SENIORS' HOUSING

# LEGAL NEWS ALERT

January 2008

## Ruskin Moscou Faltischek's Seniors' Housing Capabilities

- Licensing Applications and Regulatory Matters
- Real Estate, Construction and Financing
- Contract Drafting and Reviews
- Counsel and Advice on Third Party Deals
- Project Related Litigation
- Compliance Audits
- Fostering Alliances Between Housing and Healthcare Providers
- Exit Strategies
- Facility Sales and Refinancing
- Evaluating Model Types for Developers
- Federal and State Legislation
- Employment Matters
- Occupational Safety and Health Administration (OSHA) Regulations
- Antitrust Regulations
- National Labor Relations Act
- Copyrights and Trademarks

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Wayne L. Kaplan

## The Industry Today

The seniors' housing market has become soft, the gap between buyer and seller expectations has grown wider making it hard to get deals done, valuations have contracted and will be driven by fundamentals instead of by cheap capital, cap rates are rising, the debt markets have become very conservative, and some lenders have been changing their terms or just getting cold feet. These factors combined or separately, are impacting participants on both sides of the table.

## Proceed with Caution

The troubles in the subprime mortgage sector have sparked concerns about credit quality. However, some industry professionals are saying that the changing climate is not necessarily a bad thing. The seniors' housing market was getting far too overheated, with easy money spiking up the price of assets and lenders going higher and higher up the risk spectrum in order to put their dollars into play. A fast adjustment was needed. This meant that on the debt side, borrowers could forget about high loan to values and lengthy interest-only periods. The capital has become more expensive and harder to come by. As a result, an increasing number of deals are being re-priced or scrapped altogether. So what does it all mean? According to Real Estate Forum, it really depends on who you talk to. Some in the business are holding on tight in hopes of weathering the storm while others are looking closely at the potential for profit. But there is one thing that everyone seems to agree on - it won't be a smooth ride. The economy is showing signs of weakness, oil is approaching $100 a barrel, the housing market is in a slump, Wall Street bonuses were lower this year, job growth is tapering off and consumer confidence continues to decline. It means that it's too early to tell just how wide and deep the impact will be.

## Financing – A Return to Normal Conditions

Spillover from the subprime mess has pushed conduit lenders to the sidelines, causing a temporary slowdown in velocity. Commercial banks, credit unions, life insurance companies and agencies have stepped in, and senior's housing investment activity is holding its own as a result. Tighter lending standards, particularly lower loan-to-value ratios, higher debt-service coverage ratios and focus on actual financials are here to stay, but should be characterized as a return to normal conditions rather than a credit crisis. More lender scrutiny and capital discipline bode well for the long-term health of the sector by limiting speculative investment and development.

## New Ways are In, Old Ways are Out

As medicine and health sciences advance, seniors are, on average, healthier and more active than ever before, and their demands have evolved accordingly, according to Commercial Property News. While the implications are far reaching, the major effect has been an overarching shift away from sterile, institutional-feeling facilities toward a more independent, amenity-rich and home-like environment. Seniors are demanding internet access, larger units, full-size kitchens are becoming standard, and apartments are starting to contain additional bedrooms, half-bathrooms and dens.

## The Flood Begins

In October, the nation's first baby boomer filed for Social Security benefits, with an estimated 78 million to follow. The number of beneficiaries will nearly double by 2040, while the work force that supports Social Security will grow by only about 16 percent.

## New Development

There has been a 28% increase since last year in the total number of units under construction in the top 75 metro markets. The NIC/ASHA report indicated that Seattle (with 2,347 units) had the greatest amount of new construction started in the survey year (April '06 through March '07). The next four metros, in order, were Dallas, New York, Houston and Chicago.

## Alzheimer's

With more and more people living into their 80s and 90s, Alzheimer's disease is more common today than it was 100 years ago. Estimates of its frequency vary, but it strikes one out of every 5 people between ages 75 and 84, and 42% of those over age 85, according to the Alzheimer's Association. More than 26 million people worldwide have the disease, and a forecast says the number will more than quadruple by 2050. The biggest jump is projected for Asia, home of almost half of the current Alzheimer's cases, or 12.6 million cases. By 2050, Asia will have 62.8 million of the world's 106 million Alzheimer's patients. A new study suggests that America's Alzheimer's toll will rise to 8.8 million by 2050 from 3.1 million today. Among estimates for other regions are: Africa, 1.3 million cases today and 6.3 million in 2050; Europe, 7.2 million and 16.5 million; Latin America and the Caribbean, 2 million and 10.8 million; and Oceania, 200,000 and 800,000.

## What Other Experts are Saying

"The seniors housing and care market is going through what we believe will be a much-needed market correction. While this may be mildly painful to some in the short term, in the long term it will benefit the industry and bring more stability."

– **Steve Monroe,** SeniorCare Investor

"When real estate finance finally settles down after this year's subprime turbulence, underwriting for seniors housing will seem downright bland compared with the recent past. Seniors housing cap rates are going up for now. The availability of capital has been curtailed - there's still some debt financing available, but the extra-high leverage available through CMBS and CDO products for all types of real estate classes is over, so we've seen a peak in prices for a while."

– **Craig S. Jones,** Sr. Managing Director of RED Capital

"Today's sellers are living in yesterday's world and today's buyers are afraid of overpaying if they no longer have to. When determining value in the acquisition market, 65% of the respondents to a survey said they will use trailing net operating income while 35% will use projected net operating income." Nine months ago, these percentages were probably reversed.

– **Steve Monroe,** SeniorCare Investor

"There are fears about the economy, but there's not a whole lot of fear about health care demand."

– **Louis W. Taylor,** Managing Director at Deutsche Bank Securities

"The seniors housing industry is changing from a need-driven model to a more choice-driven model. Today's seniors are more active and independent. They expect a lot more choices. They're going to demand the best of all worlds."

– **Steve Gilleland,** Director for CapitalSource's Healthcare Real Estate Finance Group

Average entrance age is 82, up from 78 just 10 years ago.

– **Larry Cohen,** CEO of Capital Senior Living Corp.

"Capital is more expensive and the terms of the loans are stricter, but investors have adjusted to the new lending environment pretty quickly."

– **Robert Kramer,** President of NIC

"Rather than focusing on the long-term baby boomer demographics which are still many years away, the focus needs to be on customer outreach and penetration of the existing demographics. The perception of senior housing is still generally negative, viewed by many as institutional buildings where senior go to die. The challenge for the industry is to explain the product and change that perception. A strong advocate for the industry is needed."

– **Dr. Peter Linneman,** a keynote speaker at this year's NIC Conference



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