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HEALTHCARE REITS

In a relatively short time, Ventas Inc. has moved to the head of the pack among healthcare and senior housing property investors. At the same time, it has become one of the largest U.S. real estate investment trusts (REITs). And just last November, Ventas moved Raymond J. Lewis up from his post as the firm's chief investment officer to become its president. Lewis spoke recently with BNA's Richard Cowden about Ventas's bold moves, completing more than $10 billion in strategic acquisitions over the past year. He also offered his perspectives on the rapidly growing healthcare industry and on Ventas's advantageous position as a property owner in that sector.

Ventas Leads Healthcare, Senior Housing Markets Primed for Even More Growth

BNA: Can you give us some background on Ventas? How long has it been in the business of investing in healthcare and senior housing facilities?

Raymond J. Lewis

Lewis: Ventas is a publicly traded real estate investment trust (REIT) listed on the New York Stock Exchange (NYSE). We are about a $23 billion market cap company. We own 1,300 properties and we are in 47 states and in two Canadian provinces. We own assisted living and independent living private-pay senior housing, medical offices, and skilled nursing buildings. We do business with some of the largest and best capitalized public and private operators in the industry. We have over 100 tenant relationships. We are headquartered in Chicago and we have major offices in Louisville; Newport Beach, Calif.; and Dallas. We have been in the business of investing in healthcare real estate since we were formed in 1997, and that is all we do.

BNA: So, you're not that old, but growing, obviously.

Lewis: We are. You know, since 2001, when we started on our strategic growth and diversification initiative, were about a $900 million market cap company, give or take. Since 2001, we have been very aggressive about finding the best operators and generating strong asset and cash-flow growth and diversification for our shareholders. Our mantra is to have reliable and growing cash flows while systematically reducing risk. That's our overarching theme and strategy in the business.

BNA: . In recent months, Ventas has undertaken a series of acquisitions—I think I heard it was in the range of $10 billion—that have substantially increased its overall size and its market share. Can you tell us if you're planning any further acquisitions in the near future?

$10 Billion in Acquisitions. Lewis: In the last 12 months, we've done three major acquisitions. The largest was the acquisition of Nationwide Health Properties (NHP), which was another publicly traded healthcare investment trust, based in Newport Beach. That was a $7.6 billion acquisition. We also acquired 118 properties from Atria Senior Living, a Louisville-based seniors housing operator. That was a $3.1 billion acquisition,

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and that closed in May. NHP just closed last week [on July 1]. The Atria transaction closed in May and then we closed the acquisition of Lillibridge Healthcare Services, which is a medical office building owner, operator, developer, and that was a $380 million acquisition that closed in July of last year. So those have been the three major transactions that we've done. In addition to that we have done a number of smaller transactions along the way. So we've been growing the company, maybe $10.5 billion in acquisitions since July of last year.

BNA: In regard to those transactions, can you explain a bit about the timing of the acquisitions? That is, did you decide the cost of capital was right and therefore the time to make such moves was right, or was the decision based on a wide range of factors?

Lewis: The decisions about all the investments had their own unique attributes. You know, Lillibridge gave us unique operating capabilities in the medical office space that we believe we can leverage over time to continue to grow that portfolio and increase our reach in the medical office area. Atria was a portfolio of very high-quality seniors housing assets in infill locations in major metropolitan areas on the East and West Coasts—so, New York, Los Angeles, San Francisco, and Boston. It was very desirable real estate that has an excellent growth profile. So we think that can generate above-average cash flow growth over time, particularly given strong fundamentals in the seniors housing space.

And then, NHP is a large, diversified portfolio, with multiple customer relationships that we think we can grow over time. It also has a lot of triple net leases in it, so it has very stable, reliable, growing cash flows. It is also a very low leverage company, so at the same time we were able to gain access to these new relationships and triple net lease cash flows, we were able to reduce leverage in our combined companies.

So those were the overarching strategic reasons. I think you also hit on a very good point, though, which is the public real estate companies, both within and outside healthcare, at the moment have a good cost of capital advantage over private buyers. So we are able to effectively compete right now for transactions—and large transactions. Not only do we have a cost of capital advantage, but we also have excellent access to multiple sources of capital—either the equity markets, the unsecured markets, or secured financing alternatives. They are available in large quantities to us right now. So all of those factors converged to create an environment in which we felt we could acquire strategically and creatively for our shareholders.

Room for More Public Company Participation. **BNA:** In a recent statement, your chief executive officer, Debra Cafaro, noted that publicly owned companies account for only 8 percent of the $1 trillion healthcare real estate market, compared to 60 percent of mall properties owned by REITs. I take it that suggests you believe the prospects for further expansion in this area are pretty strong, right?

