. Sales and sale listings of completed senior housing projects have begun to increase as adequately financed owner/operators begin to nibble at the assets of troubled companies. As reflected in the results of this 2001 survey, the consensus of most but not all industry professionals is that overall market conditions for most types of senior housing will continue to deteriorate before they begin to improve. Uncertainty and consolidation pervade the assisted living and alzheimer/dementia care market segments in 2001.

The results of this survey can be an asset in the evaluation of new development or acquisitions by lenders and investors. However, overall 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 included debt coverage ratios, relationships to replacement cost, market share, portfolio affect 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 more comprehensively assess the impact of a potential default and resale of a property. As the senior housing industry matures and more institutionally driven investment decisions are made, we would expect that the application of capitalization/discount rate analysis for senior housing properties would become more uniform and better understood and consequently, more widely relied upon.

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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