



HOULIHAN LOKEY

The REVU

THE REAL ESTATE VALUATION UPDATE

SPRING 2019 | INVESTING IN THE BOOMER BOOM



General Real Estate Market Overview

TRANSACTION VOLUME AND DETAIL

- **Total transaction volume** in U.S. real estate sales reached near record levels of activity in 2018 totaling \$562.1 billion, an increase of 15.0% year-over-year (YoY). The year was the third largest on record for commercial property sales as capital continues to find opportunities in the U.S. commercial real estate market. Portfolio and entity-level sales played an important role in the growth of deal volume for 2018 and represented 31.0% of all investment activity. The entity-level deals represented the strongest component of mega deal growth, both on a percentage basis and in absolute dollars.¹
- **Multifamily** transaction volume in 2018 totaled a record high of \$172.6 billion. Deal volume was up 12.0% YoY despite cap rates at record lows and continuous increase in prices over the past few years. Single asset sales were the mainstay of the growth in volume for the year.²
- **Retail** transaction volume totaled \$84.5 billion in 2018. The sector saw a 32.0% YoY increase in volume driven primarily by entity level transactions. Deals involving portfolios or entity-level transactions grew 131.0% in 2018 from the pace set in 2017.³
- **Office** transaction volume totaled \$134.6 billion, representing a growth of 1.0% YoY. While the growth rate was not as strong as the other sectors, it is favorable given that deal volume in the office space had fallen in the past two years.⁴
- **Hotel** transaction volume totaled \$42.0 billion in 2018, up 5.0% YoY. The largest source of growth from a dollar volume perspective was from portfolio deals.⁵
- **Industrial** transaction volume in 2018 came in at an all-time record high of \$92.4 billion, an increase of 25.0% YoY. Entity level deals were up 300.0% in 2018 with sales totaling just under \$20 billion. Portfolio sales hit a record high level in 2018. The growth rate was modest at only 3.0% from the pace set in 2017, but \$21.9 billion in sales is the highest measure for such sales on record. Single asset sales played a role in the growth in deal volume for the year as well. Here too, volume hit an all-time high, clocking in at \$50.6 billion. This level is up 6.0% from the pace set in 2017.⁶

TRENDS

- **Multifamily** and **retail** cap rates witnessed little or no movement in 2018. Prices for the apartment market overall were up 6.2% YoY in Q4 '18. Prices in the retail sector grew 2.0% YoY in Q4 '18. Office cap rates compressed YoY. Prices for the CBD office sector posted only 0.4% YoY increase in Q4 '18. In the industrial sector, cap rates for flex assets remained largely unchanged, while warehouse assets noticed a decrease in cap rates from the prior year. In the hotel sector, cap rates remained unchanged for full service hotels while limited service hotels saw a decrease in cap rates from the prior year. Prices in the sector were up only 1.6% in Q4 '18.^{2,3,4,5,6}

Q4 2018 Scorecard

Average U.S. Cap Rates & YoY Movement

Multifamily – Garden Style Apartments	Multifamily – Mid/High-Rise Apartments	Industrial – Flex	Industrial – Warehouse	Hotel – Limited Service	Hotel – Full Service	Retail	Office – CBD	Office – Suburban
5.5% (unch.)	4.9% (unch.)	6.7% (unch.)	6.3% (↓ 20 bps)	8.9% (↓ 30 bps)	7.7% (unch.)	6.6% (unch.)	5.2% (↓ 3 bps)	6.8% (↓ 6 bps)