Lewis: We think there is a real, long-term opportunity in our space for natural holders of real estate, like real estate investment trusts, to continue to grow and acquire property from other holders of real estate, like large health systems and hospital systems that truly aren't natural holders, and where owning real estate is not the best use of what is becoming an increasingly scarce commodity in terms of their capital. So, think about it this way: if you're a large health systems company that owns multiple medical office buildings or ancillary service centers, you could either invest in the real estate at one return or invest in the operations at multiples of those returns, and I think the trend that we're seeing is that health systems are increasingly deploying their scarce capital in higher-returning operating investments, like buying physician practices, like adding more programming to their hospitals. That's where they are getting the best return on their capital. There is a large opportunity set that we have not yet tapped and we think the market forces are favorable for us to gain a share of that space.

BNA: I also saw that Ms. Cafaro said the healthcare and senior housing markets are ''fragmented.'' Does that also suggest an opportunity for REITs to consolidate and restructure a lot of those properties, just as industrial parks and shopping centers did in recent years?

Lewis: Absolutely. Most of the seniors housing real estate is owned by local and regional operators. And the healthcare REITs are very uniquely positioned to help those operators recycle capital out of their real estate and either allow them to do their next acquisition or development project. One of the things we really liked about the NHP transaction was that we acquired as part of that company a network of regional originators that have the relationships with these smaller local and regional operators that can generate nice-yielding, attractive, consistent deal flow. And that's a big part of our investment strategy going forward.

BNA: Ventas indicates that its real estate investment structure encourages physicians to invest in medical buildings. Can you explain how you do this and what kinds of outcomes you expect?

Lewis: This is typical in the medical office building area. Often we will find that physicians will want either to have their own building or be an investor in a building in which they are a tenant. So in some circumstances, we will offer them the opportunity to invest in the buildings as we are acquiring them, say, from a health system. They would be a non-controlling partner in the asset and have the ability to gain appreciation as the asset increases in value over time. It's just an opportunity for physicians to invest in the real estate if they so choose. It's a nice alignment vehicle for us with our tenants.

Demographics Driving Sector Growth. **BNA:** Do you believe your growth strategy relies more on the prospects of a recovering economy or to the inevitability of U.S. demographic patterns?

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Lewis: I would say it's a mixture of both but probably weighted more heavily to the latter. Our industry has excellent supply/demand fundamentals, particularly in the private pay seniors housing space, as well as in the medical office building space. There has really been very limited new construction. The first wave of the baby boom demographic is turning 65 this year, so they are Medicare-eligible, which means they will start using more doctor services, and that will drive utilization of our medical office buildings. The 80-plus population group is the fastest growing age cohort in the U.S. demographic, and they are the primary target for our seniors housing buildings. So those demographics, coupled with very limited new supply because of A, the lack of development capital and B, the infill nature of a lot of our properties, whether they are the seniors housing buildings in high-income, high barrier-to-entry suburbs, or medical office on-campus where the hospital controls development. We think there is excellent underlying fundamentals in both of those markets.

Then, on top of that, if we get a little bit of acceleration in the economic recovery, that could really leverage those fundamentals in a very attractive way for our company.

BNA: So you think the prospects are good for your company, but if the economy picks up, it will be just that much better.

Lewis: Yes, I think that's right. Our sector proved itself very well during the downturn. We had positive rent growth in our private pay seniors housing buildings when other property types were seeing declining rent growth. It was very resilient during that period. We think that in any kind of sustained economic recovery, our assets are poised to do extremely well. In fact, I would argue that even in the weak economic recovery that we've had, our assets have continued to perform extremely well, with increasing occupancies and continued rate growth. So any improvement in the economic could really have a beneficial effect on our portfolio.

BNA: Have you revised your view of the need for senior housing in light of the major overall shift we've seen away from single-family homes to apartments?

Clients Tend to Own Their Homes. Lewis: Most of our seniors housing is assisted living or Alzheimer's care. We do have some independent living as well, but a lot of that also has programming available either through home health or through third-party providers, so most of the residents who move into our buildings are moving in because they have needs—that they can't live in their homes independently. Moreover, they also have very low debt, if any. The homes they own often are free and clear, and they often have owned them for a number of years. So for them to sell their homes is not as difficult a decision as it is for somebody who bought their house in 2006 and put a lot of debt on it. So we haven't seen as big an impact of the housing market on our asset class as other asset classes.

I think there are pockets like, continuing care retirement communities, which we don't own a lot of, that have experienced more of an impact, but by and large our industry, particularly the need-based products that we have invested in have not been impacted much by the housing market.

