

# Seniors Housing

## RESEARCH REPORT

Marcus & Millichap

First Half 2011

## HARDEST-HIT SENIORS HOUSING SECTORS TURNING THE CORNER

An expanding U.S. economy will restore several facets of seniors housing demand, while another year of subdued construction tempers supply concerns, paving the way for a modest recovery during 2011. Already, the sector shows signs of being in the initial phase of a durable recovery. The resumption of job creation has begun to restore healthcare benefits for Americans, for instance, enabling the re-employed to move ahead with procedures requiring rehabilitative services in skilled nursing facilities. Seniors housing property groups closely tied with the housing market, meanwhile, such as independent living facilities and CCRCs also have begun to stabilize, despite headwinds in the residential sector. Home prices continue to fall, but the rate of decline has moderated drastically, making sales decisions palatable for seniors to transition into retirement communities. Nonetheless, a full upturn in seniors housing remains a few quarters out, and the speed of a revival will hinge on regulatory actions and an upturn in the housing market. With the pace of supply growth to remain muted, however, the sector will trend toward recovery, supporting across the board rent growth.

With healthcare-oriented real estate operations stabilizing, and growing share of baby boomers on the brink retirement, cash-rich REITs are back in the marketplace and driving seniors housing sales activity. Healthcare REITs, whose stock prices have been rising, accounted for more than 90 percent of the sector's buyer composition early this year, bidding up prices for Class A facilities. As such, direct cap rates for desirable properties have dipped from year-ago levels. To be sure, the dominance of REIT transactions stems from large portfolio buyouts, not the purchase of single properties. Still, investor demand for single modernized facilities will remain high, and with this year's building pipeline to remain light, quality assets brought to market will receive multiple offers. These trends could squeeze private-equity buyers out of the top-tier arena, but overall closings should gain steam in 2011 as more investors, betting on a strong recovery, buy discounted properties ahead of further operational improvements.

### SENIORS HOUSING MARKET HIGHLIGHTS<sup>1</sup>



**Independent Living (IL):** During 2011, occupancy in the IL sector will improve 80 basis points to 88.1 percent, supporting a 1.1 percent increase in rents to \$2,678 per month.



**Assisted Living (AL):** AL operations will hold relatively steady, but a modest rise in completions will lower the occupancy rate 40 basis points to 88 percent this year. As operators compete for residents, rent growth will ease to just 0.8 percent to \$3,543 per month.



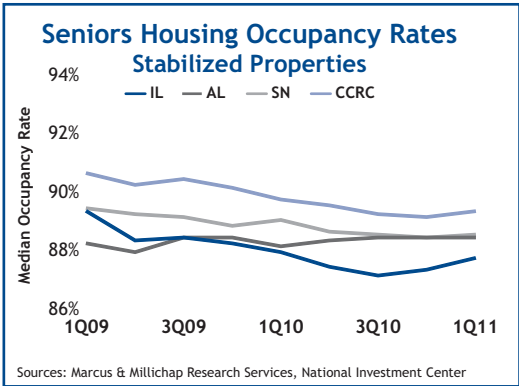
**Skilled Nursing (SN):** This year, renewed job growth will increase rehab facility visits, resulting in a 50 basis point increase in SN occupancy to 88.9 percent. Average daily revenues will advance 3.2 percent to \$274 per occupied bed per day.



**Continuing Care Retirement Communities (CCRCs):** Decelerating stock additions and moderating home price reductions, which are likely to increase the number of seniors able to sell their homes, will contribute to a slight 40 basis point improvement to 89.5 percent.



