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THE SeniorCare INVESTOR

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Breaking The Logjam In The Senior Care M&A Market

Even though last month's lead story was based on the seniors housing and care merger and acquisition market being in a near-term slumber, we are going to be very contradictory in just a month's time. The odd thing is that while nothing has really changed in a month's time, everything has changed, at least perhaps the perception that everything has changed. What may have summed up the market for the past six months was a quote from someone who prefers to remain anonymous, which was, "I was the only one to show up to bid, and I still didn't win."

This may say it all. First, although many were invited to the party, not many wanted to show up. Second, just showing up doesn't mean you are going home with anything. This can have several meanings which can lead to a few questions. First, what was the reason only one bidder showed up and made a bid? Second, is the fact that their bid was not the "winning bid," since it was the only bid, indicative of the problem for the past six months the market has had, namely that we are still going through a price rationalization process in the acquisition market? Many sellers have still not accepted the new reality in the market, whatever that reality may

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First Quarter Earnings Results

Occupancy Is Down, But Results Could Have Been Worse

All of the first quarter earnings reports are now out, and while the numbers were not particularly good, they could have been a lot worse. Keep in mind that the first quarter often has some softness with occupancy as the annual flu season usually takes its toll. On the flip side, a lot of icy weather can certainly bolster the rehab units of skilled nursing facilities.

All in all, given the state of the economy and the housing market, the first quarter results for the assisted and independent living companies were mostly acceptable.

We focus on the public companies because they can be used as a good, real-time barometer on what is happening in the market because of their combined size and national breadth. Almost every company reported a year-over-year decline in occupancy, as well as a drop sequentially from the fourth quarter on a same-store basis, except for

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Emeritus Corporation (AMEX: ESC), which does not report same-store occupancy results. Year-over-year occupancy at Emeritus actually increased by 40 basis points, mostly because of the acquisition of **Summerville Senior Living** in September of last year, but sequentially occupancy was flat, beating the results of its peer group. In this market, that can be considered a big success.

One of the problems with looking at overall occupancy levels at these publicly traded companies, and using these results to make a judgment on the state of the industry, is that out of a portfolio of 100 properties, fewer than 10% of the facilities can be having difficulties, either as a result of key personnel leaving (marketing director, executive director), bad local press because of an "incident" (see below) or renovations that temporarily result in a lower census. The other 90% or more may be doing just fine, even increasing their census a bit, but it is the other ones that can bring the total average down. Does that mean trouble is brewing? Not necessarily, and **Sunrise Senior Living** (NYSE: SRZ) is an example of where a small percentage of joint venture properties caused the total of 147 JV properties to experience a year-over-year 100 basis point occupancy decline, even though the rest were doing just fine.

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Occupancy, of course, is just one side of the equation, with rental rates and expenses the other. The seniors housing industry has been coping fairly well in these difficult times by being able to achieve attractive annual rental increases. For the most recent quarter, the year-over-year same-facility rent increases for these companies have ranged from about 4.4% to 8.3%. While good, they have also been coming under attack by some consumer groups, and it is questionable how sustainable these increases will be unless the economic climate improves. Also, these rate increases have been implemented during a several-year period when new developments have been somewhat minimal in most markets, and it is unclear what will happen when development starts increasing to meet the growing demand. In addition, for some companies expense growth has outpaced revenue growth, and that can't go on for too long. With basics such as energy and food costs rising well above the "general" inflation rate, we are not sure what is going to happen. What are they going to do, institute a 5% "fuel surcharge" like so many service providers have done in the past few years in your town and mine?

One of the bellwether companies to watch is **Brookdale Senior Living** (NYSE: BKD), given its size, national presence and variety of property types. The company's same facility year-over-year occupancy declined by 150 basis points to 89.8%, most of which has occurred since the fourth quarter of last year. Same facility revenue per unit increased by 8.7% from a year ago, some of which must be coming from the roll-out of therapy services at the Brookdale legacy facilities, in addition to rent increases. But they need to have a healthy revenue increase, because the year-over-year same facility expenses increased by 7.1%, with total facility operating expenses jumping by 8.6% from a year ago. Part of this is a result of adding more than 50 marketing people, so when times are better some of this additional expense could go away.

On an earnings basis, the first quarter results sent a mixed message. The EBITDAR margin dropped by 34 basis points from a year ago, while the EBITDA margin increased by 85 basis points. But since cash flow is king, the funds from facility operations increased by more than 19% to $38.6

The Providers

Company	Ticker	Current Price 5/30/08	Adjusted P/E Ratio[1]	% Change from Prior Month	% Change from 1/1/08	52-Week Range High	52-Week Range Low
Skilled Nursing							
Advocat	AVCA	$12.04	7.1	14%	9%	$12.75	$ 9.25
Ensign Group[2]	ENSG	10.41	5.5	8	-28	16.65	7.50
Kindred Healthcare[3]	KND	27.59	8.4	16	10	28.74	17.35
National HealthCare	NHC	52.25	8.4	4	1	55.75	45.75
Skilled Healthcare Group[4]	SKH	13.46	8.7	11	-8	16.81	9.83
Sun Healthcare	SUNH	14.36	8.9	9	-16	18.78	11.72
Assisted/Independent Living							
Assisted Living Concepts	ALC	6.70	10.2	-8	-11	11.87	5.46
Brookdale Senior Living	BKD	26.38	13.9	1	-7	48.41	20.46
Capital Senior Living	CSU	8.04	11.1	-6	-19	11.19	6.32
Emeritus Assisted Living	ESC	21.23	14.5	-14	-16	39.40	19.99
Five Star Quality Care	FVE	6.70	9.3	12	-19	10.20	5.70
Sunrise Senior Living[5]	SRZ	26.48	NA	23	-14	42.97	16.27