Source: Real Capital Analytics

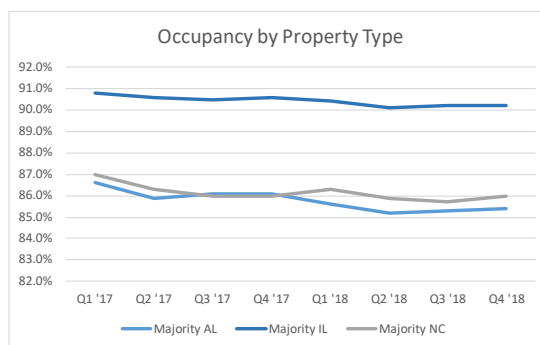
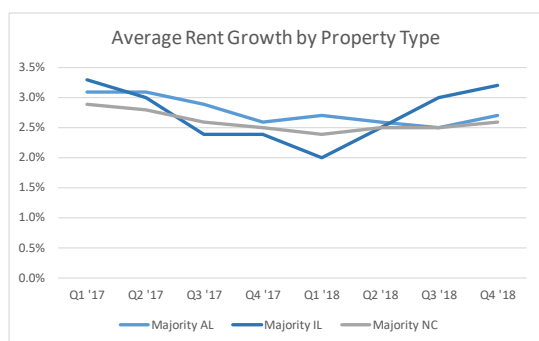
1 Real Capital Analytics, U.S. Capital Trends Report Year in Review 2018.
 2 Real Capital Analytics, Multifamily Trends Report Year in Review 2018.
 3 Real Capital Analytics, Retail Trends Report Year in Review 2018.
 4 Real Capital Analytics, Office Trends Report Year in Review 2018.
 5 Real Capital Analytics, Hotel Trends Report Year in Review 2018.
 6 Real Capital Analytics, Industrial Trends Report Year in Review 2018.

Sector Focus

SENIOR HOUSING AND CARE

Industry Fundamentals:

- The average rental rate for seniors housing in Q4 '18 was \$4,064 per month, a 3.0% increase YoY. Average occupancy stood at 88.0%, down 0.7% from the previous year.⁸
- The average rental rate for nursing care was \$335 per day in Q4 '18, a 2.6% increase YoY. Average occupancy for nursing care facilities stood at 86.3%, unchanged from the prior year. This past April, the Centers for Medicare & Medicaid Services (CMS) announced major simplifications to a previously pitched resident classification system. The proposed Patient-Driven Payment Model (PDPM), a switch from last spring's originally pitched RCS-1, will replace the Resource Utilization Group system, or RUG-IV, used to categorize Part A residents into various payment groups based on their level of need. A 2.4% market Medicare rate increase went into effect October 1, 2018 and the PDPM is effective October 1, 2019. The rate hike, mandated by the 2018 Bipartisan Budget Act, will infuse the industry with an additional \$850 million.^{7, 8}
- The average rental rate for nursing care was \$335 per day in Q4 '18, a 2.6% increase YoY. Average occupancy for nursing care facilities stood at 86.3%, unchanged from the prior year.⁹
- Average initial rates for residents moving in were below average asking rates for both majority independent living and majority assisted living properties. As of December 2018, initial rates for majority assisted living properties averaged 8.8% below their average asking rate, which equates to an average initial rate discount of 1.1 months on an annualized basis, up from 1.0 months in December 2017, but down from 1.2 months in December 2016. The average discount for majority independent living properties was smaller at the equivalent of 0.7 months and was down from 0.8 months in December 2017, but up from 0.4 months in December 2016. This is symptomatic of the significant increase in supply over the same period and the resultant pressure on occupancy levels and rents.⁹
- Average asking rates for majority independent living properties have exceeded in-place rates for the past eight months, a change from the prior 14 months (March 2017–April 2018) when asking rates were less than in-place rates. For majority assisted living properties, average-asking rates have consistently exceeded average in-place rates.⁹



Source: NIC MAP Seniors Housing & Care Market Performance Report Q4 2018.

- The average majority independent living initial rate in December 2018 was 6.7% above its year-earlier level, registering the strongest pace in the 33 months that NIC has reported annual growth rates and significantly more than the average in-place rate growth of 2.2%. Annual growth for independent living move-in rates has been positive for the past eight consecutive months, a sharp contrast with the prior 16 months when year-over-year growth had been generally negative (January 2017 through April 2018). This pattern is not evident, however, in assisted living properties.⁹
- Annual growth in the average in-place rate for majority independent living properties has averaged 2.1% for the past five months, an acceleration from earlier in the year when growth averaged 1.3%. For majority assisted living properties, the annual growth in the average in-place rate has hovered around 1.9% since April 2018, up from 0.5% in the first three months of the year.⁹

⁷ McKnight's – "CMS gives skilled nursing 2.4% Medicare pay raise, unveils another new resident classification system", Kimberly Marselas, April 27, 2018.

