SeniorsHousing
R E S E A R C H   R E P O R T

Marcus & Millichap

Second Half 2008

Housing Crisis Affecting Seniors Housing Market

The seniors housing market will continue to transition during the coming months as state budgets tighten, forcing owners to become more creative when seeking to boost revenues. Areas where state spending increased due to the booming residential market, such as the retirement hotbeds of Florida and Arizona, will record the largest declines in reimbursement from state governments as a result of the economic and housing market downturn. In addition, homeowners are unlikely to transition into seniors housing until home values rebound, placing downward pressure on occupancy levels in the independent living segment. To support revenue growth, builders in the West are capitalizing on the aging baby boomer population, a large portion of which have significant retirement funds, by focusing on Continuing Care Retirement Communities that offer upgraded amenities, including clubhouses and seniors-focused events. In the Southeast, revenue gains for properties in the skilled nursing segment will have to come from operational improvements. The region's assisted living facilities, however, may benefit from the current budget crisis, as residents that are unable to qualify for state funds will remain in facilities longer, buoying occupancy levels.

The investment climate in the seniors housing market will remain positive during the next several months, given the long-term prospects for growth, though velocity will stay relatively subdued as few publicly traded firms expand portfolios. In the short term, fewer buyers will transition into seniors housing from other commercial real estate sectors due to financing hurdles. The independent living segment, which generally attracts the most crossover investors, is facing elevated competition from alternative housing options, causing many buyers to take a "wait-and-see" approach. Nonetheless, cap rates in seniors housing are currently among the highest in the commercial real estate investment market and should keep cash-heavy buyers active. Smaller skilled nursing assets will offer the most value-add potential, while new mega-projects in the West remain attractive to institutional buyers implementing a flight-to-safety strategy.

Seniors Housing Market Highlights[1]

8.4% Cap Rate
Up 50
Basis Points
2Q07-2Q08

Independent Living (IL): Softer demand and elevated construction in the IL sector have resulted in a 200 basis point drop in occupancy to 94.1 percent over the past year. Revenue growth has eased to 4 percent in the same period to $2,471 per occupied unit per month.

8.7% Cap Rate
Up 40
Basis Points
2Q07-2Q08

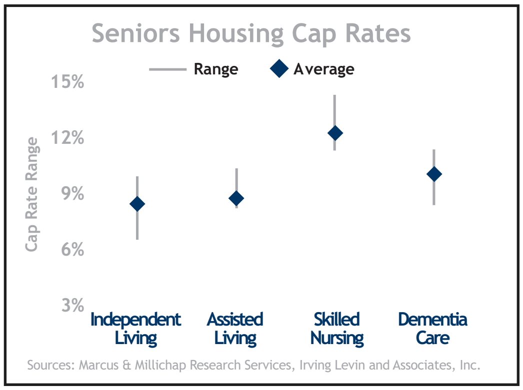
Assisted Living (AL): Occupancy in AL facilities fell 120 basis points during the past 12 months to 94.3 percent in the second quarter. Revenue growth remained healthy in that time, climbing 4.5 percent to $3,543 per occupied unit per month.

12.2% Cap Rate
Up 20
Basis Points
2Q07-2Q08

Skilled Nursing (SN): Conditions in the SN segment have stayed relatively stable due to a lack of substitute care. Occupancy has inched down 70 basis points year over year to 93.2 percent, while per-diem revenue has advanced 4.2 percent to $224 per occupied bed.

10.0% Cap Rate
Up 50
Basis Points
2Q07-2Q08

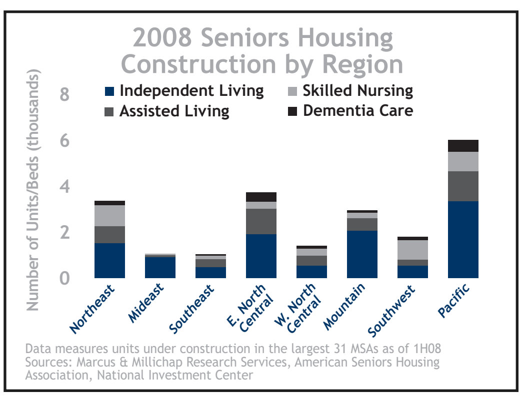
Dementia Care (DC): New construction has helped push DC occupancy down 180 basis points to 94.4 percent over the last year. The DC segment has recorded the largest improvement in revenue through that stretch at 5.4 percent to $5,343 per occupied unit per month.



