

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 17th annual Senior Housing Investment Survey was sent to 238 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 18, 2011 cutoff date, 56 surveys or 24% of the total sent had been returned. Of the respondents, 39% represent market principals such as owner/operators or financial institutions/ investors, a slightly lower 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 48% of respondents this year identified themselves as having a national perspective, a higher percentage compared to previous years. The respondents indicated an immaterial difference between annual cash flow growth factors in revenue (3.0% average) and expense (2.9% average) projections. Both cash flow growth factors were near projections of overall inflation (2.8% average).

50% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (below the 67% from last year). 23% of respondents expected capitalization rates to increase up to 100 basis points in the next year (near the 21% from last year). 27% of respondents expected capitalization rates to decrease up to 100 points in the next year (sharply above the 8% of last year). No respondents expected capitalization rates to increase or decrease by more than 100 basis points in the next year. It appears that a slight majority of respondents believe that overall market conditions are recovering with an anticipated downward trend of capitalization rates.

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 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 2011 survey results include a downward trend in overall capitalization and discount rates for most categories of senior housing. Indicated 2011 capitalization rates for nursing care (flat to slight increase for subacute care) and continuing care retirement communities (slight increase) were exceptions. Overall capitalization rate decreased by 30 to 60 basis points for age restricted apartments, unlicensed congregate living, licensed assisted living and licensed alzheimer/dementia care. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects remained relatively constant at about 70 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 licensed assisted living and licensed alzheimer/dementia care (from 60 to 30 basis points).

**SENIOR LIVING VALUATION SERVICES, INC.
2011 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>28%</u>	Owner/Operator	<u>35%</u>	Appraiser
<u>11%</u>	Financial Institution/Investor	<u>3%</u>	Consultant
<u>23%</u>	Broker/Mortgage Banker		

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

<u>12%</u>	East	<u>19%</u>	West
<u>12%</u>	South	<u>48%</u>	National
<u>9%</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>3.0%</u>	Revenues
<u>2%-5%</u>	<u>2.9%</u>	Expenses
<u>1.5%-5%</u>	<u>2.8%</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):

2011		2010	2009
<u>0%</u>	Increase more than 100 basis points	<u>5%</u>	<u>8%</u>
<u>23%</u>	Increase 0 to 100 basis points	<u>21%</u>	<u>67%</u>
<u>50%</u>	Flat, no significant change	<u>67%</u>	<u>21%</u>
<u>27%</u>	Decrease 0 to 100 basis points	<u>8%</u>	<u>2%</u>
<u>0%</u>	Decrease more than 100 basis points	<u>0%</u>	<u>2%</u>

Overall Capitalization Rate

	2011		2011		Basis Point Change from 2010
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	5%-9%	7.5%	7%-9%	7.5%	-50
Unlicensed Congregate Living	6%-15%	8.4%	7%-9%	8.2%	-30
Licensed Assisted Living	7%-14%	8.9%	7%-10%	8.8%	-30
Licensed Alzheimer/Dementia Care	7%-12%	9.2%	7.5%-10.5%	9.1%	-60
Licensed Skilled Nursing-Long Term Care	10%-15%	12.5%	10%-15%	12.5%	0
Licensed Skilled Nursing-Subacute Care	10%-16%	12.9%	10.5%-15%	13.0%	+20
Continuing Care Retirement Community	7%-15%	9.7%	7%-12%	9.8%	+40

Internal Rate of Return (Discount Rate)

	2011		2011		Basis Point Change from 2010
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	7%-15%	9.8%	8%-11%	9.6%	-130
Unlicensed Congregate Living	7.5%-20%	11.4%	9%-15%	11.1%	-130
Licensed Assisted Living	8%-23%	12.1%	10%-15%	11.7%	-190
Licensed Alzheimer/Dementia Care	8.5%-20%	12.3%	10%-14%	12.1%	-200
Licensed Skilled Nursing-Long Term Care	10%-20%	14.7%	13%-17%	14.9%	-30
Licensed Skilled Nursing-Subacute Care	10%-20%	15.1%	13%-18%	15.3%	-30
Continuing Care Retirement Community	8.5%-25%	13.6%	10%-20%	13.3%	-70

Equity Dividend Rate (Cash on Cash Return)

	2011		2011		Basis Point Change from 2010
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	7%-16%	10.0%	8%-12%	9.4%	-200
Unlicensed Congregate Living	7.5%-20%	12.5%	9%-15%	12.3%	-80
Licensed Assisted Living	8%-20%	12.6%	9%-20%	12.6%	-80
Licensed Alzheimer/Dementia Care	8%-22%	13.5%	11%-20%	13.0%	-140
Licensed Skilled Nursing-Long Term Care	10%-20%	15.7%	15%-20%	15.8%	+120
Licensed Skilled Nursing-Subacute Care	10%-25%	16.9%	15%-20%	16.5%	+170
Continuing Care Retirement Community	8%-22%	13.9%	10%-20%	13.6%	+80

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

One of the more significant results of the 2011 survey was the reduction in discount rates for most senior housing property types. The indicated discount rates in the 2009 and 2010 surveys were atypically high. In the 2011 survey, discount rates fell across the board for all senior housing property types, with large decreases (130 to 200 basis points) for age restricted apartments, unlicensed congregate living, licensed assisted living and licensed alzheimer/dementia care. In our opinion, the relationship between the cap rates and discount rates in 2011 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 slightly 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 2011 decreased for most senior housing property types, nursing care and continuing care retirement communities being exceptions. This decline could be reflecting the beginnings of increasing buyer demand and competition to buy. Equity dividend rate averages ranged from approximately 9% to 16%.

Survey Relevance

2010/2011 saw some slight recovery from the severe 2007 to 2009 economic downturn. However, ongoing weakness in local real estate market conditions in many areas of the country continue to put pressure on most senior housing project occupancies and rates/fees. Never-

theless, developers exist to develop and some proposed senior housing projects have begun to appear in many markets. Though little new supply has been added to the market in the past few years, indications of pent-up demand for new senior housing are still uneven. Sale activity has shown signs of life as some buyers seek to take advantage of underperforming assets and REIT money floods the market for healthier companies and assets. However, many financial institutions previously active in the senior housing industry have frozen new transactions, continue to evaluate new deals conservatively, concentrate on cleaning up overleveraged deals from the mid 2000's and even leave the industry. Overall prospects for continued market recovery are good although the industry green shoots still appear tender.

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.

Inquiries, comments or requests of interested parties wanting to participate in the 2012 survey can be directed to:

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