

**SUNNY RESULTS:** Ventas-owned buildings operated by Sunrise Senior Living have outperformed industry averages. This Sunrise assisted living building with 77 units is located in Wayne, N.J.



## Healthy Appetite for Acquisitions

Ventas, the giant REIT, is in a buying mood as economy begins to heal. **By Jane Adler**

**A**rmed with a \$1 billion war chest, Ventas Inc. is seeking new acquisitions. The giant health care REIT has seniors housing in its sights, along with medical office buildings. The company already owns 505 properties, about 430 of which are nursing homes and assisted living facilities.

The push comes amid a changing investment climate. Property prices are well below the highs of several years ago. Cash buyers are picking up properties at a discount. And investment returns are expected to improve as the economy recovers.

“Our pipeline is full of attractive acquisition opportunities,” says Ray Lewis, chief investment officer

at Chicago-based Ventas. “Six to 12 months ago, we had no properties to even look at,” he says. “Now we’re very busy.”

Like many REITs, Ventas has cleaned up its balance sheet over the last 18 months. In a secondary offering, the company issued 13.1 million shares of stock, raising \$312.2 million in 2009. Mortgage debt obligations have been pared by \$148.7 million.

At the end of 2009, Ventas was the nation’s eighth largest REIT with a market capitalization of \$6.9 billion. Ventas was added last year to the Standard & Poor’s 500 Stock Index. Share prices at Ventas (NYSE:VTR) closed at \$45.12 on March 5, more

than double the share price of \$21.20 the year before.

### Strong vital signs

Ventas had a \$1 billion line of credit with \$992 million available as of mid-February. At the end of 2009, the company had \$107.4 million in cash and short-term investments on hand. The company says it will invest the cash on hand this year. But industry analysts peg the total investment for 2010 at about \$375 million.

Seniors housing has performed well for Ventas during the downturn. Occupancies started to climb in the second half of last year and rental rates are rising. “Our margins have held up,” says Lewis.

Lewis attributes the portfolio's strength to its skilled nursing and assisted living buildings, or what are called "needs-driven" properties. Residents typically move to these buildings because they need help.

Independent living buildings for seniors have not fared as well during the recession because the typical resident can delay a move until the housing market improves. "The properties that have held up the best are the ones least correlated with the residential housing market," says Lewis.

Rents at Ventas buildings should grow between 1.5% and 3% this year, Lewis forecasts. "Relative to other real estate asset classes, we have a pretty decent growth profile."

Revenue is expected to grow at the 79 assisted living buildings managed by Sunrise Senior Living. About 20% of Ventas' income comes from the properties, notes Jerry Doctrow, managing director at Stifel Nicolaus & Co. in Baltimore.

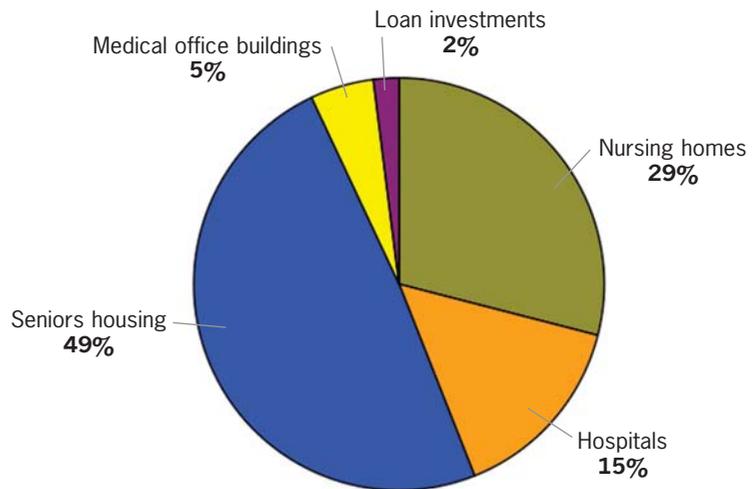
Though most of the Ventas portfolio is comprised of buildings with triple-net leases, Ventas receives the net operating income from the Sunrise properties. Ventas is the only health care REIT with a direct link to market fundamentals, says Doctrow. "There's more growth potential if seniors housing fundamentals improve this year."

Ventas acquired the Sunrise properties in 2007 with the \$1.96 billion purchase of the Toronto-based Sunrise Senior Living REIT. Most of the Sunrise properties are located in the United States. Sunrise owns a portion of 60 of the buildings it manages for Ventas. Sunrise's ownership share averages about 15%.

