HEALTHTRUST
Seniors Housing & Healthcare Real Estate Advisory Services

TRENDS IN SENIORS HOUSING

A Message from Alan Plush, MAI

2017 Spring NIC Takeaways

For those that receive this who aren't familiar with the NIC (National Investment Center), they are a Senior Housing and Healthcare industry trade group that offers two annual conferences. The first (the original) occurs in the fall, typically in DC or Chicago, and boasted an attendance of 1,800 last fall. The "smaller" regional is held in the spring, and was intended to have attendance of 500-700. In a clear sign of the times, over 1,600 people attended the spring event of which some 350 were first time attendees.

HealthTrust founded the nursing home component of the Spring event and after running it successfully for 7 or 8 years gifted it to NIC because, candidly, it was growing well beyond the size that could be considered a "hobby business" for us. NIC has an excellent team for running these events specifically in our industry, and the combination of their existing spring event with the nursing conference has proven to be a great success for the industry and NIC as well.

With that backdrop, whenever I attend a NIC event I pay particular attention to the 'buzz." As a specialty appraiser, this industry is much more than just "comps and spreadsheets," which anyone can master. The ability to judge an institutional asset that would command a 6.0-cap (Senior Housing) vs one that is not and warrants a 7.5-cap is nuanced and we glean much of our expertise from these events, talking to buyers, sellers, brokers, lenders, and equity investors.

This year I could say that, despite the number of people attending being a record, a note of caution exists in the crowd. Like that feeling when you have seen a movie and know how it will end, and the "bad part" is coming soon. Concerns mainly related to interest rate risk, operational fundamentals (Senior Housing) and regulatory risk/reimbursement risk (Skilled Nursing). These concerns have been present for a while, but the evidence of each one is now harder to ignore.

For interest rates, we just had a rate hike and many expect more this year. While not hugely material, nonetheless the hikes signal a slow monetary tightening that will affect riskier asset classes more so than more stable asset classes. Real Estate in general, and Senior Housing/Healthcare in particular, are huge consumers of debt. REITs' largest single expense is debt service; thus, these changes can have serious impacts on pricing for assets. By itself, this is a concern but not overarching.

However, couple this with operating fundamental erosion in many markets on the Senior Housing front. Historic low costs of debt have fueled a development cycle that is the second largest I have seen in my 33 years as a specialty valuation professional. While the statistics that give comfort show "new construction as a percentage of existing supply" the reality is that most of the new construction is at the mid to higher end of the quality spectrum and that market is starting to show weakness in many of the markets we work. Having completed some 1,900 valuation assignments last year exclusively of Healthcare and Senior Housing assets, we are in many markets. The reality is that real estate is demand/supply driven; while these assets contain an operational component, the real estate component competes as a traditional real estate asset. Thus, oversupply of a component will affect the larger fundamentals for the asset class. Our expectation is that the effects will be felt mostly by the older assets that have not been well maintained; we expect to see a further valuation bifurcation across

the spectrum based on the amount of new supply being introduced and the resulting erosion of operating fundamentals.

Regulatory/reimbursement risk has always been present in the nursing home industry, thus the average cap rate of 13%, however, concerns are now heightened on several fronts. First CMMS is subtly indicating a shift to ever more home based post-acute rehab and care, using home health. This is robbing nursing facilities (in some cases) of their higher margin patients, which have typically offset the marginal profitability of Medicaid. Add to this staffing and wage rate woes, and industry experts see 2017 and maybe even 2018 being years of significant headwinds for the nursing home industry.

While not being much of a sports guy, I understand the universal language of communicating intuition via baseball innings. For several years, I have felt we were in the middle of an extensive 7th inning, the one that wears out the bullpens on both teams and maybe even has the catcher pitching. Now, my sense is top of the 9th. The development cycle for senior housing is in its third and typically last phase, when we see sponsors doing deals that have little senior housing experience and operators with unproven track records pitching these deals to lenders that are new to the space. Low interest rates on floating rate debt will start to increase and over levered or underperforming (or both) assets will become distressed. Nursing homes that are no longer functional will likely be closed, undermining the assumption that no matter what they always have SOME value.

All in all, a very interesting NIC and a very interesting 9th inning.

Valuation Insight with Anthony Stablein, MAI

Business / Intangible Value Allocations

Seniors housing and skilled nursing valuation results in the divergence of real estate, personal property/equipment and business/intangible value. As valuation experts, it is incumbent on us to allocate values to these three components across a wide array of clients and users of our services. We consistently provide valuation services to capital providers (banks, REITs, private equity), owner/operators and developers. The scope of these services varies as well, from bank appraisals, ASC-805-compliant valuations, asset management and litigation or tax support. The implications of intangible value vary depending on the user and scope of the assignment, as well as property specific factors (age, location, market, etc.). Consequently, the valuation of such components requires industry leading expertise like HealthTrust.

