

# MID-YEAR FINANCIAL REVIEW SHOWS OPTIMISM IN SENIORS HOUSING AND CARE

## Areas of Concern Also Cited by Lenders and Investors

ANNAPOLIS, Md. – A review of the first-half of 2006 confirmed that seniors housing and care is a “hot” market, according to financiers on a recent conference call held by the National Investment Center for the Seniors Housing & Care Industry (NIC). The call featured five lenders and investors – from three of the top commercial finance companies, one of the largest real estate investment trusts (REITs) and one of the largest institutional equity investors – who are actively providing financing to the seniors housing market. “One observation that came up time and again was that it’s a good time to be a borrower in seniors housing and care,” said Anthony J. Mullen, NIC research director. “But the lenders and investors on the call also expressed legitimate concerns about the financing environment going forward.”

The financiers on the call acknowledged the growing competitive environment. “It’s definitely been a competitive market over the last 12 to 18 months where everybody’s struggling to deploy capital,” said Kevin McMeen, managing director at Merrill Lynch Capital. “Seniors housing is a very attractive industry right now based on the fundamentals and it’s drawing in a lot of new capital providers, both larger national money-center bank types, investment banks, as well as some of the local and regional banks. That’s resulting in competition for individual transactions, which is pushing spreads down and leading to situations where leverage is more aggressive.”

Sarah Sumner Duggan, senior vice president of Seniors Housing and Health Care Financing for Capmark Finance Inc. (formerly GMAC), noted that “There’s always been competition on the good deals, but now we’re seeing a lot of companies taking deals on weaker transactions that we would not have seen in the past.” She noted that there’s been a lot of business placed with Freddie Mac and Fannie Mae, and with some foreign banks that have entered the market during the last six months.

Institutional equity and pension funds are also increasingly investing in the sector. “I think it’s a strong vote of confidence in the industry that you’ve got quality institutional groups that are stepping up and saying, ‘I want to participate now on the equity side,’” said Jim Pieczynski, co-president of the HealthCare & Specialty Finance Group at CapitalSource. He pointed to GE Capital’s recent purchase of Formation Capital’s nursing home portfolio as an example of a transaction that “is going to have additional institutions looking at the nursing home industry.”

Balancing this optimism were concerns expressed about the industry, with one of the biggest being the rising interest rates. “This is particularly disconcerting as it relates to assisted living and independent living,” said Pieczynski, “where we’ve seen cap rates that have dropped into the 7s. As long-term rates move up, they can have an impact on valuation, and ultimately, the ability to service debt.”

Raymond Braun, president of Health Care REIT, noted that rising interest rates could impact financing in other ways. “We’re going to see rising cap rates and exit cap rates may not approximate cap rates that are being used to purchase assets right now,” he said. “That’s certainly going to be a risk for people who have short-term needs to refinance or

sell.”

Another issue that could impact future financing decisions is the obsolescence of buildings. “There’s a huge need for the replacement of skilled nursing facilities and the question of how the states are going to be willing to pay for them,” said Sumner Duggan.

Braun pointed out the remodeling needs on the assisted living side. “We’re seeing a lot of the older buildings that are filled with studios becoming functionally obsolete and consumers demanding more one-bedrooms or two-bedrooms,” he said. “So I think there’s a large group of properties out there that are not going to be sustainable for a long period of time.”

Labor was another concern, both from a cost-control standpoint, and in the need to find and retain top management and employees. Another concern was an overbuilding of assisted living and independent living properties, especially with the flattening senior demographics between now and 2011.

“One of my concerns is that there’s some financial engineering that’s replacing portfolio management and underwriting fundamentals,” said Braun. “While that’s attractive in the short run to segregate yield and risk, a lot of these structures will not withstand the inevitable down cycle. We’re concerned about that from an industry perspective, because we have worked very hard to become a mainstream asset class and the last thing we need to see is another period like we had in the late ‘90s.”

“An issue that concerns me most is the integration of consolidated companies, especially as it relates to the potential for operational missteps,” said Kathryn Sweeney, principal at AEW Capital Management LP. “As the firm’s band of control increases, will its ability to oversee the day-to-day operations keep pace with the increasing size of the company?” Each quarter, industry leaders who subscribe to NIC’s Executive Circle participate in a conference call, where they hear panelists discuss hot-topic issues concerning the seniors housing and care industry.

Founded in 1991, the National Investment Center for the Seniors Housing & Care Industry is a nonprofit organization providing information about business strategy and capital formation for the senior living industry. Proceeds from its annual conference – scheduled for Sept. 27-29, 2006 in Chicago, Ill. – are used to fund research on issues of importance to the industry.

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