SeniorsHousing

RESEARCH REPORT

Marcus & Millichap

First Half 2010

Seniors Housing Grapples with Impact of Healthcare Reform

The Community Living Assistance Services and Supports (CLASS) Act, part of the federal government's sweeping healthcare reform legislation, will likely have a significant impact on the seniors housing sector. This portion of the bill will set up government-sponsored, long-term care insurance, which could revalue skilled nursing communities across the country over the next several years. Users of government-sponsored healthcare will be automatically enrolled in the program, though the high cost will likely drive many to opt out shortly after implementation. Consequently, premiums will fall short of benefits paid out after the five-year vesting period, leading to further stress on Medicaid and reduced payouts under the current system. Since most of the value in skilled nursing facilities relates to the profitability of the business and not its physical site, any decrease in Medicaid payouts will lower the value of the business. This trend will wedge a divide between new, state-of-the-art facilities that cater to Medicare and private-pay users and older communities that depend on Medicaid supplements.

While the CLASS Act will likely impair operations at some skilled nursing properties, assisted living units may benefit from the legislation. Projected reimbursements will be at least $50 per day, helping pay for the less expensive living arrangement. Anyone enrolled, vested and needing support for at least two activities of daily living can opt for home healthcare or assisted living properties, rather than skilled nursing beds. With approximately half of the cost of assisted living covered, more seniors will stay in these facilities longer. The resulting evolution in the census at skilled nursing facilities will cut further into margins as residents with more challenges move into beds later and the cost of care escalates. Over the next 10 years, these changes will encourage developers to build CCRCs with larger assisted living components to stay solvent. A severe shortage of skilled nursing facilities will emerge as margins fall, requiring additional government intervention to spur development and supplement the high cost of care.

Seniors Housing Market Highlights[1]

Occupancy down 70 basis points

Independent Living (IL): Occupancy in the IL segment is expected to fall to 87.5 percent this year, down 70 basis points from year-end 2009. Average rents are forecast to finish 2010 at $2,668 per month, an annual climb of 0.9 percent.

Occupancy down 50 basis points

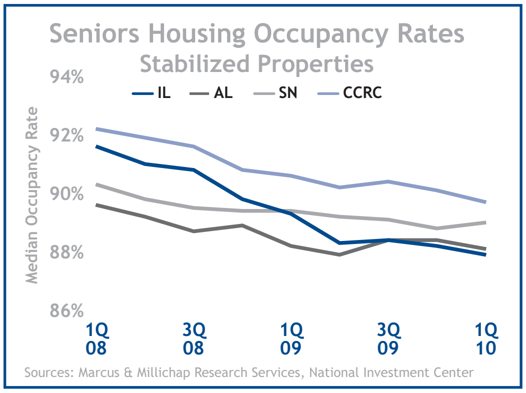
Assisted Living (AL): The AL sector is projected to post a 50 basis point occupancy decrease to 87.9 percent in 2010, while average rents will reach $3,565 per month, a rise of 1.2 percent from last year.

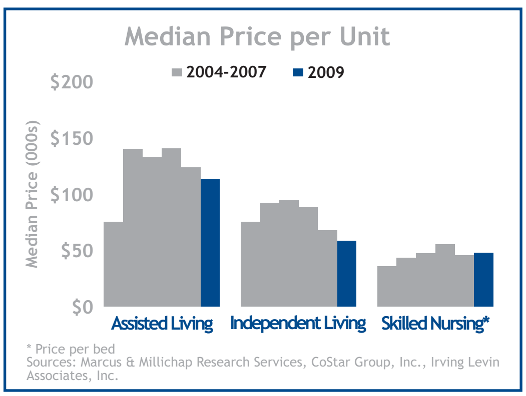
Occupancy up 100 basis points

Skilled Nursing (SN): Positive absorption in the SN arena will push occupancy to 89.8 percent this year, 100 basis points higher than at the close of 2009. Average per-diem revenue will end 2010 at $266 per occupied bed, an annual gain of 3.5 percent.

