SeniorsHousing
RESEARCH REPORT

Marcus & Millichap

Second Half 2012

"Fiscal Cliff" and Affordable Care Act Support Consolidation

The federal government's rising role in healthcare, particularly through the Affordable Care Act, will ultimately impact the seniors housing industry. Up to 16 million more Americans will qualify for Medicaid in 2014, if all states opt into the program. Initially, the federal government will assume the entire increase in costs, but states will increase their individual responsibility to 10 percent by 2020, which will put rising pressure on budgets. The Medicaid system is already on a path to bankruptcy, and increasing the number of qualified recipients will accelerate the fate of the system. As costs rise, reimbursements will inevitably be shaved by states, forcing operators to push for higher efficiency levels. This trend will leave large companies with several facilities in a much stronger position to absorb the cuts and force older facilities to close or commit to a significant capital infusion. The challenges posed by the ACA are minor compared with the impending "fiscal cliff." If lawmakers are unable to reverse the spending cuts and tax hikes scheduled for 2013, Medicaid cuts could result in the loss of nearly a half million jobs next year.

The investment market will remain strong for seniors housing properties over the next several quarters as capital comes off the sidelines, assuming no major economic headwinds rise. Buyers will focus on top-tier or B+ properties in good locations. Assets with a dementia care unit are in the greatest demand due to the decreased oversight and elevated revenue streams. Cap rates for an assisted living facility with dementia care can dip into the mid-7 percent range, though older properties often report double-digit cap rates at closing. In the independent living arena, deal flow is at a sustainable pace after last year's blistering pace. These properties will attract attention at first-year returns between 7 and 8 percent. Operations in the sector continue to improve instep with the housing market, and these owners are in the best position to absorb rising costs. Skilled nursing deals, meanwhile, remain limited and typically record cap rates near 13 percent. Properties with a heavy Medicaid census will need to trade at higher yields due to the potential risk.

Seniors Housing Market Highlights

Occupancy up 130 basis points

Independent Living (IL): Occupancy will continue to strengthen through the end of the year, finishing 2012 at 89.8 percent, up 130 basis points annually. Rents will climb 3.5 percent as operators take advantage of tighter conditions. At year end, national average rents will be $2,768 per month.

Occupancy up 30 basis points

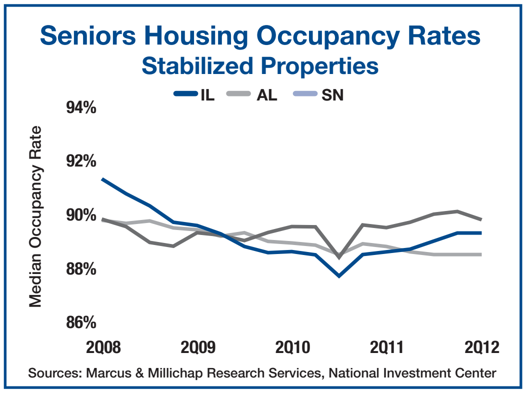
Assisted Living (AL): As developers bring more units out of the ground, the balance between supply and demand could tip, but not until 2013. Occupancy will trend up to 90.3 percent this year, an increase of 30 basis points. Average rents will climb 2 percent to $3,530 per unit during 2012.

Occupancy down 50 basis points

Skilled Nursing (SN): More state budgets are on solid footing as the economy improves, which should alleviate some pressure on rents, though occupancy will remain challenged. By year end, occupancy will fall to 87.9 percent, an annual loss of 50 basis points, while rents rise 3.5 percent to $272 per occupied bed per day.

Occupancy up 40 basis points

Continuing Care Retirement Communities (CCRCs): The rapidly improving housing market should pay dividends for CCRC operators in the coming quarters, though improvements will be incremental. By year-end 2012, occupancy at CCRCs will climb to 89.1 percent, up 40 basis points from the recessionary low.