[1] Adjusted P/E = (market cap + total debt + capitalized leases - cash)/annualized EBITDAR based on the most recent quarter. The rate used to capitalize the leases has been changed from 12.5% to 10.0% effective 1/31/06 to better reflect market conditions. [2] The Ensign Group went public on November 8, 2007 at a price of $16.00 per share. [3] Effective August 1, 2007 Kindred Healthcare spun out and merged its pharmacy division into a separate publicly traded company called PharMerica Corp. [4] Skilled Healthcare Group went public on May 15, 2007 at a price of $15.50 per share. [5] Sunrise Senior Living has not submitted financial statements to the SEC for the four quarters and full year of 2007, but has recently submitted revised financial statements for 2004 and 2005 and its 10-K for 2006. Therefore, we have stopped reporting an adjusted P/E ratio until the financial data is current.

million in this year's first quarter. The company finally lowered its dividend by 50%, something that should have been done months earlier, and it has recently announced that the board has authorized a stock buy-back program of up to $150 million. While we understand that this helps bolster the price with market buys, as well as valuations by decreasing the number of shares outstanding, we always view this device, in any industry, as a negative statement on the company's business, especially when management says they can get the best return on capital by buying shares.

What does this say about the future prospects of the business, that they don't have any good investment possibilities, such as acquisitions, development…growth of any kind? We don't mean to pick on Brookdale, but isn't this somewhat similar to paying a dividend, in terms of it being a "benefit" to shareholders? If they cut the dividend because they needed the cash, why is it just going to be used to buy back shares, as opposed to investing in the company's facilities and people? Meanwhile, both **Stifel Nicolaus** and **Jefferies & Company** have Buy ratings on the stock and price targets 33% above current levels.

The results at a completely different type of company, **Assisted Living Concepts** (NYSE: ALC), were not exactly what investors were hoping to see, especially after we touted the stock as being way to cheap when it hit $5.50 per share two months ago. Year-over-year, same-facility occupancy plunged by 1,260 basis points to 71.1%, most of it by design as the company "disengages" from the Medicaid waiver program in most states. The problem has been filling those former Medicaid-occupied units with residents at the higher private pay rates. A year ago, there were 5,219 private pay units filled, but in the first quarter of 2008, on a same-facility basis it was just 5,065 units, representing a 3% decline. This is not the direction you want to go when your Medicaid census has declined by 50% in 12 months.

Despite these problems, operating margins did not decline, thanks to some cost-cutting as well as a $2 million deferred income tax credit. In fact, the EBITDAR margin increased by 110 basis points, helped by an acquisition with higher margins. Management has stated that some of its private-pay residents have moved out to be cared for at the home of relatives, but that there should be a turnaround in the private census starting sometime in the second half of the year. They will need to do this just as the additional 400 units they are adding to 20 facilities start to come on stream, doubling their marketing needs. Perhaps they can borrow some of Brookdale's new marketing staff.

The company trades at a premium to its peer group when looked at as a multiple of cash flow from facility operations, partly because of the expectation that private-pay occupancy will start to rise, and also because ALC has about the highest percentage of owned facilities among its peer group. Jefferies & Company maintained its Buy rating, but lowered its price target from $9.25 to $8.50 per share. Unfortunately, management will have to deal with the bad press it continues to get, such as the story about a 99-year old woman who, after spending about $330,000 over nine years at an ALC facility and running out of money, has been asked to leave because they will not accept any more Medicaid residents because they have reduced the number of Medicaid beds at this facility in Washington state. ALC apparently filed an eviction notice but then canceled a hearing on the eviction.

If you want to keep away from Congressional hearings, there is a better way to handle it than this. In fact, in addition to the **Elderlife Financial Services** consumer financing program we mentioned last month as a way to increase census, there is another financing mechanism that is just coming on to the market. This one is different in that it does not involve borrowing money, but selling the potential resident's life insurance contract, called a Life Settlement. Institutional investors will pay the policyholder more than what the stated cash surrender value is on the policy, which is often just 2% to 5% of the face amount, compared with 25% to 60% with a Life Settlement.

Unfortunately, this concept gained favor 20 years ago among AIDS patients with high medical bills and a short life expectancy. In the case of an elderly resident, with the market value of the policy often greater than the cash surrender value, it can be a win-win if they need the proceeds from the sale of their house before moving into a seniors housing residence, or even affording it. The investor who purchases the policy continues to pay the premiums as well, so after receiving the lump-sum payment, there is no additional cash outflow for the resident.

