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Senior Housing Moves Differently – New Evidence of its Diversifying Impact

The current recession has had an adverse effect on the office, industrial, hotel and retail sectors, and now even apartments are being impacted. Fourth quarter numbers show that vacancy rates continue to rise for all property types, except senior housing. For example, in just 4 quarters the national office vacancy rate has gone from 8.5% to 14% - a 60% increase; office space actually had a negative absorption of space for the first time since records have been kept. Industrial vacancy rates have gone from 6.5% to 8.5% - a 30% increase. Retail has gone from 8.5 to 10.5% - a 20% increase. Most savvy market watchers expect further increases over the next two to three quarters. As a consequence, income and total returns are going down for all major property types according to the NCREIF Index.

However, senior housing vacancy rates have been decidedly different. The congregate segment, has had no change in vacancy rate over this same measurement period (4Q 2000 – 4Q 2001), remaining steady at 9%. The assisted living vacancy rate actually decreased between the second and third quarter of 2001, but the vacancy rate remains quite high by historical standards.

Why does senior housing move differently? Why is it so resistant to downturns in the economy? It is because of several major reasons:

1. The various segments in senior housing are needs-driven or needs-influenced such that the decision is not easily deferred.

2. Seniors' incomes are not tied to employment, and are mostly indexed for inflation through social security, many pensions and interest rate changes on certificates of deposit reflecting inflation.
3. Seniors as retirees do not move out due to job loss or to buy a single family home because interest rates are low.

Recently, the National Investment Center for the Seniors Housing and Care Industry ("NIC"), the major research group in the Industry, published some substantial evidence on the needs-driven element of demand.

Here in the chart below, we can see the urgency of the move. Certainly, assisted living is more needs-driven than independent living, but even in independent living, there is a fairly high stated (and unstated) urgency to move.

**Needs-Influenced vs. Needs-Driven Element of IL vs. AL
Proportion of Residents by Urgency of Move**

	CCRC**	CONG.**	AL*
Extremely	5%	7%	32%
Very	6%	11%	30%
Somewhat	30%	31%	20%
Not	25%	26%	14%
Not at All	34%	25%	4%

** CCRC and Congregate Date: ASHA Independent Living Report

*AL Data: NIC National Survey of Adult Children

Susan Hudson - Wilson of Property & Portfolio Research noted in a recent study (“The Investment Market for Senior Housing”) that the demand for senior housing may be demand inelastic - changes in supply (i.e., more competition) does not reduce rents the way you would expect in the other real estate classes. The reason for this is largely explained by an important element of a senior’s psychology or mental/social needs. The decision to move is extremely difficult and not made lightly (and often forced by children in the case of assisted living), so once made it is not undone easily by moving to a competitor for what are considered to be fairly minor rent savings, normally offered by no more than one competitor in a market (senior housing local markets are smaller than apartment office, industrial and retail markets).

Senior housing rents have increased at 4.25% compound rates over the last 8 years, with no single year below a 4% increase in street rents.

What could hurt senior housing demand, especially independent living demand? A serious housing recession, with significant housing prices reductions, would slow senior housing demand.

The above outlines several important reasons why we recommend senior apartments and congregate care housing investments as core investments, particularly in adverse economic periods. We recommend assisted living for opportunistic investors. There are several exceptional investment strategies available that can strategically take advantage of these opportunities.

Major Pension Funds Invest in Senior Housing

Many major domestic pensions funds have invested in private direct senior housing over the last couple of years. These funds include the State of Michigan Retirement System, State of Wisconsin Investment Board, Verizon Corporation, Pennsylvania State Employees Retirement Association, Colorado PERA, and CALPERS. A number of other funds have invested in senior housing at the operating level through diversified opportunity funds. The number of funds seriously considering investment in senior housing is definitely increasing. In fact, we are aware of major foreign pension funds that are preparing to make investment in U.S. senior housing assets.

New Investment Resources For You

Several Funds are in the process of making recommendations to their Board for an allocation to senior housing.

Two new studies are available to assist in this process and provide information not available in any other document.

The first is “The Case for Investing in Senior Housing and Care Properties” by the Global Real Estate Research Group at PricewaterhouseCoopers (“PWC”). We will send you a complimentary copy of this Study – just e-mail or write us with your request.

The second is a proprietary study by PWC on analyzing markets for investing in senior housing. This study was recently presented at the 2nd annual KMF Senior Housing Conference in Phoenix, Arizona. We will also provide this valuable information to investors, who are interested in senior housing investment.

The Property & Portfolio Research Paper “The Investment Market for Senior Housing – An Investigation” is also available upon request from KMF Senior Housing Investors.

For further information on articles in this briefing or on any aspect of investing in senior housing, please contact Jim Smith at 312-993-7800 smith@kmfseniorhousing.com or visit our website <http://www.kmfseniorhousing.com>

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