# 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 23rd annual Senior Housing Investment Survey was sent to 340 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 22, 2017 cutoff date, 57 surveys or 17% of the total sent had been returned. Of the respondents, 34% 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. Geographic location did not appear to bias the survey results as responses were not materially different between differing portions of the country. Approximately 45% 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 (3.1% average) and expense (2.8% average) projections. Both cash flow growth factors were above projections of overall inflation (2.4% average).

55% 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 62% last year). No respondents expect capitalization rates to increase or decrease by over 100 basis points in the next year. No respondents expect capitalization rates to decrease up to 100 points in the next year (below the 5% of last year). 45% of respondents expect capitalization rates to increase up to 100 basis points in the next year (above the 33% from last year). The weighted average responses are expecting an increase in capitalization rates during the next year, similar to last year. No respondents expect cap rates to decrease in the next year.

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 2017 survey results include little change from 2016 in overall capitalization rates for all categories of senior housing. Although expectations are for higher cap rates, it appears that the increase has yet to happen in any significant way. Capitalization rates for all types of senior housing and care changed from 2016 to 2017 by only 0 to 30 basis points, an immaterial amount. The spread between the overall capitalization rates of unlicensed congregate living projects and licensed assisted living projects decreased slightly from 80 basis points in 2016 to 50 basis points in 2017. The cap rate spread between licensed assisted living and licensed memory care increased by a small 30 basis points from 2016 to 2017. The cap rate spread between long term nursing care and subacute nursing care decreased by only 10 basis points from 2016 to 2017.

## SENIOR LIVING VALUATION SERVICES, INC.
## 2017 SENIOR HOUSING INVESTMENT SURVEY

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

| | | | |
|---|---|---|---|
| 24% | Owner/Operator | 33% | Appraiser |
| 10% | Financial Institution/Investor | 3% | Consultant |
| 30% | Broker/Mortgage Banker | | |

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

| | | | |
|---|---|---|---|
| 15% | East | 21% | West |
| 9% | South | 45% | National |
| 10% | 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 | |
|---|---|---|
| 2%-5% | 3.1% | Revenues |
| 1.5%-5% | 2.8% | Expenses |
| 0%-3% | 2.4% | 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):

| 2017 | | 2016 | 2015 |
|---|---|---|---|
| 0% | Increase more than 100 basis points | 0% | 0% |
| 45% | Increase 0 to 100 basis points | 33% | 21% |
| 55% | Flat, no significant change | 62% | 62% |
| 0% | Decrease 0 to 100 basis points | 5% | 17% |
| 0% | Decrease more than 100 basis points | 0% | 0% |

## Overall Capitalization Rate

| | 2017 All Responses Range | 2017 All Responses Average | 2017 Adjusted Responses (1) Range | 2017 Adjusted Responses (1) Average | Basis Point Change from 2016 |
|---|---|---|---|---|---|
| Age Restricted Apartments | 5%-8% | 6.1% | 5%-7.5% | 6.0% | -30 |
| Unlicensed Congregate Living | 5.5%-8% | 6.8% | 6%-7.5% | 6.8% | 0 |
| Licensed Assisted Living | 6%-10% | 7.6% | 6.5%-8.3% | 7.3% | -30 |
| Licensed Memory Care | 6%-11% | 7.9% | 7%-9% | 7.9% | 0 |
| Licensed Skilled Nursing-Long Term Care | 8.5%-13% | 11.6% | 9%-13% | 11.7% | +30 |
| Licensed Skilled Nursing-Subacute Care | 8%-14% | 12.0% | 10%-13% | 12.0% | +20 |
| Continuing Care Retirement Community | 5%-11% | 8.8% | 7.5%-11% | 8.8% | 0 |

## Internal Rate of Return (Discount Rate)

| | 2017 All Responses Range | 2017 All Responses Average | 2017 Adjusted Responses (1) Range | 2017 Adjusted Responses (1) Average | Basis Point Change from 2016 |
|---|---|---|---|---|---|
| Age Restricted Apartments | 7%-16% | 8.9% | 7.5%-10% | 8.5% | +10 |
| Unlicensed Congregate Living | 8%-17% | 9.7% | 8.5%-10.5% | 9.2% | 0 |
| Licensed Assisted Living | 8.5%-21% | 10.9% | 9%-12% | 10.1% | -90 |
| Licensed Memory Care | 9%-17% | 11.0% | 9.5%-12% | 10.4% | -80 |
| Licensed Skilled Nursing-Long Term Care | 11%-15% | 13.5% | 12%-14.5% | 13.6% | -40 |
| Licensed Skilled Nursing-Subacute Care | 12%-16% | 14.2% | 14%-15% | 14.3% | -40 |
| Continuing Care Retirement Community | 10%-17% | 11.5% | 10%-12.8% | 11.0% | 0 |

## Equity Dividend Rate (Cash on Cash Return)

| | 2017 All Responses Range | 2017 All Responses Average | 2017 Adjusted Responses (1) Range | 2017 Adjusted Responses (1) Average | Basis Point Change from 2016 |
|---|---|---|---|---|---|
| Age Restricted Apartments | 6%-15% | 9.4% | 7%-12% | 9.2% | -20 |
| Unlicensed Congregate Living | 6.5%-15% | 10.2% | 7%-15% | 10.1% | +20 |
| Licensed Assisted Living | 6.5%-20% | 11.5% | 9%-17.5% | 11.3% | -30 |
| Licensed Memory Care | 7%-20% | 11.7% | 8%-17.5% | 11.4% | -20 |
| Licensed Skilled Nursing-Long Term Care | 10%-20% | 14.6% | 10%-20% | 14.6% | +20 |
| Licensed Skilled Nursing-Subacute Care | 10%-20% | 15.3% | 10%-20% | 15.3% | +30 |
| Continuing Care Retirement Community | 9%-20% | 12.0% | 9%-15% | 11.5% | -30 |

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

One of the more significant results of the 2017 survey was the decreasing difference between overall capitalization rates and discount rates for licensed assisted living and licensed memory care. The change in the spread between cap rates and discount rates for other types of senior housing was more modest. In our opinion, the relationship between the cap rates and discount rates reflected in the survey results in 2017 is more indicative of a market relationship, or that used by most appraisers. The indicated spread between cap rates and discount rates is slightly smaller than in the previous year and more consistent with 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 2017 also changed by immaterial amounts from 2016 for all types of senior housing. Equity dividend rate adjusted averages ranged from approximately 9.2% to 15.3%.

## Survey Relevance

2016/2017 saw continued active and healthy markets across the spectrum of senior housing and care with some indications of market saturation within the assisted living and memory care segments in some markets. Interest rates have increased during the past year but are still historically low. Expectations of higher overall interest rates appear to have influenced expectations of higher cap rates for senior housing. Though financing is available for new construction, REIT activity appears to have slowed, possibly due to the lesser number of attractive purchase opportunities. Nevertheless, larger and premium senior housing properties are still in high demand, achieving still historically low cap rates. New senior housing construction is still active for all types of senior housing and care including the emergence of developers with little previous experience in the industry. Overall prospects for continued industry strength and new construction are good, supported by undeniable favorable long term demographics (only 8 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. 

Inquiries, comments or requests of interested parties wanting to participate in the 2018 survey can be directed to:

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