

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 20th annual Senior Housing Investment Survey was sent to 373 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 May 26, 2014 cutoff date, 67 surveys or 18% of the total sent had been returned. Of the respondents, 29% 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 52% of respondents this year identified themselves as having a national perspective, a higher percentage compared to previous years. The respondents indicated a material difference between annual cash flow growth factors in revenue (3.2% average) and expense (2.9% average) projections. Both cash flow growth factors were above projections of overall inflation (2.6% average).

66% 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 49% from last year). No respondents expect capitalization rates to increase over 100 basis points in the next year and only 2% expect capitalization rates to decrease by more than 100 basis points in the next year. Only 11% of respondents expect capitalization rates to decrease up to 100 points in the next year (well below the 45% of last year). 21% of respondents expect capitalization rates to increase up to 100 basis points in the next year (well above 6% from last year). The weighted average responses are expecting a slight increase in capitalization rates during the next year, a reversal of the expected declines of the past few years.

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 memory care to licensed long term 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 2014 survey results include the continuation of a four year downward trend in overall capitalization rates for most categories of senior housing. However, the decline is less than in previous years suggesting that cap rates are approaching a trough. Capitalization rates for all types of senior housing and care declined from 2013 to 2014 although the declines were slight. Overall capitalization rates decreased by 0 to only 30 basis points from 2013 to 2014 for all types of senior housing and care. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects decreased slightly from 90 basis points in 2013 to 80 basis points in 2014, an insignificant difference. The cap rate spread between licensed assisted living and licensed memory care did not change from 40 basis points in both 2013 and 2014. The cap rate spread between long term care and subacute care decreased to only 10 basis points in 2014 from 30 basis points in 2013.

**SENIOR LIVING VALUATION SERVICES, INC.
2014 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>22%</u>	Owner/Operator	<u>41%</u>	Appraiser
<u>7%</u>	Financial Institution/Investor	<u>4%</u>	Consultant
<u>26%</u>	Broker/Mortgage Banker		

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

<u>11%</u>	East	<u>19%</u>	West
<u>9%</u>	South	<u>52%</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>1%-5%</u>	<u>3.2%</u>	Revenues
<u>1%-5%</u>	<u>2.9%</u>	Expenses
<u>0%-4%</u>	<u>2.6%</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):

2014		2013	2012
<u>0%</u>	Increase more than 100 basis points	<u>0%</u>	<u>2%</u>
<u>21%</u>	Increase 0 to 100 basis points	<u>6%</u>	<u>4%</u>
<u>66%</u>	Flat, no significant change	<u>49%</u>	<u>72%</u>
<u>11%</u>	Decrease 0 to 100 basis points	<u>45%</u>	<u>22%</u>
<u>2%</u>	Decrease more than 100 basis points	<u>0%</u>	<u>0%</u>

Overall Capitalization Rate

	2014		2014		Basis Point Change from 2013
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	5%-9%	6.6%	5.5%-8%	6.6%	-20
Unlicensed Congregate Living	6.8%-11%	7.3%	6.5%-8%	7.2%	-20
Licensed Assisted Living	7.5%-12%	8.1%	7%-9%	8.0%	-30
Licensed Memory Care	7.5%-12%	8.5%	7.5%-9.5%	8.4%	-30
Licensed Skilled Nursing-Long Term Care	9%-14%	12.0%	10%-13%	12.1%	0
Licensed Skilled Nursing-Subacute Care	9%-15%	12.2%	11%-14%	12.2%	-20
Continuing Care Retirement Community	7%-11%	9.1%	8%-10.5%	9.1%	-10

Internal Rate of Return (Discount Rate)

	2014		2014		Basis Point Change from 2013
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-20%	10.2%	8%-15%	9.7%	+10
Unlicensed Congregate Living	7.5%-16.5%	10.3%	9%-13%	10.0%	-60
Licensed Assisted Living	8%-25%	11.3%	10%-18%	11.1%	0
Licensed Memory Care	9.5%-22%	11.9%	10.5%-18%	11.7%	-50
Licensed Skilled Nursing-Long Term Care	11%-20%	13.9%	14%-15%	14.5%	-30
Licensed Skilled Nursing-Subacute Care	13%-17%	14.0%	13%-16%	14.9%	-80
Continuing Care Retirement Community	10%-15%	11.4%	11%-13%	11.8%	-120

Equity Dividend Rate (Cash on Cash Return)

	2014		2014		Basis Point Change from 2013
	<u>All Responses</u>		<u>Adjusted Responses ⁽¹⁾</u>		
	Range	Average	Range	Average	
Age Restricted Apartments	6%-20%	10.9%	9%-15%	10.4%	+80
Unlicensed Congregate Living	5.5%-18%	10.8%	9.5%-12%	10.8%	-50
Licensed Assisted Living	8%-20%	12.2%	9.5%-15%	12.1%	-10
Licensed Memory Care	9%-20%	12.8%	10%-15%	12.6%	-70
Licensed Skilled Nursing-Long Term Care	9.5%-30%	16.4%	12%-20%	15.7%	-20
Licensed Skilled Nursing-Subacute Care	9.5%-28%	16.4%	13%-19%	15.7%	-70
Continuing Care Retirement Community	6%-23%	12.6%	10%-15%	12.4%	-80

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

One of the more significant results of the 2014 survey was the decreasing difference between overall capitalization rates and discount rates for most senior housing property types (an exception is for age restricted apartments) although the absolute change in discount rates from 2013 to 2014 was variable by senior housing property type. In our opinion, the relationship between the cap rates and discount rates reflected in the survey results in 2014 is more indicative of a market relationship, or that used by most appraisers. The indicated spread between cap rates and discount rates appears to have been too high in the previous year 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.

Equity dividend rates in 2014 decreased for most senior housing property types, age restricted apartments being the only exception. This decrease is probably reflecting greater competition and demand for all types of senior housing and care. Equity dividend rate averages ranged from approximately 10.4% to 15.7%.

Survey Relevance

2013/2014 saw active and healthy markets across the spectrum of senior housing and care. Interest rates have increased only slightly during the past year and are still historically low. The increased availability of financing including new construction financing, REIT competition, a growing number of investors and developers and strengthening upward trends in local real estate prices, all have contributed to the recent declining trend in capitalization rates, industry mergers and higher sale prices per unit and per bed. New senior housing construction

is increasingly active for all types of senior housing and care including the emergence of developers with little previous experience in the industry. With little new supply having been added to the market in the past several years, indications of pent-up demand for new senior housing are generally positive although development pipelines are filling in many markets, especially in the assisted living and memory care market segments. Sale activity has been relatively active as a larger number of adequately financed buyers are seeking senior housing assets for purchase. Overall prospects for continued industry strength and escalating new construction are good, supported by the industry's undeniable favorable long term demographics (only 11 years to the first baby boomers turning 80 years old!) and still low interest rates.

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 some 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 2015 survey can be directed to:

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