Marcus & Millichap

Seniors Housing Research REPORT

September 2005

Discriminating Investors Seek Opportunity as Seniors Housing Matures

The outlook for the seniors housing market is increasingly positive. Facilitated by a slowdown in construction, occupancy in existing communities continues to climb from the lows recorded in 2002 and has surpassed 90 percent in many metros. Operating models have become more homogeneous and well defined, which has helped lift margins to enticing levels. As a result, investor appetites are high, but finding good, well-priced product has become a challenge. Fueling increased competition are institutional investors, who have raised their stake in the market over the past several months. Owners have witnessed healthy asset appreciation due to the impact of both improved operations and falling cap rates.

Stringent Buyer Requirements Make Finding Property a Challenge

Investment activity today mirrors the heated pace of the mid-to-late 1990s. Cap rates have returned to similar levels, occupancy rates are up, and capital is more plentiful than ever. What is different today is the sophistication of the buyer. Today's seniors housing investors, and the industry in general, have a clearer sense of what works and what does not. Operating models are more defined as a result. Larger unit sizes, quality locations, state-of-the-art amenities and a clearer sense of service levels and the average associated costs drive today's growing pool of investors. As a result, time on the market for quality properties has shortened tremendously and portfolio sales have risen. Conversely, time on the market for older properties with smaller unit sizes and antiquated service levels has lengthened. Today's discriminating investors are finding it difficult to accept the risk associated with turnarounds or redevelopment plays at current prices.

Skilled Operators Lifting Margins

The seniors housing industry has emerged successfully from a period when developers and investors, with several different business models, flooded the market. Gone are participants that viewed the industry as a development play or a hospitality business model. Skilled operators are beginning to dominate the landscape, which is resulting in improved operations. As a result, average margins for quality properties are up across all sectors. The independent-living (IL) sector is reporting margins in excess of 40 percent, while assisted-living (AL) margins have risen to over 30 percent for larger communities. Skilled nursing (SN) has also reported gains, with margins for quality facilities in the 11 percent to 13 percent range.

Executive Summary

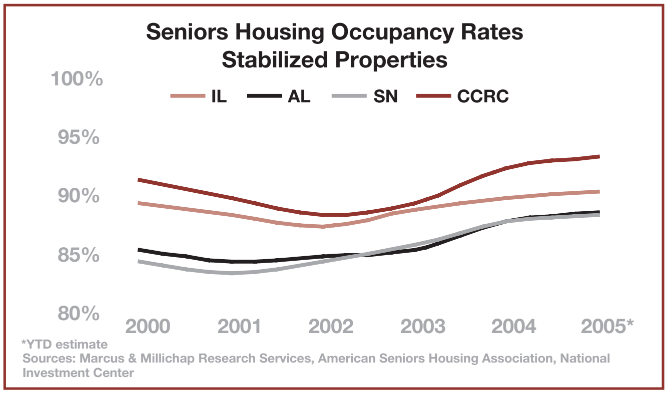
- Overall, occupancy is improving. The once severely overbuilt AL sector is now posting occupancy of 94 percent in many major metros.
- Revenues increased across all sectors over the past year. Independent living (IL) facilities enjoyed the greatest gain of 5 percent per occupied unit, followed by a 3.1 percent increase in per diem revenue in the skilled nursing (SN) sector.
- There are currently 33,000 seniors housing units under construction that are slated to come online over the balance of 2005. Seniors apartments represent the majority of new units.
- Cap rates have fallen to historic lows. The average in the AL sector has eased to 10 percent from 11.5 percent three years ago. Cap rates for IL and SN are running at 9.5 percent and 13 percent, respectively.
- Pension funds and other institutions are fueling bidding wars for institutional-grade properties. Prices, however, have remained relatively flat in the lower tiers of the market.

