Seniors Housing Newsletter

HEALTHTRUST

Market Update with Alan Plush, MAI

The Stroke of the Pen

It has become commonplace to discuss long term care (nursing home) cap rates as being higher than senior housing (AL and IL) due to the "stroke of the pen" risk. This is jargon for the possibility of a surprise reimbursement reduction at either a state or federal level. The cap rate is a measure of risk, and the thinking goes that since the risk of a capricious rate reduction is always present, the cap rate needs to be higher (and values lower) to buffer this risk. In exchange, nursing homes in most states enjoy quasi-monopoly protection from competition to ensure greater efficiency thus occupancy risk is generally less in long term care than other senior housing (private pay) assets.

As an example of the magnitude of the risk premium, while we had a practice in Canada I observed that their cap rates for long term care ranged from 8-9% where those in the US for similar assets ranged from 12.5-14%. The simple explanation is that reimbursement in Canada is not politicized, unlike the US where it is subject to periodic arbitrary and capricious changes. Furthermore, in Canada there is virtually no legal risk from medical liability cases while in the US it seems to be a national pastime.

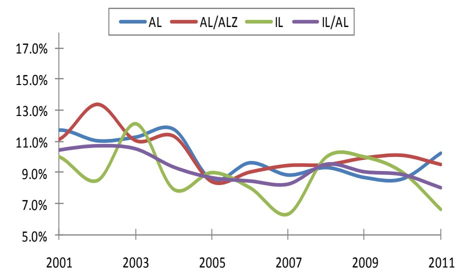
So, when CMS released rate cuts, a year ahead of schedule and with cuts at the draconian end of the spectrum, a few weeks ago, nursing home stocks were crushed, analysts at all of the major and minor operators and REIT's scurried to their models, and operators were besieged with calls to discuss mitigation plans. This of course comes on top of the efforts of many states to balance their budgets and Medicaid is in most states the single largest line item. So, taken together, the near term profitability of many nursing homes could be under stress.

In our newsletter we have a case study of the impact on an operator that is in this exact situation. Through the years we have observed that, after the initial shock and impact, prudent management/operators are able to adjust staffing and other expenses to the new reimbursement reality thus restoring margins. This is why when assessing and appraising nursing homes, we place a lot of weight on market margins and the operator's historic performance at the subject or similar properties. We find that over-reaction to reimbursement rate changes can result in valuations that understate the true value of a long term care facility. Similarly, in good times, it is easy to forget the "stroke of the pen" risk and see nursing home cap rates trend down to unsustainable levels (i.e. produce values that will not hold over the long term).

In the final analysis, appraisal is both art and science. What happened recently is a perfect example of not only "stroke of the pen" risk, but also the dynamic that occurs in every valuation of a going concern asset, or one that includes business, real estate and personal property in a single bundled market value estimate. It requires a blend of technical expertise tempered with judgment.

Issue 5

Cap Rate Trends



Source: HealthTrust

Conference Schedule

National LCS-Westminster Funds Finance Conference
September 13-14, 2011
Racquet Club of Chicago, Chicago, IL
lcsnet.com
westminsterfunds.com

ELA LEAN Training
September 13-15, 2011
Swissotel, Chicago, IL

ASHA Executive Board & Fall Meetings
September 20-21, 2011
Marriott Wardman Park Hotel
Washington, DC
seniorshousing.org

21st Annual NIC Conference
September 21-23, 2011
Marriott Wardman Park Hotel
Washington, DC
nic.org

Ziegler Senior Living Finance and Strategy Conference
September 21-23, 2011
The Broadmoor, Colorado Springs, CO
ziegler.com

Contact us to arrange a time to visit during any of these upcoming conferences. We look forward to meeting with you.

