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Senior housing investment market to remain positive over next several months

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Marcus & Millichap Real Estate Investment Brokerage Co. recently released a Seniors Housing Research Report. Highlights for each of the four property types are as follows.

Independent Living (IL): Occupancy levels in the IL sector fell to 94.1% 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% year over year to \$2,471 per occupied unit per month, in order to attract tenants.

Sales velocity in this sector has mirrored that of the nation's apartment market, falling significantly as the number of potential buyers in the market dissipates. With fewer properties selling, capitalization rates have increased 50 basis points to the mid-8% range. The median sales price has declined 28% 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.

Assisted Living (AL): AL facilities have felt the crunch of the current economic climate over the past year, with occupancy levels slipping 120 basis points to 94.3%. Nationwide, revenues have increased 4.5% year over year to \$3,543 per occupied unit per month.

The investment climate for AL facilities remains positive, though velocity will stay modest through the end of the year. Average capitalization rates have risen 40 basis points in the last 12 months to the high-8% range, and some assets traded at double-digit initial yields during the first part of 2008. Capitalization rates for high-end properties were in the high-6% 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% to \$136,600 per unit. Looking ahead, several states that have approved their budgets for 2009 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.

Skilled Nursing (SN): Fundamentals in the SN sector have remained relatively stable despite a national economic slowdown. Occupancy has decreased 70 basis points in that time to 93.2%. 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% of payments in SN properties originate from federal or state governments in the form of Medicare or Medicaid. The average per diem revenue has risen 4.2% 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.

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, capitalization rates have inched up 20 basis points over the last 12 months into the low-12% range. The median sales price has dropped 20% 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 capitalization rates in the sector are among the most attractive of any real estate property. Properties will remain in demand in the Northeast, where occupancy rarely falls below 96% and construction is limited by strict Certificate of Need guidelines and elevated building costs.

Dementia Care (DC): The DC segment continues to emerge as a standalone asset class in the seniors housing market. Occupancy in the sector, however, has fallen 180 basis points to 94.4%. Nationally, DC revenue growth of 5.4% to \$5,343 per occupied unit per month over the past year was the highest of the seniors housing asset classes.

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 capitalization rates in the 10% range, up 50 basis points from initial yields recorded one year ago. Some properties will likely exchange as high as the 11.5%, though capitalization rates are expected to remain below those in the SN segment.

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