Average Cap Rate Trends (Last 12 Months)

IL	AL	SN	CCRC
9.5% down 50 basis points	10.0% down 80 basis points	13.0% down 50 basis points	9.7% down 80 basis points

Independent-Living Facilities

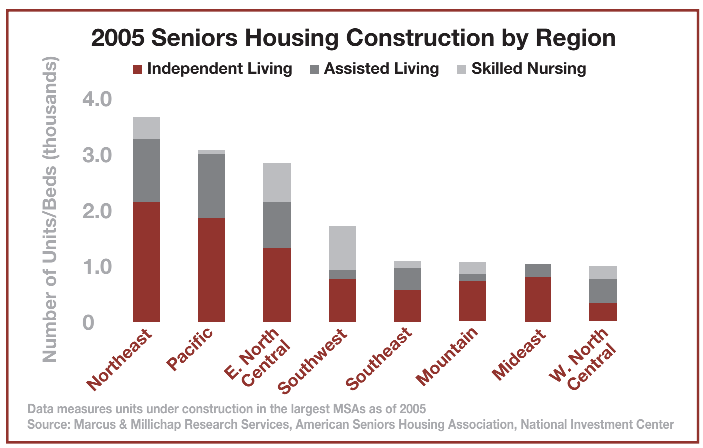
The IL sector continues to outperform its seniors housing counterparts. The nationwide occupancy rate has remained relatively flat over the past few quarters at 91 percent; however, when analyzing the 30 largest MSAs, occupancy rises to 95.1 percent. Boston, Baltimore and Washington, D.C., all boast occupancy rates above 98 percent, which has lured many developers to the northeast. As a result, the majority of the 8,400 IL units expected to be completed this year are located in the northeast, which could dampen revenue growth over the near term. Comparatively, the revenue outlook for Orlando and Miami is stronger. These markets are relatively undersupplied and have limited construction activity. Similar dynamics are found in Sacramento, Los Angeles and the Bay Area. Despite rising occupancy, concessions remain prevalent in many markets.



In the past, cap rates for IL facilities have been more than 300 basis points above traditional apartments, but the gap is narrowing. While IL cap rates average 9.5 percent, quality facilities have sold at 8 percent, 150 to 200 basis points above the apartment average. Investors have been tempted by heftier yields and higher operating margins in the IL sector. While the average price fell slightly in 2004 to $71,600 per unit, this was not indicative of market fundamentals. Only 35 percent of the sales involved stabilized properties with occupancy at 90 percent or better. Stabilized properties traded for an average price per unit in excess of $100,000, compared to $55,000 per unit for unstabilized properties. This year, a few quality portfolios have sold. One example is the announced sale of a six-community portfolio from Meridian Retirement to Canadian interest Chartwell Seniors Housing REIT for approximately $222,000 per unit. The combination of large sales and cap rate compression are expected to push the average price to over $90,000 per unit this year, with another 5 percent to 10 percent gain forecast in 2006.

Assisted-Living Facilities

The AL sector continues to improve, with overall occupancy up 70 basis points so far this year to 88.7 percent, following a 250 basis point gain in 2004. Of the 30 largest MSAs, several are now reporting occupancies above 93 percent, and the number of fully occupied facilities has grown to nearly 25 percent of the inventory. While positive, this suggests that there are several facilities still underperforming, offering a pool of assets for opportunistic investors. Consistent with the IL sector, occupancy remains highest in the northeast, led by New York, Boston and Washington, D.C., and followed by San Jose and San Francisco. When assessing supply/demand indicators, the strongest markets are San Jose, Sacramento and San Diego.