Independent Living Facilities

According to NIC MAP, occupancy levels in the IL sector fell to 94.1 percent during the first six months of 2008, down 200 basis points from the same period last year. Most of the decrease can be attributed to supply-side pressure, as builders have accelerated deliveries over the past year. Signs that construction is cooling emerged in the second quarter, though development activity remains robust and will likely not subside until early 2009. As such, owners may have to ease revenue growth, which has climbed 4 percent year over year to $2,471 per occupied unit per month, in order to attract tenants. In the Pacific region, where 30 percent of all under way construction is located, occupancy has dropped 320 basis points in the last year. The number of units being built, however, has decreased 12 percent from a peak in the first quarter, which could stabilize occupancy levels during the first half of 2009.

Sales velocity in the IL sector has mirrored that of the nation's apartment market year to date, falling significantly as the number of potential buyers in the market dissipates. With less activity in the marketplace, cap rates have increased 50 basis points to the low-8 percent range. The median sales price has declined 28 percent from year-end 2007 to $110,500 per unit, as the remaining buyers in the market have been presented with fewer top-tier listings. In fact, owners conscious of limited reinvestment opportunities have kept their stabilized, high-end properties. Going forward, this trend will persist, offsetting some of the strain on prices resulting from the credit crunch. The presence of Fannie Mae and Freddie Mac as primary lenders in the sector, however, will help to retain some capital, though fewer buyers will qualify due to more conservative lending criteria.



Assisted Living Facilities

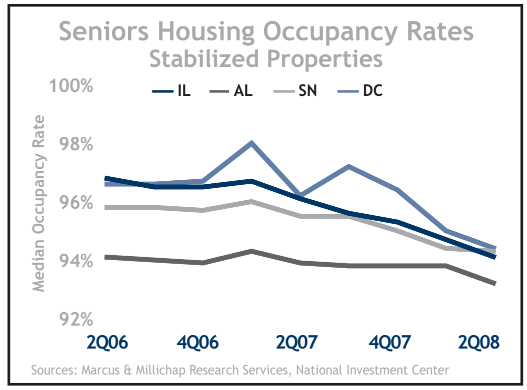
AL facilities have felt the crunch of the current economic climate over the past year, when occupancy levels have slipped 120 basis points to 94.3 percent, per NIC MAP. In the Pacific region, where AL construction remains robust, occupancy has fallen 200 basis points to 92.2 percent, the second lowest rate in the nation. As a result, operators have reduced prices in the region, and revenues have slipped 0.8 percent to $3,339 per occupied unit per month from a peak during the first quarter. Nationwide, revenues have increased 4.5 percent year over year to $3,543 per occupied unit per month. The largest climb has occurred in the Mountain region, despite a 330 basis point decline in occupancy; over the past 12 months, revenues in the area have jumped 9.4 percent to $3,213 per occupied unit per month. Growth is projected to slow in the coming months, however, until occupancy stabilizes.

The investment climate for AL facilities remains positive, though velocity will stay modest through the end of the year. Average cap rates have risen 40 basis points in the last 12 months to the high-8 percent range, and some assets traded at double-digit initial yields during the first part of 2008. Cap rates for high-end properties were in the high-6 percent range through the first half and are not expected to fluctuate as much as initial yields for older assets. The median sales price has retreated in the past 12 months, falling 16 percent to $136,600 per unit. Looking ahead, several states that have approved their budgets for 2009, including Arizona, Florida and California, have announced cuts to Medicaid. With state assistance getting more difficult to acquire, borderline residents are anticipated to remain in AL facilities, supporting occupancy levels in the near term.

[1]*Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 2Q 2008, www.nicmap.org*