The company that is launching this Life Settlement product is Maine-based **Life Care Funding Group** (www.lifecarefunding.com), which was founded by Chris Orestis; a recently released white paper on the concept should be available at the web site. The company has already signed up some regional operators, such as **Epoch Senior Living**, **Continuum Health Care**, **North Country Associates** and **Schooner Estates**, but more are expected in the near future. When we say "signed up," it is really more getting their name to the marketing director at a company's facilities and making sure, when going over a resident's financial profile, they let them know that there is a company that can step in and buy out a life insurance policy at a much greater value, providing the resident with the cash she or he may need to live in an assisted or independent living facility. It is the awareness of this availability that is key, and providers do not want to lose potential residents because of the cost when they may not realize the true value of an asset they have. Combined with the Elderlife financing program, there are a lot of ways providers can help residents make the financial decision to make the move. And that will help census.

On the skilled nursing side of the business, it is usually not expected that economic woes and a declining housing market would impact occupancy levels, and they didn't. Year-over-year, most of the companies posted increases in overall occupancy, as they did sequentially. **Kindred Healthcare** (NYSE: KND), posted its best occupancy results in a few years with an 89.2% census in the first quarter of 2008, up 140 basis points from the fourth quarter and up 100 basis points from the year-ago quarter. With the skilled nursing industry, it's all about reimbursement, especially Medicare reimbursement, and despite a proposed 0.3% Medicare cut, it is expected that providers will be able to adjust their census mix to partially offset this.

Even though we have heard of more instances of states increasing their Medicaid rates, or making a commitment to not lowering them, if the housing market and economy get worse, which is a good bet, many state budgets are bound to be seeing red ink by 2009. In that case, the pressure will be on. For now, however, investors have liked what they have seen with the publicly traded skilled nursing operators after the first quarter earnings were announced, as can be seen on page 3 in their stock price performance in May. All moved up, with three companies increasing by more than 10%.

Senior Care Portfolios

continued from page 1...

be, and buyers continue to be tempted to prey on the thinned-out market demand and bid a little too low in their attempt to "steal" a deal. But then again, one has to define what the word "steal" means in this market, and no one really knows.

Getting back to the perception that the market may be about to turn for the better, for months we have been saying that it was unlikely that many large deals, defined as over $500 million, would get done this year because of the lack of funding, or the cost of it, for anything that size. In fact, we thought at best there might be one large deal, and perhaps someone would take a run at one of the public companies when it looked like a few of their stock values were getting enticingly low. A month ago, there did not seem to be any real possibilities on the table. Today, the potential dollar value of portfolios that have just come on to the market, or are about to, is between $3.0 and $4.0 billion. Say what? It is almost as if a group of M&A bankers got together, clicked their slippered heels three times and chanted, "Take me back home to…2006."

The first portfolio, and the largest, is privately-held **Sava Senior Care**, which is basically the remnant of the former **Mariner Health Care**. On December 10, 2004, the predecessor of Sava, **National Senior Care**, purchased Mariner for approximately $1.0 billion, which included $615 million in cash for the stock and $385 million of assumed debt, plus the assumed leasehold interests. At the time, Mariner operated 256 skilled nursing facilities and eight assisted living facilities with a total of more than 31,400 beds and trailing 12-month revenues of $1.7 billion. We understand that the portfolio is down to around 200 properties with revenues maybe in the $1.5 to $1.6 billion range.

Sava tried to sell its portfolio of mostly leased California skilled nursing facilities last year, but without the real estate, the pricing was too rich for a market that was beginning to deteriorate. We have heard that there was some talk of just selling the operations of Sava, but we understand that the entire portfolio going on the market will be for the operations and the real estate, when available. Although we thought **Credit Suisse** was going to be tapped to represent Sava (and may have done some preliminary testing of the market last fall, given that they did the acquisition financing more than three years ago), Gray Hampton and Lyle Wilpon of **Banc of America Securities** have been given the job.


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It is too early to know about any pricing, and usually in these large corporate transactions there is no asking price. That being said, our guess is that they are looking for a price somewhere between $1.5 and $2.0 billion. A few months ago, most everyone would have said, “No way.” What we don’t know is how serious the owners are about selling the company. If they didn’t like what they saw in a preliminary look late last year, has something changed in their price expectations, do they need some liquidity for their investors and other real estate interests, or do they simply see a market that is more willing—and able—to finance a large transaction? We hope to find out soon, but since a deal won’t close until the end of the year, that would be a four-year holding period for the asset, which is about the right timing for a sale.

So, who would the likely buyers be for a deal of this size? We have to assume that **Formation Capital** will take a hard look, as will **Fillmore Capital**, although we have heard mixed news about how Fillmore’s investment in the former **Beverly Enterprises** is going. Fillmore would be an interesting player in a deal for Sava, because there is certainly no love lost between Fillmore and Formation after the battle for **Genesis Healthcare** last year, nor is there any love lost between Fillmore and some of the investors in Sava who thought they were mistreated when Fillmore came in at the last minute to “save” the Beverly deal (whew, too much history here). After those two, we assume that **Blackstone Group** and **KKR** will take a look, and a REIT or two should have some interest. Most everyone will want to look, partly out of curiosity about the portfolio, but also to get a flavor as to pricing parameters in today’s market. There is a good chance, however, that nothing will get done.

GE Portfolio. Speaking of pricing parameters, we hear some rumblings that **GE Healthcare Financial Services** is about to go to market with a large portion of its owned skilled nursing facility portfolio that is leased out to third party operators. Apparently, this will be a bit different from the portfolio that GE tried to sell last year, with the former Beverly, Mariner and Genesis Florida nursing facilities included, but perhaps with the **Laurel Health Care** assets added this time around instead of the **Centennial Healthcare** assets. This would be a pure real estate play since GE just collects the rental income plus a share in the extra cash flow based on a formula.

