SeniorsHousing
RESEARCH REPORT

Marcus & Millichap

First Half 2008

Seniors Housing Extending Offerings to Grow Revenue

The long-term outlook for the seniors housing market remains favorable, despite mixed fundamentals anticipated for this year. While revenue growth will remain strong, occupancy is expected to inch lower due to new construction, especially in the western and southwestern areas of the country. Along the Atlantic seaboard, limited available land, high construction costs and strict Certificate of Need standards will restrict development, keeping occupancy relatively stable and supporting healthy revenue growth. In the West, where construction is more active, owners are realizing revenue gains by offering increased amenities. As a greater number of people enters retirement with more wealth accumulated than any previous generation, seniors housing owners are attempting to maximize revenue by offering premium services and environments. Further development of Continuing Care Retirement Communities will also remain prevalent, offering potential residents lifetime care in a variety of seniors housing facilities, depending upon need.

The investment climate for seniors housing assets will remain favorable through the end of this year, though velocity is expected to maintain the slower pace recorded during the final two quarters of 2007. Assisted Living facilities, where resident demand will be supported by tighter state and private budgets due to the economic slowdown, will make up the largest portion of listings. Average cap rates across most sectors, including Assisted Living, are anticipated to edge higher due to tighter lending standards and an elevated risk of rate cuts from Medicare and Medicaid. As such, prices have likely peaked in the near term, and sellers will have to reconsider valuations to narrow the expectations gap. Although health care real estate is generally perceived as safe during an economic downturn, a significant amount of crossover from investors in alternative products is not anticipated. Cap rates are attractive, though few Independent Living deals are expected to hit the market, and Skilled Nursing transactions will be dominated by value-add owner-users. Nonetheless, seniors housing continues to become a more complex asset class that will garner investor attention as the baby boomer population ages.

Seniors Housing Market Highlights[1]

7.8% Cap Rate
Up 20
Basis Points
4Q06 - 4Q07

Independent Living (IL): Due to elevated construction activity, occupancy in the IL sector finished 2007 at 95.3 percent, down 120 basis points from the same period one year ago. As occupancy rates receded, revenue growth eased to 2.2 percent, or $2,390 per unit per month.

8.5% Cap Rate
Up 40
Basis Points
4Q06 - 4Q07

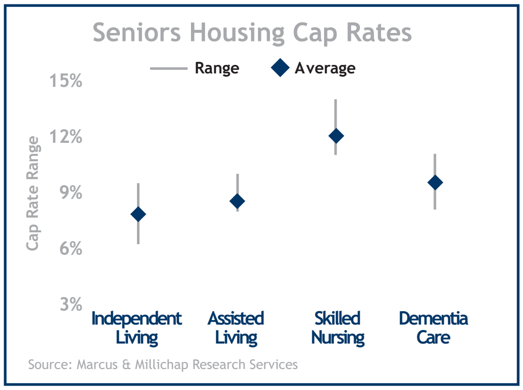
Assisted Living (AL): AL construction activity accelerated during the final two quarters of 2007, resulting in occupancy falling to 95 percent, a year-over-year drop of 70 basis points. Despite the decline, fundamentals remained strong enough for owners to realize a 3.7 percent rise in revenue to $3,435 per unit per month.

12.0% Cap Rate
Down 50
Basis Points
4Q06 - 4Q07

Skilled Nursing (SN): Development in the SN sector kept pace with demand in 2007, resulting in a modest 10 basis point decrease in occupancy to 93.8 percent. Average daily revenue, however, climbed a robust 7.4 percent to $219 per bed.

9.5% Cap Rate
Up 40
Basis Points
4Q06 - 4Q07

Dementia Care (DC): Despite a 30 basis point decline in occupancy last year, DC facilities boasted a 96.4 percent occupancy rate, the highest in the seniors housing sector. Over the past 12 months, revenue increased 3.6 percent to $5,214 per month.



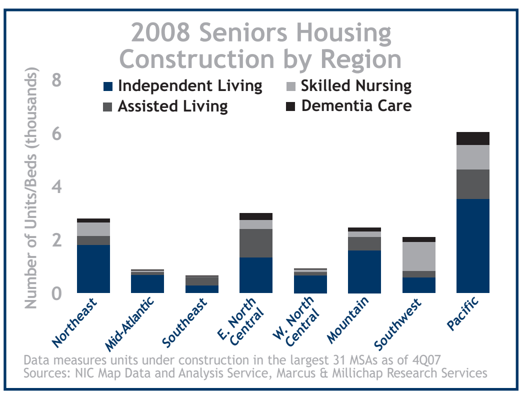
Independent Living Facilities

According to NIC MAP, occupancy levels in Independent Living (IL) facilities have fallen 120 basis points over the past year, to 95.3 percent in response to a spike in new construction. A large number of deliveries last year came online in the Southeast region, where occupancy decreased 290 basis points to 94.6 percent. Construction activity in the area has abated, however, and occupancy rates are expected to climb in the coming quarters. Elsewhere, development activity is still high, especially in the Pacific region, where 3,500 units are under way. As projects are completed, occupancy is forecast to continue to decrease in the short term. Revenue growth has eased to 2.2 percent, or $2,390 per occupied unit per month, in the last year. Going forward, revenue growth will remain modest in 2008 as existing facilities compete with new space for residents, especially in high-development areas such as the Pacific region.