Independent Living Facilities

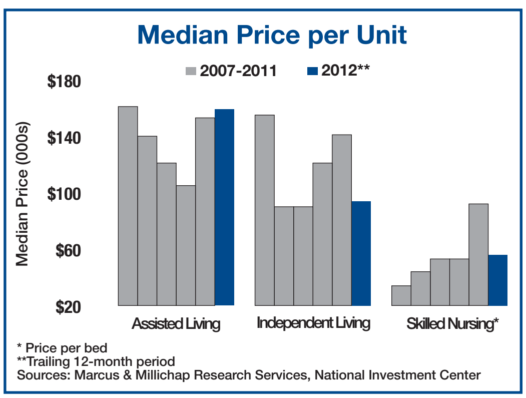
- Builders added 5,000 IL units to inventory during the 12-month period ending in the second quarter, expanding national stock 1 percent, according to industry tracker NIC MAP. Another 8,000 units are under way across the country in slightly more than 80 projects.

- Over the past year, occupancy increased 70 basis points to 89.4 percent in the second quarter as the national housing market gained traction, giving retirees confidence to sell their homes. In the first half of 2012, IL occupancy climbed 20 basis points.

- Operators recorded monthly rents at $2,728 per unit in the second quarter, up 2.6 percent from 2011's midpoint. Rent growth has accelerated as occupancy approaches the 90 percent threshold. Year to date, average reported rents have risen 2 percent.

- Deal flow remained relatively flat during the most recent 12-month period. When the large portfolios that traded during the previous period are excluded, deal flow accelerated modestly. The median price fell to $119,000 per unit in the period, down 34 percent from the previous year.

- **Outlook:** Occupancy will strengthen through the end of the year, finishing 2012 at 89.8 percent, up 130 basis points annually. Rents will climb 3.5 percent as operators take advantage of tight conditions. At year end, national average rents will be $2,768 per month.



Assisted Living Facilities

- Over the past 12 months, developers completed 4,700 AL units across the nation, up from 3,700 during the previous 12-month period. Inventory expanded 1.6 percent in the last year as builders rushed to bring facilities online as demand for new units firmed.

- Despite the increase in development, new demand for AL units outpaced supply growth. Per NIC MAP, average national occupancy climbed 20 basis points in the past year to 90 percent in the second quarter. Year to date, however, occupancy has remained flat as the balance between supply and demand growth leveled off.

- Operators lifted average rents 1.5 percent in the last 12 months to $3,503 per month in the middle of this year. Owners only recently regained leverage to push rents higher. Through most of 2011, average rents remained flat before growth finally resumed in the fourth period of last year.

- During the most recent 12-month period, deal flow plunged 67 percent to a sustainable pace. The previous year's large volume of trades came from huge portfolio sales. The median price during the period $159,300, down about 6 percent from the prior year, while cap rates averaged between 7 and 10 percent.

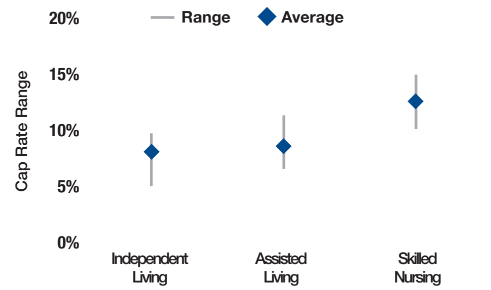
- **Outlook:** As developers bring more units out of the ground, the balance between supply and demand could tip, but not until 2013. Occupancy will trend up to 90.3 percent this year, an increase of 30 basis points. Average rents will climb 2 percent to $3,530 per unit during 2012.

Occupancy, rent and construction data throughout this report measure the 100 largest MSAs unless otherwise noted.
NIC MAP Data and Analysis Service, 2Q 2012, www.nicmap.org

