SENIOR HOUSING INVESTMENT

S U R V E Y

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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 eleventh annual *Senior Housing Investment Survey* was sent to 275 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 23, 2004 cutoff date, 71 surveys or 25.8% of the total sent had been returned. Of the respondents, 47% represent market principals such as owner/operators or financial institutions/investors, a similar percentage compared with previous years.

Survey Results

Survey respondents were geographically dispersed throughout the country with a large majority of respondents having a national perspective. 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 slight difference between annual cash flow growth factors in revenue (3.4% average) and expense (3.2% average) projections. Both cash flow growth factors were slightly above projections of overall inflation (2.8% average). 42% 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 below the 66% from last year. Only 12% of respondents expected capitalization rates to increase up to 100 basis points in the next year (similar to the 13% from last year). A small 2% of the respondents expected capitalization rates to decrease more than 100 points in the next year. In one of the more significant results from this 2004 survey, a very high 40% of all respondents expected capitalization rates to decrease by up to 100 basis points in the next year (up from 19% last year). This expectation combined with lower reported 2004 capitalization rates for most senior housing property types as noted below, suggest an overall senior market rebounded from soft market conditions during the 2001 to 2003 period.

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 slightly below the average range of the other categories of senior housing types.

Highlights of the 2004 results include a material decreasing trend in overall capitalization rates for unlicensed congregate living, licensed assisted living, licensed Alzheimer/dementia care and even subacute skilled nursing facilities. Overall capitalization rates for age restricted apartments, conventional long term care nursing facilities and continuing care retirement communities were essentially flat to slightly higher. The trend of decreased capitalization rates was largest for unlicensed congregate living facilities, with a 70 basis point decline to an adjusted average capitalization rate of 9.7%. While indicated capitalization rates for licensed assisted living facilities decreased by 50 basis points to 10.8%, the capitalization rate gap between unlicensed congregate and licensed assisted living projects increased from 90 to 110 basis points. The gap between the overall capitalization rates of Alzheimer/dementia care facilities and long term care nursing facilities increased from 80 to 140 basis points. On balance, the downward trend in overall capitalization rates for most senior housing property types is palpable, with the notable exception being long term care nursing facilities.

Unlike overall capitalization rates, reported discount rates remained flat to slightly higher for most senior housing property types. One would expect capitalization rates and discount rates to move in tandem, but the 2004 survey

SENIOR LIVING VALUATION SERVICES, INC.
2004 SENIOR HOUSING INVESTMENT SURVEY

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

30%	Owner/Operator	27%	Appraiser
17%	Financial Institution/Investor	13%	Consultant
13%	Broker/Mortgage Banker		

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

18%	East	17%	West
7%	South	42%	National
16%	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	
0%-10%	3.4%	Revenues
0%-5%	3.2%	Expenses
0%-4%	2.8%	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):

2004		2003	2002
0%	Increase more than 100 basis points	2%	0%
12%	Increase 0 to 100 basis points	13%	29%
46%	Flat, no significant change	66%	71%
40%	Decrease 0 to 100 basis points	19%	5%
2%	Decrease more than 100 basis points	0%	0%

Overall Capitalization Rate

	2004 All Responses		2004 Adjusted Responses[1]		Basis Point Change from 2003
	Range	Average	Range	Average	
Age Restricted Apartments	7%-12%	9.0%	7.5%-11%	8.9%	0
Unlicensed Congregate Living	8%-12%	9.7%	8%-12%	9.7%	-70
Licensed Assisted Living	7%-13.5%	10.8%	9%-12.5%	10.8%	-50
Licensed Alzheimer/Dementia Care	8%-20%	11.6%	10%-13%	11.5%	-40
Licensed Skilled Nursing-Long Term Care	9%-20%	13.1%	11%-15%	12.9%	+20
Licensed Skilled Nursing-Subacute Care	9%-17.5%	13.5%	12%-15%	13.4%	-40
Continuing Care Retirement Community	8%-15%	11.3%	9%-13%	11.3%	+10

Internal Rate of Return (Discount Rate)