BNA: As you know, Americans have lost a lot of equity in their homes in recent years. Does that suggest there could be a negative effect from that moving through as those families become your potential customers?

Lewis: Think of it this way: Let's use one of our Sunrise properties as an example. If the average monthly rent for the residence, including care and services, is about $5,200 a month and the average length of stay is maybe 18 months, you are talking $90,000 to $100,000 for full care in one of our buildings. Most seniors own a home or have savings that are in excess of that, particularly in the higher-income suburban markets that we are located in. I don't think that's much of a threat to our business model. Our product, though it may sound somewhat expensive, once you put it into context, is really an excellent value for seniors. It's something that most seniors are able to afford as they reach basically end-of-life care.

BNA: . How has the recent economic downturn affected your long-range strategy? For example, have the problems in the ''Sand States'' changed your view of where older people are likely to locate as they reach retirement age?

Seniors Move Closer to Families. Lewis: Yes, it's interesting. As I said, we have 1,300 properties in 47 states, so we're all over the country. We never really targeted the Sun Belt as a strategy. Our experience is that seniors tend to move to the Sun Belt states when they are still relatively healthy and independent—sort of to enjoy what we all refer to as their ''golden years.'' And then once they have some sort of event—it's typically the death of a spouse or a decline in physical condition—they move back to where their family is. And it's typically the first-born daughter who is the primary caregiver. And those people are located in suburban locations around major metropolitan cities. So, whether they are located in the Sand States or the Rust Belt, or the Northeast, or Coastal California, we find that seniors tend to migrate back to where their family is for their last couple of years, which is really when they are living in our buildings.

I would argue that even in the weak economic recovery that we've had, our assets have continued to perform extremely well, with increasing occupancies and continued rate growth. So any improvement in the economic could really have a beneficial effect on our portfolio.

BNA: How do you regard the prospective impacts of Obamacare on your business? Will it help underpin the demand for your services, or is it likely to create more bureaucratic costs and headaches?

Lewis: Well, fully 70 percent of our [net operating income] is derived from businesses that are private pay—[or],with no government funding. That's the seniors housing and medical offices. I think Obamacare could have some positive impacts for our space. Certainly adding 30 million to 35 million more insured people into the healthcare system should drive incremental demand, particularly in our medical office buildings. Doctors should have a need for more space, so that's one thing.

You know, certainly the flip side of that is costs are going to be under pressure, and the hospitals and the health systems are going to continually ask to find ways to move patients to the lowest care-appropriate cost settings. So we think that some of our buildings, like our skilled nursing buildings where they can provide rehab care in a post-acute setting, could be beneficiaries of that trend over time. So while I think there will be cost pressures on the system, I think we have assets that will be beneficiaries [by being] the lower-cost providers. Having more people in the system should create more demand for our real estate. But it's not clear exactly how all that is going to play out yet, so it's obviously something we watch very closely.

Thriving as Public Company. **BNA:** Could you see Ventas operating as a private company or is your REIT structure integral to your long-term business plan?

Lewis: You know, you can be private and be a REIT. There are minimum shareholder requirements and other structural requirements that you can meet in either a public or private format. So those aren't mutually exclusive choices. But we have excellent access through the public markets right now to multiple sources of capital and that creates a real advantage for us in terms of being able to acquire and grow. I think being public is the right format for Ventas, but if circumstances were to change and it was the right thing to do for our investors to go private—I mean we are all about creating shareholder value and creating the right outcome for our shareholders. We consider everything in light of current circumstances, but right now it makes a ton of sense for us to continue to be a public company, accessing the public markets the way we have over the last couple of years.

BNA: What do you see in the future for potentially new senior care services that may not be on everyone's radar screen right now?

Lewis: I think there will continue to be a lot of demand for dementia services. Our Alzheimer's buildings are by and large full. There continues to be a tremendous need for that product. It's a product that our operators have really developed and perfected over the last seven to 10 years, so the programming being done now is really exceptional. I think there is going to continue to be demand for that. There is going to continue to be post-acute care settings in the skilled nursing buildings and in rehab hospitals and long-term acute care hospitals, and out-patient settings in our medical office buildings where people are receiving treatment that used to be done in the hospital.

I think the hospitals are going to become very acute care-focused, very focused on the higher-complexity treatment, whether it's complex surgery or intensive care, trauma—those sorts of things. Some of our nursing homes and medical office buildings will be the settings in which people go to recuperate when they're discharged from the hospital. That trend I think has been going on for several years and it will continue to accelerate.

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