Skilled Nursing Facilities

- According to NIC MAP, SN inventory fell by 3,700 beds during the past 12 months as dilapidated stock was removed. Developers are constructing facilities that will include 7,500 beds, which is an increase from the 6,100 beds that were under way during the second quarter of last year.
- Occupancy retreated 40 basis points over the past 12 months to 88.1 percent. As Medicaid reimbursements were squeezed, occupancy fell 30 basis points during the first six months of this year. The rate peaked at 90 percent in the second quarter of 2010 before trending lower.
- In the second quarter, average rents at SN facilities were $268 per occupied bed per day, a year-over-year increase of 3.1 percent. Rent growth accelerated during the first six months of this year as the per-day rate gained 1.8 percent. Nonetheless, cuts to Medicaid could limit gains in the future.
- As few stabilized facilities traded in the past year, deal flow fell approximately 75 percent, though comparisons with the previous period are unfair due to the large portfolios that changed hands. The median sales price during the last 12 months was $55,900 per bed, while cap rates hovered near 13 percent.
- **Outlook:** More state budgets are on solid footing as the economy improves, which should alleviate some pressure on occupancy, though the rate will continue to inch lower. By year end, occupancy will fall to 87.9 percent, an annual loss of 50 basis points, while rents rise 3.5 percent to $272 per occupied bed per day.

Seniors Housing Cap Rates

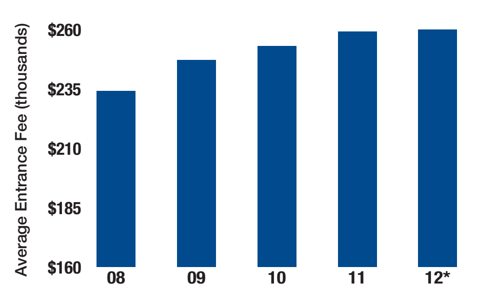


Sources: Marcus & Millichap Research Services, CoStar Group, Inc., National Investment Center

Continuing Care Retirement Communities

- Improving healthcare is keeping seniors alive much longer, which is resulting in a population boom in the highest age cohort. The number of residents over 85 years old jumped more than 40 percent from 2000 to 2011, and will climb another 9 percent by 2016.
- Over the past 12 months, the national median home price climbed 7 percent to $177,300, a welcome sign for entrance-fee CCRC owners. Seniors often rely on the equity in their home to afford the steep initial cost, and further action from the Fed to support the housing market should support occupancy gains by 2013.
- Occupancy at CCRCs was 88.9 percent in the second quarter, according to NIC MAP. The rate has increased 10 basis points from one year ago and is 20 basis points above the cyclical low at the end of 2010. Entrance-fee facilities recorded a rate of 89.1 percent, while rental CCRCs reported occupancy at 88.6 percent.
- Just 2,600 CCRC units were under construction in the second quarter, down nearly 15 percent from the same period last year. The average entrance fee climbed to $260,000 at this year's midpoint, up 2.7 percent from 2011. The median entrance fee is significantly lower, however, at $216,000.
- **Outlook:** The rapidly improving housing market should begin to pay dividends for CCRC operators in the coming quarters, though improvements will be incremental. By year-end 2012, occupancy at CCRCs will climb to 89.1 percent, up 40 basis points from the recessionary low.

Average CCRC Entrance Fee



*Through 2Q
Sources: Marcus & Millichap Research Services, National Investment Center

