SENIORS HOUSING REPORT

VIEWPOINT 2016 / COMMERCIAL REAL ESTATE TRENDS

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Has the Market Peaked?

The seniors housing market has had an incredible run over the past five years, as cap rates fell to historic lows, while investment activity soared. Seniors housing, once considered a "specialty niche" by investors, is now attracting more capital from institutional investors, sovereign wealth funds, and private equity.

Part of the reason is demographic trends. Baby Boomers began turning 65 in 2011 and are now turning 65 at a rate of more than 10,000 per day! This "graying of America" will lead to significant demand over the next few decades.

New supply has been increasing in response; NIC MAP© Data Service (NIC MAP) reported that seniors housing construction hit an all-time high in the fourth quarter of 2015, with units in the pipeline totaling nearly 49,000, representing 5.8% of existing inventory.

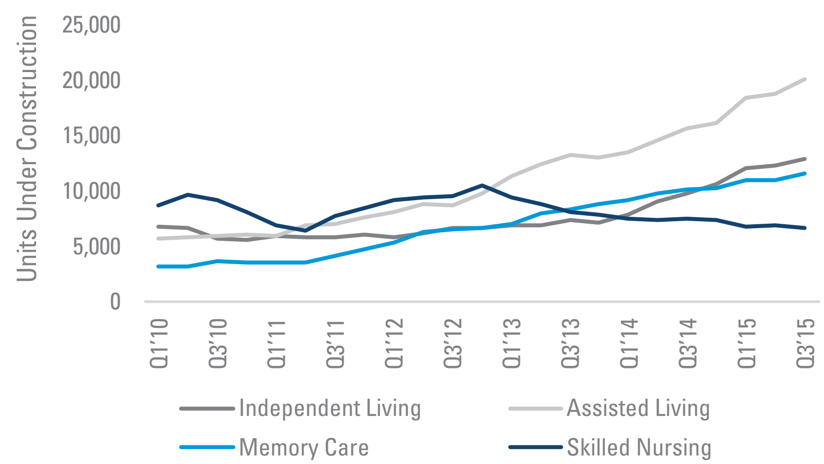
Individuals enter seniors housing at 80 years of age, on average. Baby Boomers won't significantly impact demand for another decade. However, growth in the age 80-plus population is forecast at 1.7% annually between now and 2020, more than twice the annual population growth rate of 0.8%, according to the U.S. Census Bureau.

Will the seniors housing market be the victim of its own success as the inflow of capital results in market saturation and funding of ill-conceived projects? Or will demand growth keep pace with the new supply, allowing market fundamentals to remain strong?

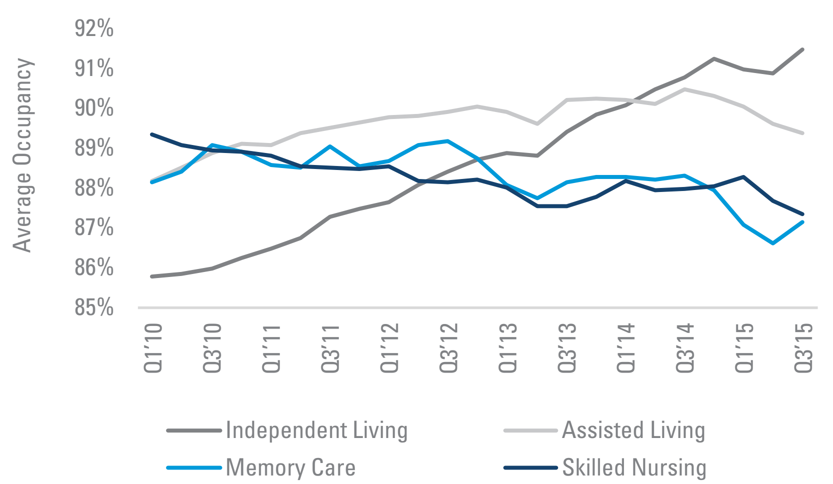
49,000

Number of Units in the Construction Pipeline as of Q4 2015

UNITS UNDER CONSTRUCTION - TOP 100 MARKETS



OCCUPANCY BY SECTOR - TOP 100 MARKETS



One Market, Many Variations

Part of the issue when it comes to analyzing seniors housing is its product variety, which includes four distinct sectors: seniors only apartments, independent living, assisted living (including memory care), and nursing. Market dynamics vary greatly by sector.

