



STALKING

VACCARO

Long-time investors in senior living get elbowed by speculators looking to cash in on the lucrative market. Added interest means an investment doesn't have to be a sure thing.

By Adam Stone

FAST FORWARD

- Some investors are looking for more value-added opportunities: Smaller portfolios, individual residences that are under-performing, or where there is a value-added play to be made.
- The search for niche markets has taken some investors to regions where the senior housing sector has not yet reached its peak potential. For example, Health Care REIT expects to close somewhere under \$100 million in assisted living deals this year, with volume driven largely by a careful scrutiny of geographic factors.
- To assemble a successful project, says one investor, "you can't just be the cheapest money. You have to have that longstanding relationship."

FOR THE PAST SEVERAL YEARS, WITH RETURNS HARDER TO COME BY IN GENERAL REAL ESTATE, THE INVESTMENT COMMUNITY HAS LOOKED TO SENIOR HOUSING AS A POTENTIAL PROFIT CENTER.

"There has been positive response from the investors, as evidenced by the fact that more and more of this real estate money is starting to push into this sector," confirms **Adam Heavenrich** of **Heavenrich & Company**, an investment advisory firm in Chicago.

Rental rates explain part of the attraction. In traditional multi-family real estate, rents tend to start low and stay low. In contrast, in a successful assisted living project offering excellent care, families will accept a 5 to 6 percent rent increase from time to time.

Given the combination of high occupancy and steadily increasing rents, says Heavenrich, "Anybody who is an investor has to be thrilled."

Yes, investors have been thrilled—and therein lies the problem.

Investors like **John Cobb** say suitable investment properties are getting harder to come by. As senior managing director at **GE Healthcare Financial Services**, headquartered in Chicago, Cobb helped lead the group through \$900 million in assisted living equity deals last year.

Two years ago, Cobb's organization competed on about half its senior living deals. Now that more money from the traditional real estate world has flooded into the sector, Cobb finds himself competing for about 80 percent of his projects—a trend that typically drives up the cost of investing. In one recent deal, he says, "we bid a crazy number, and we still came in last place."

With market forces pressing from all sides—high costs, low returns—investors say there is no easy way to pump money

into senior housing. "It's hard for a health-care REIT to buy stable products, because the cap rates are such that we can't make a sufficient return for our shareholders," says **Joe Weisenburger**, vice president of senior housing at **Health Care REIT Inc.**, Toledo, Ohio.

Properties With Room to Grow

In the current environment, investors remain on the lookout for properties whose values have not been fully realized to date. These under-performers may need management changes or would benefit from careful expansion.

"We are looking for more value-added opportunities: Smaller portfolios, individual residences that are under-performing, or where there is a value-added play. Maybe you could add a wing, or maybe if they are assisted living residences, you might add an independent living component," says **Ken Assiran**, managing partner with **Capital Health Group LLC** in Media, Pennsylvania.

Assiran's firm recently paid about \$70 million to acquire four senior housing communities in New England. He says the firm had to carefully evaluate residences to find those that would meet its criteria of "value-added" opportunities.

"Obviously I would prefer to find premium properties in great locations at higher cap

THE DEAL

rates, but the reality is that for where we are in the cycle, that doesn't exist," Assiran says. "So we are looking for the special niches."

One advantage to taking the value-added approach is that it removes investors from the high-pressure bidding situations that tend to push up prices.

"There is less competition, let me put it that way," Assiran says. "There are fewer buyers who want to get involved in buying a community that requires a turnaround."

Finding the Niche

The search for niche markets has taken some investors to regions where the senior housing sector has not yet reached its peak potential. With such strategic geographic planning, they say, they are able to sidestep the competition and get in at prices that can potentially generate satisfactory gains.

Weisenburger expects Health Care REIT to close somewhere under \$100 million in assisted living deals this year, with volume driven largely by a careful scrutiny of geographic factors. "With senior housing, you have to look at the local market. Each local market has different opportunities," he says. In particular, Weisenburger adds, "we are still looking at underserved markets and at developing projects within those markets."

Determining whether a given locale is underserved is more complicated than simply counting units.

"You're looking to see if there are enough people who are age qualified," says Weisenburger. For example, "How many of them have income that supports whatever rents you need to charge? How many of them would need assisted living based on our frailty models?"

Social considerations also factor into the equation. Suppose a given area could, on the face of it, carry a few more senior housing communities. Why isn't someone else there already? Maybe senior housing isn't welcome.

"You can look at some small markets in some parts of the country where people take care of their own family members, and you have to factor that in," explains Weisenburger. "Maybe certain religions or other [social groups] are more likely to take care of family members rather than using an [outside provider]."

Partners for the Long Haul

Cobb believes the best way to find and secure winning deals is to work through one's channel of connections. "Deals aren't built overnight. You need relationships," he says.

As an example, he points to GE Healthcare Financial Services' decade-long relationship with **Sunrise Senior Living**. Together, the two organizations have weathered numerous changes in market climates. Of course, there's more to successful deals than business friendships—but they certainly help open doors.

"It's all about getting the first call, about having a partner who still has to go to the market [for bids] but who wants to do the deal with you," Cobb says. To assemble a successful project, he adds,

"You can't just be the cheapest money. You have to have that long-standing relationship."

Investors wanting to stay with the sector over the long term must understand that this "relationship investing" differs from more traditional forms of lending, Cobb notes.

"When you do [senior housing] investing, it's not like a home loan where you don't really care where you pay your mortgage," he says. Given the push and pull of market forces, "there are always changes going on, so you want to be in a relationship where you will be there for one another."

Money Matters

Speaking of relationships, strengthening those between investors and operators may call for a better balance of risk.

"What I am a little bit concerned about is a situation where there is a detachment between the operator and their risk," says Heavenrich. Operators will put in the labor, he notes, "but they are not at risk financially if the thing doesn't work out."

"We like to find strong regional operators or sometimes national operators who will work with us, and we want them to put some skin in the game as well," Assiran agrees. "We want them to put something in beside us, to have some money at risk." Capital Health Group typically looks for an operator to invest 5 to 10 percent of the cost of an entire deal.

What investors don't want to see are speculators—investors from other sectors looking to test the waters in senior housing.

"We hope there isn't a lot of dumb money coming into the market, a lot of people who want to be invested in the segment but don't know what they are doing," Weisenburger says. "We have seen a lot of venture capital companies and hedge funds getting into the business, and they are clearly competing for deals that three years ago we would have gotten."

"That's what I fear the most—all these outside influences that you not only cannot control but cannot even predict," says Cobb. "You just don't know what other people will do."

That said, investors remain largely optimistic. Business cycles come and go and if the chances of a profitable return are slim today, the situation may change tomorrow. Speculators may come and go, too. But those who stay in the game, learn the rules, and build solid relationships will craft a winning strategy over time. □

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