SENIOR HOUSING INVESTMENT

S U R V E Y

VOLUME 25 SENIOR LIVING VALUATION SERVICES, INC. SPRING 2019

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 25th annual *Senior Housing Investment Survey* was sent to 345 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 May 12, 2019 cutoff date, 62 surveys or 18% of the total sent had been returned. Of the respondents, 25% 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 slightly lower response from 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 41% of respondents this year identified themselves as having a national perspective, a lower percentage compared to previous years. The respondents indicated no difference between annual cash flow growth factors in revenue (3.0% average) and expense (3.0% average) projections. Both cash flow growth factors were above projections of overall inflation (2.5% average).

A sharply higher 73% 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 above the 24% last year). No respondents expect capitalization rates to increase or decrease by over 100 basis points in the next year. In one of the most significant results of this survey, a much lower 20% of respondents expect capitalization rates to increase up to 100 basis points in the next year (well below the 71% from last year). The weighted average responses are expecting no material increase in capitalization rates during the next year, unlike last year. Only 7% of respondents expect cap rates to decrease in the next year.

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 are 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 memory care to licensed long term 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 of the range of the other categories of senior housing types.

Highlights of the 2019 survey results include little change from 2018 in overall capitalization rates for all categories of senior housing, continuing an approximate five year long trend. Expectations for similar cap rates over the next year suggest that this trend will continue. Capitalization rates for all types of senior housing and care from 2018 to 2019 changed by only 0 to 20 basis points, an immaterial amount. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects did decrease by a small 20 basis points in 2019.

SENIOR LIVING VALUATION SERVICES, INC.
2019 SENIOR HOUSING INVESTMENT SURVEY

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

16%	Owner/Operator	30%	Appraiser
9%	Financial Institution/Investor	15%	Consultant
30%	Broker/Mortgage Banker		

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

15%	East	10%	West
16%	South	41%	National
19%	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	
2%-5%	3.0%	Revenues
2%-4%	3.0%	Expenses
1%-3%	2.5%	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):

2019		2018	2017
0%	Increase more than 100 basis points	0%	0%
20%	Increase 0 to 100 basis points	71%	45%
73%	Flat, no significant change	24%	55%
7%	Decrease 0 to 100 basis points	5%	0%
0%	Decrease more than 100 basis points	0%	0%

Overall Capitalization Rate

	2019 All Responses		2019 Adjusted Responses (1)		Basis Point Change from 2018
	Range	Average	Range	Average	
Age Restricted Apartments	5%-7.5%	6.0%	5%-7%	6.0%	0
Unlicensed Congregate Living	5.5%-7.8%	6.7%	6%-7.5%	6.6%	+10
Licensed Assisted Living	6%-9%	7.4%	6.3%-8.5%	7.4%	-10
Licensed Memory Care	6.3%-9%	7.9%	6.8%-9%	7.9%	-10
Licensed Skilled Nursing-Long Term Care	7.3%-13.3%	11.7%	11%-13%	11.9%	+10
Licensed Skilled Nursing-Subacute Care	7.3%-14.5%	12.0%	10.5%-13%	12.2%	-10
Continuing Care Retirement Community	7.3%-11%	8.9%	7.5%-10%	8.9%	+20

Internal Rate of Return (Discount Rate)

	2019 All Responses		2019 Adjusted Responses (1)		Basis Point Change from 2018
	Range	Average	Range	Average	
Age Restricted Apartments	7%-12%	8.7%	7.5%-10%	8.7%	-20
Unlicensed Congregate Living	7.5%-12%	9.3%	8%-10.3%	9.2%	-60
Licensed Assisted Living	3.5%-15%	9.9%	8.3%-11%	9.9%	-130
Licensed Memory Care	8.3%-15%	10.7%	9%-12%	10.4%	-110
Licensed Skilled Nursing-Long Term Care	13%-16%	14.5%	14%-15.5%	14.4%	+90
Licensed Skilled Nursing-Subacute Care	14%-30%	15.0%	14%-16%	14.9%	+70
Continuing Care Retirement Community	9.5%-18%	11.4%	10%-12%	11.0%	-10

Equity Dividend Rate (Cash on Cash Return)

	2019 All Responses		2019 Adjusted Responses (1)		Basis Point Change from 2018
	Range	Average	Range	Average	
Age Restricted Apartments	6%-23%	9.4%	7%-10%	8.4%	-20
Unlicensed Congregate Living	6%-23%	10.0%	7%-12%	9.2%	0
Licensed Assisted Living	7%-25%	11.8%	8%-14%	11.1%	+70
Licensed Memory Care	7%-26%	12.0%	8.3%-15%	11.2%	+20
Licensed Skilled Nursing-Long Term Care	10%-24%	16.2%	14%-20%	16.8%	+150
Licensed Skilled Nursing-Subacute Care	10%-24%	17.0%	15%-20%	17.8%	+180
Continuing Care Retirement Community	8%-23%	12.3%	10%-15%	11.7%	+110

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

The cap rate spread between licensed assisted living and licensed memory care did not change from 2018 to 2019. The cap rate spread between long term nursing care and subacute nursing care decreased but by only 20 basis points from 2018 to 2019.

One of the more significant results of the 2019 survey was the decreasing difference between overall capitalization rates and discount rates for unlicensed congregate living, licensed assisted living and licensed memory care. However, the difference between overall cap rates and discount rates for long term nursing care and subacute nursing care significantly increased. The change in the spread between cap rates and discount rates for age restricted apartments and continuing care retirement communities was minor. In our opinion, the relationship between the cap rates and discount rates reflected in the survey results of 2019 is more indicative of a market relationship, or that used by most appraisers. The indicated spread between cap rates and discount rates is larger than in the previous year and less consistent with the forecasts of annual revenue and expense increases. Most appraisers rely on an industry accepted relationship between overall cap rates and discount rates that can be summarized in the following formula: overall cap rate plus annual cash flow growth rate less 100 basis points = discount rate. This formula does not appear to be widely used or known by many (non-appraiser) senior housing industry participants. 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 2019 increased by 20 to 180 basis points for most senior housing property types. Exceptions include the lower operating costs and less heavily regulated age restricted apartments and unlicensed congregate living property types which indicated immaterial equity dividend changes from 2018 to 2019. Equity dividend rate adjusted averages ranged from approximately 8.4% to 17.8%.

Survey Relevance

2018/2019 saw continued active and healthy markets across the spectrum of senior housing and care with indications of market saturation within the assisted living and memory care segments in some markets. Interest rates increased during 2018 and have levelled off in 2019 but are still historically low. Uncertainty about the future of interest rates appears to have influenced expectations of flat cap rates for senior housing over the next year. Per usual, larger and premium senior housing properties are in high demand, still achieving historically low cap rates. New senior housing construction is active for all types of senior housing and care including the emergence of developers with little previous experience in the industry. Overall prospects for continued industry strength and new construction are good, supported by undeniable favorable long term demographics (only 6 years to the first baby boomers turning 80 years old!) and still low (though recently rising) interest rates.

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 some not-for-profit owners/investors.

Other investment criteria used include the terms and availability of debt and equity financing, property age and size, debt coverage ratios, market share, 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.

Inquiries, comments or requests of interested parties wanting to participate in the 26th annual 2020 survey can be directed to:

Michael Boehm, MAI, CRE
Senior Living Valuation Services, Inc.
1458 Sutter Street
San Francisco, CA 94109
(415) 385-2832
email: mboehm@slvsinc.com