SENIORS' HOUSING
LEGAL NEWS ALERT
November 2009

Ruskin Moscou Faltischek's Seniors' Housing Capabilities

- Licensing Applications and Regulatory Matters
- Real Estate, Construction and Financing
- Contract Drafting and Reviews
- Counsel and Advice on Third Party Deals
- Project Related Litigation
- Compliance Audits
- Fostering Alliances Between Housing and Healthcare Providers
- Exit Strategies
- Facility Sales and Refinancing
- Evaluating Model Types for Developers
- Federal and State Legislation
- Employment Matters
- Occupational Safety and Health Administration (OSHA) Regulations
- Antitrust Regulations
- National Labor Relations Act
- Copyrights and Trademarks

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Wayne L. Kaplan

The Industry Today

As the economy begins to shift gears from dismal to slightly improved, the seniors' housing industry sees some reason for hope. Senior housing valuations may have decreased 20-25% from peak to trough, but this is significantly better than overall commercial real estate – like offices or hotels – which have had to rely on commercial mortgage-backed securities for permanent, take-out financing and whose valuations have decreased by 40%. Economic conditions today are nowhere as severe as the "Great Recession" the country experienced from September 2008 to March 2009, but the continuing economic downturn has been clearly longer and more difficult than many of us have experienced before. And while Ben Bernanke, the Federal Reserve chairman, recently said that the recession was "very likely over," unemployment shows few signs of improving and foreclosures keep piling up. What little capital is out there is either afraid to make a move or is waiting for some tangible sign that we have bottomed out and the bad times are indeed over. There is still little or no conventional financing and agency financing (Fannie, Freddie & FHA) for refinancing or acquisitions is still hard to get and takes a very long time (if you can get it), even for stabilized properties. There probably won't be much activity for the balance of the year, but there are probably many in the industry that are gearing up to pounce once conditions improve and opportunities arise.

Private Pay Senior Housing

Stifel Nicolaus, the investment bank, sees four key reasons to invest in private-pay senior housing stocks.

1. *Need-driven nature of underlying demand* – Over the past year, most operators have grown both revenue and operating contribution despite occupancy declines. They believe the resiliency shown by operators in the face of a severe recession demonstrates the need-driven nature of the industry.

2. *Ability to adapt to recessionary/housing market pressures* – Operators stepped up marketing, improved their ability to properly price for services delivered and showed considerable pricing discipline. They have improved operating margins through improved purchasing, tighter controls on labor utilization and declining fuel and food costs. Improved operating efficiency should continue to benefit public operator performance going forward.

3. *Ability to rapidly increase earnings in an economic recovery* – In even a mild economic recovery it is expected that rapid earnings and cash flow growth will occur because the number of new senior housing units being delivered will drop dramatically in 2010, with a high degree of operating and financial leverage amplifying any improvement in fundamentals.

4. *Potential for industry consolidation* – A major consolidation transaction was recently announced that Stifel expects to close in 1Q10; they believe further consolidation is likely because large operators control only about 11% of the total supply.

There are an estimated 11,640 professionally managed private-pay seniors' housing properties in the U.S. today containing approximately 1.5 million units/beds. Since there is no financing available for new construction, one of the most attractive aspects of the private-pay seniors' housing market is that there will be very little new competition coming on-line in the next few years – leading to more stabilized occupancy for existing operators.

Cap Rates

For 1Q09, cap rates for independent living rose to 8.1%, compared to 7.6% last year and 7.7% in 2007. In assisted living, cap rates for 1Q09 were 9.9%, up from 8.8% in 2007 and 2008. To put those rates in perspective, the cap rates for the same quarter in 2003 – prior to the real estate boom – were 10% for independent living and 10.9% for assisted living.

The Aging Population & the Future

According to the U.N.'s latest biennial population forecast, by 2050 22% of the world's population will be over the age of 60 (compared with just under 11% today). In developed countries, this percentage will grow to 33%. Life expectancy in wealthy nations will increase from 77 at present to 83 by 2050. Worldwide, it will increase from 68 to 76 years by 2050. Estimates indicate that in 2050, one in three will be a pensioner and nearly one in ten will be over 80 years of age. The period of poor health typically preceding death is shorter than in the past few decades. Demographers call this "compression of mortality."
As a general rule of thumb, the bulk of spending on an individual's health care is concentrated in the last year or two of life, and particularly in the final six months.

What Other Experts Are Saying

"The prognosis of the senior housing industry is very good. Senior housing is still a young industry heading toward a time of great opportunity."

– **Penny Pritzker**, Chairperson,
Classic Residence by Hyatt

"… [W]e have seen a more steady occupancy level, week after week, month after month, in assisted living versus independent living, because of the need-driven nature of assisted living. What's interesting about this industry is not only that we disbanded our development teams, most companies have. Now, I think that's actually very positive for our industry, because it's unlikely in the next 3 – 5 years to see much of the supply coming online and, obviously, we're seeing demand pick up, occupancy pick up, the demographics are in our favor and I think that the outlook over the near term is very positive for senior housing."

– **Larry Cohen**, President & CEO of
Capital Senior Living

"We may have reached bottom, but we'll be bouncing along the bottom for a while."

– **Steve Gilleland**, Director of Healthcare
Real Estate for Capital Source

"Seniors' housing is ultimately a capital-intensive industry and capital is scarce and expensive."

– **R. Buford Sears**, Senior Vice President,
M&T Bank

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