This article is not intended to get into the various methodologies for concluding to values of these components, as the obvious challenge is that we rarely observe transactions of these separate components within the marketplace. Rather, this article is to evaluate the results, based on our breadth of experience and juxtapose that to what we see within the industry. The analysis encompasses business value allocations as a percentage of overall value from over 1,200 fee simple seniors housing and skilled nursing appraisals and valuation assignments performed by HealthTrust in 2016.

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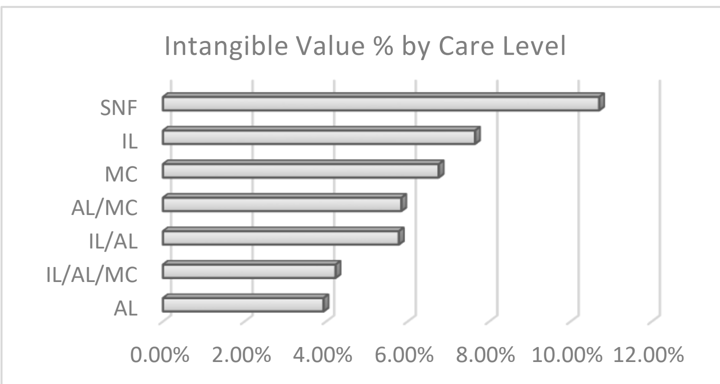
As seen in the table to the right, the average intangible values of these property types are 8.11% of total value, while the median is 7.46%.

CONTRIBUTION OF INTANGIBLE VALUE TO OVERALL VALUE	
	Intangible %
Average	8.11%
Median	7.46%
Lower Quartile	3.70%
Upper Quartile	10.41%

Source: HealthTrust, LLC

We have further broken down average intangible value indications by level of care, as seen in the chart below. As expected, properties containing skilled nursing facilities exhibit higher business allocations. This is intuitive for the following reasons: generally older age of the stock, higher intensive management requirements and impacts on government reimbursement/regulation. On the opposite end of the spectrum, properties including assisted living fall at the lower end of the continuum.

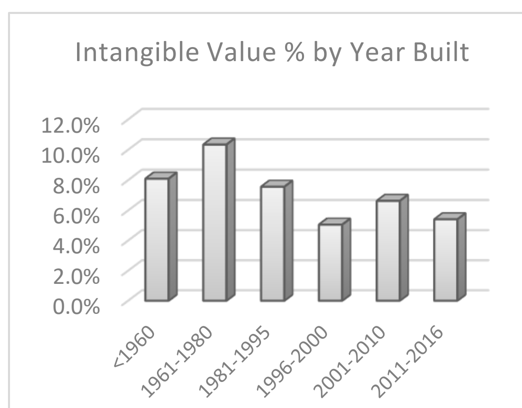


Surprisingly, Independent Living (IL) falls at the upper end of the level of care range. Typically, independent living is viewed as being the closest care level to pure play real estate, similar to multifamily. While a higher intangible value for IL may be counter intuitive, we can attribute this to a few things:

- A decline in stand-alone independent living communities following the housing crisis. After the onset of the housing downturn, many owner/operators moved to add assisted living to their properties in order to mitigate their exposure to potential residents needing to sell their home prior to moving in.

- Consistent with above, there are fewer pure play independent living owner/operators in the market. The resulting inefficiencies in the market leave fewer managers with the expertise to increase their worth in an increasing valuation cycle.

- Older average stock of independent living communities. However, going forward given the run up in assisted living and memory care development, there has been an emerging trend toward pure play IL new development.



As mentioned above, one clear driver of intangible value is the age of the real estate asset. Overall, across all property types, there is clear correlation between the age of the asset and the resulting intangible value percentage. As one would expect, older, more depreciated assets tend to have higher percentages of their overall value attributed to the business component. Of course, this will be property specific and highly dependent on capital investments within the specific property in addition to the respective market.

