

SENIOR HOUSING INVESTMENT

S U R V E Y

VOLUME 7

SENIOR LIVING VALUATION SERVICES, INC.

SPRING 2000

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 seventh annual *Senior Housing Investment Survey* was sent to 267 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 15, 2000 cutoff date, 63 surveys or 24.0% 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, 55% represent market principals such as owner/operators or financial institutions/investors, a slightly higher 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. A similar percentage of respondents this year identified themselves as having a national perspective compared to previous years. The respondents indicated a fairly tight range of annual cash flow growth factors in revenue (2.6% average) and expense (2.9% average) projections. These cash flow growth factors were slightly above projections of overall inflation (2.4% average). 24% of all respondents noted that capitalization

rates for senior housing properties in general are not expected to significantly change in the next 12 months (down 46% from last year). In the most significant change from the 1999 survey results, 74% of respondents expected cap rates to increase up to 100 basis points in the next year (up 38% from last year). No respondents expected cap rates to decrease up to or over 100 points in the next year (down 8% and 2% from last year, respectively).

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 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 within the average range of the other categories of project types (near the middle).

Highlights of the 1999 results include a slight drift upward in capitalization rates for most senior housing property types except for unlicensed noncongregate senior apartments which showed a slight decline in capitalization rates. This confirms an anecdotal im-

**SENIOR LIVING VALUATION SERVICES, INC.
2000 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>35%</u>	Owner/Operator	<u>31%</u>	Appraiser
<u>20%</u>	Financial/Institution/Investor	<u>2%</u>	Consultant
<u>12%</u>	Broker/Mortgage Banker		

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

<u>12%</u>	East	<u>21%</u>	West
<u>14%</u>	South	<u>41%</u>	National
<u>12%</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>2.6%</u>	Revenues
<u>0%-5%</u>	<u>2.9%</u>	Expenses
<u>0%-5%</u>	<u>2.4%</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>2000</u>		<u>1999</u>	<u>1998</u>
<u>2%</u>	Increase more than 100 basis points	<u>6%</u>	<u>0%</u>
<u>74%</u>	Increase 0 to 100 basis points	<u>38%</u>	<u>24%</u>
<u>24%</u>	Flat, no significant change	<u>46%</u>	<u>59%</u>
<u>0%</u>	Decrease 0 to 100 basis points	<u>8%</u>	<u>17%</u>
<u>0%</u>	Decrease more than 100 basis points	<u>2%</u>	<u>0%</u>

Overall Capitalization Rate

	2000 <u>All Responses</u>		2000 <u>Adjusted Responses⁽¹⁾</u>		<u>Basis Point Change from 1999</u>
	Range	Average	Range	Average	
Age Restricted Apartments	8%-12%	9.3%	8%-11%	9.2%	-10
Unlicensed Congregate Living	8.5%-12.8%	10.2%	9%-12%	10.1%	+20
Licensed Assisted Living	9%-13.5%	10.9%	9.5%-12%	10.8%	0
Licensed Alzheimer/Dementia Care	10%-15%	11.6%	10.5%-14%	11.5%	+20
Licensed Skilled Nursing-Long Term Care	9%-18%	12.9%	11%-17%	12.9%	+30
Licensed Skilled Nursing-Subacute Care	8%-18%	13.2%	11%-15%	13.3%	+10
Continuing Care Retirement Community	9%-14%	11.2%	10%-13%	11.1%	0

Internal Rate of Return (Discount Rate)

	2000 <u>All Responses</u>		2000 <u>Adjusted Responses⁽¹⁾</u>		<u>Basis Point Change from 1999</u>
	Range	Average	Range	Average	
Age Restricted Apartments	8%-20%	11.6%	10.5%-13%	11.2%	-90
Unlicensed Congregate Living	10%-35%	14.5%	11%-20%	13.6%	+50
Licensed Assisted Living	11%-40%	15.1%	12.5%-25%	14.1%	+20
Licensed Alzheimer/Dementia Care	11%-28%	15.1%	13%-15%	14.5%	0
Licensed Skilled Nursing-Long Term Care	12%-45%	17.2%	13%-21%	15.3%	+190
Licensed Skilled Nursing-Subacute Care	12%-30%	16.6%	13.5%-20%	15.6%	+40
Continuing Care Retirement Community	11%-20%	14.5%	12%-16%	14.2%	0

Equity Dividend Rate (Cash on Cash Return)

	2000 <u>All Responses</u>		2000 <u>Adjusted Responses⁽¹⁾</u>		<u>Basis Point Change from 1999</u>
	Range	Average	Range	Average	
Age Restricted Apartments	6%-20%	10.2%	8%-12%	9.9%	-210
Unlicensed Congregate Living	8%-20%	12.2%	9%-12.5%	11.9%	-170
Licensed Assisted Living	8%-30%	14.3%	10%-20%	13.8%	+10
Licensed Alzheimer/Dementia Care	10%-25%	15.2%	12%-21%	14.7%	+190
Licensed Skilled Nursing-Long Term Care	10%-25%	17.0%	12%-24%	16.9%	+190
Licensed Skilled Nursing-Subacute Care	10%-30%	17.1%	12%-20%	15.4%	+90
Continuing Care Retirement Community	10%-30%	14.3%	12%-15%	13.4%	+50

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

pression of upward pressure on cap rates in 2000 although the increases in cap rates from 1999 is small. Given changes in macro market conditions within the highly visible assisted living market segment, the zero basis point cap rate change from 1999 to 2000 for assisted living projects is surprising. The paucity of sales of individual senior projects since mid 1999 may have made an evaluation of current cap rates less precise and current. The spread of capitalization rates between the lower rate unlicensed congregate living facilities and the higher rate licensed assisted living projects declined slightly to about 70 basis points from 90 basis points in the prior year. The spread between the lower rate conventional assisted living projects and the higher rate specialized alzheimer/dementia care projects increased by a modest 20 basis points.

Capitalization rates for conventional nursing homes increased about 30 basis points from the 1999 survey results which incorporates an industry segment with more uncertainty. Equity dividend rates increased for most senior housing property types as equity funds have become more scarce. Changes in discount rates were positively correlated to and even generally larger than increases in capitalization rates.

Survey Relevance

1999/2000 has been a transitional period in the senior housing industry as the mid to late 1990's development cycle of new senior housing projects has slowed to a trickle of new development projects. Many markets in the country are still in the process of consolidating and absorbing the recent large increases in supply of mostly assisted living and alzheimer/dementia care facilities. Many, but not all, proposed projects planned in the late 1990's have been withdrawn. Absorption rates of new projects opened in the last 12 months have been highly variable and more dependent on the acumen of on site

administration than usually is the case. The lack of sale activity of individual projects is probably a combination of decreased funding availability and many owner/operators waiting for further deterioration and better potential upside returns at troubled projects. As reflected in this 2000 survey, most industry professionals project conditions to get worse in the next 12 months before they get better.

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 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 included debt coverage ratios, relationships to replacement cost, market share, portfolio affect and 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 more comprehensively assess the impact of a potential default and resale of a property. As the senior housing matures and more institutionally driven investment decisions are made as is beginning to 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.

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