Although Sunrise faces financial difficulty and large debt burdens, its buildings have outperformed the industry. The occupancy rate in the fourth quarter of 2009, for example, registered 88.8% portfolio-wide, up 70 basis points from the previous quarter. By comparison the

## DIVERSIFYING ITS INCOME STREAM

As a commercial property owner, Ventas generated 20% of its net operating income in the fourth quarter of 2009 from hospitals and medical office buildings.



Source: Ventas

average occupancy rate at assisted living buildings stood at 88.2% in the fourth quarter, according to the National Investment Center for the Seniors Housing & Care Industry (NIC).

The average daily rent at the Sunrise buildings in the fourth quarter of 2009 was \$174, up 0.5% from the previous quarter, according to Ventas. The average daily rate at assisted living properties in 2009 was \$104, according to a study by the MetLife Mature Market Institute.

The recovery in the seniors housing industry has been somewhat choppy though, according to NIC's most recent report (*see related sidebar*). Most observers expect better results going forward.

Demand for seniors housing, especially assisted living, is expected to accelerate. The demographic group age 85 and older, the prime age for assisted living, is the most rapidly growing elderly segment. The number of persons 85 and older is expected to number 19 million by 2050, or 24% of elderly Americans, according to the U.S. Census.

At the same time, little new seniors housing is being planned or built. "The supply-demand fundamentals look strong," says Robert Mains, research analyst at Morgan Keegan & Co. in Saratoga Springs, N.Y. "The outlook for the next three to five years is favorable."

## Buying strategy

Ventas is planning to invest in high-quality assets with top-tier operators. For example, its Sunrise portfolio consists of attractive mansion-style buildings in prime locations. "Our strategy is to keep things simple," says Lewis.

Lewis won't comment on specific deals, and he says nothing has been finalized yet. But a number of pension funds and private equity firms have accumulated portfolios of seniors housing in the last five to seven years. Managers will be looking to cash out at the end of the life of a fund, or to sell assets and realize some gains.

Ventas isn't shopping just for portfolios, however. One-off deals also are under consideration as long as the property fits the company's criteria.

Medical office buildings are a target, too, in an effort to diversify the company's portfolio. Ventas acquired four Class-A medical office buildings for \$77.7 million in the fourth quarter of 2009. The buildings are located

on hospital campuses in the major metro markets of Chicago, Denver, and Baltimore.

A number of hospitals are looking to sell assets in order to increase revenues, according to Mains of Morgan

Keegan & Co. Non-profit hospitals especially are under financial pressure because of the growing number of people without health insurance and less charitable giving by donors. Also, the supply of new medical

## Uneven seniors housing recovery takes shape

**I**s the seniors housing market stabilizing? The latest data offers conflicting signals as occupancies continue to decline while rents cling to slightly positive gains, according to newly released figures from the National Investment Center for the Seniors Housing & Care Industry (NIC).

Construction activity continues to slow, which could mean higher occupancies ahead. Still, it may take several more quarters to burn off excess inventory. A big supply of new buildings in some metros could be a drag on those markets for the remainder of the year.

"We're looking at a choppy recovery," says Michael Hargrave, vice president of NIC based in Annapolis, Md.

Occupancies at seniors housing properties had mostly been falling since the first quarter of 2007. But occupancies turned up unexpectedly in the third quarter of 2009, hitting 88.5% across the top 31 markets tracked by NIC and raising hopes that a recovery was under way. Then occupancies fell again in the fourth quarter to 88.2%, according to the latest NIC report.

All property types suffered an occupancy decline in the fourth quarter. Occupancies at independent living buildings fell to 88.2% compared with 88.5% in the third quarter. Assisted living occupancies fell by 10 basis points to 88.2%. Nursing homes saw the biggest fourth-quarter decline to 88.7% from 89.1% in the previous quarter.

### Absorption remains fickle

The occupancy dip came with a slow-

down in demand. Some 950 units were absorbed in the quarter, about average for the sector. But in the third quarter, 3,978 units were absorbed. "That's huge," says Hargrave.

The big number could be due to pent-up demand from seniors who no longer could put off a move, he adds. But that doesn't explain why demand dropped in the fourth quarter. Hargrave says it's up for debate how strong demand will be in the months ahead.

New inventory also pushed occupancies lower. About 2,300 units were added in the fourth quarter, far outstripping demand. "This is a bottom-finding process," notes Hargrave.

The construction pipeline is emptying, however, which should help boost occupancies going forward. There are about 8,700 new units under way, equal to about 1.8% of the existing inventory.

By comparison, in the first quarter of 2008 there were 20,000 units under way, or 4.2% of the existing inventory. "Supply will not be as much of a challenge this year as it was in the last few years," says Hargrave.