Although we don’t know for sure, GE may have some concerns because of the profit-sharing arrangement in some of the leases and the appearance that they then have some control over operations, and thus some liability. As we have always stated, we believe there is no operational control or influence over what happens inside these skilled nursing facilities, but with people like Henry Waxman and Pete Stark populating Congress, a company such as GE is forced to proceed with caution. Since the big up-tick in Medicare census and cash flow has already occurred, if GE can’t get a deal done, one solution might be to convert some portion of the participations into the base rent to avoid the potential liability problem.

We believe that GE paid about 10.5x (or slightly higher) rental income, which we assume includes the participations, but that the asking price may be closer to 12.0x, which would put the asking price just over $1.0 billion. The timing of last year’s attempt to divest some of these assets was awful, to say the least, so the fact that they are coming out again may indicate that they see the market strengthening a bit, or they are hedging their bets. Once again, the success of this potential deal will have a significant psychological influence on the market, perhaps not quite the impact of the original purchase in 2006, but important nonetheless. We hear that **Houlihan, Lokey** has been tapped to handle the sale this time around.

AL/IL Potential Portfolios. The two skilled nursing facility portfolios mentioned above have a combined potential value of $2.5 billion or more, but there are also some deals

brewing on the assisted/independent side of the market. Although not technically for sale (yet), the first one we have to mention is **Capital Senior Living** (NYSE: CSU), which announced on May 29 that a special committee of the board hired Gray Hampton and Michael McIvor of Banc of America Securities as its financial advisors to assist the committee in actively exploring a range of "strategic alternatives" to maximize shareholder value. Now, this does not always mean that a sale will be the outcome, and in this market that is certainly not a given. Shareholders were certainly not impressed, initially sending the stock price down by 4.5% on the news, which is unusual when the ubiquitous "strategic alternatives" announcement is made. Our view has been that if truly maximizing shareholder value is the goal, they should continue to grow the company and, when cash flow is higher and the markets stronger, they should then look to capitalize on that increase in cash flow and value through a sale. That may end up being the recommendation of the advisor, but current shareholders may be impatient since there is certainly no guarantee that values will be higher in 12 to 24 months' time, and there is that notion of the time value of money.

Capital Senior Living has been trading between $8.00 and $9.00 per share for the past few months, and while we are not sure what would entice a buyer to pay a 20% to 25% premium to get control of the company, we don't think that kind of price would be acceptable to the board in terms of "maximizing" shareholder value, even though there are some shareholders who would now jump at that higher price level. In a simplistic way of valuing the company, by taking the first quarter EBITDA (annualized), adding back the G&A expense and then subtracting a 5% management fee, you derive a $9.90 per share value using an 8% cap rate after deducting the outstanding debt. That represents an attractive 23% premium to the closing price at the end of May, but is that really what shareholders want? When **Mercury Real Estate Advisors**, which used to own 9.8% of CSU, was pushing for a sale of the company two years ago, we came up with a theoretical value of $10.65 per share with some different assumptions (7% cap rate, for one), which was less than the then market price.

In a recent report by **Stifel Nicolaus** after CSU's first quarter earnings came out, Jerry Doctrow came up with a $15 per share net asset value (which usually overstates the value), a $10 per share value using a cash flow from facility operations analysis and an $8 per share value using a discounted cash flow analysis. Frank Morgan of **Jefferies & Company** has a price target of $11 per share based on an 11.25x multiple of his estimated 2009 EBITDAR. These are wide ranges which just illustrate why valuing these companies, and assets, in this market is so difficult. It is also why you should attend our audio conference on June 17 (new date) to learn how four seniors housing and care equity analysts view the current state of the market and how they are valuing the industry.

For Capital Senior Living, there are not many logical cash buyers in the market, and we are not sure the board would, or should, accept the stock of a strategic buyer, and there are not many of them looking to do a deal right now anyway. It is always better to sell from a position of strength; on a sequential basis, CSU's EBITDAR and occupancy declined, and a buyer will have to wonder if there will be any more census weakness. Since the company mostly targets the middle market, and with that kind of consumer usually having a larger percentage of their net worth tied up in their home value, the current housing market weakness does not help matters, which is another reason why we say CSU should wait. There has been some mention of selling the assets in pieces and not the company as a whole, but that is a much higher risk today than 12 months ago, because if half the assets (the better ones) were sold off, what would be the value of what's left, especially if the remainder couldn't be sold?

Obviously, the Banc of America advisors are going to have to do some homework to decide whether a sale of Capital Senior Living is in the best long-term interests of shareholders, but another portfolio that we hear has recently come onto the market may shed some light on current investor demand. We understand that **Arcapita, Inc.**, formerly known as the **First Islamic Bank**, has just gone to market to try to sell its 80% interest in **The Fountains**, which was purchased with **Sunrise Senior Living** (NYSE: SRZ) in the middle of 2005 for a total of $483 million. At the time, there were 18 retirement communities, many of which were CCRCs, with a capacity for 2,769 independent living residents, 1,318 assisted living residents and 779 skilled nursing beds. Arcapita actually purchased an 80% in the real estate of 16 of these properties, with Sunrise paying about $67 million for its 20% interest and, of course, the right to manage the entire portfolio. And that may be the rub in this deal.

