

SENIOR HOUSING INVESTMENT

S U R V E Y

VOLUME 18

SENIOR LIVING VALUATION SERVICES, INC.

SPRING 2012

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 18th annual Senior Housing Investment Survey was sent to 322 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 June 4, 2012 cutoff date, 63 surveys or 20% of the total sent had been returned. Of the respondents, 36% 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 47% of respondents this year identified themselves as having a national perspective, a similar percentage compared to previous years. The respondents indicated an immaterial difference between annual cash flow growth factors in revenue (2.8% average) and expense (2.9% average) projections. Both cash flow growth factors were slightly above projections of overall inflation (2.6% average).

A high 72% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months (above the 50% from last year). Only 4% of respondents expect capitalization rates to increase up to 100 basis points in the next year (well below the 23% from last year). 22% of respondents expect capitalization rates to decrease up to 100 points in the next year (slightly below the 27% of last year). Only 2% of respondents expect capitalization rates to increase by more than 100 basis points in the next year and 0% expect cap rates to decrease by more than 100 basis points in the next year. The weighted average of respondents are expecting a slight overall decrease in capitalization rates during the

next year, similar to the indicated cap rate decrease during the past 12 months.

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 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 2012 survey results include a slight downward trend in overall capitalization rates for most categories of senior housing. Indicated 2012 overall capitalization rates for alzheimer/dementia care was the only category of senior housing facilities to reflect a slight increase in cap rates. Overall capitalization rates decreased by 20 to 80 basis points from 2011 to 2012 for age restricted apartments, unlicensed congregate living, licensed assisted living, licensed long term care nursing care, licensed subacute nursing care and continuing care retirement communities. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects remained relatively constant at about 80 basis points. The spread between cap rates of most other senior housing property types was also consistent with the prior year. An exception includes an increasing cap rate spread between

**SENIOR LIVING VALUATION SERVICES, INC.
2012 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>25%</u>	Owner/Operator	<u>38%</u>	Appraiser
<u>11%</u>	Financial Institution/Investor	<u>7%</u>	Consultant
<u>19%</u>	Broker/Mortgage Banker		

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

<u>6%</u>	East	<u>25%</u>	West
<u>11%</u>	South	<u>47%</u>	National
<u>11%</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>2.8%</u>	Revenues
<u>1%-5%</u>	<u>2.9%</u>	Expenses
<u>1%-3.5%</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):

2012		2011	2010
<u>2%</u>	Increase more than 100 basis points	<u>0%</u>	<u>5%</u>
<u>4%</u>	Increase 0 to 100 basis points	<u>23%</u>	<u>21%</u>
<u>72%</u>	Flat, no significant change	<u>50%</u>	<u>67%</u>
<u>22%</u>	Decrease 0 to 100 basis points	<u>27%</u>	<u>8%</u>
<u>0%</u>	Decrease more than 100 basis points	<u>0%</u>	<u>0%</u>

Overall Capitalization Rate

	2012		2012		Basis Point Change from 2011
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	6%-9%	7.2%	6%-9%	7.2%	-30
Unlicensed Congregate Living	6%-12%	7.9%	7%-11%	8.0%	-20
Licensed Assisted Living	7%-12%	8.6%	7%-11%	8.5%	-30
Licensed Alzheimer/Dementia Care	8%-12%	9.2%	8%-12%	9.2%	+10
Licensed Skilled Nursing-Long Term Care	8%-15%	12.2%	10%-15%	12.2%	-30
Licensed Skilled Nursing-Subacute Care	7%-20%	12.3%	10%-15%	12.2%	-80
Continuing Care Retirement Community	7%-15%	9.5%	8%-12%	9.4%	-40

Internal Rate of Return (Discount Rate)

	2012		2012		Basis Point Change from 2011
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	6%-20%	10.2%	8%-15%	10.1%	+50
Unlicensed Congregate Living	6%-20%	11.1%	9%-15%	10.9%	-20
Licensed Assisted Living	5%-25%	12.4%	9%-15%	12.2%	+50
Licensed Alzheimer/Dementia Care	6%-25%	13.0%	9%-24%	12.6%	+50
Licensed Skilled Nursing-Long Term Care	6%-28%	14.9%	12%-17%	14.6%	-30
Licensed Skilled Nursing-Subacute Care	6%-28%	15.7%	12%-20%	15.2%	-10
Continuing Care Retirement Community	5%-24%	12.9%	10%-20%	12.5%	-80

Equity Dividend Rate (Cash on Cash Return)

	2012		2012		Basis Point Change from 2011
	<u>All Responses</u>		<u>Adjusted Responses</u> ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	4%-18%	9.9%	5%-13%	9.7%	+30
Unlicensed Congregate Living	4%-20%	11.3%	5%-15%	11.1%	-120
Licensed Assisted Living	3%-21%	12.3%	7%-17.5%	12.3%	+20
Licensed Alzheimer/Dementia Care	3%-25%	12.9%	7%-18%	12.6%	-40
Licensed Skilled Nursing-Long Term Care	2%-30%	15.1%	8%-20%	14.9%	-90
Licensed Skilled Nursing-Subacute Care	3%-30%	16.0%	10%-20%	15.9%	-60
Continuing Care Retirement Community	6%-21%	13.1%	9.5%-18%	12.9%	-70

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

licensed assisted living and licensed alzheimer/dementia care (from 30 basis points in 2011 to 70 basis points in 2012).

One of the more significant results of the 2012 survey was the increasing spread between overall capitalization rates and discount rates for most senior housing property types although the absolute change in discount rates from 2011 to 2012 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 2012 is less indicative of a market relationship, or that used by most appraisers. The indicated spread between cap rates and discount rates appears to be 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.

Equity dividend rates in 2012 decreased for most senior housing property types, age restricted apartments and assisted living being exceptions. This decline is reflecting increasing buyer demand and competition to buy, especially for healthier properties. Equity dividend rate averages ranged from approximately 10% to 16%.

Survey Relevance

2011/2012 saw continued, albeit modest 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. Nevertheless, developers exist to develop and proposed and under construction senior housing projects have begun to appear in many markets. With little new supply

having been added to the market in the past few years, indications of pent-up demand for new senior housing are generally positive. Sale activity has been relatively active as a growing number of buyers seek to take advantage of underperforming assets and new financing sources. REIT money continues to flood the market for healthier companies and assets creating competitive pressure for aggressive cap rates. However, some financial institutions continue to evaluate new deals conservatively and manage overleveraged credits from the mid 2000's. Scattered entry fee CCRC covenant violations and bankruptcies continue to impact this market segment. Nevertheless, overall prospects for continued market recovery and escalating new construction are good, supported by the industry's undeniable favorable long term demographics (only 13 years to the first baby boomers turning 80 years old!) and 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 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 2013 survey can be directed to:

Michael Boehm, MAI, CRE
Senior Living Valuation Services, Inc.
1458 Sutter Street
San Francisco, CA 94109
(415) 749-1387
Fax (415) 749-1487
Email: mboehm@slvsinc.com