Skilled Nursing Facilities

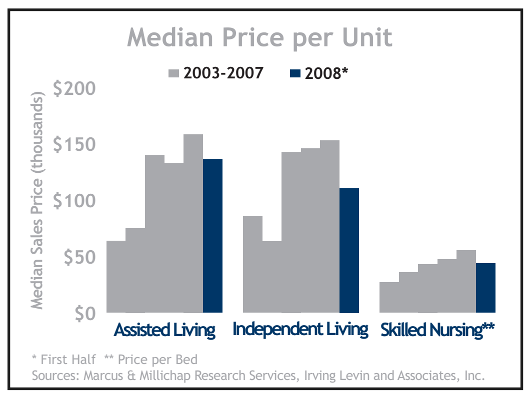
Fundamentals in the SN sector have remained relatively stable over the past year, despite a national economic slowdown. NIC MAP reports that occupancy has inched down 70 basis points in that time to 93.2 percent. Few substitute goods for SN facilities exist, especially with the prevalence of two-income families in a country that limits home care as an option. Additionally, nearly 80 percent of payments in SN properties originate from federal or state governments in the form of Medicare or Medicaid. As such, the average per-diem revenue has risen 4.2 percent during the past 12 months to $224 per occupied bed. With budget cuts, however, operators in states where the housing crisis is weighing on local tax gains will likely be unable to expand revenues through billing increases. Occupancy improvements could be a major source of revenue improvement during the next year, especially in the Pacific and Southwest regions, where occupancy rates of 92.4 percent and 86.9 percent, respectively, are below the national average.



Transaction velocity for SN properties is off significantly from peak levels. Fewer potential buyers remain in the marketplace, as portfolio expansion has slowed. As such, cap rates have inched up 20 basis points over the last 12 months into the low-12 percent range. The median sales price has dropped 20 percent to $43,900 per bed due to elevated risk from state budget cuts to Medicaid. Opportunities exist for owners willing to improve operations at struggling SN assets, as cap rates in the sector are among the most attractive of any real estate property. Savvy buyers should consider properties in states where cutbacks to Medicaid are unlikely to occur, such as Texas. Properties will also remain in demand in the Northeast, where occupancy rarely falls below 96 percent and construction is limited by strict Certificate of Need guidelines and elevated building costs.

Dementia Care Facilities

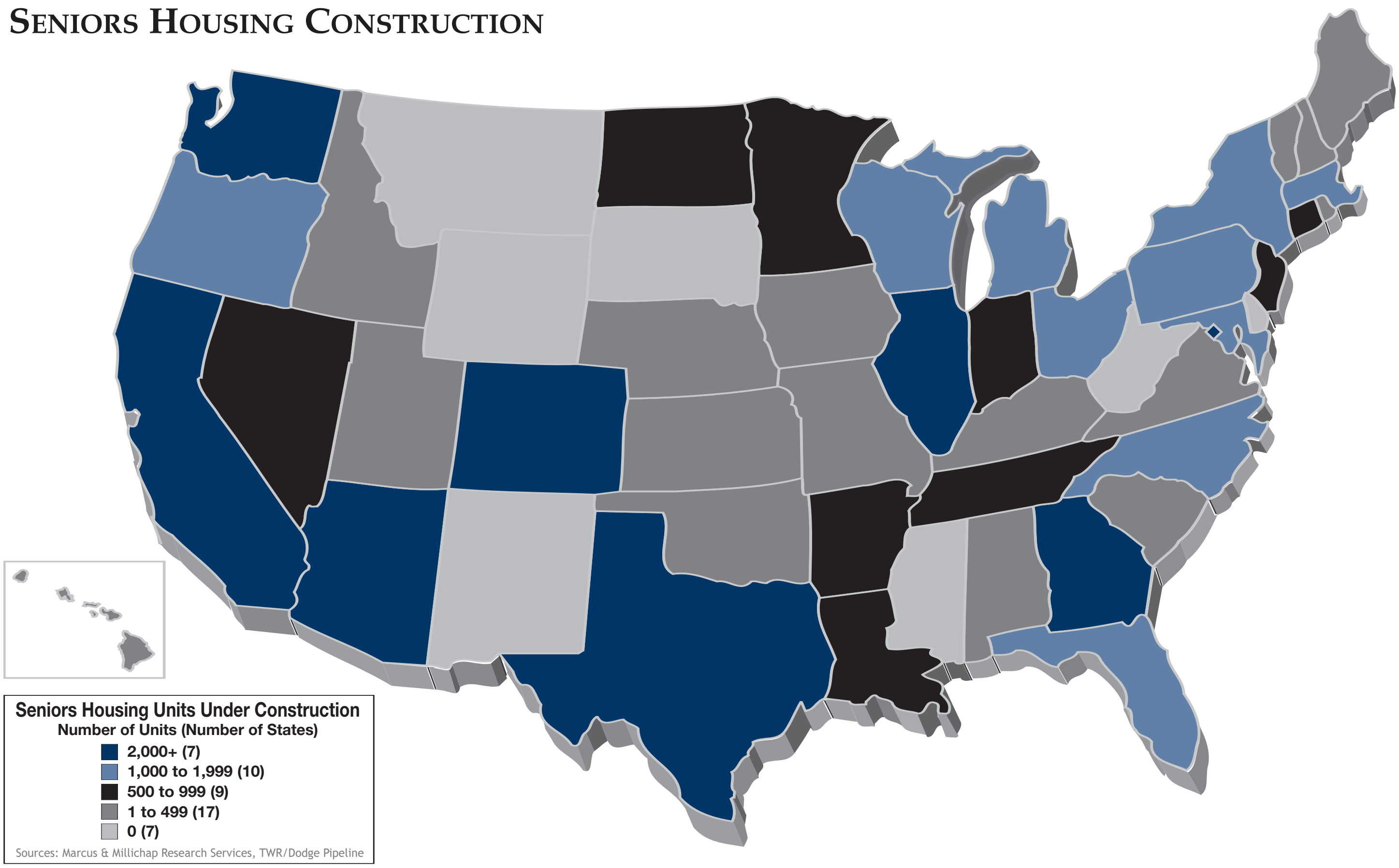
The DC segment continues to emerge as a standalone asset class in the seniors housing market, though limited inventory is contributing to significant fluctuations in fundamentals. During the past 12 months, occupancy in the sector has fallen 180 basis points to 94.4 percent, according to data from NIC MAP. In the Pacific region, which has the largest DC stock, occupancy is below the national average at 92.9 percent. As a result, 12.5 percent of all DC properties in the region offer concessions of at least one month of free rent, compared to the national average of 8.8 percent. Additionally, more construction will increase competition from the relatively small consumer base. As of the second quarter, 33 percent of units under way in the country were in the Pacific region, primarily in California. Nationally, DC revenue growth of 5.4 percent to $5,343 per occupied unit per month over the past year was the highest of the seniors housing asset classes. The Mountain region has posted the strongest annual gain at 7.2 percent to $5,298 per occupied unit per month, after occupancy approached 100 percent at the end of last year.