Occupancy down 60 basis points

Continuing Care Retirement Communities (CCRCs): Occupancy in CCRCs is forecast to slide 60 basis points to 89.5 percent in 2010.





Independent Living Facilities (IL)

Properties comprised mostly of independent living units currently operate in a challenging environment and will continue to face headwinds through the end of the year before stabilizing in 2011. Demand for IL facilities has retreated as seniors who delayed moving during the recession now transition into higher-cost assisted living units. A struggling housing market and intense competition from substitute goods, however, such as condos available at fire-sale prices, have kept absorption by new users from gaining traction. As a result, occupancy rates have slipped 140 basis points to 87.9 percent in the past 12 months and have declined nearly 500 basis points since the cyclical peak. Only six major metros have posted an increase in occupancy during the last year, primarily areas where barriers to entry remain significant, including New York City and San Francisco/Oakland. Despite the weakness, rents continue to rise, albeit at a modest pace. Year over year, the average monthly rent gained 1.5 percent to $2,672, according to industry-tracker NIC MAP. By year end, rents will settle at $2,668 per month, an annual increase of 0.9 percent, while occupancy will slip to 87.5 percent.

Limited buyer interest in IL properties has made it challenging to determine prices and yields. In 2009, IL buildings traded at $58,400 per unit, down 14 percent from the previous year and a significant correction from 2006, when prices reached nearly $100,000 per unit. A lack of crossover demand from multifamily investors has fueled much of the reduction in sales velocity, as buyers were far more active in the seniors housing market when commercial real estate was climbing. In the coming months, however, few investors outside of the traditional seniors housing buying pool will venture into the market, due mostly to ambiguity surrounding the new healthcare legislation. Although the IL segment will be least affected by the measure, many investors will target more familiar assets such as apartments. Moreover, as seniors housing buyers continue to shy away from IL properties until a pricing floor emerges, average cap rates, currently near 9 percent, will rise further to attract bids.

Assisted Living Facilities (AL)

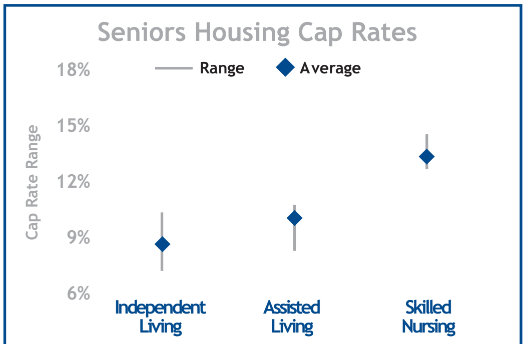
Operators of assisted living facilities may benefit the most from government-backed healthcare, though the impact of the new legislation on the sector remains speculative and distant. Over the past year, fundamentals have begun to stabilize, and most metro areas have posted improvements in occupancy as seniors transition into more costly assisted living units from IL complexes. Florida markets, in particular, have performed well, accounting for half of the top six markets with occupancy gains. Nationwide, occupancy rates dropped just 10 basis points year over year to 88.1 percent in the first quarter, per NIC MAP. Average rents, meanwhile, have risen 1.4 percent from one year ago to $3,553 per month.

The investment market began to improve late last year, and velocity could climb again in 2010 as REITs re-enter acquisition mode. Many REITs remain awash with cash, and market capitalization for most major players has increased to at least triple their 52-week lows. Most of the deals executed in recent months involved Sunwest properties, though Blackstone recently purchased the remaining assets in that pipeline for $1.3 billion. As a result, other sellers may emerge in the coming months to capitalize on initial yields starting in the 10 percent range and eager institutional buyers.

Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 1Q 2010, www.nicmap.org

Skilled Nursing Facilities (SN)

The recently enacted healthcare legislation will impact the skilled nursing segment most significantly, and government intervention on health insurance could revalue SN facilities over the next several years. SN operating conditions have exceeded expectations, however, with occupancy dipping just 40 basis points in the past year to 89 percent in the first quarter. In the year's opening period, occupancy climbed 20 basis points, marking the first quarterly rise since early 2007, according to NIC MAP. As occupancy reversed trend, owners recorded accelerated per-occupied-bed rent growth for the first time in more than two years; over the past 12 months, the average per-diem revenue increased 3.3 percent to $260 per occupied bed in the first quarter. Through the end of 2010, both occupancy and revenue should post improvements as demand intensifies due to family members returning to work and no longer being available to help with care. Occupancy is forecast to close the year at 89.8 percent, up 100 basis points from 2009, while the average daily revenue will inch up 3.5 percent to $266 per occupied bed.

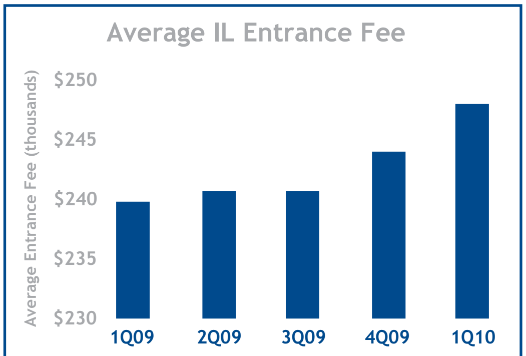


Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Irving Levin Associates, Inc.

Investment activity and prices have been most resilient for SN facilities through the recession. SN prices rose to $47,500 per bed last year, an annual gain of 4 percent and a level last reached in 2006, placing the segment ahead of other seniors housing property types in the recovery. SN prices never advanced at the pace of other commercial real estate offerings, however, and the business operations at a facility remain the primary factor when determining value. As the Medicaid cuts outlined in the Patient Protection and Affordable Care Act take effect, SN investment trends will diverge even further. Currently, 65 percent of the revenue generated by SN facilities originates from Medicaid, and 15 percent comes from Medicare. Reduced funding will make older Medicaid-focused facilities more difficult for sellers to move going forward. Conversely, facilities with a strong census of private-pay and Medicare patients will command top dollar when brought to market, as operators typically prefer these residents.

Continuing Care Retirement Communities (CCRCs)

The recession has caused CCRCs to struggle, though softness remains on par with the overall seniors housing market. In the past year, occupancy in the sector has decreased 90 basis points to 89.7 percent. Weakness was pronounced in the last six months, when occupancy sank 70 basis points. Economic turmoil and the troubled stock market have impacted entrance-fee CCRCs, in particular, as some potential residents have been hesitant to alter their liquidity standings. Occupancy in the segment averaged 89.6 percent in the first quarter, while rental CCRCs had a modestly better occupancy rate of 89.7 percent. Nonetheless, average IL entrance fees climbed 1.6 percent in the first quarter to $247,900. Despite near-term weakness, developers continue to favor the entrance-fee model, as more than twice as many new units/beds are under construction in the segment than in rental CCRCs.



Sources: Marcus & Millichap Research Services, NIC MAP

The investment market for CCRCs remains very soft, and few deals closed in 2009. Transaction velocity fell by nearly 50 percent, though the number of properties that will change hands in 2010 should outpace the rate registered last year, indicative of buyers returning to the market. The median price per unit/bed was nearly $40,000 in 2009, down significantly from the previous year. As the segment grows in popularity, especially given the reduced risk of owning a range of seniors housing property types, more investors will transition into CCRCs.

