

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 second annual *Senior Housing Investment Survey* was sent to 265 potential respondents including those with membership in various national senior housing associations and other parties involved in the senior housing industry and known to the editor. As of a April 21, 1995 cutoff date, 61 surveys or 23.0% 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, 50% represent market principals such as owner/operators or financial institutions/investors.

In this year's survey, we have split the skilled nursing facilities property type into the more conventional long term care and the higher acuity and shorter stay subacute care to recognize the growing impact of subacute care within the nursing home segment of the industry.

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 (3.7% average) and expense (3.6% average) projections. These cash flow growth factors generally equaled projections of overall inflation (3.5% average). 60% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months. Only 3% of respondents expected cap rates to increase up to 100 basis points in the next year and 31% expected cap rates to decrease up to 100 points in the next year. These results suggest that the industry is expected to continue a recent trend of decreasing cap rates, primarily due to the greater availability of financing, a larger pool of buyers and investors and a decreasing number of existing properties available for sale.

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

**SENIOR LIVING VALUATION SERVICES, INC.
1995 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>23%</u>	Owner/Operator	<u>18%</u>	Appraiser
<u>27%</u>	Financial Institution/Investor	<u>7%</u>	Consultant
<u>24%</u>	Broker/Mortgage Banker	<u>1%</u>	Other

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

<u>12%</u>	East	<u>28%</u>	West
<u>11%</u>	South	<u>32%</u>	National
<u>17%</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%-7%</u>	<u>3.6%</u>	Revenues
<u>2%-6%</u>	<u>3.7%</u>	Expenses
<u>2%-6%</u>	<u>3.5%</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>1995</u>		<u>1994</u>
<u>3%</u>	Increase more than 100 basis points	<u>0%</u>
<u>3%</u>	Increase 0 to 100 basis points	<u>12%</u>
<u>60%</u>	Flat, no significant change	<u>61%</u>
<u>31%</u>	Decrease 0 to 100 basis points	<u>27%</u>
<u>3%</u>	Decrease more than 100 basis points	<u>0%</u>

Overall Capitalization Rate

	1995		1995		Basis Point Change from 1994
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-13%	10.1%	8%-12%	10.1%	+10
Unlicensed Congregate Living	9%-14%	11.1%	9%-13%	11.1%	-30
Licensed Assisted Living	10%-16%	12.1%	10%-15%	12.0%	-10
Licensed Skilled Nursing-Long Term Care	11%-16%	13.2%	11.5%-16%	13.1%	+10
Licensed Skilled Nursing-Subacute Care	10%-18%	13.6%	11%-17%	13.6%	N/A
Continuing Care Retirement Community	9.5%-18%	12.2%	10%-14.5%	12.1%	0

Internal Rate of Return (Discount Rate)

	1995		1995		Basis Point Change from 1994
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	10.5%-25%	13.8%	11%-20%	13.2%	-40
Unlicensed Congregate Living	11.5%-30%	15.6%	12%-20%	15.0%	+20
Licensed Assisted Living	12%-25%	16.3%	12%-20%	15.9%	+50
Licensed Skilled Nursing-Long Term Care	12%-30%	15.9%	12%-20%	15.4%	-140
Licensed Skilled Nursing-Subacute Care	12%-30%	16.5%	12%-22.5%	16.0%	N/A
Continuing Care Retirement Community	11%-30%	15.6%	12%-20%	15.3%	-100

Equity Dividend Rate (Cash on Cash Return)

	1995		1995		Basis Point Change from 1994
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-20%	12.8%	8%-22%	12.6%	-20
Unlicensed Congregate Living	6%-30%	14.7%	8%-20%	14.4%	0
Licensed Assisted Living	6.5%-30%	15.9%	8%-25%	15.6%	-50
Licensed Skilled Nursing-Long Term Care	8%-30%	17.0%	10%-22%	16.7%	-60
Licensed Skilled Nursing-Subacute Care	8%-30%	18.0%	8%-30%	17.8%	N/A
Continuing Care Retirement Community	10%-75%	20.4%	10%-30%	17.8%	+90

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

retirement communities which are typically combinations of each of the above categories of senior projects, fell within the average range of the other categories of project types (near the middle).

The relationship of capitalization rate, discount rate and equity dividend rate averages are generally consistent with those seen in other more liquid property types. The indicated average spread between discount rates and overall capitalization rates is slightly larger than seen at other property types and slightly larger than would be expected given the indicated cash flow growth rate averages.

Despite a general impression of declining capitalization and discount rates from 1994 to 1995, the 1995 survey results reflect more inconclusive trends when compared to the 1994 survey results. Though a majority of property type capitalization and discount rates showed some decline from 1994 to 1995, others rose. A comparison of the 1994 to 1995 results also reflected the inconsistent pattern of declining capitalization rates and rising discount rates, or vice versa, for each individual property type. One would expect capitalization and discount rates to move in tandem. In part, this may illustrate a still murky understanding of the relationship between capitalization and discount rates to many respondents. Tracking rate trends and relationships between capitalization and discount rates over several years will allow a more thorough analysis.

Survey Relevance

Several respondents and non-respondents have commented to the editor that the more traditional measures of analyzing real estate such as capitalization, discount and return on equity rate analysis is not used or given little weight in their evaluation of senior housing investment decisions. They noted 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 market 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 1996 survey can be directed to:

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