A limited number of DC properties are expected to be listed in the coming year. Healthy revenue gains and few options in which to invest 1031 capital after divestiture will keep stabilized properties from being brought to market. Assets are expected to trade with cap rates in the 10 percent range, up 50 basis points from initial yields recorded one year ago. Some properties will likely exchange as high as the mid-11 percent spectrum, though cap rates will remain below those in the SN segment. Going forward, private buyers are expected to make inroads into the DC sector, providing competition for chains.

[1] *Occupancy, rent and construction data throughout this report measure the 31 largest MSAs unless otherwise noted. NIC MAP Data and Analysis Service, 2Q 2008, www.nicmap.org*

Seniors Housing Construction



Recent Sales Highlights

Property Type	Property Name	City, State	Sales Price	No. of Units/Beds*	Price per Unit/Bed*
AL	Crown Pointe Retirement	Corona, CA	$23,000,000	159	$144,654
SN	Gordon Oaks Retirement Community	Mobile, AL	$20,500,000	304	$67,434
AL	The Woodlands	Columbus,OH	$6,500,000	89	$73,034
SN	Laurelton Rehabilitation & Nursing Center	Alabaster, AL	$6,090,000	230	$26,478
SN	Marigold Health Care Center	Galesburg, IL	$5,612,952	172	$32,633
SN	McAllister Nursing Home	Country Club Hills, IL	$4,600,000	111	$41,441
AL	Shepherd House	Chapel Hill, NC	$4,511,366	77	$58,589
SN	Erwin Garden	Durham, NC	$4,300,000	125	$34,400
SN	Freeport Manor Nursing Center	Freeport, IL	$4,020,539	122	$32,955
SN	Harrah Nursing Center	Harrah, OK	$3,400,000	147	$23,129
SN	Liberty Nursing Care	Wheelersburg, OH	$3,100,000	75	$41,333
SN	Hillsboro Healthcare Center	Hillsboro, IL	$3,009,237	110	$27,357
SN	Benner Convalescent Center	Houston, TX	$2,500,000	68	$36,765
SN	Sunshine Manor Nursing Center	Carlinville, IL	$2,400,000	94	$25,532
SN	McLoud Nursing Center	McLoud, OK	$2,200,000	85	$25,882
SN	Meeker Nursing Center	Meeker, OK	$2,000,000	70	$28,571
SN	Polo Rehabilitation & Health Care Center	Polo, IL	$1,508,304	77	$19,588
SN	Medical Center Nursing Home	Clarendon, TX	$992,000	26	$38,154

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

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

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein.

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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