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 16th annual *Senior Housing Investment Survey* was sent to 226 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 22, 2010 cutoff date, 56 surveys or 25% of the total sent had been returned. Of the respondents, 44% represent market principals such as owner/operators or financial institutions/ investors, a similar 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 33% of respondents this year identified themselves as having a national perspective, a lower percentage compared to previous years. The respondents indicated a non-material difference between annual cash flow growth factors in revenue (3.0% average) and expense (2.9% average) projections. Both cash flow growth factors were slightly above projections of overall inflation (2.5% average).

67% 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 21% from last year). 21% of respondents expected capitalization rates to increase up to 100 basis points in the next year (well below the 67% from last year). 8% of respondents expected capitalization rates to decrease up to 100 points in the next year. Only a few (5%) respondents expected capitalization rates to increase by more than 100 basis points in the next year. It appears that a majority of respondents believe that the market has or is near bottoming out and that the recent upward pressure on 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 near the average range of the other categories of senior housing types.

Highlights of the 2010 survey results include a stabilizing trend (but not downward) in overall capitalization rates for almost all categories of senior housing. The indicated average overall capitalization rates changed little from 2009 to 2010, age restricted apartments being an exception. Capitalization rate changes from 2009 to 2010 were less than 50 basis points for all senior housing property types, except for age restricted apartments which increased by 100 basis points. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects remained relatively constant at about 60 basis points. The spread between cap rates of most other senior housing property types was consistent with the prior year. Exceptions include a declining cap rate spread between age restricted apartments and unlicensed congregate living (from 140 to 50 basis points) and an increasing difference between conventional, long term nursing care and

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2010 SENIOR HOUSING INVESTMENT SURVEY

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

33%	Owner/Operator	26%	Appraiser
11%	Financial Institution/Investor	4%	Consultant
26%	Broker/Mortgage Banker		

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

18%	East	20%	West
13%	South	33%	National
16%	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%	3.0%	Revenues
1.5%-4%	2.9%	Expenses
0%-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):

2010		2009	2007 (2)
5%	Increase more than 100 basis points	8%	2%
21%	Increase 0 to 100 basis points	67%	45%
67%	Flat, no significant change	21%	45%
8%	Decrease 0 to 100 basis points	2%	8%
0%	Decrease more than 100 basis points	2%	0%

Overall Capitalization Rate

	2010 All Responses		2010 Adjusted Responses (1)		Basis Point Change from 2009
	Range	Average	Range	Average	
Age Restricted Apartments	6.8%-9%	8.0%	7%-9%	8.0%	+100
Unlicensed Congregate Living	7%-10.5%	8.5%	7.5%-10%	8.5%	+10
Licensed Assisted Living	7%-12.3%	9.1%	7.5%-10.6%	9.1%	-10
Licensed Alzheimer/Dementia Care	7.5%-12%	9.7%	8.5%-11.5%	9.7%	-10
Licensed Skilled Nursing-Long Term Care	8.5%-18%	12.6%	10%-14%	12.5%	0
Licensed Skilled Nursing-Subacute Care	8.5%-15%	12.7%	9.3%-14%	12.8%	+40
Continuing Care Retirement Community	7%-15%	9.7%	8%-12.5%	9.4%	0

Internal Rate of Return (Discount Rate)

	2010 All Responses		2010 Adjusted Responses (1)		Basis Point Change from 2009
	Range	Average	Range	Average	
Age Restricted Apartments	8%-15%	11.0%	9%-13%	10.9%	-160
Unlicensed Congregate Living	8%-25%	13.1%	10%-20%	12.4%	-50
Licensed Assisted Living	8.8%-30%	14.3%	11.5%-20%	13.6%	-40
Licensed Alzheimer/Dementia Care	9.3%-30%	14.8%	11%-20%	14.1%	-20
Licensed Skilled Nursing-Long Term Care	11%-30%	16.1%	12%-20%	15.2%	0
Licensed Skilled Nursing-Subacute Care	11%-30%	16.4%	12%-20%	15.6%	+20
Continuing Care Retirement Community	10%-25%	14.4%	11%-20%	14.0%	+30

Equity Dividend Rate (Cash on Cash Return)

	2010 All Responses		2010 Adjusted Responses (1)		Basis Point Change from 2009
	Range	Average	Range	Average	
Age Restricted Apartments	7%-15%	11.4%	9%-14%	11.4%	-240
Unlicensed Congregate Living	8%-20%	13.2%	10%-18%	13.1%	-50
Licensed Assisted Living	7%-25%	13.3%	9%-20%	12.9%	-130
Licensed Alzheimer/Dementia Care	7%-25%	14.5%	10%-20%	14.3%	-50
Licensed Skilled Nursing-Long Term Care	10%-30%	15.8%	11%-25%	14.6%	-100
Licensed Skilled Nursing-Subacute Care	10%-30%	15.5%	12%-16%	14.8%	-120
Continuing Care Retirement Community	9%-30%	14.3%	10%-20%	12.8%	-130

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

subacute nursing care (from a negative 10 basis points to 30 basis points).

One of the more significant results of the 2010 survey was the reduction in discount rates for most senior housing property types. The discount rates in the 2009 survey were atypically high. In the 2010 survey, discount rates generally fell while cap rates remained flat. In our opinion, the relationship between the cap rates and discount rates in 2010 is more indicative of a market relationship, or that used by most appraisers. However, the indicated spread between cap rates and discount rates still appears to be too high given 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.

Interestingly, equity dividend rates in 2010 decreased for all senior housing property types. This could reflect a decreased expectation of investment returns in a weak market rather than increasing buyer demand. Equity dividend rate averages ranged from approximately 11% to 15%.

Survey Relevance

2009/2010 saw the stabilizing of deteriorating market conditions that occurred between 2007 and 2009. However, market conditions do not appear to have materially improved due to the continued lack of available credit, an ongoing soft single family home market and the high visibility financial difficulties of several senior housing industry leaders. Financing renewals and restructurings dominated market activity in 2009 and 2010, with little new construction. Sale activity has shown some signs of life as some buyers take advantage of troubled assets and special situations although market activity is still relatively sluggish. Many financial institutions previously active in the senior housing industry have frozen new transactions, continued to evaluate new deals conservatively, concentrated on cleaning up overleveraged deals from the mid 2000's and even left the industry. Prospects for a market cycle near a tipping point of new construction and new financings still appear to be gloomy, with some isolated exceptions. The industry hangover from robust market activity from 2004 to 2007 appears to be lingering.

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, market share, portfolio affect, 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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