Seniors-Only Apartments: An Emerging Sub-Sector

Traditionally, the inventory of seniors-only apartments has consisted primarily of Low-Income Housing Tax Credit (LIHTC), HUD Section 202, and Section 8 projects. But over the past decade, a new generation of private-pay seniors-only apartments have emerged. Geared toward younger, healthier seniors who aren't interested in bundled services, such as meals or housekeeping, such projects offer extensive amenities without service levels found in independent living.

Market fundamentals for this sector are difficult to determine. These properties are lumped in with non-age-restricted apartments by the various data sources, or are sometimes classified as independent living. As a result, the statistics noted elsewhere in this analysis are exclusive of seniors-only apartments.

Independent Living and the Baby Boomer Wave

Nationally, the independent living market is the healthiest of the sectors, with the occupancy rate averaging 91.5% in the fourth quarter of 2015, marking its highest level since before the Great Recession.

New development in the sector has been more modest than in the assisted living sector. Assisted living was the most resilient during and after the economic downturn and, as a result, attracted more development capital in the post-recession period. But this trend has been changing, with more developers focusing on independent living. As of the fourth quarter of 2015, NIC MAP reported 18,867 independent living units under construction, representing 3.9% of the existing inventory.

The Independent Living Market is the Healthiest, with Occupancy Rates averaging 91.5%

The current wave of independent living under developement is exhibiting the changing tastes of consumers. In an effort to lure Baby Boomers, many projects boast modern architecture with larger units featuring premium finishes such as granite countertops, stainless steel appliances, and upgraded flooring. Another emerging trend is that many new projects are being built in infill locations, where residents have the ability to walk to restaurants, shops, and cultural attractions.

Action in Assisted Living and Memory Care

Development activity in the assisted living and memory care segments has been strong for several years and shows few signs of abating. NIC MAP reported that, as of the fourth quarter of 2015, approximately 30,000 assisted living units were under construction, representing 8.3% of existing inventory.

The focus on development in the assisted living and memory care sectors is due to several factors. Assisted living and memory care assets performed extremely well during and following the Great Recession, leading to investor perception that these sectors were recession-resistant, and thus, a safer bet in comparison to other real estate. Furthermore, these assets are generally smaller, less expensive projects, with developers locating sites, equity, and financing more easily. This is especially true of the memory care market, where smaller facilities are typical.

As a result of new supply, occupancy levels dipped from a high of 89.3% in the third quarter of 2013 to 88.5% at the close of the fourth quarter of 2015, according to NIC MAP. But in some markets, supply delivery has been much higher and occupancy levels have dipped more dramatically. For example, in the Houston market, the supply of memory care has more than doubled over the past five years and the average occupancy has fallen below 80%.

In 2016, continued supply is likely to erode occupancy levels in certain markets. Markets at risk include all the major Texas markets, plus Atlanta, Sacramento, Salt Lake City, and many markets in Florida.

Skilled Nursing – Less Construction, Shorter Stays, Cap Rate Compression

The nursing market consists of two sub-segments: long-term care funded by Medicaid, and short-term rehabilitation care funded primarily by Medicare, insurance, and private-pay payment sources. This latter type of care is increasingly being lumped into the post-acute care category. Such facilities can compete against other nursing homes, as well as Long Term Acute Care Hospitals (LTACHs) and Inpatient Rehabilitation Facilities (IRFs).

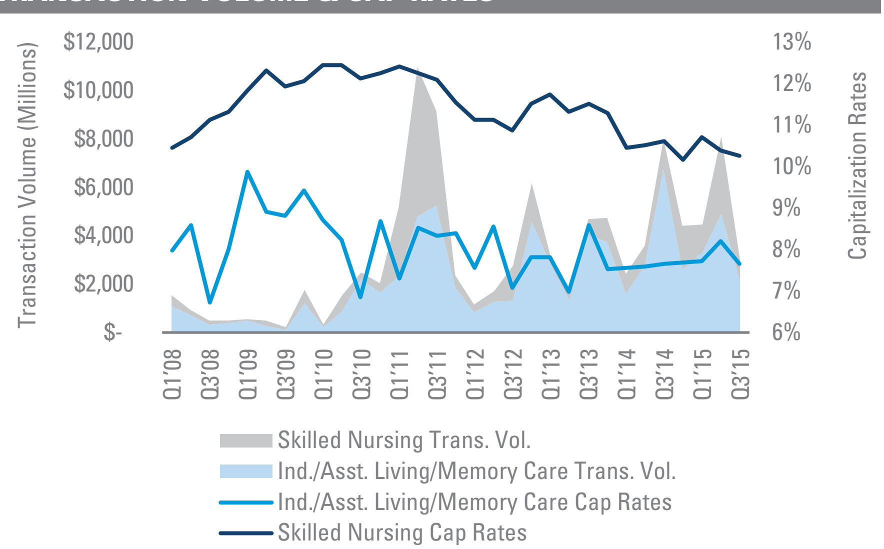
Overall, the supply of nursing home beds in the US is contracting, a trend likely to continue as older facilities are closing at increasing rates. Nationally, NIC MAP reports only 7,051 beds under construction. The new generation of nursing homes being built bear little resemblance to the nursing homes of the past. The newer facilities offer amenities such as private resident rooms, expansive therapy areas, bistros and swimming pools.

