SENIOR HOUSING INVESTMENT

S U R V E Y

VOLUME 14 **SENIOR LIVING VALUATION SERVICES, INC.** **SPRING 2007**

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 14th annual *Senior Housing Investment Survey* was sent to 309 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, 2007 cutoff date, 62 surveys or 20% 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 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 49% of respondents this year identified themselves as having a national perspective, a higher percentage compared to previous years and the highest in the 14 years of this survey. The respondents indicated a material difference between annual cash flow growth factors in revenue (4.1% average) and expense (3.5% average) projections. Both cash flow growth factors were above projections of overall inflation (3.2% average). 45% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (similar to the 47% from last year). 45% of respondents expected capitalization rates to increase up to 100 basis points in the next year (also similar to the 44% from last year). 8% of respondents expected capitalization rates to decrease up to 100 points in the next year. Only a few (2%) 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 most likely peaked and that the recent downward trend of 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 2007 results include a continuing downward trend in overall capitalization rates for almost all categories of senior housing to the lowest levels in the 14 years of this survey. However, the 2006 to 2007 decrease in cap rates was less than in prior years. Also, cap rates for unlicensed congregate living actually increased a bit. Capitalization rates declined for all other categories of senior housing- each by about 50 basis points. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects decreased substantially, to an only 20 basis point difference. Except for the congregate living anomaly, the spread between cap rates of other senior housing property types was consistent with prior years.

One of the more significant results of the 2007 survey was the sharp reduction in discount rates for all senior housing property types. The discount rate decrease was much more pronounced than the cap rate decrease. In our opinion, the relationship between the cap rates and dis-

SENIOR LIVING VALUATION SERVICES, INC.
2007 SENIOR HOUSING INVESTMENT SURVEY

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

23%	Owner/Operator	31%	Appraiser
21%	Financial Institution/Investor	3%	Consultant
23%	Broker/Mortgage Banker		

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

11%	East	22%	West
3%	South	49%	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%-8%	4.1%	Revenues
2%-5%	3.5%	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):

2007		2006	2005
2%	Increase more than 100 basis points	2%	0%
45%	Increase 0 to 100 basis points	44%	21%
45%	Flat, no significant change	47%	56%
8%	Decrease 0 to 100 basis points	7%	23%
0%	Decrease more than 100 basis points	0%	0%

Overall Capitalization Rate

	2007 All Responses		2007 Adjusted Responses[1]		Basis Point Change from 2006
	Range	Average	Range	Average	
Age Restricted Apartments	5.8%-9%	7%	6%-9%	7.0%	-40
Unlicensed Congregate Living	6%-11%	8.2%	6.5%-10%	8.2%	+10
Licensed Assisted Living	6%-12.5%	8.5%	7%-11%	8.4%	-60
Licensed Alzheimer/Dementia Care	7%-14%	9.4%	7.5%-12%	9.3%	-50
Licensed Skilled Nursing-Long Term Care	8%-16%	11.6%	9%-14%	11.6%	-50
Licensed Skilled Nursing-Subacute Care	8.5%-18%	12.3%	9%-14.5%	12.1%	-50
Continuing Care Retirement Community	7%-13%	8.8%	7%-12%	8.7%	-60

Internal Rate of Return (Discount Rate)

	2007 All Responses		2007 Adjusted Responses[1]		Basis Point Change from 2006
	Range	Average	Range	Average	
Age Restricted Apartments	7%-13%	9.5%	8%-10%	9.5%	-90
Unlicensed Congregate Living	8.8%-21%	11.7%	9%-17%	11.3%	-160
Licensed Assisted Living	9%-20%	12.2%	9%-19%	11.9%	-230
Licensed Alzheimer/Dementia Care	9%-20%	12.7%	10%-19%	12.5%	-150
Licensed Skilled Nursing-Long Term Care	9%-18%	13.1%	10.5%-16%	13.0%	-230
Licensed Skilled Nursing-Subacute Care	9%-20%	13.5%	10.5%-18.5%	13.4%	-180
Continuing Care Retirement Community	6%-15%	10.8%	7%-14%	10.8%	-250

Equity Dividend Rate (Cash on Cash Return)

	2007 All Responses		2007 Adjusted Responses[1]		Basis Point Change from 2006
	Range	Average	Range	Average	
Age Restricted Apartments	5%-13%	8.1%	5%-10%	8.0%	-90
Unlicensed Congregate Living	5.5%-15%	11.0%	7%-15%	11.2%	-30
Licensed Assisted Living	6%-15%	11.3%	7.5%-15%	11.4%	-50
Licensed Alzheimer/Dementia Care	7.5%-16%	12.3%	8%-15%	12.4%	+40
Licensed Skilled Nursing-Long Term Care	7.5%-25%	15.4%	12%-20%	15.2%	+20
Licensed Skilled Nursing-Subacute Care	7.5%-25%	15.9%	12%-20%	15.8%	+60
Continuing Care Retirement Community	7.5%-20%	12.8%	8%-18%	12.6%	+50

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

count rate results in 2007 is more indicative of a market relationship, or that used by most appraisers. In other words, discount rates seemed unusually high in the most recent prior years and in 2007 have come down to more consistent and appropriate levels in relation to the indicated capitalization rate results. It appears that a widely used formula defining the relationship of cap rates and discount rates (overall cap rate plus the annual cash flow growth factor less 100 basis points = the discount rate) is being recognized by more participants in the survey. 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.

As a general rule, equity dividend rates in 2007 decreased for the less complicated and regulated senior housing property types and increased for the more complicated and regulated senior property types. As suggested by the 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 8% to 15%.

Survey Relevance

2006/2007 has seen the continuation of unprecedented 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 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.

It appears that the current historically low cap rate environment is unlikely to change until the broader availability of money materially changes. However, most respondents seem to indicate that cap rates will not go even lower from current levels and the only direction from today is up.

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

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.

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