Although the portfolio has been difficult for Sunrise, especially with regard to some occupancy issues at some of the newer properties, we have to believe that Sunrise wants to continue managing the portfolio for a new buyer. So, just as GE wants to sell the real estate with leases in place, it looks as if Sunrise and Arcapita will be trying to recapitalize the Fountains portfolio, but with the Sunrise management contracts in place. That obviously limits the appeal of this acquisition for those strategic buyers who want to operate the communities themselves, as well as for any investors who, for whatever reason, may not want Sunrise in as the manager. We have not heard of an asking price, if there is one, nor whether Sunrise will be selling its 20% interest as part of the deal. Since the original price was about $483 million, that may be a starting point, and the middle of 2005 was still 18 months from the peak in the acquisition market. But…if the portfolio's performance has not improved, the original price may have no bearing on today's value at all.

Other Portfolios. The big transactions always make the headlines, but there are several smaller portfolios that either have recently come to the market or are about to go. We had mentioned last month that **Heavenrich & Company** was working on the sale of an assisted and independent living portfolio that may go for $180 million, but we also hear that **CB Richard Ellis** will have in the market a portfolio of more than 1,000 independent living units that could have a value in excess of $200 million. In addition, Mark Myers of **Marcus & Millichap** is marketing a portfolio of assisted living facilities located in various states that can be expanded up to 50 facilities. A buyer who can purchase all 50 will have the higher priority, but these properties can be sold individually or in small groups. We assume the maximum value for the entire group would be in the $400 million to $500 million range, but the individual prices would have a wide range because of quality and occupancy.

On the skilled nursing side, **Senior Living Investment Brokerage** is going to market with a five-facility portfolio, and there has been a $300 million deal (or so we hear) in the works for several months through Lee Haris, who quietly returned from China a few years back. The point is that, in addition to the single-facility sales, there is a lot of inventory on the market with prices between $50 million and $2 billion, not to mention a few medium-size portfolios that are set to close in the next month or two.

This represents the most potential sales activity since the first quarter of 2007, but there is a little debate as to exactly what it all means. Is the fact the a few very large portfolios are coming to market at a time when the capital markets are still troubled, to say the least, a sign of distress selling by investors who may be worrying that the markets and values will get worse before they get better? Or, is this a signal that some people believe that the debt markets are strengthening, and with some liquidity returning, investors are ready to put their money to work?

If one or two of the large transactions actually get done, it will be a huge boost to the seniors housing and care acquisition market and we may see a substantial increase in inventory coming to market late in the year and into 2009. However, if the market basically says no, and they don't get done, then a certain degree of pricing reality may finally set in with all players, and we may see more deals getting done and the current disconnect between many buyers and sellers disappearing, with the logjam of deals breaking up. It is important to remember that under either scenario, M&A activity would theoretically increase, just not for the jumbo transactions.

Skilled Nursing Market

While the attention over the next several months will certainly be on the larger portfolio deals and what degree of price rationalization will occur, and whether lenders will step up to the plate, the little deals are still getting done. **Ensign Group** (NASDAQ: ENSG) has been plugging away with several small acquisitions. In early May the company exercised an option to acquire a 130-bed skilled nursing facility in Scottsdale, Arizona for $5.2 million, or $40,000 per bed. Renovations are already under way at the facility, which are expected to be completed by July.

The company also purchased a 120-bed nursing facility in Orem, Utah in a deal that was first struck in mid-2007 but with the closing delayed because of some title issues. Ensign has been operating the facility since then under a short-term lease, and paid $2.0 million to acquire and assume a favorable long-term lease on the facility. Also in Utah, at the end of May ENSG closed on the purchase of an 83-bed nursing facility for $3.0 million, or just over $36,100 per bed. The company's footprint in the Ogden-Salt Lake-Provo corridor now includes five facilities with 552 beds. Ensign now owns 28 of its 62 facilities, and has purchase options on eight of the remaining 34 leased facilities.

Kindred Healthcare (NYSE: KND) continues to close on some of its skilled nursing facilities slated for sale last year. In Lincoln, Nebraska, the company sold a 163-bed facility to Illinois-based **Hunter Management** for $6.0 million, or $36,800 per bed. In Washington, KND sold a 93-bed nursing facility to Washington-based **Prestige Care** for $3.35 million, or $36,000 per bed. Mark Davis of **Healthcare Transactions Group** represented Kindred in these sales and has been handling the divestitures over the past several years.

Missouri has been seeing a lot of activity lately. In one transaction, an out-of-state owner sold his single property located outside St. Louis, Cori Manor, to a regional operator with central office functions in the St. Louis metro area. The regional provider purchased the 146-bed facility that was built in 1976 for $6.2 million, or about $42,500 per bed. The facility actually has 124 skilled beds and 22 residential care beds, and occupancy has historically been near 80%. That may change for the better when a new 158-bed hospital opens nearby sometime during the fourth quarter of this year. Cori Manor will be one of the closest nursing facilities, so overall census and its Medicare census may increase. Annualized revenues and EBITDA, taking into account a $9.00 per day Medicaid rate increase and a private pay rate increase, were about $5.85 million and $760,000, respectively, resulting in a 12.3% cap rate, which is very close to what the market has been. With an expected $6.00 per day Medicaid rate increase this summer, combined with the local management and a new hospital about to open, cash flow could improve significantly next year, taking the pro forma cap rate much higher. Jeff Binder and Patrick Byrne of **Senior Living Investment Brokerage** handled the sale.