Investor sentiment for IL facilities is expected to remain healthy this year, as velocity reached a more sustainable pace during the final six months of 2007. Limited access to capital is keeping some private buyers on the sidelines, and few properties that are easily financed are likely to be listed. Average cap rates have hovered in the 8-percent range, though some upward pressure is anticipated in response to tighter lending guidelines. While high-end properties will continue to garner attention from institutions, competition from foreign buyers is expected to develop due to the current favorable exchange rate climate.

Assisted Living Facilities

Assisted Living (AL) facilities have posted mixed fundamentals over the past 12 months, as new additions to supply have pushed occupancy down 70 basis points to 95 percent, according to NIC MAP. Most of the new construction came online in the last two quarters, when occupancy fell 50 basis points. In the Southwest region, particularly in Arizona and Nevada where building costs are reduced due to the availability of land, new developments have decreased occupancy 320 basis points to 95.2 percent over the past year, still higher than the national rate. Nevertheless, area owners realized a 4.2 percent increase in the average monthly revenue to $3,126 per unit, due to the higher mix of top-tier properties; nationally, average revenues climbed 3.7 percent to $3,435 per unit per month. As owners upgrade facilities to attract residents with large retirement savings in the form of 401(k)s and pensions, average monthly revenues will push higher.



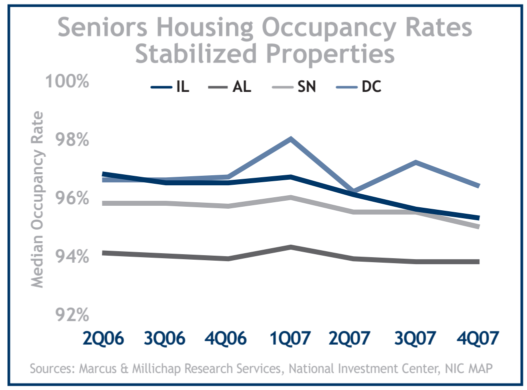
Transaction velocity for AL facilities has been the strongest of the seniors housing segments over the last year. During that period, the median sales price was $135,000 per unit, down slightly from the previous year, as fewer high-end assets changed hands. Cap rates in the sector, meanwhile, averaged in the mid-8 percent range, though high-end assets traded at cap rates in the high-6 percent range and were targeted by cash-heavy institutions. Older, smaller properties, on the other hand, sold at cap rates in the high-9 percent range, and deal flow centered around owner-users seeking value-add assets. Going forward, buyers may want to target AL assets in states with diversion programs. As budgets wane due to lower property and sales tax collections, some states that utilize AL facilities in conjunction with SN properties are expected to refer residents to AL units to maintain costs. Private-pay users are also expected to be more hesitant to move into SN facilities as economic woes limit family incomes.

[1]*Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 4Q 2007, www.nicmap.org*

Skilled Nursing Care Facilities

Fundamentals in the Skilled Nursing (SN) sector remained relatively steady last year as supply and demand remained near equilibrium. Occupancy ticked down 10 basis points in 2007 to 93.8 percent, according to NIC MAP. An aging population and state governments with stringent Certificate of Need standards in the Northeast region, supported the highest occupancy rates in the country at 96.5 percent. The nation's lowest occupancy rate last year was 86.7 percent in the Southwest, where the population is relatively young and new building faces fewer hurdles from government regulations or construction costs. Elevated development in the region resulted in a 160 basis point decline in occupancy during the last 12 months. Nationally, owners were able to raise average per-diem revenue 7.4 percent to $219 per occupied bed due to healthy demand. In the Northeast region, average revenue climbed 5.4 percent to a national high of $291 per occupied bed per day as occupancy improved.