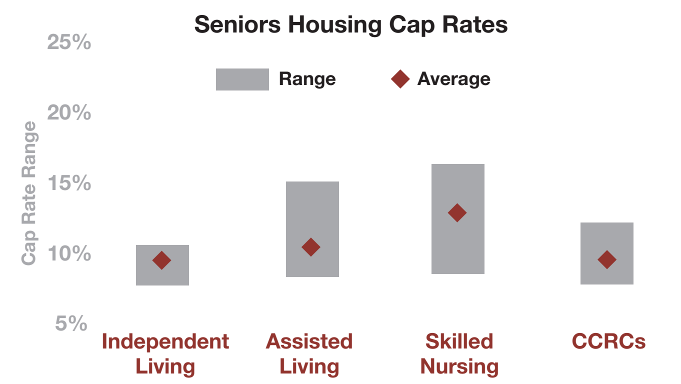


Improved operations are drawing investors back to this once supply-plagued sector. As a result, values are climbing, with the average price per unit currently up 2 percent from 2004 to $97,000. Cap rates have fallen to an average of 10 percent, with some assets trading in the low- to mid-8 percent range. Furthermore, there have been some large portfolio sales announced in recent months at sub-8 percent cap rates. In the mid-1990s, capital flowed into the AL sector, putting upward pressure on prices. This ultimately contributed to financial stress in the industry. This time around, however, AL prices are rising in response to improved operations. As long as construction remains restrained, we expect continued improvement in operations. Investors and developers should note, however, that demand in the AL sector is growing at 3 percent per year, and a spike in demand is still years away.

Skilled-Nursing Facilities

Consistent with the overall seniors housing industry, the SN market continues to climb up from the bottom reached in 2001. Occupancy is rising and currently stands at 88.5 percent, with Minneapolis, New York, Philadelphia and Tampa boasting occupancy rates above 95 percent. Construction remains modest with only 2,400 units under way.

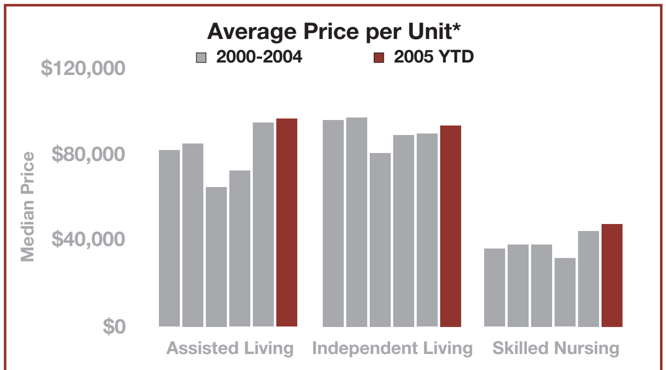
The shift in the SN investment environment has undoubtedly been the most remarkable in the industry this year. The average price per bed soared to $44,000 in 2004 and has jumped to approximately $50,000 this year. While the average cap rate has declined to 13 percent, they can range from 8.5 percent to 16.5 percent. This suggests that owners are bringing high-end properties to market. Several factors have supported value growth, including a shift in the buyer profile. After years of consolidation, larger owners have sold many assets to local or regional operations. Many of these buyers have been willing to pay higher prices, confident in their ability to increase cash flow through lower cost structures and a deeper understanding of local market nuances. It should be noted, however, that many local and regional buyers have been funded by institutional sources. Also, the Medicare rate increases initiated in 2003 have gone a long way to buoy operators' financial statements and profits over the past 18 months, and anticipated Medicaid cuts have not yet materialized. In 2006, however, a revision in payment systems will be adopted. In June 2005, The Centers for Medicare and Medicaid Services (CMS) announced the final rules related to payment rates to nursing centers. Inherent in these rules is an increase in the indexing of resource utilization groupings, with the number of categories rising from 44 to 53. In doing so, the CMS will eliminate the 20 percent add-on for higher-acuity care. Kindred Healthcare estimates this action will reduce their payment receipts by 4.5 percent in 2006. SN margins, which currently range from 11 percent to 13 percent for healthier properties, will be affected.



Source: Marcus & Millichap Research Services, National Investment Center, Irving Levin and Associates, Inc.

