

SENIOR HOUSING INVESTMENT

S U R V E Y

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SENIOR LIVING VALUATION SERVICES, INC.

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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 third annual *Senior Housing Investment Survey* was sent to 195 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 April 19, 1996 cutoff date, 63 surveys or 32.3% of the total sent had been returned. Ideally, we would prefer sending the survey only to those parties actually making or involved in investment decisions. However, because the senior housing industry is relatively new and limited in size, we have included other parties such as brokers, appraisers, consultants and other knowledgeable parties with opinions or perceptions of investment criteria used by market principals. Because the industry is relatively immature, these secondary parties can more significantly influence investment decisions. Of the respondents, 46% represent market principals such as owner/operators or financial institutions/investors.

Though not specifically identified in this year's survey, we plan to request investment criteria used for the emerging alzheimer's senior housing property niche in next year's survey.

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. The respondents indicated a fairly tight range of annual cash flow growth factors in revenue (3.6% average) and expense (3.5% average) projections. These cash flow growth factors generally equaled projections of overall inflation (3.3% average). 49% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months. 12% of respondents expected cap rates to increase up to 100 basis points in the next year and 37% expected cap rates to decrease up to 100 points 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 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 illustrated.

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 facilities to licensed conventional and subacute skilled nursing facilities. Rates for continuing care retirement communities which are typically combinations of each of the

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1996 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>25%</u>	Owner/Operator	<u>19%</u>	Appraiser
<u>21%</u>	Financial/Institution/Investor	<u>7%</u>	Consultant
<u>28%</u>	Broker/Mortgage Banker	<u>0%</u>	Other

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

<u>13%</u>	East	<u>30%</u>	West
<u>11%</u>	South	<u>32%</u>	National
<u>14%</u>	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	
<u>0%-5%</u>	<u>3.6%</u>	Revenues
<u>2%-5%</u>	<u>3.5%</u>	Expenses
<u>2%-4%</u>	<u>3.3%</u>	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):

<u>1996</u>		<u>1995</u>	<u>1994</u>
<u>0%</u>	Increases more than 100 basis points	<u>3%</u>	<u>0%</u>
<u>12%</u>	Increase 0 to 100 basis points	<u>13%</u>	<u>12%</u>
<u>49%</u>	Flat, no significant change	<u>60%</u>	<u>61%</u>
<u>37%</u>	Decrease 0 to 100 basis points	<u>31%</u>	<u>27%</u>
<u>2%</u>	Decrease more than 100 basis points	<u>3%</u>	<u>0%</u>

Overall Capitalization Rate

	1996		1996		Basis Point Change from 1995
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-14%	10.0%	7%-12%	9.9%	-20
Unlicensed Congregate Living	9%-14%	10.6%	9.5%-12%	10.6%	-50
Licensed Assisted Living	10%-16%	11.3%	10%-14%	11.2%	-80
Licensed Skilled Nursing-Long Term Care	10%-18%	13.0%	11%-16%	12.9%	-20
Licensed Skilled Nursing-Subacute Care	10%-18%	13.7%	11%-16%	13.7%	+10
Continuing Care Retirement Community	9.5%-15%	11.8%	10%-15%	11.7%	-40

Internal Rate of Return (Discount Rate)

	1996		1996		Basis Point Change from 1995
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	7%-18%	12.1%	11%-13%	13.5%	+30
Unlicensed Congregate Living	9%-20%	14.1%	12%-18%	14.0%	-100
Licensed Assisted Living	10%-25%	15.2%	12%-20%	15.0%	-90
Licensed Skilled Nursing-Long Term Care	12%-20%	15.1%	13%-19%	15.0%	-40
Licensed Skilled Nursing-Subacute Care	12%-22%	16.3%	15%-19%	16.2%	+20
Continuing Care Retirement Community	10%-22%	14.7%	12%-20%	14.5%	-80

Equity Dividend Rate (Cash on Cash Return)

	1996		1996		Basis Point Change from 1995
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	7%-20%	11.3%	8%-13%	10.7%	-190
Unlicensed Congregate Living	8%-30%	15.0%	10%-20%	14.5%	+10
Licensed Assisted Living	8%-35%	17.2%	10%-25%	16.5%	+90
Licensed Skilled Nursing-Long Term Care	8%-45%	18.9%	10%-25%	18.2%	+150
Licensed Skilled Nursing-Subacute Care	8%-45%	19.8%	13%-25%	20.2%	+240
Continuing Care Retirement Community	8%-35%	17.2%	12%-25%	16.5%	-130

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

above categories of senior projects, fell within the average range of the other categories of project types (near the middle).

The 1996 survey results confirm a general impression of material declines in capitalization rates for most senior housing property types, especially for the unlicensed congregate and licensed assisted living industry segments. As would be expected, changes in discount rates were positively correlated to declines in capitalization rates. An interesting result in the survey is the comparison of the decline in average capitalization and discount rates for most property types to the increase in average equity rates of return. This comparison is explainable by the increased availability and lower interest rates for debt financing.

Survey Relevance

1995/1996 saw significant shifts in the senior housing industry as many owner/operators looked to aggressively expand their portfolio of properties through acquisition of existing projects or through the development or renovation of new or existing projects. This renaissance has been driven by the greater availability of financing through public offerings, renewed (but still spotty) financial institutional and investor interest in the senior housing industry, pent-up market demand due to an overall paucity of new development in the early 1990's and a greater investor and public awareness and un-

derstanding of the assisted living segment of the industry. 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 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 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 matures and more investment decisions occur, 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.

Inquiries, comments or requests of interested parties wanting to participate in the 1997 survey can be directed to:

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