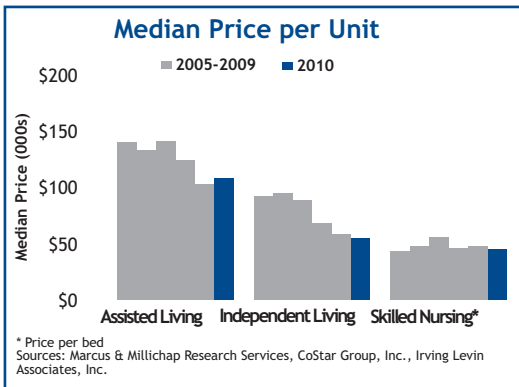
## INDEPENDENT LIVING FACILITIES (IL)



Indicators that the IL sector is entering recovery are mounting, highlighted by two consecutive quarters of occupancy gains. According to the NIC MAP, IL occupancy rose 40 basis points in the first quarter to 87.7 percent, which is up 50 basis points from the year-ago level. Outsized occupancy gains were recorded in markets such as Las Vegas, where supply growth has been minimal. As occupancy levels rose nationally, IL operators pushed up average rents 0.9 percent year over year. While recent strengthening has been aided by a decrease in stock additions, demand is improving. Housing market conditions remain a challenge, but home values are no longer falling steeply and more seniors who delayed moving during the recession are beginning to sell their homes more easily. These trends will support further improvements through 2011, with occupancy levels to reach 88.1 percent by year end, driving a 1.1 percent rise in average rents to \$2,678 per month. Beyond 2011, the expiration of the Mortgage Forgiveness Debt Relief Act of 2007 should bolster demand growth further by placing the housing market on better footing, prompting more seniors to exit ownership and move into IL units.

Investors have begun to re-enter the IL investment arena to take advantage of discounts and prospects for healthy long-term revenue gains. Attractive price points catalyzed sales last year, with IL deal flow rising 40 percent above recessionary lows established in 2009. IL assets traded in 2010 changed hands at \$54,700 per unit, a considerable discount from the \$94,100 per unit recorded at the cyclical peak in 2006. For the most part, cap rates for performing IL facilities ranged between 7.6 percent and 8.1 percent, while distressed properties or those located in secondary markets sold as much as 150 basis points higher.

## ASSISTED LIVING FACILITIES (AL)



Occupancy in the AL sector rebounded before other seniors housing property groups early in 2010, and has since held constant as construction fell well below trend. Per NIC MAP, occupancy in the sector has held firm at 88.4 percent during the past three quarters, which is still up 90 basis points from the year-ago level, marking the largest year-over-year spike in four years. Despite the sector's relative stability, average rent remained unchanged over the past 12 months, compared with a 1.3 percent rise registered in the preceding year. With supply growth anticipated to pick up modestly in the coming year, however, the national occupancy rate is likely to slip, decreasing 40 basis points to 88 percent this year. Subsequently, operators will refrain from implementing aggressive rent increases, pushing up rent just 0.8 percent to \$3,543 per month this year.

The AL sector is poised for a relatively active year of trading as well-capitalized healthcare REITs, banking on an economic recovery and improved property revenues, pursue acquisitions. AL sales velocity remained healthy through 2010, contributing to a 5.2 percent increase in the median price to \$107,800 per unit. As a result, average cap rates dipped 40 basis points for the year to the mid-9 percent range, though stabilized Class A properties targeted by large buyers changed hands between 7.0 percent and 8.0 percent. Top-tier AL assets will remain in high demand but short in supply through 2011, and assets listed for sale will attract REITs, which have become emboldened by strong share-price growth. As such, direct cap rates for institutional-grade assets will likely face further downward pressure. Cap rates for single properties targeted by private investors, meanwhile, will likely vary between 9.0 percent and 10.0 percent for another year.

Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted.  
NIC MAP Data and Analysis Service, 3Q 2010, [www.nicmap.org](http://www.nicmap.org)