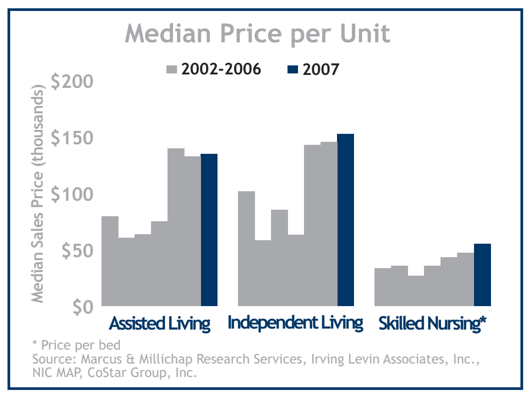
On the investment side, buyer demand for SN facilities has been healthy over the past 12 months, though velocity has trailed off in the wake of the credit crunch. Average cap rates, however, pushed down 50 basis points into the 12 percent range. Much of the decline is attributed to a shift in investor focus to higher-end assets, which changed hands as cash-heavy institutional buyers expanded their portfolios. Going forward, upward pressure on cap rates is expected due to elevated risk factors, including a higher cost of capital. In addition, potential rate cuts to Medicare and Medicaid could emerge, as states now face significant budget deficits resulting from declining property and sales tax revenues during the economic slowdown and national housing downturn. Government cuts, representing 80 percent of payors, could potentially trim owners' revenues in the short term or keep residents in AL facilities for a longer period.



Dementia Care Facilities

Dementia Care (DC) represents an emerging asset class in the seniors housing sector, with a greater number of facilities rising as stand-alone properties. DC facilities specialize in neurodegenerative conditions, including Alzheimer's and ALS. The prevalence of neurodegenerative diseases is expanding in the population as life expectancy lengthens and health care providers improve treatment for conditions that generally appear earlier, such as heart disease and cancer. With demand escalating, developers have ramped up construction. NIC MAP data shows that 1,380 units are currently under way, a 25 percent increase from the same period one year ago. The addition of new units will put downward pressure on occupancy in 2008, following a decrease of 30 basis points to 96.4 percent last year. While occupancy may tick lower, newly developed units designed specifically for dementia patients are commanding premium rates, which will increase revenues further. In 2007, owners realized a 3.6 percent gain in the average monthly revenue to $5,214 per unit.

Investment activity in the relatively small DC sector will remain modest due to the limited number of listed properties expected this year. Currently, 83 percent of DC properties are owned by for-profit organizations, according to NIC MAP, including 55 percent by chains that are unlikely to shed assets in 2008. Assets that do trade are anticipated to change hands at cap rates between 8 percent and 11 percent, with an average in the mid-9 percent range. Cap rates are expected to remain stable in the coming months, since nearly all properties that trade are relatively new.



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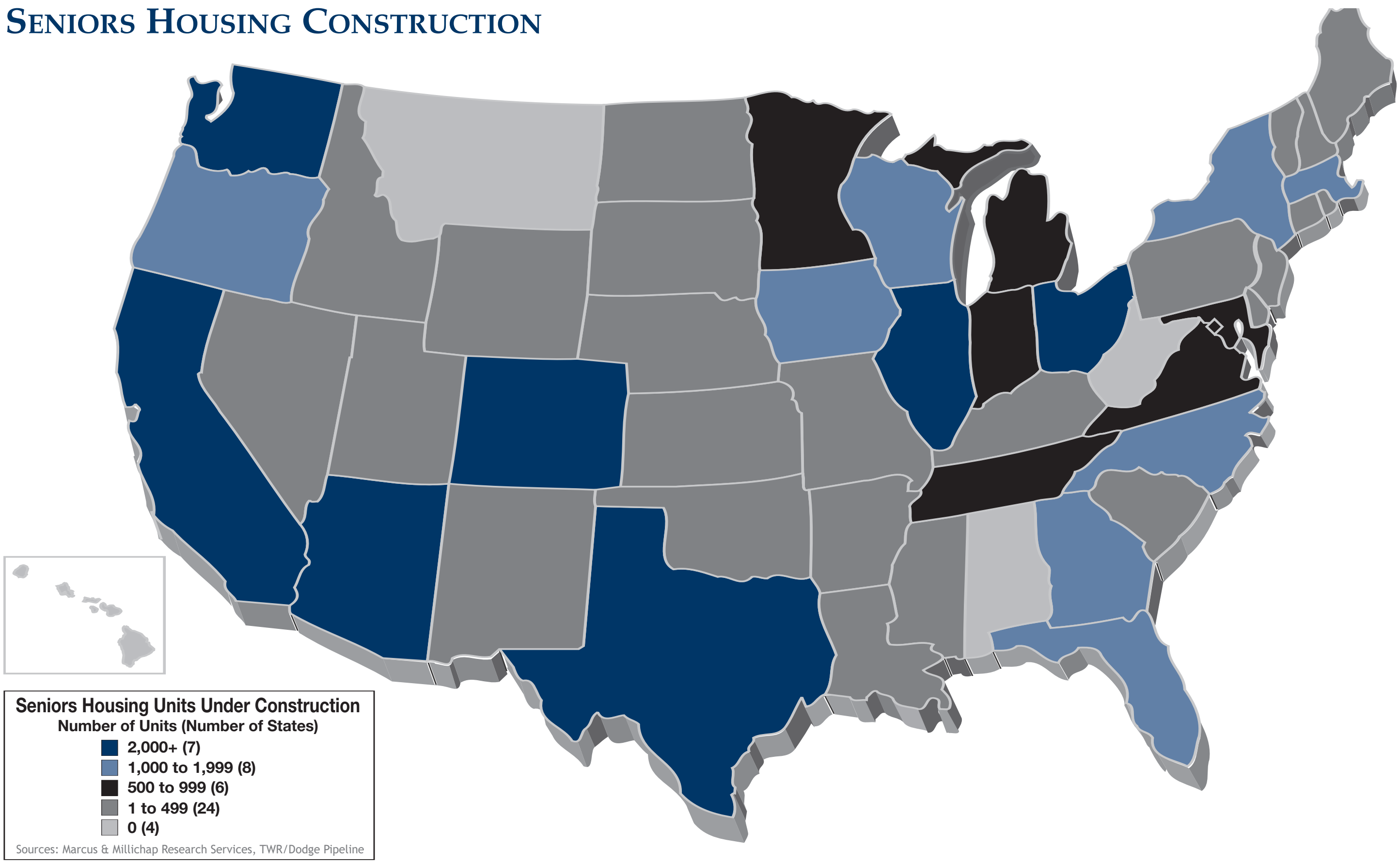
Seniors Housing Construction