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A Case Study on the Impact of CMS' Final Rule for FY2012

Since CMS announced its 11.1% reduction for skilled nursing Medicare reimbursement, operators, lenders, underwriters and appraisers have been scrambling to understand how the cut impacts deals they have in their pipelines or in the LEAN queue. Having run revised analyses on nearly 100 homes already, we can tell you that the short answer is "it depends."

Lining up the FY2011 rates with the FY2012 rates, we note that broadly speaking, rates for the heavier rehab categories (RUX through RLA) declined by 14-20% with the remaining categories increased by 1-2%. The rationale behind the rate cut was to off-set the double-digit increases that operators were collecting with RUGS IV, which CMS introduced in 2011 with the intention it would be budget-neutral. Even with the rate cuts, CMS' expectation is that the FY2012 payment will be 3.4% above FY2010. However, a case study of 19 nursing homes located in the Mid-Atlantic and Northeast suggests that the FY2012 can, in fact, result in average rates even lower than the FY2010 rates:

Impact of FY2012 at the Property Level

Property	*FY 2012*	*FY 2010*	*Δ*
1	$440.72	$447.82	-1.59%
2	$501.85	$389.81	28.74%
3	$443.23	$385.68	14.92%
4	$463.93	$431.42	7.54%
5	$463.99	$432.73	7.22%
6	$519.30	$404.03	28.53%
7	$458.41	$449.66	1.95%
8	$482.85	$448.91	7.56%
9	$555.39	$441.45	25.81%
10	$485.06	$462.99	4.77%
11	$439.31	$449.92	-2.36%
12	$459.03	$517.22	-11.25%
13	$490.27	$461.56	6.22%
14	$526.36	$458.26	14.86%
15	$515.85	$525.03	-1.75%
16	$481.75	$462.42	4.18%
17	$527.63	$438.49	20.33%
18	$491.74	$484.44	1.51%
19	$513.32	$495.23	3.65%

This particular operator has been very proactive with capital investments in its homes and over the last two years has opened short-term rehab units in several of these 19 properties. We examined, on a portfolio basis, the weighted average Medicare rate under FY2010, FY2011 and FY2012 and found the following variances:

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Archived Newsletters

Past issues of our newsletter are available on our website.
Newsletter Archive

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SARASOTA
6801 Energy Court, Suite 200
Sarasota, FL 34240
P 941-363-7500 F 941-363-7525

BIRMINGHAM
3008 7th Avenue South
Birmingham, AL 35233
P 205-320-7523 F 205-320-7595

BOSTON
10 Liberty Square
Boston, MA 02109
P 617-542-2125 F 617-542-2150

LOS ANGELES
315 S. Beverly Drive | Suite 202
Beverly Hills, CA 90212
P 310-557-1100 F 310-557-1101

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CMS Case Study Continued…

Weighted Average Medicare Rates FY2010-FY2012

Year	Wtd Avg Rate	Δ
FY 2010	$455.70	--
FY 2011	$568.36	24.7%
FY 2012	$490.78	-13.6%
Δ FY2010-2012:		7.6%

Two inferences can be drawn from this case study:

Firstly, the impact of the FY2012 rates will vary at each individual property and broad assumptions cannot be accurately made. Secondly, with pro-active management, the new environment even at the lower rates can present an opportunity. Well and perhaps a third inference – CMS' intentions often do not translate to reality.

Senior Housing Faring Well During Challenging Economy

Last month, ASHA in conjunction with NIC, ALFA, LeadingAge and NCAL released the 17th edition of *The State of Seniors Housing*. It has been our pleasure to be the Task Force Leader of this research effort for over a decade. This year's publication included the largest sample size ever (more than 1,700 properties) and nearly 1,100 properties in the same-store analysis. While the entire report provides meaningful insights into the industry, the same-store analysis offers perspective on how the sectors that comprise this industry – IL Communities, AL Residences and CCRCs – are faring during this period of limited capital, rising unemployment and broad economic uncertainty.