Minimal new development will take place in 2016; development that does occur will be focused on the post-acute segment. But this sector has some headwinds, with the increasing prevalence of Medicare Advantage creating revenue declines and average lengths of stay are continuing to grow shorter.

Increased Supply in Memory Care and Assisted Living Facilities has Led to a Dip in Average Occupancy to 85.5%

While nursing home investments were out of favor for several years, investors are paying closer attention, and increased competition has led to cap rate compression. Premier facilities can now sell at cap rates below 12%, and a few sales have cracked the $100,000-per-bed barrier. As capital continues seeking richer returns, look for a continued decline in nursing home cap rates.

TRANSACTION VOLUME & CAP RATES



Strong competition for seniors housing investments during 2015 resulted in soaring valuations and decreasing capitalization and yield rates. NIC MAP reported a four-quarter rolling average sales price for seniors housing, exclusive of skilled nursing, of $174,000 per unit, a 72% increase from the $101,000 reported in 2010.

Capitalization rates for assisted living and independent living remained low by historical standards, with Class A+ projects trading in the 5% range. The more common Class A- and Class B projects have generally been selling with cap rates in the 6%-7.5% range. The risk premium that used to exist between independent and assisted living facility cap rates has essentially evaporated. Investors are showing preferences for properties with multiple levels of care, located in markets with strong barriers to entry.

The four-quarter rolling average price-per-bed in the skilled nursing sector was $72,000, an increase from 2010's price of $53,745. These days, it's not uncommon to see facilities selling for upwards of $100,000-$200,000 a bed, a price that would have been considered unrealistic even a few years ago. Nursing home cap rates have also declined. In most cases, sale/leaseback transactions are closing in the 8%-9% range, and "going concern" sales are being transacted in the 11%-13% range. Increasingly, higher-quality facilities are trading at the low end of the range.

The recent decline in REIT stock prices has had an impact on the ability of the Big Three seniors housing REITs (HCP, WellTower, and Ventas) to dominate the acquisition market as they did for most of 2015. All are off by 7% or more from their 52-week highs.

Cap Rates for Assisted and Independent Living Assets have been in the 5% Range

Due to the REIT pullback, turbulence in the stock market, and overbuilding concerns, the acquisition market has softened. An IRR survey of active market participants conducted in January 2016 revealed that more than 80% of respondents believe that the independent and assisted living markets are at or past their peak. Respondents were more optimistic about the nursing home market, with 39% indicating that the market has not yet peaked, and only 19% saying the skilled market is post peak.

Where to Go from Here

IRR is forecasting saturation of assisted living and memory care segments in some of the markets where development has been the most active. This will lead to lower occupancy levels and rents in those markets. However, there appears to be a massive amount of capital available to swoop in and scoop up any troubled projects. So, while there could be more distressed deals in 2016, the number of buyers chasing them will likely keep pricing relatively high.

Longer term, a worker shortage looms as the ratio of working-age adults to seniors will continue to decline for the next few decades. Finding and retaining staff is a challenge for seniors housing owners and operators.

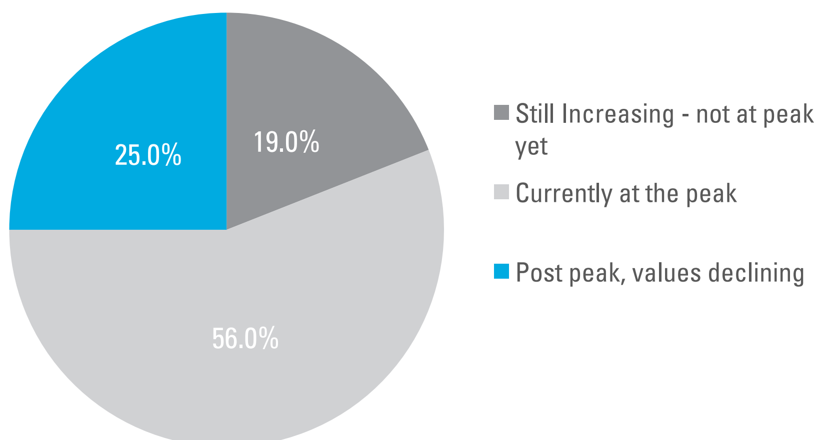
Another record-setting year for transactions is likely not in the cards for 2016, unless significant consolidations take place among public companies. Transactions will continue at a healthy pace; but with the Big Three REITs being not nearly as aggressive, the market should not be as frothy as it was in 2015.