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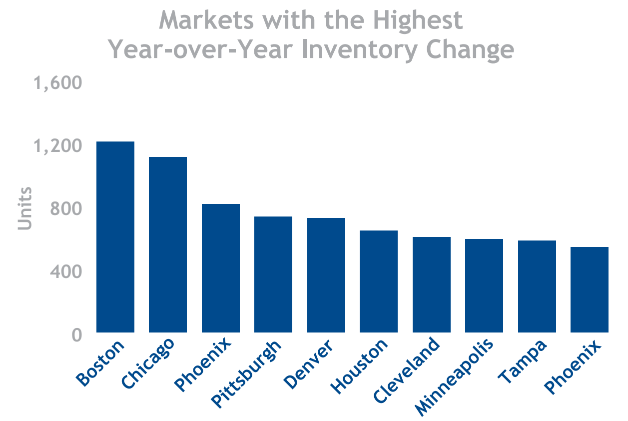

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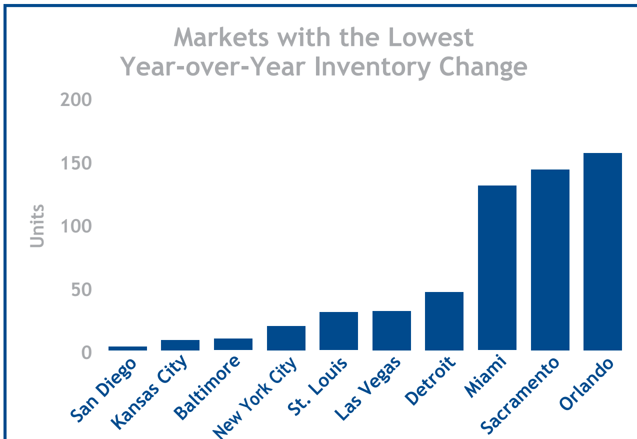

Sources: Marcus & Millichap Research Services, NIC MAP

Metro Occupancy Ranking*

Rank	Metro, State	IL Occupancy	Y-O-Y Basis Point Change	AL Occupancy	Basis Point Change
1	Minneapolis, MN	94.3%	10	93.1%	80
2	Baltimore, MD	93.9%	40	87.5%	-10
3	San Jose, CA	92.2%	-290	85.2%	180
4	San Francisco, CA	91.3%	100	86.2%	30
5	Pittsburgh, PA	90.8%	-440	92.4%	90
6	New York, NY	90.3%	40	93.5%	150
7	Los Angeles, CA	89.8%	-90	84.6%	-160
8	Boston, MA	89.7%	-160	92.2%	-80
9	San Antonio, TX	89.7%	-400	90.0%	-110
10	Philadelphia, PA	89.5%	-130	87.8%	-60
11	Washington, DC	89.4%	-380	90.5%	30
12	Atlanta, GA	88.8%	-10	83.4%	-310
13	Sacramento, CA	88.1%	-170	86.3%	130
14	St. Louis, MO	88.0%	-160	84.9%	-300
15	Phoenix, AZ	87.8%	-20	86.9%	-30
16	Detroit, MI	87.3%	-70	83.5%	-20
17	Chicago, IL	86.7%	-30	81.5%	-420
18	Cleveland, OH	86.7%	-40	88.3%	60
19	San Diego, CA	86.7%	-200	86.0%	250
20	Tampa, FL	86.7%	-180	92.2%	290
21	Cincinnati, OH	86.2%	-380	94.1%	520
22	Orlando, FL	86.2%	90	91.9%	210
23	Miami, FL	85.7%	-250	88.8%	380
24	Riverside, CA	85.7%	-30	88.2%	260
25	Seattle, WA	85.6%	-170	87.2%	60
26	Portland, OR	85.5%	-410	88.8%	-50
27	Dallas, TX	84.4%	-160	85.6%	-60
28	Houston, TX	84.0%	-340	87.3%	-430
29	Kansas City, MO	83.9%	-80	86.1%	150
30	Denver, CO	83.5%	-130	88.1%	-280
31	Las Vegas, NV	82.6%	100	85.4%	-10

Marcus & Millichap
NATIONAL SENIORS HOUSING GROUP

Gary Lucas
Managing Director
glucas@marcusmillichap.com
750 Battery Street, Fifth Floor
San Francisco, California 94111
Tel: (415) 391-9220

Marcus & Millichap
Real Estate Investment Services

Edited and prepared by
Stephen Hovland
Market Analyst
Research Services

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