

COMMERCIAL INVESTMENT

# Real Estate

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Wilkinson Corp., a holding company for West Coast seniors-housing communities, is diversifying its portfolio by purchasing properties in midrange markets, including the Gardens, a four-property assisted-living facility located in Orange County, Calif.

## Seniors Housing

# Blossoms

**The outlook is rosy  
for this perennial  
investment option.**

by John Cobb

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In terms of net operating incomes and real estate market values, America's long-term care industry is about equal in size to the hospitality lodging industry — a fact that surprises most people but makes sense given the aging U.S. population. Since its quiet turnaround starting in 2003, seniors housing has experienced increased activity, particularly right now: Long-term care facilities have an estimated total capacity of 3.68 million, according to the National Investment Center for

the Seniors Housing & Care Industry, with occupancy rates hovering around 90 percent. Occupancy will continue to rise as senior population demographics increase unless construction keeps pace.

On the investment side, capitalization rates have fallen dramatically during the last 24 months with certain sectors experiencing declines of up to 300 basis points. The sector's high demand, stability, and improved occupancy rates are driving these declines and correlated pricing in-

Sterling Senior Communities in Temecula, Calif., was acquired by MBK Senior Living in an all-cash deal. The facility has 51 independent units, 73 assisted living units, and an Alzheimer's care facility.



growth. A strategic building approach will continue to prevail across the industry; gone are the days of thinking "if we build it, they will come." Today's industry insiders are more in tune with the realistic needs of the rapidly aging American society.

Demographics are another key factor. The baby boomers, which make up 26 percent of the population, have longer life expectancies and have shifted away from living with adult children in their old age, unlike previous generations. They're also more willing and able to pay premium prices to maintain independence in their senior years. Finally, the 85-year and older population is estimated to grow three times that of the U.S. population as a whole this decade, according to the Census Bureau. These statistics demonstrate the growing need for care and housing for this population segment.

The long-term care industry's maturation also has made these properties attractive to investors and potential customers, and the diverse range of options within the industry is expanding.

Finally, in terms of financing, select lenders are bullish on the market — approaching each opportunity with intense due diligence to ensure strategic growth. ■

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tered the industry in hopes of a quick, sizable return on investment. The downturn pushed these operators aside, making room for those who understand what it takes to run a successful long-term care property. Efficient operators know what works and what doesn't, leading to better business models that attract both investors and residents. Characteristics of today's most successful properties include larger unit sizes, state-of-the-art amenities, quality locations, and higher service levels. As a result, quality properties don't sit on the market very long and portfolio sales are rising; older properties with smaller units are taking longer to sell.

Finally, the industry has learned a valuable marketing lesson about its primary users, which is affecting location decisions. Today's customers not only are seniors but also their adult children who frequently are involved in their parents' housing decisions. For example, if a parent is ill or suffering from Alzheimer's disease or another form of dementia, adult children make long-term care decisions. For this reason, some major seniors-housing providers are strategically placing facilities closer to concentrations of baby boomers, rather than concentra-

tions of seniors, to make their properties more attractive.

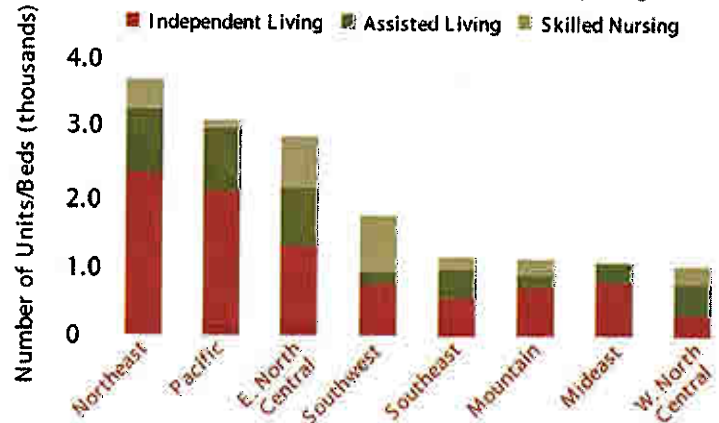
**Long-Term Care's Outlook**

Industry insiders agree that long-term care's outlook is positive, especially in the next five to 10 years. Several factors will weigh heavily into just how successful the industry will be.

Supply-and-demand dynamics, again, are creating a foundation for future

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**2005 Seniors-Housing Construction by Region**



Data measures units under construction in the largest MSAs as of 2005  
 Source: Marcus & Millichap

creases. For example, Nationwide Health Properties, a real estate investment trust in Newport Beach, Calif., last fall paid around \$171 million for 13 skilled nursing homes and one assisted-living facility in the Northeast. The price is about \$92,000 per bed, almost twice the previous year's average price per bed for that region, according to McKnight's Online. Another major deal involved Ventas REIT in Louisville, Ky., buying six retirement communities for \$85 million or around \$89,000 per unit. Both transactions were structured as sale-leasebacks. Competition from institutional investors also is driving up prices for top-tier seniors-housing properties, as they seek to diversify portfolios.