Continuing Care Retirement Communities

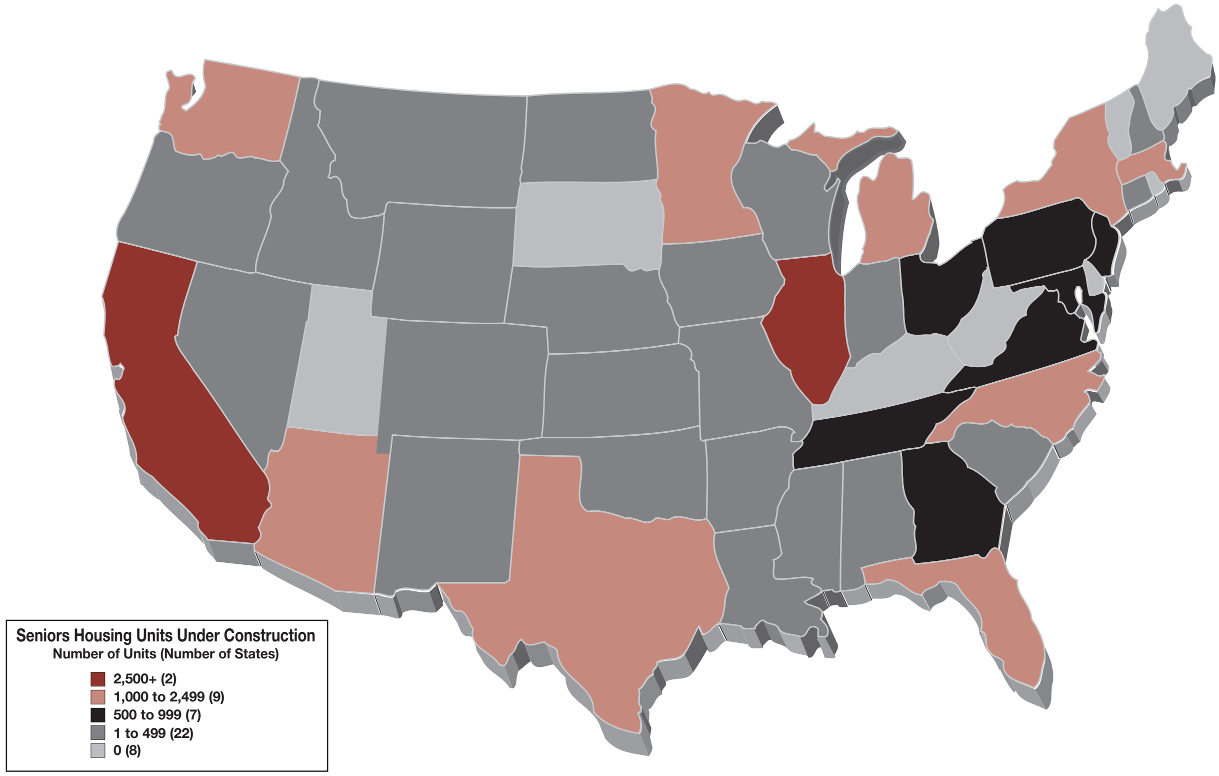
Continuing Care Retirement Communities (CCRCs) continue to demonstrate their desirability among the senior population. Across all types of service levels, occupancy remains highest in the CCRC sector at more than 94 percent. When measuring the 30 largest markets, occupancy approaches 96 percent. Within these MSAs, occupancy is above 96 percent for the IL and AL components of the community, while occupancy in the SN component is slightly below 94 percent. The average annual turnover rate for CCRCs is less than 29 percent, excluding turnover associated with skilled-nursing beds. CCRC residents typically have a financial interest in staying, as private-pay arrangements account for 40 percent to 60 percent of receipts. Despite healthy fundamentals and increased construction this year, CCRC transactions will remain minimal, due in part to the nature of ownership, which has a significant non-profit component.



* Price per bed for Skilled Nursing
Source: Marcus & Millichap Research Services, Irving Levin Associates, Inc.

