Seniors Housing Newsletter

HEALTHTRUST

Welcome

Volume 1, Quarter 1, 2010

Greetings from HealthTrust

I would like to make a few points as we re-inaugurate HealthTrust's quarterly newsletter. For those of you who have followed our Firm over the years, first as Gulf/Atlantic, then during our stint at Pricewaterhouse Coopers, and finally our emergence as HealthTrust, you know that we have at various times had newsletters. In the early years they were less substance and more whimsy, at PWC we neglected them altogether (too much bureaucracy to contend with), and at HealthTrust we have sporadically offered them.

However, I am continually asked to speak at various industry events on the topic that I know best, valuation trends in the healthcare and seniors housing industry. Over the years, we have steadily built up the practice to the point that we now have specialty groups within HealthTrust. These teams include those dedicated to HUD, CCRC's, portfolio transactions, feasibility and market studies, and of course the traditional block and tackling of our business, healthcare and seniors housing appraisals (including ALR's, ILR's, SNF's, Hospitals, MOB's, and CCRC's). Each product line has its own uniqueness but generally they operate in tandem. Our goal will be to make sure we do not bore, and have interesting perspectives each quarter from a valuation point of view.

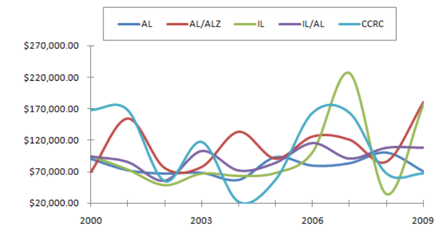
Market Update with Alan Plush

Industry Snapshot

What a time it is. After the initial shock of the "great recession", we now find ourselves in a strange calm. Is it after the storm or the calm between the storms (the eye of the hurricane as it passes over)? There are two distinct camps out there, and honestly I am on the fence as to which is correct. Who cares? Well, seniors housing is more of a consumer choice as you move down the acuity scale. Independent Living has a small need driven component, Assisted Living is mid range on the scale, and of course Skilled Nursing is almost purely need driven. Recession proof components are better the higher up you go on the need driven scale, so we see that the segment with the largest worry lines under their collective eyes are the ILR folks. We have seen that in our practice, noting that ILR's include CCRC's (entry fee model) as well as rental product. This is due primarily to difficulty in selling single family residences or to the lower price levels, or both. Do you hear a "but" coming?

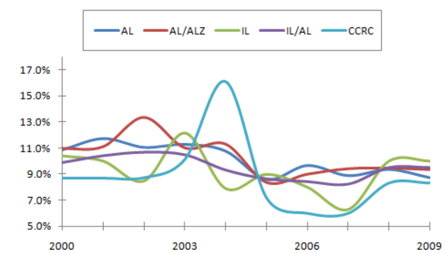
We continue to see relatively good occupancy rates across the board. I say "relatively good" because, having done this for quite a while (the actual duration of my career is classified), I have seen much worse. While liquidity remains challenged for our space, fundamentals remain strong.

Price Trends



Source: ASHA & HealthTrust

Cap Rate Trends



Source: ASHA & HealthTrust

HealthComps 2.0

HealthComps has undergone some exciting changes! Our proprietary database with thousands of properties nationwide now provides more detail, better searching, targeted results, and reporting. This allows us to provide our clients with the highest quality products and services.

This is a perfect storm brought on mainly by competent operators (the industry as we know it is 25 years old and fortunately we HAVE learned something along the way) coupled with a startling lack of new construction. NIC Map (nic.org) reports occupancy holding steady in all asset classes, at approximately the 90% level. I say approximately because the industry is still evolving to better reporting of data and even on a good day it's never going to be perfect. So we can say 90%+/-, at which level most facilities work fine. Yes, there are rent concessions; yes people are working weekends to keep facilities full; yes expense management has become a focus. However, employee retention is less of an issue (thank the US unemployment measure of 17.5% for that).

Capital structure seems to be at the root of most difficulties. Take Sunwest for example. This is a classic case of a good idea done too many times, with the last deals pushing the company into bankruptcy. The days of abundant cheap capital are behind us, the Federal Government is sopping up all of the excess liquidity in the world like a shop vac in a saw mill, so we will likely continue to see debt restructuring issues going forward caused by lower loan to value or higher coverage criteria, or both. However, we are seeing far fewer issues on the operational side than in past downturns. The credit crunch came at just the right time to stop a wave of new development, and what is getting done now is primarily being done by knowledgeable operators. Any large "overhang" of poorly conceived assets run by inexperienced folks is unlikely.

On the nursing side, clearly the largest headwinds emanate from the state and federal governments. Reimbursement risks, something we like to call the "stroke of the pen effect", are in focus now. The budgetary winds clearly favor at BEST a flat line of nursing reimbursements. At worst, we could see 3-5% declines in revenues for a few years, as the economy recovers. There is no science in this, nursing home reimbursements are politicized hence impossible to forecast. Also, I have observed that every 5-7 years, whether it needs it or not, reimbursement seems to get whacked. Based on my purely anecdotal logic, I see flat or marginally declining reimbursements for the SNF sector for a few years. This will vary by state, of course, with some worse than others.

All of this contributes to a strange phenomenon. Limited transactions. Sellers remain patient since fundamentals aren't forcing transactions of marginal assets. Buyers expect better yields (lower prices) given the fallout of the "great recession" on most other real estate asset classes. So we have a stare down instead. This is not confined to our sector. The WSJ recently reported concern that there are too many vulture funds and REIT liquidity is very high, yet there is very little to buy. We have the marquis deals (Erickson, Sunwest, Sunrise) but little else in our sector. The same is true again of other real estate sectors. My guess? First or second quarter of 2010, collectively the market will say enough is enough and transactions will start to occur, though at a constrained level. Hopefully, by Q1 or Q2, some clarity will emerge but until true stability returns in the form of lower unemployment, I personally don't think much serious activity will occur.

Please enjoy our newsletter. You will see recurring items (cap rates, sales write-ups, case studies) plus rotating articles by our Partners. I hope the new year is enjoyable for you and yours, and that this is a V or a Swoosh, not a W or an L recovery.

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