Examining the weighted average occupancy of the industry during 2010, we found that occupancy was stable and actually up 0.6% over the 2009 weighted average occupancy. IL and AL properties were up 0.7-0.8% while CCRCs were down 0.5%. In addition to maintaining occupancy, the industry reported significant revenue gains in the IL (4.1%) and AL (7.4%) sectors but sizable declines for CCRCs (-7.3%). Unlike last year (2009), when the industry largely kept expenses flat, the seniors housing properties saw expense increases ranging from 0.6% for IL to 5.8% for AL with CCRC expenses rising by a weighted average of 3.0%.

In aggregate, the weighted average NOI grew by 2.5% across all sectors with the upper quartile reporting NOI growth of 15.2% in 2010. While most CCRCs reported lower NOI in 2010 than in 2009 with a median decline of 1.4%, there were some CCRCs that fared better in 2010; the upper quartile of CCRCs posted positive NOI growth for 2010 of 21.7%.

As competition for capital continues to remain fierce, the industry's ability to weather the economy's turmoil is an advantage over more traditional asset classes that have seen significant vacancies and rent declines.

-Colleen Blumenthal, MAI

About the Author

Colleen Blumenthal, MAI

Ms. Blumenthal has specialized in real estate valuation and consulting throughout her career, initially in hospitality before migrating towards seniors housing, long-term care, and acute care facilities.

Since specializing exclusively in the appraisal of seniors housing and healthcare properties in 1992, Ms. Blumenthal has contributed to ongoing transaction studies with the American Seniors Housing Association as well as co-written seminars for general appraisers and mass appraisers in this specialty field. She has served as the Task Force Leader for the last ten years of the State of Seniors Housing.

As Managing Partner at HealthTrust, her present focus encompasses management of the firm's agency (appraisals, management assessments and regulatory compliance assignments) and medical office building practice, while providing valuation expertise for more complex assignments. Ms. Blumenthal's efforts allow the firm to remain on the cutting edge of appraisal methodology for seniors housing and healthcare appraisals.

She has been involved with providing valuation and consulting services for the most active lenders, operators, and investors throughout the nation and has managed the appraisal process of some of the largest portfolios completed in the industry. She typically supervises the development of 400 or more appraisals each year.

Ms. Blumenthal will be attending this year's 21st Annual NIC Conference and welcomes your comments. To schedule a meeting, email her at: colleen.blumenthal@healthtrust.com

Market Indicators

September - 2011

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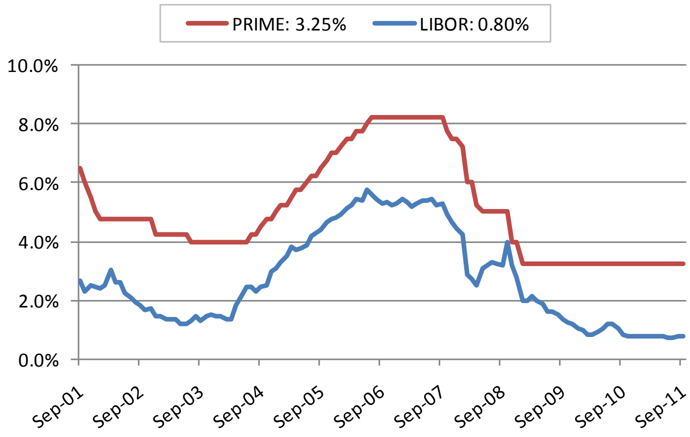
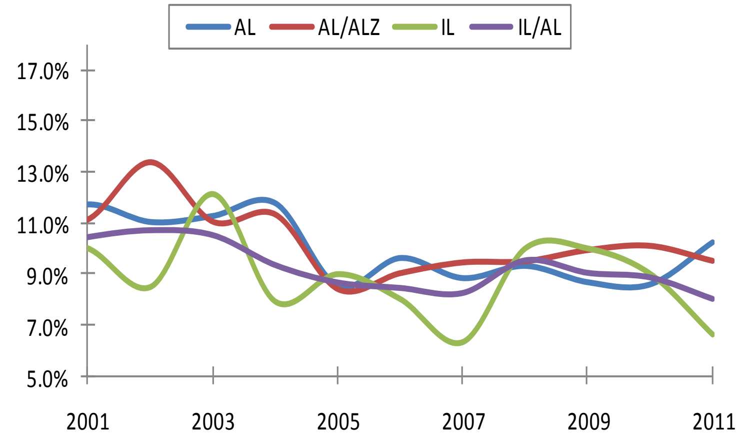
U.S. PRIME AND LIBOR