While today's seniors-housing investment market bears resemblance to that of the late 1990s, sophisticated investors knowledgeable about seniors-housing pitfalls are making all the difference. Having learned from the mistakes of the 1990s, today's investors and developers are making wiser decisions and seeing better returns. The long-term care industry holds great potential, and understanding its fundamentals and learning from the past are the keys to success in this segment.

### Industry Drivers

Shifting supply-and-demand dynamics have been a major force in the long-term care segment's recovery from the late 1990s market slowdown. During the last five years, annual demand for seniors housing has averaged 29,700 residents per year according to the NIC, and construction of seniors-housing units has averaged 23,200 per year. With demand exceeding new supply by about 6,500 units each year, occupancy rates have been climbing steadily.

Several factors have contributed to the supply-and-demand shift. First, seniors-housing companies have changed their development strategies, dramatically cutting back on new construction compared to the late 1990s. For example, in the assisted-living sector, new construction has averaged about 6,000 units per year over the last four years compared to roughly 30,000 units constructed annually in the late 1990s.

The second reason for the shift is the aging population. According to the U.S. Census Bureau, the "roaring 1920s" babies, who currently make up about 5 per-

cent of the population, are creating greater demand for these facilities. This demand will increase as the population growth rate of seniors age 75 and older skyrockets in the next 10 years to 20 years.

Increased understanding that quality of care is just as important as real estate performance is another factor contributing to industry growth. In the 1990s, many people hopped into the long-term care industry seeing quick cash and hot real es-

tate, but they did not understand the industry for what it was — a business that could wither without high quality of care for residents. Today savvy investors looking to get into the industry consider high-quality care a major determining factor.

Operators also play a major role in the industry. The 1990s saw many inexperienced operators who didn't understand long-term care's intricacies. They viewed it as a hospitality model and en-

## Understanding Long-Term Care

The long-term care industry is made up of several different segments. Understanding the differences can help investors decide which type of property suits their objectives.

**Skilled nursing.** These licensed properties serve people who need 24-hour medical or nursing care. The skilled-nursing category includes traditional nursing homes and skilled-nursing units in assisted-living, independent-living, and continuing-care retirement communities. There are approximately 16,000 nursing homes in the United States with about 1.5 million residents. Costs range from about \$3,500 to \$10,500 per month. Capitalization rates have declined in the skilled-nursing sector up to 200 basis points over the last 24 months.

**Assisted living.** These are age-restricted rental communities that provide meals and staff to help with daily needs such as bathing, medication, and dressing. Assisted-living units can be found in traditional assisted-living facilities, independent-living communities, and continuing-care retirement communities; some may include special sections for patients with Alzheimer's disease or other memory impairments. There are an estimated 7,300 assisted-living residences in the United States; an average assisted-living facility has about 76 units and is about six years old. The average age of the residents is 80 years old. Rent per unit ranges from \$2,400 to \$4,800 per month and occupancy hovers around 90 percent in the top 30 metropolitan statistical areas. Improved operations are fueling today's growth instead of the capital infusion seen in the late 1990s. Capitalization rates in this sector have declined up to 300 basis points.

**Independent living.** These age-restricted rental communities number about 6,200 in the United States, and offer more community support than medical care. Rents range from \$1,900 to \$2,600 monthly. The average independent-living community in the United States has about 160 units and is about 15 years old. This sector has outperformed its counterparts in the long-term care industry. While occupancy hovers at around 91 percent nationwide, it's more than 95 percent in the top 30 metropolitan statistical areas. Occupancy reaches 98 percent in select markets such as Boston and Washington, D.C., which has spurred plans to build an additional 8,400 units on the East Coast next year. Look for undersupplied markets such as Miami, Orlando, Fla., Los Angeles, and San Francisco to see building increases as well. Cap rates in this sector have declined up to 200 basis points.

**Continuing-Care Retirement Communities.** Continuing-care retirement communities are becoming increasingly popular with senior citizens because they enable residents to move from independent living to assisted living to skilled nursing while staying on one campus. Typical CCRCs are about 60 percent independent living, 13 percent assisted living, and 23 percent skilled nursing, and there are more than 2,200 of these communities in the United States. As with other long-term care sectors, cap rates for CCRCs have fallen about 200 basis points. The occupancy rates for CCRCs speak volumes, with levels around 94 percent in the top 30 MSAs and nearly 96 percent in select metro markets. Turnover in this sector also is low at about 29 percent excluding skilled-nursing beds, making this segment attractive to investors.

Sources: American Seniors Housing Association and National Investment Center for Seniors Housing & Care Industry