	2004 All Responses		2004 Adjusted Responses[1]		Basis Point Change from 2003
	Range	Average	Range	Average	
Age Restricted Apartments	9%-14%	10.4%	10%-12%	10.3%	-10
Unlicensed Congregate Living	9%-25%	12.9%	10%-14%	12.5%	+50
Licensed Assisted Living	10%-30%	14.7%	12%-18%	14.1%	0
Licensed Alzheimer/Dementia Care	10%-24%	15.5%	12%-19%	15.0%	+50
Licensed Skilled Nursing-Long Term Care	12%-25%	15.4%	13%-17%	15.5%	+10
Licensed Skilled Nursing-Subacute Care	12%-21.5%	15.9%	13.5%-18%	15.8%	-80
Continuing Care Retirement Community	10%-25%	14.4%	11.8%-18%	13.7%	+50

Equity Dividend Rate (Cash on Cash Return)

	2004 All Responses		2004 Adjusted Responses[1]		Basic Point Change from 2003
	Range	Average	Range	Average	
Age Restricted Apartments	8%-18%	12.8%	8%-18%	12.8%	0
Unlicensed Congregate Living	9%-20%	14.1%	9%-18%	14.2%	+50
Licensed Assisted Living	8%-25%	15.1%	10%-20%	14.9%	-100
Licensed Alzheimer/Dementia Care	8%-25%	15.9%	12%-22%	15.7%	-240
Licensed Skilled Nursing-Long Term Care	8%-30%	20.4%	12%-29%	20.6%	+100
Licensed Skilled Nursing-Subacute Care	10%-32%	20.5%	13%-30%	20.2%	-110
Continuing Care Retirement Community	9%-25%	15.7%	10%-20%	15.7%	-280

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

results indicate a widening of the spread between capitalization rates and discount rates for most senior housing property types. Because discount rates are essentially overall capitalization rates with inflation built in, this could reflect expectations of higher inflation. However, this may reflect varying interpretations and understanding of what a discount rate is and its relationship to capitalization rates, more than any actual market trend or expectation.

Equity dividend rates decreased for most senior housing property types, with the exceptions of unlicensed congregate living and long term care nursing facilities, which saw increases in equity dividend rates. This spread between equity rates of return between unlicensed congregate living facilities and licensed Alzheimer/dementia care projects and even continuing care retirement communities closed significantly.

Survey Relevance

2003/2004 has seen the clear reversal of industry trends of the past few years. From a period of uncertainty, market conditions and trends have noticeably improved for most senior housing property types. A greater number of adequately financed investors and buyers have targeted an essentially flat nationwide supply of properties resulting in decreased capitalization rates. If lower capitalization rate levels can be sustained, one would expect actual development of or pressure to develop new senior housing projects to become more numerous. The 2003/2004 period has seen the decreased availability of distressed senior housing properties, industry consolidation, increased demand for stable and larger senior housing projects, the increased presence of not-for-profit developers/owners/operators and an increased number of and highly visible sale leaseback transactions. These sale leaseback transactions can easily be mistaken for arms length sales but in reality and in most cases, represent a financing transaction wherein most "buyers" (lenders would be a more accurate description) do not have operating capability. This is especially true when the "seller" (borrowers would be a more accurate description) retain operational control of their project. Though admittedly different than a conventional lending transaction, a sale leaseback agreement in most cases, represents essentially a financing and not a sale transaction.

The availability of equity and debt financing for new or small senior housing developers or investors is still limited. New development activity remains isolated to specialty situations and markets with higher barriers to entry. Many markets in the country that were overbuilt during the late 1990's have become healthier as the growing senior household demand pool has approached equilibrium with a mostly constant supply. The number of markets that would be considered as overbuilt for senior housing has declined. Development and expansions of continuing care retirement communities have remained relatively strong into 2004 due to an atypical ability to attract below market rate tax exempt financing, historically low interest rates, an increased understanding or interest in this complex senior housing property type and the potential for higher returns. Age restricted apartments saw continued signs of a large scale emerging senior housing property type.

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, the spread between the cost of capital and expected property rates of returns, exposure to health care liability costs, 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 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.

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