

# SENIOR HOUSING INVESTMENT

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## S U R V E Y

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VOLUME 1

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.

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### Survey Methodology

The first annual *Senior Housing Investment Survey* was sent to 309 potential respondents including those with membership in various national senior housing associations and other parties involved in the senior housing industry and known to the editor. As of a April 10, 1994 cutoff date, 55 surveys or 17.8% 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, 62% represent market principals such as owner/operators or financial institutions/investors.

### 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. The respondents indicated a fairly tight range of

annual cash flow growth factors in revenue (3.4% average) and expense (3.5% average) projections. These cash flow growth factors equaled projections of general inflation (3.4% average). 61% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months. 12% of respondents expected cap rates to increase up to 100 basis points in the next year and 27% expected cap rates to decrease up to 100 points in the next year. These results suggest that the industry may be stabilizing from the recent two to three year trend of increasing cap rates, primarily due to a more difficult financing climate, overbuilt markets and the impact of the sale of distressed properties by the RTC/FDIC and other lenders.

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 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

**SENIOR LIVING VALUATION SERVICES, INC.  
1994 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>37%</u> Owner/Operator	<u>11%</u> Appraiser
<u>25%</u> Financial Institution/Investor	<u>6%</u> Consultant
<u>16%</u> Broker/Mortgage Banker	<u>5%</u> Other

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

<u>13%</u> East	<u>33%</u> West
<u>6%</u> South	<u>36%</u> National
<u>13%</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:

<b>Range</b>	<b>Average</b>	
<u>0%-5%</u>	<u>3.4%</u>	Revenues
<u>2%-5%</u>	<u>3.5%</u>	Expenses
<u>2.5%-5%</u>	<u>3.4%</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>0%</u>	Increase more than 100 basis points
<u>12%</u>	Increase 0 to 100 basis points
<u>61%</u>	Flat, no significant change
<u>27%</u>	Decrease 0 to 100 basis points
<u>0%</u>	Decrease more than 100 basis points

### Overall Capitalization Rate

	<u>All Responses</u>		<u>Adjusted Responses (1)</u>	
	Range	Average	Range	Average
Age Restricted Apartments	6%-13%	9.9%	8%-12%	10.0%
Unlicensed Congregate Living	9%-14%	11.5%	10.5%-13%	11.4%
Licensed Assisted Living	9%-16%	12.1%	10%-14%	12.1%
Licensed Skilled Nursing	9%-16%	13.0%	10%-15%	13.0%
Continuing Care Retirement Community	9%-15%	12.2%	10%-14.5%	12.1%

### Internal Rate of Return (Discount Rate)

	<u>All Responses</u>		<u>Adjusted Responses (1)</u>	
	Range	Average	Range	Average
Age Restricted Apartments	10%-100%	18.2%	11%-20%	13.6%
Unlicensed Congregate Living	12%-30%	15.2%	12%-20%	14.8%
Licensed Assisted Living	11%-28%	17.0%	12%-22%	15.4%
Licensed Skilled Nursing	11%-25%	17.0%	12%-20%	16.8%
Continuing Care Retirement Community	11%-20%	16.3%	12%-20%	16.3%

### Equity Dividend Rate (Cash on Cash Return)

	<u>All Responses</u>		<u>Adjusted Responses (1)</u>	
	Range	Average	Range	Average
Age Restricted Apartments	5%-30%	13.4%	7%-22%	12.8%
Unlicensed Congregate Living	5%-30%	14.8%	8%-24%	14.4%
Licensed Assisted Living	0%-30%	16.0%	7%-26%	16.1%
Licensed Skilled Nursing	12%-30%	17.8%	12%-26%	17.3%
Continuing Care Retirement Community	0%-30%	16.4%	10%-25%	16.7%

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

moves up the continuum of senior housing from age restricted apartments to unlicensed congregate facilities to licensed assisted living facilities to licensed 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).

The relationship of capitalization rate, discount rate and equity dividend rate averages are generally consistent with those seen in other more liquid property types. The indicated average spread between discount rates and overall capitalization rates is slightly larger than seen at other property types and slightly larger than would be expected given the indicated cash flow growth rate averages.

Surveys in future years will allow a more comprehensive tracking of trends and relationships in rates over a period of time.

### **Survey Relevance**

Several respondents and non-respondents have commented to the editor that the more traditional measures of analyzing real estate

such as capitalization, discount and return on equity rate analysis is not used or given little weight in their evaluation of senior housing investment decisions. They noted 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 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 investment decisions 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.

Inquiries, comments or requests of interested parties wanting to participate in the 1995 survey can be directed to:

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