Although we had hoped to have more details for this issue, a six-facility skilled nursing portfolio recently sold in Missouri, with **Eldercare Management** as the buyer. This will take his operations to nine facilities, and by next month we should know more. Meanwhile, in California Darius Porshab of **Senior Care Real Estate Brokerage** sold a 59-bed skilled nursing facility for $2.1 million, or about $35,600 per bed. The facility was remodeled as a nursing facility in 1962 and consists of mostly ward rooms. The number of deficiencies and recorded complaints have been well below the state average. The census is about 14% private pay and Veterans, 83% Medi-Cal and 1% Medicare. Revenues and EBITDA for the 2007 fiscal year were just under $2.0 million and $300,000, respectively, yielding a cap rate of 14.1%.

Retirement Housing Market

Not-for-profit providers are known more for building rather than buying, especially when it comes to CCRCs, but perhaps that is changing. This month, we have two acquisitions by large not-for-profit CCRC providers in opposite ends of the country. In the first transaction, **ACTS Retirement-Life Communities** was the winning bidder, at auction, of a 267-unit/bed CCRC in Huntsville, Alabama. This community opened in early 2003 and has 36 duplex homes, 13 single family homes, 113 independent living units and a 105-bed (91 units) skilled nursing, Alzheimer's and personal care center. In its short life, this CCRC has proven to be a case study for how Murphy's Law works.

In the first two years after opening, the manager had to close down part of the health care center at various times because of mold, but we don't know which manager since the community had three managers during the first 18 months. By August of 2006, the community finally entered into Chapter 11 bankruptcy protection, but that couldn't protect them from a series of unfortunate events, even though Lemony Snicket and Count Olaf were nowhere to be found in residence. Two months after the bankruptcy filing, there was a Medicare freeze, and six months after that an employee set a room on fire and was charged with arson and first degree attempted murder. Not even Elderlife Financial could help the census with those kinds of problems. At the time of sale, the IL units and homes were 47% occupied and the health care center was at 67%. Needless to say, the community was losing money, and we don't believe bondholders were getting a penny of interest on their $77.08 million of bonds outstanding.

Allen McMurtry and his team at **CLW Health Care Services Group** were hired by the bankruptcy court in November of last year to sell the community, and they went to market in January. Partly because the community was losing money, and partly because the financial statements had to be a mess and meaningless to any buyer, the offering memorandums went out to interested buyers with no financial statements. Bidders had 45 days to complete due diligence and submit a marked up purchase and sale agreement with a 10% refundable deposit. Five of the bidders were deemed to be qualified and two weeks later were invited back to a live auction, where the opening bid was around $25 million, and bidding had to be in minimum increments of $100,000. The winning bidder would be required to go hard with their 10% deposit that day, so they had to be pretty confident in their ability to close. Two of the five were not-for-profits and the remaining three were for-profits.

ACTS was the last bidder standing with a price of $27.25 million, or just over $107,000 per unit. Now, we don't want to understate the amount of work that ACTS will have to do to change the reputation of the community, known as Carlton Cove, and stabilize the census. Even though this will cost the provider a few million in additional operating costs above the purchase price, it is getting a beautiful community on 43 acres that should never have performed so poorly. The average entrance fee is about $232,000, with average monthly fees around $3,100. Just filling up the remaining independent living homes and apartments will bring in between $15 million and $20 million of cash, and when compared with the purchase price and the cost to build the community just five years ago, this should be a great deal for them. Cheap? Yes. A steal? Well, ACTS beat out four other bidders in the final round, so the losing bidders can't think it was stolen from them. It could be said they paid a "market price," but ACTS is a strong operator with a very good track record and a good balance sheet, and we suspect they think they got a deal and had decided ahead of time that they were not going to walk away from the auction empty-handed.

Out in California, **Pacific Retirement Services** (PRS) will be making its third acquisition of the year when it absorbs not-for-profit **Brethren Hillcrest Homes** located in the historic town of La Verne. Hillcrest opened its doors in 1949 on its 51-acre campus and it has single family homes, independent living, assisted living, skilled nursing and dementia care. It was also the first retirement community in California to be nationally accredited by the **Continuing Care Accreditation Commission** of CARF/CCAC. We don't believe there was a purchase price involved, but that Hillcrest will be simply merged into PRS. With this community, PRS will operate 13 communities in five states. Later this month, PRS is expected to close on a large CCRC in Florida in a sale that was handled by **CB Richard Ellis**.

In a few much smaller deals, a 60-unit retirement community in Pensacola, Florida was sold for just under $3.6 million, or nearly $60,000 per unit. The community was built in 2003 and there are a total of 774 square feet per unit in the building. Separately, **Capital Health Group, LLC** just purchased an 86-unit independent living facility in Troutdale, Oregon for $10.8 million, or $125,600 per unit. It will be managed by **CXA Management**.