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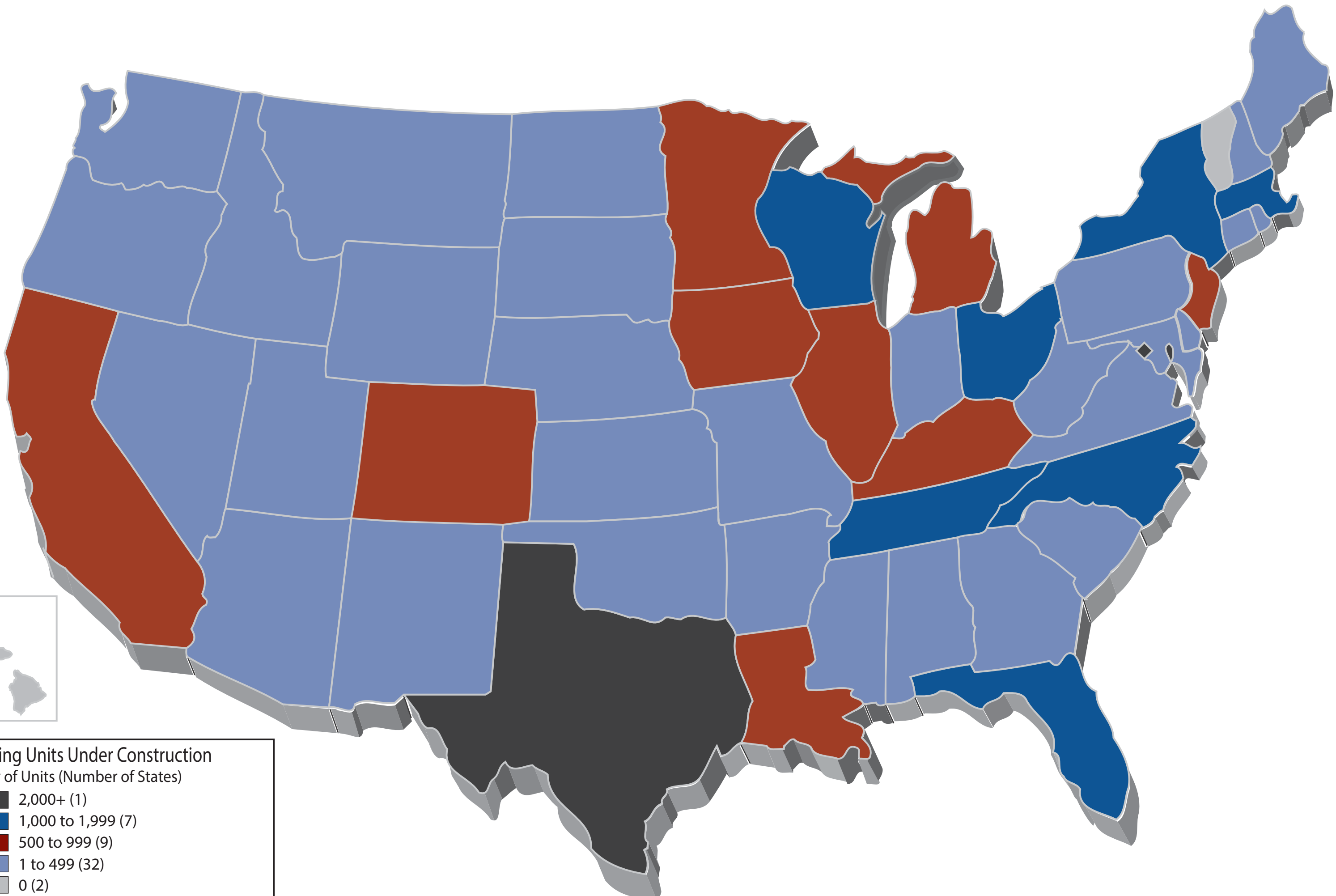

Seniors Housing Units Under Construction
Number of Units (Number of States)
- 2,000+ (1)
- 1,000 to 1,999 (7)
- 500 to 999 (9)
- 1 to 499 (32)
- 0 (2)

Sources: Marcus & Millichap Research Services, TWR/Dodge Pipeline

Metro Occupancy Ranking*

Rank	Metro, State	IL Occupancy	Y-O-Y Basis Point Change	AL Occupancy	Basis Point Change
1	Minneapolis, MN	94.7%	30	90.8%	-20
2	Baltimore, MD	93.9%	60	85.5%	-240
3	San Francisco, CA	93.7%	290	88.4%	-150
4	Cleveland, OH	92.8%	360	90.9%	30
5	Pittsburgh, PA	92.4%	100	92.2%	110
6	San Jose, CA	92.4%	-60	91.1%	-50
7	Boston, MA	91.7%	-30	93.3%	20
8	Portland, OR	91.5%	320	89.6%	20
9	Detroit, MI	91.4%	200	87.2%	120
10	New York, NY	91.1%	90	94.0%	10
11	Philadelphia, PA	90.7%	50	86.2%	-60
12	Kansas City, MO	90.1%	100	90.1%	220
13	Washington, D.C.	89.8%	10	91.9%	20
14	San Antonio, TX	89.6%	-60	89.4%	-40
15	St. Louis, MO	89.6%	100	89.8%	-170
16	San Diego, CA	89.2%	100	90.7%	370
17	Atlanta, GA	88.6%	210	88.9%	230
18	Los Angeles, CA	88.1%	-40	86.8%	130
19	Riverside, CA	88.1%	190	88.6%	130
20	Seattle, WA	88.1%	190	90.4%	90

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