### Bucking the trend

But some markets will struggle with too much seniors housing, including Denver, Atlanta, Dallas, Boston and Portland, Ore. Developers typically target cities with high population growth rates and few barriers to entry.

In Denver, the percentage of new construction to existing inventory hit a high of 31.7% in the first quarter of 2008. Denver's current occupancy

rate at independent living buildings is 83.5%. Markets with a lot of new construction may not hit bottom until the third or fourth quarter. "It's clear that some markets are under more stress," says Hargrave.

About 47% of building operators did not raise rents in the fourth quarter, but asking rents overall are up slightly. Year-over-year asking rents at independent buildings rose 1.6% to \$2,659 a month. Assisted living rents are up 1.7% to \$3,536.

Nursing home rents rose 3% to an average of \$7,830 a month. "The good news is that rents are growing," says Hargrave.

Seniors housing compares well to other commercial real estate sectors, says Hargrave, citing the MBA Quarterly Data Book that shows a decline of asking rents at office and multifamily properties.

According to a third-quarter 2009 report by the National Council of Real Estate Investment Fiduciaries (NCREIF), its database of seniors housing properties has outperformed the NCREIF Property Index (NPI) of all property types both for income and appreciation for more than five years. Total returns for seniors housing over the last six years is 14.43%, compared with 7.18% for the NPI.

Seniors housing has been resilient during the recession because older people who need help often must move into a building with services, notes Hargrave. "Seniors housing could turn out to be a defensive investment in tough times." ■

— Jane Adler

office buildings situated on hospital grounds — the type of property sought by Ventas — is fairly limited.

A seniors housing deal could be in the works with Sunrise. According to Sunrise's fourth-quarter earnings call on Feb. 25, the company is working with Ventas to restructure its property management contracts. That could result in the sale of Sunrise's joint venture interest to Ventas.

"We've had a number of conversations with Sunrise," says Lewis. "It could be a good way for us to buy the minority interest in those properties at an attractive price and provide Sunrise with some near-term liquidity."

Sunrise is in the midst of a corporate restructuring and has defaulted on some of its debt. Sunrise sold a portfolio of 18 assisted living buildings last November for \$190 million to Brookdale Senior Living. Sunrise has extended some of its loans. Still, Sunrise could still go bankrupt and that could hurt Ventas share prices, observers say.

As for other potential seniors housing investments, Ventas won't necessarily avoid independent living buildings. "If we can find good, attractive buildings, we would like to own them," says Lewis. The strategy is to buy buildings at prices tied to existing cash flows. "If we buy them on a dip in cash flow and then ride them into a recovery in the housing market, that seems like a pretty good

investment to us," Lewis explains.

Though some local markets appear to be overbuilt, Ventas isn't avoiding seniors housing investments in select cities. The overall macro economic trends, such as unemployment, in states like Ohio and Michigan are a concern, however. "It's a little hard to get comfortable with those places," says Lewis. In California, it's essential to understand specific submarkets in order to make wise investments.

Determining valuations is a challenge because so few big portfolios have been sold. Seniors housing buildings are selling at a discount, observers say, but not at distressed prices.

Three years ago, high-quality seniors housing assets might have traded for a capitalization rate below 7%. (The higher the cap rate, the lower the purchase price). As the economy sank, cap rates rose to as much as 8.9%. Cap rates are now around 8%. "It's not distressed pricing as much as it's attractive pricing," says Doctrow at Stifel Nicolaus. "It's not a fire sale."

### Long-term care in spotlight

The ultimate outcome of a controversial health care reform bill signed into law by President Barack Obama — which still faces several legal challenges — could affect the seniors housing industry and the Ventas strategy. The new law establishes

the Community Living Assistance Services and Supports Act (CLASS), a long-term care insurance program.

Premiums would be paid for by voluntary payroll deductions. Monthly premiums would average about \$85 to \$100. Individuals must pay into the system for at least five years in order to qualify for benefits.

Beneficiaries would receive cash payments averaging no less than \$50 a day to help cover the cost of long-term care at home or at a facility of their choice. That could help make private pay assisted living more affordable for more people and eventually help boost occupancies.

However, the new law will trim proposed Medicare reimbursements to nursing homes and long-term care hospitals in a few years. That could represent a risk to owners and operators of buildings that rely heavily on government programs for revenue.

Nursing homes and long-term care hospitals account for about 44% of net operating income at Ventas. If reform brings more people into the health care system, Lewis figures more real estate will be needed to provide care in the lowest possible cost setting. Nursing homes and long-term care hospitals have already proven to be low-cost providers, concludes Lewis. "It generally should be good for the assets we own." ■

Jane Adler is a Chicago-based writer.