Assisted Living Market

Could the assisted living acquisition market really be as quiet as it seems, or is it just that the deals are harder to find, are less "glamorous" or are being done more often by the publicity-shy local and regional operators? We say "yes" to all three. Just like the large portfolio deals, the price rationalization process is still going on, but the sellers of one or two properties usually have a much different incentive when it comes to selling, not worried about outside investors and total return on investment concepts. There are, however, several small portfolios (three to six properties) brewing in the market, according to our sources, but we will have to wait to report on them.

Meanwhile, in Florida, Krone Weidler of Marcus & Millichap sold a 32-unit (licensed for 55 beds) Alzheimer's facility for $3.0 million, or $93,750 per unit. The second phase of construction was completed in 2000, and there is an adjacent lot available for sale that can accommodate 24 extra units. The asking price had been $3.3 million. Separately, Capital Health Group, LLC (CHG) bought a 100-unit (licensed for 130 beds) assisted living facility in Fremont, California, by purchasing the note from **HUD**, and the owner of the property settled with CHG by providing a deed in lieu of foreclosure. Management of this facility will be taken over by **Senior Care Communities**.

Updates

We thought by now we would know who the winning bidder would be for the **Haven Healthcare** portfolio, since a decision was supposed to be made by May 30. The problem is that it is a complicated bankruptcy auction, with several moving pieces. Perhaps the biggest problem was when the stalking horse bidder, **LifeHouse Retirement Properties** (OTCBB: LHRP), dropped out just before the "auction." Apparently, this was because its $105 million stalking horse bid no longer made financial sense when the State of Connecticut finally disclosed the Medicaid rate increases for Haven's 15 Connecticut facilities, increases that fell far short of expectations, according to sources. In addition, we understand that the company's census has fallen by a few hundred basis points since last fall and that the losses are mounting.

As far as we know, the two main interested parties were

LifeHouse and **Formation Capital**, but with a potential bid now below $100 million, and probably below $90 million given the financial deterioration, the unsecured creditors may try to muscle their way in. The DIP lenders are **Omega Healthcare Investors** (NYSE: OHI) and **CapitalSource** (NYSE: CSE), and their line is apparently due at the end of June. Omega also owns the majority of the real estate in the portfolio. Now, it may be a game of chicken, in terms of who blinks first, because we assume that any bidders that are left are smelling blood and trying to see how long they can wait, and how low they can go, and still win the bid. That may be a dangerous game if they truly want to buy these assets, but given the current circumstances, who can blame them.

Earlier this year we reported on an acquisition by California-based **The Pacifica Companies**, but we recently learned of another deal completed earlier this year involving five assisted living facilities with 400 units in California (3), North Carolina and Virginia. These are all newer properties, with one renovated in 2005, and the average occupancy rate is 95%. Although a price has not been revealed yet, Pacifica paid all cash and later arranged financing with **Key Bank** and **Fannie Mae**. Pacifica does not manage their properties, which now total seven with another six in the pipeline. They hope to do $150 million of acquisitions this year, but that could be much higher if one deal comes to fruition. Lee Blake of **JCH Consulting Group** assisted in the most recent transaction.

Finally, a deal we reported on in February "officially" closed late last month, after a bit of turbulence on the way to the closing table that has become so commonplace. The buyer for a group of skilled nursing facilities in Indiana, known as the **Heritage Portfolio**, had to find a new lender at the 11th hour after there was a zoning problem with one of the properties. While the zoning issue was being resolved, the buyer apparently went to the existing lenders on the facilities and negotiated the assumption of those loans, which also required putting in more equity than was originally anticipated. Chris Hyldahl and Mark Myers of Marcus & Millichap represented the seller and helped move the transaction to closing.

FINANCING NEWS

Laura Saull-Smith of **Love Funding** arranged a $2.4 million refinancing of a 66-bed skilled nursing facility in Maryland with HUD. The new loan is paying off an existing HUD loan from 1996 as well as some additional debt, and the extra funds will be used to finance repairs and fund a

replacement reserve of $260,000. The interest rate on the new loan is 6.5% and the debt service coverage ratio is 2.27x. Ms. Smith also arranged construction and permanent financing totaling $15.5 million for a proposed 97-unit independent living community in Williamsburg, Maryland. The 17-month construction loan has a 4.952% interest rate, while the permanent financing will have an interest rate of 7.5% with a 1.33x debt service coverage. The community will have one-, two- and three-bedroom units with unit sizes between 704 and 1,264 square feet.

Contemporary Healthcare Capital Fund I, LP and related funds provided $6 million in mezzanine loan financing to Texas-based **Integra Healthcare Holdings**. The funds will be used to finance working capital and closing costs for the renovation of a 42-bed rehabilitation hospital in Baton Rouge, Louisiana and a 73-bed rehab hospital in Plano, Texas.

Emeritus Corporation closed on the refinancing of five assisted living facilities. Three of the facilities were financed through Fannie Mae with a $25.4 million note and an interest rate of 6.29% over the 10-year term. The remaining two were financed with variable rate debt of $13.3 million, of which $7.2 million was withheld at closing and is available for funding construction projects on the two properties. Key Bank was the originating lender, and after closing costs Emeritus received $11.2 million of cash from the refinancing.

