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The Seniors Housing Capital Environment: A Discussion with Noah Levy



In the latest in a series of dialogues with key players regarding the current capital environment in the seniors housing and care industry, Michael Hargrave, Vice President, NIC MAP, recently interviewed Noah Levy, Managing Director, Senior Housing, Prudential Real Estate Investors.

Congratulations on your closing of PREI Senior Housing Partners Fund IV in which you raised \$568 million. This is one of the largest funds raised to date in our sector, why now and why a fund this size?

Mr. Levy: Thanks. It took a while, but it is nice to get the fund completely closed and focus on the fun part - investing in the sector. As to the why now and the size, I think it reflects a growing interest and acceptance of the Senior Housing industry on the part of institutional investors. This interest is reinforced both by the industry's and PREI's past track record and their ability to perform through hopefully the roughest economic cycle of our lifetimes. It also reflects the positive outlook for the industry. We think Senior Housing is positioned to grow and prosper as the underlying demographic trends intensify over the next two or three decades. Our investors like long cycle plays, which can also generate solid income as you go.

Can you provide any specifics on types of properties and situations you will be looking to invest in?

Mr. Levy: Certainly. It is no different than when we launched our first fund almost 15 years ago: independent living, assisted living and memory care and communities with various combinations of those levels of service. We can invest in CCRCs, but we will be selective on that front. Skilled nursing has never been part of our strategy. The "situations" have not really changed either. The majority of equity will go into existing assets, be they stabilized or not. Some will be new, some may be older and perhaps in need of repositioning or a turnaround. Some communities may just be in need of having their capital structure reworked. We tend to joint venture with strong operators, but there will be some wholly owned projects with incentivized management agreements so that we can align interests as much as possible. We will do a limited amount of forward commitments on "to be built" communities as well as ground-up development. We can also do mezzanine structures. As always the focus will be working with the best operators we can. It is a 10 year fund. We plan to invest over a 3 to 4 year period. Our average hold will be 6-8 years. We build a portfolio, work to grow NOI and look to find a favorable exit. It is pretty simple and straight forward.

In 2011, Private equity firms were net sellers to the tune of \$6.358 Billion in our sector while the REITs were net buyers of over \$15.3 Billion. Despite this, several private equity funds, including PREI's, have closed in the past 6 months. When do you see this imbalance of buying activity changing and what will drive this change?

Mr. Levy: I think what you are asking is how can we compete with the healthcare REITs? That is a fair question. The healthcare REITs, especially the big 3, are likely to dominate acquisition volumes for the foreseeable future given their very low cost of capital. That said, not every deal is in their sweet spot and not every operator wants to be involved in or is ready for a net lease or RIDEA structure. The market is also probably too efficient for opportunistic buyers to fill out a broad portfolio. We occupy the space between the REITs and the more opportunistic players. As the sales you mention suggest, private equity, which never has a perpetual life, often does sell to the REITs. We are no exception. We are used to all sorts of competition. And it is not as if we have not sold to other private equity participants and visa versa. So in some sense we all need each other. When we first got into this arena, one of the risks our investors took was that we had not proven that a good exit might exist.

The evolution of the transaction market has proven to be positive for us. Hopefully as we move forward with SHP IV, our hard work and reputation will allow us to find great deals and invest the funds at our disposal.

You attended the recent NIC spring conference and I am sure you were hearing the same thing I was hearing - that the word "construction" is becoming a warmer topic than it has been recently. Despite this, recent NIC MAP data shows that the construction to inventory pipeline is still at a cyclical low of 1.5% and construction starts have not picked up from their lows. Considering the recent cyclical high was 4.6% in 4Q07 (when 21,850 seniors housing units were under construction), where do you see the construction vs. inventory pipeline heading over the next 18-24 months? What level of construction vs. inventory would begin to concern you?

Mr. Levy: Mike, as you know, I have been heavily focused on industry construction data going back to when ASHA generated the data on its own. The collaboration between NIC and ASHA on this front is a huge advancement in this regard. In my view, the most critical data point we have to get right **and** communicate is construction starts. Otherwise we run the risk of reprising the overbuilding that followed the assisted living IPO bubble of the late 1990s. Unlike the turn of the century cycle, Senior Housing construction starts slowed sharply even before the economic downturn began in earnest. So we and industry construction lenders have shown we can be disciplined.

All that said, I did hear some of the buzz you described. Coming out of the cycle some of that is to be expected. But I try to take it in stride. As I have said on many occasions, if dreams were actual units, this

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industry would always be overbuilt. Fortunately, pulling off new construction is easier said than done. There just are not that many outfits that can do it successfully. Many of large developers from the last decade have pretty much dismantled their development capability. There also are not that many construction lenders out there. Those that are in the market are not foolish in their choice of sponsors. These factors combined create what I describe as an industry capacity issue. In the near to medium term it may be hard to gear up enough of this capacity (developers, sites, equity and construction loan dollars) to get us back to the run rate of starts seen in the, say, 2003-2007 timeframe. However, our industry is real estate based, so you cannot fully discount our ability to screw it up. That is why good data is a must, so industry participants will get a clear signal before we get building too fast.