Recent Sales Highlights

Property Type	Property Name	City	State	Sales Price	No. of Units/Beds*	Price per Unit/Bed*
SN	Erwin Garden	Durham	NC	$4,300,000	125	$34,400
AL	The Chateau at Lawnwood	Fort Pierce	FL	$7,550,000	58	$130,172
AL	Lighthouse Inn North	Pompano Beach	FL	$2,800,000	25	$112,000
AL	Lighthouse Inn South	Pompano Beach	FL	$2,050,000	19	$107,894
AL	Shepherd House	Chapel Hill	NC	$4,511,366	77	$58,589
AL	Edgewater Manor	Clearwater	FL	$1,825,000	24	$76,041
AL	A Loving Care Inn	Hollywood	FL	$2,555,000	34	$75,147
AL	Bethesda at Longwood	Longwood	FL	$5,000,000	80	$62,500
SN	Gordon Oaks Retirement Community	Mobile	AL	$20,500,000	279	$73,477
SN	McAllister Nursing Home	Country Club Hills	IL	$4,600,000	111	$41,441
SN	Pavilion of Waukegan II	Waukegan	IL	$3,725,425	109	$34,178
SN	Freeport Manor Nursing Center	Freeport	IL	$4,020,539	122	$32,955
SN	Marigold Health Care Center	Galesburg	IL	$5,612,952	172	$32,633
SN	St. Elizabeth Care Center	St. Elizabeth	MO	$1,800,000	63	$28,571
SN	Hillsboro Healthcare Center	Hillsboro	IL	$3,009,237	110	$27,356
SN	Sunshine Manor Nursing Center	Carlinville	IL	$2,400,000	94	$25,531
SN	Polo Rehabilitation & Health Care Center	Polo	IL	$1,508,304	77	$19,588
AL	Dogwood Inn	Bonifay	FL	$195,000	21	$9,285

* Number and price per bed apply to sales of SN facilities

AL = Assisted Living IL = Independent Living CC = Congregate Care SN = Skilled Nursing

Marcus & Millichap
Real Estate Investment Services

Edited and prepared by
Stephen Hovland
Market Analyst
2398 E. Camelback Road, Suite 550
Phoenix, Arizona 85016
Tel: (602) 952-9669
shovland@marcusmillichap.com

Marcus & Millichap
NATIONAL SENIORS HOUSING GROUP
Gary Lucas
Managing Director
750 Battery Street, Fifth Floor
San Francisco, California 94111
Tel: (415) 391-9220
glucas@marcusmillichap.com

Sources: NIC Map Data and Analysis Service (www.nicmap.org), Marcus & Millichap Research Services, American Health Care Association, American Legislative Exchange Council, American Retirement Corp., American Seniors Housing Association, Assisted Living Federation of America, Capital Senior Living Corp., CoStar Group, Inc., Council for Affordable Health Insurance, Eli Research, Irving Levin Associates, Property & Portfolio Research (PPR), Ziegler Capital Markets Group.

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