



Seniors Housing's Evolution

Following a rocky period in the '80s and '90s, the seniors housing sector is performing and receiving the recognition due to a maturing asset class.

By Mel Gamzon

For many who entered the emerging seniors housing industry during the early '80s, the experience since has been at times a wild ride. Many early business platforms were ill conceived or undercapitalized. The market was generally not educated about the benefits of alternative living and service options for our aging society.

The good news is, the dust has settled and the fog has substantially cleared, with the industry having bottomed out in 2003. Overexuberance by developers and investors during the mid- to late '90s, primarily in the assisted-living sector, has led to an industry that acknowledges its past mistakes and is poised for measured growth well into the next decade and beyond. The hype is gone, and proven financial results have brought a variety of investors to the table.

Industry fundamentals have clearly been showing improved consistency. Industry researchers estimate that Americans spend more than \$65 billion on private-pay seniors housing a year. Overall industry occupancy levels are at an all-time high of 93 percent, according to *The State of Seniors Housing 2006*, the annual report from American Seniors Housing Association. Profit margins are solid and improving in all seniors housing asset classes, and the availability of both debt and equity from U.S. and foreign sources is expanding in step with the industry's capital needs.

Looking forward, with the front edge of the demographic tsunami fewer than five years in the future, the theoretical demand for new seniors facilities is already growing dramatically, at roughly 30,000 new units per year through 2010. And given the cost and availability of land, in conjunction with escalating construction costs and the time frame required to procure entitlements, it is highly unlikely that the demand forecasts will be met. The result will be an industry in which the supply-and-demand relationship will be in equilibrium at least in most areas. "Right now, it would appear that seniors housing construction is modest relative to the volume of con-

struction activity in this space a decade ago. This is actually very good news for the industry," said American Seniors Housing Association president David Schless.

Lenders and investors in the United States and abroad have sharpened their underwriting standards and generally remain focused on only the most prudent seniors housing acquisitions and new-construction ventures. As capital competes for projects, the hope is that their enthusiasm will not translate into poor decisions. Today, the default rate on industry loans is less than 1 percent, and insiders expect this impressive statistic to remain steady as the real estate and investment communities become aware of business fundamentals and industrywide financial information.

Seniors housing is not without its pitfalls. Developers and investors should consider any regulatory and operational risk and make every effort to mitigate those concerns before proceeding. The astute investor or developer might consider, subject to extensive predevelopment planning, several new-construction opportunities:

- **Mixed-use developments:** Seniors housing can be a viable component of a mixed-use venture in a prime urban or suburban location. Seniors housing can create enhanced density concessions for other housing and commercial and entertainment uses;
- **Continuum campuses:** The continuum is a proven format. Innovative prototypes from single-family through assisted-living housing are evolving, with a spectrum of housing and service options in place for residents as they age;
- **Condominiums/cooperatives:** Ownership models will become increasingly important as consumers attempt to control their own destinies and developers grapple with the overall cost of seniors rental construction. As the industry continues to reach out to younger segments of the market, these evolving models will become increasingly prevalent, especially in high-cost markets;
- **Strategic alliances with not-for-**

profits: These entities bring a wealth of goodies to the table. They control prime real estate, are well regarded by municipalities and potentially provide credibility to the market as venture participants. They may also have the opportunity to secure attractive financing through tax-exempt and other types of vehicles;

- **University-based ventures:** More than 70 projects have been built in conjunction with or near a university. These institutions, which also may have available land for devel-

largest seniors housing owner-operator, Chartwell Seniors Housing REIT will likely emerge as a dominant player in the U.S. seniors housing marketplace, with more than \$800 million in seniors housing assets recently acquired. Its operating platform includes the full spectrum of housing, from independent living through assisted living and Alzheimer's disease housing in both middle-market and high-end locations. ING Australia Ltd. is expected to be another major factor.

Further reflection of the industry's

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opment, provide a significant affinity market for a seniors venture. As baby boomers age, this area of development will become increasingly important.

Certainly, such new opportunities indicate further evolution of the industry. So too does continued consolidation, with the focus of attention currently on megadeals. While prime individual and small-portfolio transactions are available on a select basis, the big players have gravitated to larger portfolios. Major institutional investment sources and their operating partners have begun to consider this asset class for its attractive returns and the reality of supply-and-demand imbalances in many markets, certainly in high-barrier-to-entry regions.

Those investors include major foreign entities, including some from Canada and Australia. As Canada's

ongoing maturation is the aggressive cap rates that have been used on recent institutional-grade acquisitions. Given alternative investment returns and the somewhat limited supply of high-caliber seniors housing assets, it is likely that these cap rates will remain low through 2007. Several major real estate transactions that will reinforce the status of this asset class and the aggressive cap rates should be announced shortly.

Indeed, the seniors housing sector has arrived.

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