

SENIOR HOUSING INVESTMENT

S U R V E Y

VOLUME 4

SENIOR LIVING VALUATION SERVICES, INC.

SPRING 1997

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 fourth annual *Senior Housing Investment Survey* was sent to 215 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 April 23, 1997 cutoff date, 68 surveys or 31.6% 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, 61% represent market principals such as owner/operators or financial institutions/investors, a higher percentage than in previous years.

For the first time, this year's survey segregates investment criteria used for the active alzheimer's/ dementia care senior housing niche.

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. More respondents this year identified themselves as having a national perspective than in previous years. The respondents indicated a fairly tight range of annual cash flow growth factors in revenue (3.6% average) and expense (3.3% average) projections. These cash flow growth factors generally equaled projections of overall inflation (3.2% average). 44% of all respondents noted that capitalization rates for senior housing properties in general are not expected to significantly change in the next 12 months. 37% of respondents expected cap rates to increase up to 100 basis points in the next year and 18% expected cap rates to decrease up to 100 points in the next year, almost the reverse of the prior year's survey results.

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.

**SENIOR LIVING VALUATION SERVICES, INC.
1997 SENIOR HOUSING INVESTMENT SURVEY**

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

<u>26%</u>	Owner/Operator	<u>16%</u>	Appraiser
<u>35%</u>	Financial/Institution/Investor	<u>6%</u>	Consultant
<u>17%</u>	Broker/Mortgage Banker		

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

<u>13%</u>	East	<u>23%</u>	West
<u>11%</u>	South	<u>46%</u>	National
<u>7%</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>2%-5%</u>	<u>3.6%</u>	Revenues
<u>2%-5%</u>	<u>3.3%</u>	Expenses
<u>2%-4%</u>	<u>3.2%</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>1997</u>		<u>1996</u>	<u>1995</u>
<u>1%</u>	Increase more than 100 basis points	<u>0%</u>	<u>3%</u>
<u>37%</u>	Increase 0 to 100 basis points	<u>12%</u>	<u>13%</u>
<u>44%</u>	Flat, no significant change	<u>49%</u>	<u>50%</u>
<u>18%</u>	Decrease 0 to 100 basis points	<u>37%</u>	<u>31%</u>
<u>0%</u>	Decrease more than 100 basis points	<u>2%</u>	<u>3%</u>

Overall Capitalization Rate

	1997		1997		Basis Point Change from 1996
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	8.5%-12%	9.8%	8.75%-11%	9.7%	-20
Unlicensed Congregate Living	9%-14%	10.4%	9.75%-12%	10.3%	-30
Licensed Assisted Living	9.5%-13%	11.1%	10%-12%	11.1%	-10
Licensed Alzheimer/Dementia Care	9%-14%	11.2%	10%-13%	11.2%	N/A
Licensed Skilled Nursing-Long Term Care	10%-16%	12.8%	11%-15%	12.8%	-10
Licensed Skilled Nursing-Subacute Care	10.5%-25%	13.4%	11.5%-15%	13.4%	-30
Continuing Care Retirement Community	10%-14%	11.6%	10%-13%	11.6%	-10

Internal Rate of Return (Discount Rate)

	1997		1997		Basis Point Change from 1996
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	11%-25%	12.8%	11%-13%	12.0%	-150
Unlicensed Congregate Living	11%-25%	13.8%	11.5%-20%	13.4%	-60
Licensed Assisted Living	10%-30%	15.2%	11%-20%	14.8%	-20
Licensed Alzheimer/Dementia Care	10%-30%	14.7%	12%-20%	14.1%	N/A
Licensed Skilled Nursing-Long Term Care	11%-20%	14.3%	13%-16%	14.5%	-50
Licensed Skilled Nursing-Subacute Care	11.5%-18%	15.0%	13%-16%	15.0%	-120
Continuing Care Retirement Community	11%-20%	14.2%	12%-15%	14.1%	-40

Equity Dividend Rate (Cash on Cash Return)

	1997		1997		Basis Point Change from 1996
	All Responses		Adjusted Responses ⁽¹⁾		
	Range	Average	Range	Average	
Age Restricted Apartments	8%-20%	11.9%	9.5%-15%	11.7%	+100
Unlicensed Congregate Living	8%-20%	14.1%	10%-17.5%	14.3%	-20
Licensed Assisted Living	9%-35%	16.7%	10.5%-20%	16.2%	-30
Licensed Alzheimer/Dementia Care	9%-25%	15.6%	12%-24%	15.7%	N/A
Licensed Skilled Nursing-Long Term Care	11%-20%	14.3%	13%-16%	14.5%	-370
Licensed Skilled Nursing-Subacute Care	10%-30%	16.9%	14%-20%	17.0%	-320
Continuing Care Retirement Community	10%-25%	17.5%	11%-20%	14.2%	-230

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

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). Alzheimer/dementia care capitalization rates were almost equal to and slightly above conventional assisted living capitalization rates. Equity rates of return were higher for Alzheimer/dementia care than for conventional assisted living.

The 1997 survey results confirm the anecdotal impression of continued declines in capitalization rates for most senior housing property types, although the rate of decline is less than in previous years. Changes in discount rates were positively correlated to and even deeper than declines in capitalization rates. An interesting result in the survey is the significant decline in equity rates of return for almost all senior property types. This may reflect a current focus on expansion of market share over short term rates of return.

Survey Relevance

1996/1997 saw the intensification of trends which had begun over the prior 12 to 18 months as most geographic markets and senior housing property types could be considered active. Liquidity in the debt and capital markets continue to feed the current activity. Indications that the market overall may be at or approaching the peak of this real estate cycle include greater concern about overbuilding in the more attractive geographic market areas, sale prices of im-

proved properties equalling and sometimes exceeding replacement cost and the emergence of less experienced senior housing developers.

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 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 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 1998 survey can be directed to:

Michael Boehm, MAI

Senior Living Valuation Services, Inc.

50 Pacific Avenue

San Francisco, CA 94111

(415) 788-4295

Fax: (415) 788-4299