Source: WSJ

CAP RATE TRENDS



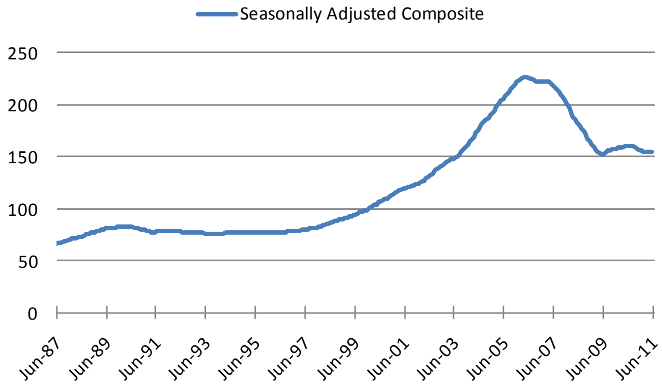
Source: HealthTrust

RECENT TRANSACTIONS

Type	State	Date	Sale Price	% Occ	$ / Unit	Cap Rate
AL	WI	Jan - 2011	$9,184,000	95 %	$86,184	8.25 %
AL/ALZ/IL	AZ	May - 2011	$25,600,000	95 %	$220,690	8.43 %
AL/ALZ	GA	Jun - 2011	$15,500,000	100 %	$206,667	9.75 %
AL/ALZ	TX	Jun - 2011	$15,400,000	86 %	$125,203	9.32 %
AL/ALZ	CA	Jun - 2011	$31,925,000	85 %	$224,824	7.50 %

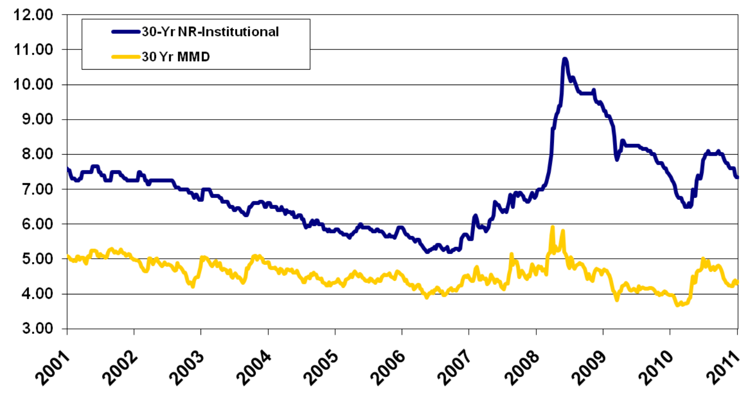
Source: HealthTrust / HealthComps

S&P CASE SHILLER



Source: standardandpoors.com

SENIOR LIVING BOND RATES



Source: Ziegler

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SARASOTA
6801 Energy Court, Suite 200
Sarasota, FL 34240
P 941-363-7500 | F 941-363-7525

BIRMINGHAM
3008 7th Avenue South
Birmingham, AL 35233
P 205-320-7523 | F 205-320-7595

BOSTON
10 Liberty Square
Boston, MA 02109
P 617-542-2125 | F 617-542-2150

LOS ANGELES
315 S Beverly Drive, Suite 202
Beverly Hills, CA 90212
P 310-557-1100 | F 310-557-1101