Lastly, we looked to the publicly traded REITs and owner/operators to evaluate how they allocate acquisitions to intangible components. The results fall in line with the previously reported HealthTrust central tendencies as follows:

REIT / OPERATOR INTANGIBLE %		
REIT	Dates	Intangible %
HCP	YTD December 2016 Acquisitions	7.09%
Ventas VTR	2015 Acquisitions - SHOP and NNN	7.47%
Welltower HCN	YTD December 2016 SHOP Acquisitions	6.42 %
Capital Senior CSU	2016 Q3	8.38%
Five Star FVE	2014 and 2015 Acquisitions (2015 10K)	7.90%
Senior Housing Property Trust SNH	2015 Balance Sheet	7.50%

Source: HealthTrust, LLC

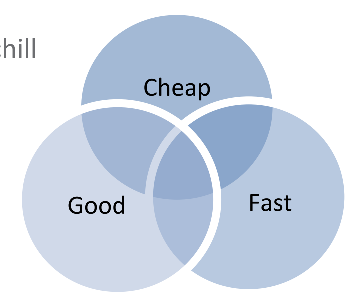
Additionally, there was a transaction in mid-2016 between NHI and Bickford Senior Living, where the two parties restructured their existing relationship, converting a portfolio from a RIDEA lease structure (where they were 85%/15% JV partners) to a more traditional NNN lease structure. In doing so, NHI paid Bickford $25.1 million for their 15% interest in the real estate and Bickford paid NHI $8.1 million for their 85% interest in the operations. Grossed up, this would imply that the total portfolio value was $177 million with the operations being worth $9.5 million, or approximately 5% of the total investment. This corresponds with the publicly reported indications as well as the HealthTrust results.

Overall, while the idea of breaking out components of value from a transaction can be esoteric at best, HealthTrust maintains the depth of knowledge and market intelligence to validate these measures. This is important to our clients, be it banks who are dealing with regulatory scrutiny or owners who require audit support for their acquisitions. Should you need valuation support services, we are here for you as well. *The author would like to thank Jesse Prato for assisting with this article.*

The Two-Week Turn Appraisal - Tony Carter, MAI

Challenges and Solutions to the New Commodity Landscape

"To improve is to change; to be perfect is to change often." -Winston Churchill



The one thing that seems to stay the same in the industry of Real Estate Appraisals is constant change. When I first started in this industry in August 1998, almost every assignment was at least four weeks. At that point, we were still using paper maps and taking our camera film to be developed at Wal-Mart so we could glue (think Elmer's) our ~~grainy~~ glossy prints into the appraisal addendum. As with most things since that time, the evolution of technology has allowed us to complete reports more quickly.

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In turn, the new norm for turn times became three weeks while fees dropped. We at HealthTrust have embraced technology to offer shorter turn times at competitive fees.

We are uniquely positioned to meet these ever-shorter turn times given our specialty healthcare/seniors' housing focus and national footprint. HealthTrust has strategically opened offices in Los Angeles, Boston, Birmingham, Sarasota, and Denver (Spring 2017) to attain geographical competence, wherever the location. We also have staff in Portland, Tampa, Orlando, and soon Columbus, Ohio. Below is a snapshot of our 2016 coverage, which included over 200 distinct clients.

*Note: Hawaii and Alaska not shown, but assignments were completed there too.

HealthTrust is continually and materially investing in our infrastructure and people to ensure accurate, timely valuations to meet the market's needs. At present, we are investing the largest dollar amount since the inception of HealthTrust into our proprietary database and internal systems. However, there will always be a human element that technology can't fully capture. That's where we welcome communication from you as clients, and we're always open to how we can "change" or improve our process. With nearly 40 employees nationally focused solely on healthcare and seniors housing, we strive to provide you the most complete product in the marketplace today.

- The ability to leverage of 100 years of experience among our Managing Directors
- Over 1/3 of our valuation professionals have attained the market-leading MAI designation
- Top to bottom, in-house resources and expertise. We do not outsource any component of the process to loosely affiliated offices who lack the seniors housing and healthcare expertise required to provide an accurate valuation.
- 100% seniors housing and healthcare focused with the ability and experience to provide an array of services

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HealthTrust News

HealthTrust Announces Promotions and New Office Locations

HealthTrust would like to congratulate **Ilya Gaev, MAI** on his recent promotion to Managing Director. Mr. Gaev joined the firm in 2013, bringing over 10 years of appraisal experience. Ilya currently manages our Boston office and specializes in seniors housing and healthcare valuation.

HealthTrust would also like to announce the opening of a new office location in Denver, Colorado. Director **Kim Walther** will manage operations of this office. We look forward to better serving our Mountain and Midwest clients from this location.

Upcoming Events

May 2 - 4, ULI Spring Meeting - More Info
June 7, Interface Seniors Housing Midwest - More Info
June 15 - 16, ASHA Mid-Year Meeting - More Info

Contact us today to schedule a meeting.

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

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

Los Angeles
3780 Kilroy Airport Way, Suite 535
Long Beach, CA 90806
P 310-557-1100

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