## SKILLED NURSING FACILITIES (SN)

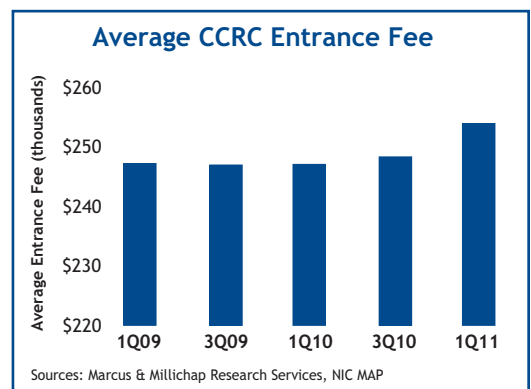
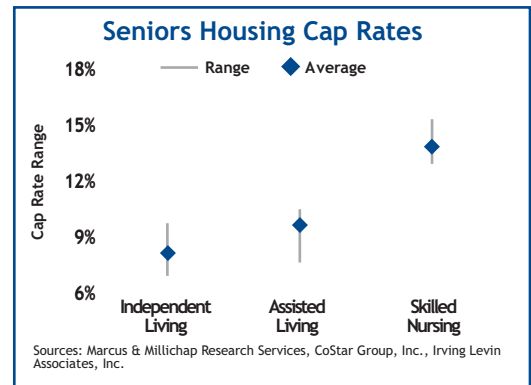
SN facilities have begun to benefit from individuals recently re-employed moving forward with procedures that require short-term rehabilitative services. As a result, occupancy in SN facilities rose 10 basis points during the opening quarter to 88.5 percent, according to NIC MAP. SN average daily rents, meanwhile, climbed 3.3 percent over the last 12 months, slightly besting the 3.2 percent gain reported in the preceding year. SN fundamentals have been mixed, however, as demand for long-term care has steadily declined in recent years. Although an aging population will sustain overall demand in the decade ahead, AL operations are becoming more sophisticated and some residents are delaying their transition into SN facilities. In the coming year, though, job growth and an ongoing slowdown in development will bolster overall SN absorption, lifting occupancy by year end to 88.9 percent. As occupancy rises, average daily rents will increase 3.2 percent to \$274 per occupied bed per day.

Stabilizing operating conditions, rising rents and a greater number of quality SN properties sold drove impressive price growth during 2010, a trend that will likely persist as buyers target strong facilities that can weather potential Medicaid reimbursement cuts. Last year, SN properties closed with per-bed prices of \$62,500, 31 percent higher than the year-earlier level, and 13 percent above the previous peak in 2007. Despite the substantial jump in the per-bed prices, cap rates for SN facilities rose 30 basis points on solid NOI growth to the low-13 range. This year, a growing number of institutions will enter the marketplace, though lingering uncertainty surrounding the structure of healthcare coverage and rising sophistication at new AL facilities will maintain investors' focus on proven assets.

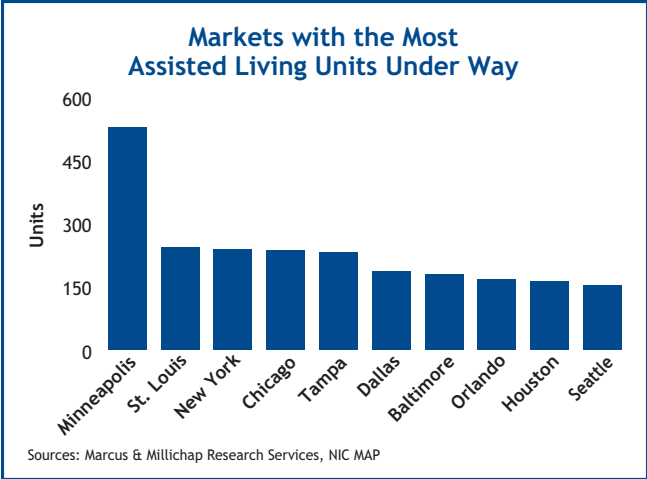
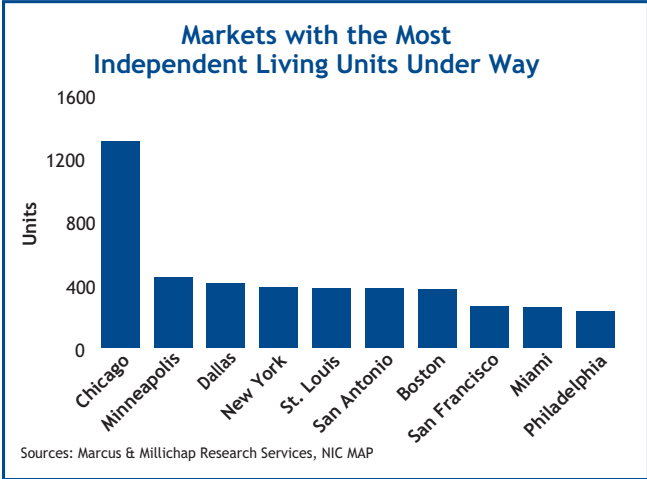
## CONTINUING CARE RETIREMENT COMMUNITIES (CCRCs)

