

PROPERTY SECTORS

Seniors Housing And Long Term Care

2003 will be remembered as the year the floodgates opened and seniors housing deals began to flow. It will also likely be viewed as the bottom of the downward cycle in the seniors housing sector that began in late 1999.

NURSING CARE SECTOR

At 2003's beginning, the nursing sector outlook was rather bleak. Liability insurance costs were continuing to skyrocket and the much anticipated Medicare Cliff had just gone into effect, lowering Medicare rates by 10%. Nursing care provider stock prices were at extremely low levels. For example, Beverly Enterprises, the nation's largest nursing home provider, closed 2002 at a \$2.85 share price, down 67% for the year.

But during 2003, nursing home providers began to react to these market forces. Companies sold off facilities in states with liability issues like Florida, California and Texas to local operators who could obtain less costly insurance. Beverly sold 73 facilities during the year. Then, effective October 1, 2003, the Centers for Medicare and Medicaid Services ("CMS") implemented two increases to nursing facility Medicare rates, with a total of just over 6%. With this boost in revenues, stock prices surged. On December 22, Beverly's stock closed at \$8.25 per share, a 189% increase in only one year.

One interesting subtext is that the nursing industry appears to be experiencing de-consolidation, as opposed to the consolidation predicted by many. Already highly fragmented, the remaining large national operators are giving way to a plethora of growing regional operators who are better able to cope with the variations in reimbursement policies from state to state.

The industry still faces challenges. Many states are facing budgetary shortfalls and Medicaid expenditures are often one of the first items for the chopping block. Also, while some states have passed tort reform legislation, liability insurance costs remain an issue.

ASSISTED LIVING SECTOR

The big story of the year in the assisted living sector was the sale of Marriott Senior Living to Sunrise Assisted Living. Sunrise, which renamed itself Sunrise Senior Living following the acquisition, added 126 senior living communities with a resident capacity of more than 23,000 via this transaction, increasing its portfolio to 340 communities with a resident capacity of close to 40,000. Later in the year, Sunrise took over management of EdenCare's 25 facilities. And, in addition to being a buyer, Sunrise continued to execute its sale/manage back strategy, selling more than 44 properties to institutional investors.

The other big news of 2003 was Alterra's emergence from Chapter 11 bankruptcy. A joint venture consisting of Emeritus Assisted Living (AMEX:ESC) and Fortress Investment Group LLC acquired all outstanding stock of Alterra Healthcare Corporation and its subsidiaries—305 communities in 21 states. Alterra Healthcare will be operated as a privately held company

Transaction volume was heavy during the year. Most sales involved underperforming assets including a continual flow of Alterra assets. The buyers were as varied as the prices paid for the assets and sales volume indicates alignment of buyer and seller expectations. Assisted living construction was very low and occupancies are firming up.

INDEPENDENT LIVING SECTOR

The congregate care/independent living sector is the healthiest sector and will be the first sector to benefit as baby boomers age. Data compiled by the American Seniors Housing Association indicates 89% average occupancy nationally, the highest of the three sectors. New construction continues to be slow as demand grows. Rental rate increases have been strong and should continue. Independent living operators have also faced rising liability insurance costs, but not to the degree experienced by other forms of seniors housing.

AVAILABILITY OF CAPITAL

Capital is now more available to the senior care industry than it has been at any time since the late 1990s. On the debt side, Freddie Mac and Fannie Mae were very active in 2001 and will continue to provide financing for stabilized assets in 2002. GE Capital has recently come out with a long-term financing platform and the health care REITs are once again active.

The most notable development in the capital market was the emergence of CNL Retirement Properties as a major

force in the industry. CNL Retirement Properties, Inc. is an unlisted real estate investment trust (REIT). CNL typically acquires facilities from operators, who retain management on a long-term basis. CNL partnered with Sunrise Senior Living to fund the acquisition of Marriott Senior Living Services.

Another notable entry into the market in 2003 was the Carlyle Group. Carlyle acquired a property on Long Island and also entered into a JV with Sunrise to develop two new communities. The Carlyle Group is a global private equity firm with more than \$16.2 billion under management.

INVESTOR CRITERIA

Capitalization of pro forma income continues to be the primary method of valuation used by industry participants. Capitalization rates from NIC's Second Quarter 2003 survey are as follows (www.nic.org):

TABLE 15

INVESTOR CRITERIA

Property Type	Low	Average	High	Number of Transactions
Independent Living	8.5%	9.9%	10.6%	6
Assisted Living	8.5%	11.4%	16.8%	40
Nursing Center	9.5%	13.1%	17.8%	63
CCRC	11.5%	-	11.5%	1

SOURCE: The National Investment Center for the Seniors Housing and Care Industries (www.nic.org)

A capitalization rate decline has been much discussed in the industry due to the inflow of capital and improving market conditions. However, survey data lags the market by many quarters, so there is only anecdotal evidence of a decline at the time of this writing.

CONCLUSION

2003 was an eventful year in the seniors housing industry. Deal flow finally increased to levels anticipated for several years, including several large acquisitions. All three industry sectors are healthier than last year and capital appears more readily available. With these conditions, 2004 should see more deal flow and tightening of asset pricing. Continued acquisition market bifurcation is likely—with premium assets bringing premium prices and underperforming assets luring bottom fishers and turnaround experts.

From Viewpoint 2004
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