Summary

The outlook for the seniors housing industry continues to brighten. We expect that further improvements in operating performance over the coming year will lure more investment dollars to the market, and renewed interest from institutional investors should fuel further price appreciation. This could, however, dampen activity among owner-operators who are interested in expanding, as their cost of capital is higher, which will hinder their ability to successfully bid on assets. Notwithstanding, peering into 2006, the market and associated investment opportunities will look much healthier than in recent years.



Recent Sales Highlights

Property Type	Property Name	Address	City	State	Sales Price	No. of Units/Beds*	Price per Unit/Bed*
AL	GHV Portfolio	Various Locations	Pittsburgh	PA	$58,000,000	622	$93,248
AL	Elysium of Boca Raton	2600 NW 5th Avenue	Boca Raton	FL	$7,000,000	144	$48,611
AL	Sun Valley	2156 House Street	Beloit	WI	$3,275,000	70	$46,786
AL	Grand Court	1219 Holland Lake Pl.	Weatherford	TX	$3,200,000	86	$37,209
AL	Magnolia Garden	594 Murray Hill Road	Southern Pines	NC	$2,250,000	56	$40,179
CCRC	Hamilton Community	31869 Chicago Trail	New Carlisle	IN	$9,000,000	375	$24,000
IL	Mission Club Apts.	6739 Mission Club Blvd.	Orlando	FL	$29,800,000	356	$83,708
IL	The Patrician	4025 Pulitzer Place	San Diego	CA	$19,085,000	136	$140,331
IL	Lake Worth Gardens	3927 Hadjes Drive	Lake Worth	FL	$10,350,000	170	$60,882
IL	Meadowglen	12465 Scenic Lake Drive	St. Louis	MO	$7,700,000	208	$37,019
IL	The Lakes	5666 E. Hampton Street	Tucson	AZ	$7,650,000	144	$53,125
IL	Presidential Place	3880 S. Circle Drive	Hollywood	FL	$5,250,000	104	$50,481
IL	Caro Senior Village	1601 West Gilford	Caro	MI	$3,000,000	100	$30,000
IL	Beehive Home Quality	1125 Brockdell Drive	Colorado Springs	CO	$1,790,000	30	$59,667
IL	Talaford Manor	900-918 Tollgate Drive	Oxford	OH	$1,350,000	30	$45,000
SN	Woodcrest Manor	3876 Turkeyfoot Road	Elsmere	KY	$8,250,000	127	$64,961
SN	Plaza Care Center	2005 Ashland Avenue	Toledo	OH	$7,700,000	180	$42,778
SN	Franklin Care	12900 W. Chicago Street	Detroit	MI	$4,100,000	57	$71,930
SN	New Perspective	760 Old McHenry Road	Wheeling	IL	$2,536,000	36	$70,444
SN	Signet Health	1505 Orrin Road	Prescott	WI	$1,600,000	61	$26,230

* Number and price per bed applies to sales of SN facilities

AL = Assisted-Living
ALZ = Alzheimer's Unit
CCRC = Continuing Care Retirement Community
IL = Independent-Living
SN = Skilled-Nursing

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Sources: Marcus & Millichap Research Services, American Health Care Association, American Legislative Exchange Council, American Retirement Corp., American Seniors Housing Association, Assisted Living Federation of America, Capital Senior Living Corp., CoStar Group, Inc., Council for Affordable Health Insurance, Eli Research, Irving Levin Associates, National Investment Center, Property and Portfolio Research (PPR), Sunrise Senior Living, Inc., Ziegler Capital Markets Group.

Marcus & Millichap
Real Estate Investment Brokerage Company

Edited and prepared by
James H. Holt
Senior Market Analyst
Research Services
2398 E. Camelback Road
Suite 550
Phoenix, Arizona 85016
Tel: (602) 952-9669
jholt@marcusmillichap.com

Marcus & Millichap
NATIONAL SENIORS HOUSING GROUP

Gary R. Lucas
Managing Director
750 Battery Street
5th Floor
San Francisco, California 94111
Tel: (415) 391-9220
glucas@marcusmillichap.com

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Internet address: www.MarcusMillichap.com