Although CCRC operations have endured challenges since the onset of the housing downturn, occupancy is slowly stabilizing in line with moderating home price declines and easing supply growth. Per NIC MAP, overall occupancy in CCRC properties ticked up 20 basis points in the first quarter to 89.3 percent. Occupancy for entrance-fee facilities held steady quarter over quarter at 89.5 percent in this year's opening period. Overall entrance fees during the quarter rose 2.3 percent to \$253,872, although more than 70 percent of operators left entrance fees unchanged to draw residents. Rental-based CCRCs, on the other hand, posted a 50 basis point rise in occupancy for the quarter to 89.1 percent, aided by a slight reduction in inventory. As a result, encouraged operators edged up rent 0.5 percent year over year. As inventory growth remains subdued through 2011, overall CCRC occupancy will strengthen 40 basis points to 89.5 percent, though more substantive gains should materialize in 2012 as housing market conditions settle further.

CCRC transaction volume has remained light over the past year, with buyers largely targeting operationally challenged entrance-fee facilities poised for rental conversion. This trend has carried over into 2011, with the bulk of year-to-date sales involving facilities with less than 70 percent occupancy rates. Property operators capable of restructuring operating costs and raising occupancy to at least 85 percent through modernization and/or the conversion of entrance-fee facilities into rentals are poised for considerable upside. Trading will remain subdued through 2011, however, as many private investors are still hesitant to deploy significant capital toward repositioning plays, a reality that is likely to persist until better clarity on the future of healthcare reimbursement materializes.



*Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 3Q 2010, [www.nicmap.org](http://www.nicmap.org)*



## METRO OCCUPANCY RANKING\*

Rank	Metro, State	IL Occupancy	Y-O-Y Basis Point Change	AL Occupancy	Basis Point Change
1	Pittsburgh, PA	94.1%	-160	92.2%	-140
2	Minneapolis, MN	93.8%	-50	91.2%	-90
3	San Jose, CA	92.4%	-180	86.5%	210
4	Baltimore, MD	92.3%	-200	88.6%	130
5	San Francisco, CA	91.6%	110	89.5%	160
6	Boston, MA	91.0%	-210	93.7%	110
7	New York, NY	90.8%	20	94.3%	60
8	San Antonio, TX	90.8%	-40	91.1%	-10
9	Philadelphia, PA	90.3%	50	86.4%	-160
10	Washington, DC	90.3%	-300	91.3%	80
11	Sacramento, CA	90.2%	120	88.4%	170
12	St. Louis, MO	88.8%	80	88.3%	230
13	Cleveland, OH	88.7%	150	92.1%	250
14	Detroit, MI	88.7%	30	87.3%	140
15	Los Angeles, CA	88.7%	-130	85.5%	-150
16	Portland, OR	88.4%	-20	87.3%	-80
17	San Diego, CA	88.0%	50	87.4%	-140
18	Cincinnati, OH	87.3%	-200	91.5%	110
19	Kansas City, MO	87.1%	190	87.8%	50
20	Phoenix, AZ	86.8%	-210	90.2%	210
21	Atlanta, GA	86.6%	-160	85.3%	10
22	Denver, CO	86.4%	-10	88.1%	120
23	Houston, TX	86.2%	-90	90.8%	60
24	Chicago, IL	85.9%	-100	88.3%	230
25	Seattle, WA	85.9%	-310	89.5%	170
26	Tampa, FL	85.6%	-160	91.6%	110
27	Miami, FL	85.4%	-40	90.2%	310
28	Orlando, FL	85.3%	200	86.9%	-390
29	Las Vegas, NV	84.5%	420	80.0%	-250
30	Riverside, CA	84.0%	-140	89.4%	170
31	Dallas, TX	83.9%	-10	86.6%	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  
**Michael L. Brown**  
 Research Analyst  
 Research Services

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 www.MarcusMillichap.com

\* Occupancy data measures the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 3Q 2010, www.nicmap.org.  
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