Valuations appear to have peaked in late 2015, and should generally remain stable or decrease very slightly in 2016. Interest rate increases this year could have some impact on the market, but seniors housing tends to have lower leverage than other property types, reducing the impact of interest rate fluctuations.

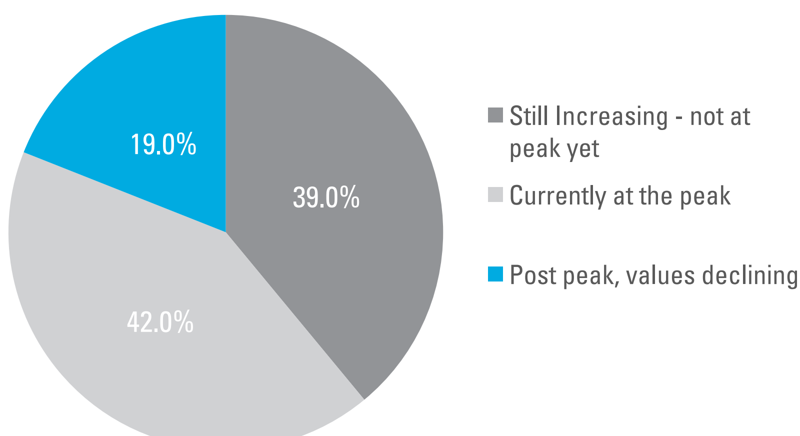
Over the long term, seniors housing will be a great asset class for capital deployment, as it will benefit from favorable demographic trends and continue to be more recession-resistant than other asset classes. This will lead to increasing institutional investments in the sector, in turn, leading to increasing sophistication in the market.

Finding and Retaining Staff is a Challenge for Seniors Housing Owners and Operators

INDEPENDENT & ASSISTED LIVING



NURSING CARE



Comprehensive Commercial Real Estate Market Research, Valuation and Advisory Services

About IRR

Integra Realty Resources (IRR) is the largest independent commercial real estate valuation and consulting firm in North America, with over 218 MAI-designated members of the Appraisal Institute among over 875 professionals based in our 58 offices throughout the United States and the Caribbean. Founded in 1999, the firm specializes in real estate appraisals, feasibility and market studies, expert testimony, and related property consulting services across all local and national markets. Our valuation and counseling services span all commercial property types and locations, from individual properties to large portfolio assignments.

About Viewpoint

IRR's Viewpoint represents the compilation and presentation of Commercial Real Estate (CRE) rates, market conditions, and forecast data. The rates, market conditions, and forecast data is generated via IRR's Viewpoint Survey. IRR's Viewpoint Survey requests market experts consisting of Appraisers and Consultants, each of whom have deep CRE expertise, to provide insights on over 60 U.S. markets. Viewpoint data is collected across five asset classes including Multifamily, Office, Retail, Industrial, and Hospitality.

Viewpoint's rates data (Cap Rates, Discount Rates, Reversion Rates, Vacancy Rates, etc.) reflects an expert's opinion based on recent market activity experienced in the past 6 months. Viewpoint forecast data represents a 12-month outlook based on current market conditions. The data in Viewpoint reflects rates data and forecasts based on stabilized properties in the respective U.S. marketplace. Where referenced, all regional and national averages are based on simple average calculations and are not weighted.

IRR's Viewpoint Survey is conducted through a proprietary data survey tool, and all data is checked both manually and by a specially designed computer editing procedure. While we do not guarantee that the survey is statistically accurate, the Viewpoint data provides, what we believe, is the best, clear-sighted insights into the CRE marketplace.

Sources

Written By: Charles A. Bissell, MAI, ASA, CRE
IRR Seniors Housing & Health Care National Practice Leader

Units Under Construction - Top 100 Markets
Source: NIC MAP Data Service

Occupancy By Sector - Top 100 Markets
Source: NIC MAP Data Service

Transaction Volume and Capitalization Rates
Source: NIC MAP Data Service

Independent & Assisted Living
Source: Integra Realty Resources

Nursing Care
Source: Integra Realty Resources

Cover Photography

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