Personally, I tend to keep an eye on the absolute level of starts and not the percent of inventory, but they are two ways of analyzing the same issue. To give you a number where I would start to get wary, I would say starts activity on an annual basis of 30,000 units or more of Senior Housing including CCRCs and market rate senior apartments (see graph 1 of the Seniors Housing Construction Trends report) would get my attention. If I am right in my thinking, it could be a while before we get back to that level. We will see.

Successful Strategies for Skilled Nursing from Dan Mendelson

As an expert on policy debates, the operations of CMS, and the politics of deficit reduction in Washington, Dan Mendelson, CEO and Founder of Avalere Health, opened the 2012 NIC Skilled Nursing Investment Forum last month in Boca Raton. In a candid presentation, Mr. Mendelson focused on critical issues such as rate cuts, therapy changes, hospital readmission penalties and accountability across care settings – and what they mean for the skilled nursing industry. Attendees gained valuable insight on how best to position properties and stay ahead of cuts with sustainable business strategies; highlights included:

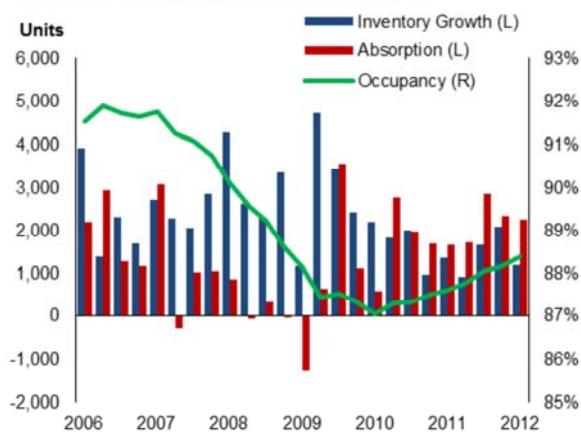
- Responding to rate pressures,
- Improving performance on current CMS outcome measures,
- Positioning for integrated or capitated systems,
- Knowing the role of SNFs in Medicare and Medicaid – identify what is unique value and how to capture value,
- Reaching agreement on the value proposition and outcome measures, and
- Coalescing around reform proposals.

The session titled What's Happening Behind the Scenes in Washington and What it Means for Skilled Nursing Providers and Lenders was well attended and feedback was very positive. It was a unique opportunity to hear the thinking behind the policies and, when the floor was opened for questions, many were asked and answered. If you would like to learn more about this session and hear Dan Mendelson's presentation in its entirety, the audio recording is available for purchase at [Convention Recordings](#).

NIC Research Insights Seniors Housing Occupancy Continues Recovery

The seniors housing occupancy rate continued its gradual recovery in 1Q12, rising 20 basis points to 88.4 percent. In the past year, occupancy has risen 80 basis points and is now 130 basis points above its cyclical low of 87.1% in 1Q10. Absorption remained solid during 1Q12, with the number of occupied units increasing by 0.5 percent from the prior quarter. While absorption continued to remain solid, inventory growth slowed significantly this quarter. In 1Q12, inventory increased by 0.2 percent from the prior quarter, which is down from the 0.4 percent pace of 4Q11.

Seniors Housing Supply-Demand; MAP31



Source: NIC MAP

While occupancy only increased 20 basis points at the national level this quarter, there was considerable variance across the metropolitan markets. Chicago had the steepest occupancy decline at 130 basis points, while Dallas had the largest improvement at 200 basis points. In MAP31, there were 18 markets that saw a relatively small change in occupancy (± 50 basis points). To find where your market ranked, contact [Hilda Martin](#).

NIC Rolls Out Debt Provider Survey

NIC has rolled out a Debt Provider Survey which will collect loan data on seniors housing and nursing care properties. The objective of this survey is to further enhance the capital markets information that NIC provides on an aggregate basis, which will be collected quarterly. If you are interested in participating and have not been contacted please [CLICK HERE TO DOWNLOAD SURVEY](#) or contact Bill Kauffman at bkauffman@nic.org

Seniors Housing & Care Industry Calendar

May 2012:

- 16-18 [ALFA](#) Annual Conference & Expo, Grapevine, TX
- 22 **NIC Investor Briefing, San Francisco, CA**

June 2012:

- 6-7 **Skilled Nursing Investment Forum & Seniors Housing Regional Symposium 2013 Planning Committees, Chicago, IL**

July 2012:

- 12 **2Q12 NIC MAP Data Release**
- 17 **2Q12 NIC MAP Subscriber Webcast**

(denotes NIC Events)

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