NEW COMPANIES

Three former partners of **Lifestyles Senior Housing Managers** formed a new company called **Milestone Retirement Communities, LLC** based in Vancouver, Washington. Paul Dendy, the CEO of Milestone, is joined by Mark Wiesner and Don Anderson, and collectively they have more than 75 years of seniors housing experience. Milestone is starting with six assisted living facilities, five owned and one managed, but one of them has an independent living component and another has an Alzheimer's component. Their equity partner is Chicago-based **Harrison Street Capital**, and they have one acquisition that is about to close with 175 units and several other acquisition candidates in the hopper. They want to buy, develop, lease and manage facilities in the Pacific and Mountain time zones, and currently operate in Washington, Oregon, Idaho and Arizona.

Multifamily developer **Opus West** is diversifying into seniors housing and has formed a joint venture with **Red Group**, an Arizona-based developer of multifamily and seniors housing communities. The joint venture is developing three rental communities in Arizona and one in Texas. **Leisure Care** has been tapped to be the manager. We haven't heard who is providing the construction financing.

Formation Development Group, formed last year, is breaking ground on its first development project, a 158-unit independent and assisted living community in the Houston, Texas metropolitan area. Formation Capital, the principals of Formation Development and an outside institutional investor have committed $56 million of equity to develop and own seniors housing properties.

ON THE MOVE

We assume **Sovereign Bank** is slowing down its seniors housing lending business, as Sarah Healy, who ran the group, has left and joined **Ziegler Capital Markets** to spearhead its for-profit CCRC practice. Joining her from Sovereign is Toby Shea, who will be part of the Northeast not-for-profit banking team focused on northern New England…**Advocat** (NASDAQ: AVCA) announced the appointment of David White as Vice President of Business Development, coming

REITs

Company	Ticker	Current Price 5/30/08	Current Yield	Dividend Status[1]	2008 % Change	52-Week Range High	52-Week Range Low
Care Investment Trust[2]	CRE	$11.50	5.9	Beg. Nov-07	7%	$14.80	$ 9.40
Health Care Property Investors	HCP	34.26	5.2	Inc. Feb-07	-1	38.75	25.11
Health Care REIT	HCN	48.30	5.6	Inc. May-08	8	50.49	35.08
Healthcare Realty Trust	HR	26.55	5.8	Dec. Aug-07	5	33.12	18.00
LTC Properties	LTC	27.80	5.6	Inc. Jan-08	11	28.10	19.02
National Health Investors	NHI	31.00	7.1	Inc. Mar-08	11	35.54	27.00
Nationwide Health Properties	NHP	34.13	5.2	Inc. Feb-08	9	37.67	22.63
Omega Healthcare Investors	OHI	17.82	6.7	Inc. May-08	11	19.20	12.00
Senior Housing Properties Tr.	SNH	22.21	6.3	Inc. Oct-07	-2	25.21	16.22
Universal Health Realty	UHT	34.11	6.8	Inc. Dec-07	-4	39.05	28.23
Ventas	VTR	47.15	4.3	Inc. Mar-08	4	50.39	26.50

[1] As of ex-dividend date. [2] Care Investment Trust went public on June 22, 2007, selling 15 million shares at a price of $15.00 per share. The initial dividend of $0.17 per share was paid to shareholders of record on November 15, 2007.

from the Transaction Support Group of **Ernst & Young**…**Apartment Realty Advisors** has decided to join the seniors housing brokerage business, although the timing would have been better five years ago. They have launched a national seniors housing group, based in Dallas, with seven employees, four of whom have prior seniors housing experience. Some of the members of the new group include Brian O'Boyle and Jeff Pritchard, both partners, and Ryan Maconachy and Ed LaFrance. The group's first deal is expected to close in July.

REITs

Care Investment Trust (NYSE: CRE) revealed that on March 31 it purchased a 35-unit Alzheimer's facility in Sioux City, Iowa from **Bickford Senior Living Group**, a wholly-owned subsidiary of **EBY Realty Group**, for $3.5 million and leased it back to the seller who will remain the operator. The 15-year lease will have an initial lease rate equal to a 9% yield on the purchase price with 3% annual escalations.

This must have been a warm-up deal, because six weeks later CRE announced a deal to purchase 12 more Bickford properties with a total of 569 assisted living, independent living and Alzheimer's units for approximately $100 million, or $175,750 per unit. This is expected to close in late June and will add about $0.03 per share per quarter to funds from operations for the REIT. The debt service coverage on the portfolio is 1.7x after a management fee and $300 per unit for replacement reserves. **Headwaters MB** represented the seller in the transaction.

In a bit of a change in strategy, **Senior Housing Properties Trust** (NYSE: SNH) has entered into a series of agreements to purchase 49 medical office buildings (MOBs) in 12 states from its former parent company, **HRP Properties Trust** (NYSE: HRP) for $565 million. Even though seniors housing and health care REITs have been jumping on the medical office building diversification bandwagon, this is a little unusual because of who the seller is, the size of the transaction and what negotiations went on behind the scenes since both REITs are managed by the same advisor, **Reit Management & Research LLC**.

The purchase prices were "established by reference to an appraisal report," but who really knows. The action does lift a restriction on SNH that prohibited it from buying MOBs and other research and laboratory buildings, and it gives SNH an option to buy 45 additional buildings. Funding for the acquisition will come from a large stock offering.