

KMF SENIOR HOUSING INTELLIGENCE

Vol. 1. No. 3 - November 6, 2001

IN THIS ISSUE:

- **Looking For A Stable Real Estate Investment in a Recessionary Economy?**
- **Investment Education News – NIC Conference Dec. 12-14**

WHY SENIOR HOUSING IS RESISTANT TO ECONOMIC DOWNTURNS?

One of the most positive investment attributes of a senior housing property is that demand is much less linked to the overall economy and the traditional business cycle than office, industrial, retail and multifamily. Economic variables such as GDP growth, unemployment rates and corporate spending have little impact on senior housing occupancy rates and rental rate growth. The last recession of 1990-1991 had little impact on the industry, due to reasons we will discuss.

A recent study on senior housing by Property & Portfolio Research, The Investment Market for Senior Housing– an Investigation, indicates that there is strong, initial evidence that rental rates for congregate properties are demand inelastic – that is increases in supply/competition don't drive down rental rates proportionately as in multifamily.

There are 6 important reasons why the business cycle has much less of an impact on senior housing investments than on office, industrial, hotel, retail and multifamily investments. We will concentrate our analysis on independent living properties (congregate and senior apartments):

1. Demand is Not Based Upon Corporate Income

Unlike office, hotels and industrial, senior housing demand is not contingent upon business or corporate income that is subject to the economic and business cycle. Senior housing revenue is dependent on the net worth and income sources of retired individuals.

2. Stable Demand Due to Revenue Source Security

Seniors primary revenue sources consist of net worth from home sales, social security, retirement plans and fixed income investments. With the exception of home sales, these income sources are largely independent of the economic cycle. To the extent home sales values are depressed, the amount of capital available for senior housing living expenses would be reduced. In contrast, social security, retirement plan income and fixed income investments are by their nature fixed or even indexed (see item 6).

3. Residents Are Retired

Virtually all residents of independent living properties are retired (97%), and are therefore not subject to lay-off or other employment security issues. Unlike multifamily, they also do not move out due to job transfers.

4. Residents Are in Their “Last Home”

Unlike multifamily, there is very little voluntary turnover (only 3% say it is likely they will move from the independent living property for voluntary reasons). Ninety-six percent of independent residents say where they live is their “home”. Because senior housing residents are typically in their 70’s or 80’s when they move to independent living, they don’t easily move-out because a new property opened in the market area. Overall, turnover in a congregate property runs about 33% per year, which is much less than a typical multifamily property (55-65%). The turnover in a congregate property is typically due to increased health care needs or death.

5. Demand is Needs-Influenced or Needs-Driven

Almost 50% of the residents moving to independent living indicate some level of urgency with regard to their move to an independent living

property, and 25% actually say it is someone else's idea (usually adult children) for them to move to the independent living property.

Almost 50% of the residents moving to a rental independent living community no longer own an automobile; and 35% use a cane, walker or scooter to get around.

It is this needs-influenced element, due to health reasons or inability/unwillingness to take care of the house that insulates senior housing from much of the negative factors due to a downturn in the economy. This needs-driven demand element is even higher in assisted living and nursing homes.

6. Senior Incomes Are Indexed to Inflation

Seniors have dramatically improved their financial position as compared to the population as a whole over the last 40 years. Virtually all of their income is now indexed to inflation:

- a. Social Security benefits are formally increased each year based upon the inflation rate;
- b. Many pensions are indexed to inflation; and
- c. Interest rates on certificates of deposit are indirectly tied to the inflation rate since interest rates reflect the expected inflation rate.

Independent living properties have been able to consistently raise rental rates. Proof of this statement is found in the State of Seniors Housing, which tracks actual financial statements of independent living properties. Resident revenues have increased at a 4% compound rate since 1994, with virtually no variation each year.

Summary

Office, industrial and hotel demand is based upon corporate income, while multifamily, retail and senior housing demand is based upon individuals net worth and income. Retail and multifamily demand is directly tied to the business cycle due to changes in discretionary spending and the "employment security" issue. Senior housing resident's ability to pay rent is generally not affected by economic downturns mainly due to the stability of seniors' income sources. For the reasons described, senior housing is clearly

the least affected by business cycle risk, and is a great diversifier of a real estate portfolio for this reason.

With going-in, free and clear yields of 10% and current equity yields of 14% or higher (with 65% leverage) on stabilized Class A properties, you can see why we are bullish on the independent living segment of senior housing.

Investment Education News

KMF Senior Housing Investors is sponsoring the new edition of the Investment Case for Senior Housing and Care Properties in an Institutional Real Estate Portfolio. The research was performed by Steve Laposa, the National Director of Real Estate at PricewaterhouseCoopers for the National Investment Center for the Seniors Housing and Care Industries (NIC). The previous edition of the Investment Case was the largest selling document in the history of the NIC.

This edition, with updated projections, will be released at the NIC Conference on December 12-14, 2001 in Washington, DC. A number of pension funds and other institutional investors will be attending this Conference, which is the premier investment conference in the Industry. Information and registration information regarding NIC and the conference can be accessed at www.nic.org.

If you would like a copy of the Investment Case or the Property & Portfolio Research report mentioned above, please e-mail us with your request. For copies of any of the research cited in this newsletter, or for further information, please contact Jim Smith at 312-993-7800 Smith@kmfseniorhousing.com or visit our website <http://www.kmfseniorhousing.com>

**Senior Housing Intelligence is published by
KMF Senior Housing Investors L.L.C.,
100 N Riverside Plaza, Suite 2300, Chicago, IL 60606
312 993-7800**