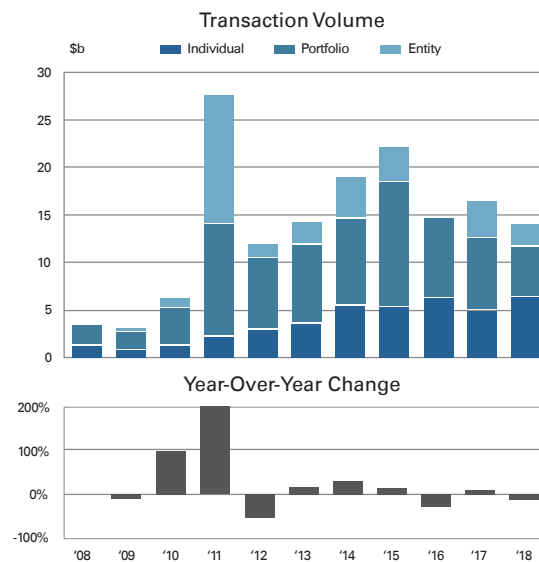
⁸ Real Capital Analytics & NIC MAP Data Service, Seniors Housing & Care Investment Trends Q4 2018.

⁹ According to the NIC Map Data Service Q4 2018.

SECTOR FOCUS: SENIOR HOUSING AND CARE (continued)

Industry Transactions:

- Total deal activity for the senior housing sector fell in 2018, down 14.0% from the pace set in 2017. Volume was down from the previous year primarily because there were fewer mega deals in 2018.¹⁰
- Some of the more notable transactions in this space were Welltower, Inc.'s acquisition of Quality Care Properties (QCP) and Welltower Inc.'s JV with ProMedica to acquire QCP's principal tenant HCR ManorCare for \$4.4 billion that closed on July 26, 2018.¹⁰
- The patterns for the sale of individual assets shows that there was still investor interest in the sector in 2018. These deals show how investors are underwriting the health of the sector when they look at each individual asset, the strengths of the local markets, and the conditions of the assets. Deal volume was up 27.0% in 2018 for such deals, on sales of \$6.5 billion.¹¹
- The skilled nursing market peaked in 2016 at an average price per bed of \$99,200. Since then we have seen a decline in prices primarily due to reduced Medicare Advantage rates, shorter lengths of stay, decline in the traditional orthopedic rehab patient and the limited supply of labor plus its escalating cost. These all contributed to the 18.0% drop in the average price per bed in 2017 and another 5.0% decline in 2018 to \$77,500 per bed.¹²
- The average fee simple cap rate for skilled nursing has ranged between 12.0% and 14.0% for just a few decades and 2018 fell within this range. Surprisingly, given the decline in the average price per bed, the average cap rate declined by 20 basis points to 12.1%. For the conservative players in the market, the weighted average fee simple cap rate was 12.9% in 2018, up from 12.1% in 2017. The weighted average is a better reflection of the market as it takes into account the size of the facility and portfolio transactions.¹²



Source: Real Capital Analytics, U.S. Capital Trends, Apartments, Year in Review 2018

- In the senior housing market, looking at the combined independent and assisted living market, the average price per unit sold dropped about 9.0% from 2017, to \$203,540 per unit. The median had a much larger fall, dropping 30% to \$150,290 per unit. While there were some record prices paid in the market, these were for A+ properties in great locations. The majority of the sales however were not in these markets and a lot of B and C properties were sold in secondary and tertiary locations. What held back the overall seniors housing market down was the assisted living sector, which has been under some pressure from new developments for several years. After peaking in 2017 at \$221,250 per unit, the average price per unit of majority assisted living communities (which also includes memory care) declined nearly 16.0% to \$186,400 per unit in 2018. That is the lowest price per unit since 2013.¹²

¹⁰ Welltower, Inc., News Releases, July 26, 2018.

¹¹ Real Capital Analytics, Multifamily Trends Report Year in Review 2018.

¹² The Senior Care Investor, Volume 31, Issue 2.

SECTOR FOCUS: SENIOR HOUSING AND CARE (continued)

- On the other hand, the independent living market continued to strengthen last year. The average price per unit increased by 3.5% to \$238,100, the second highest year ever after 2014 at \$246,800 per unit. The reason for this high average was the number of very high-priced transactions, including 11 over \$300,000 per unit, five of which were over \$400,000 per unit. Some of these were portfolios and others standalone properties. The upper quartile price was \$315,500 per unit, much higher than in 2017. However, there was a fair share of lower-priced deals, resulting in the median plunging by 27.0% to \$145,400 per unit. The lower quartile, at \$138,300 per unit, was almost identical to that in 2017.¹²
- The independent living market was not immune to worries about capital costs, as the average fee simple cap rate increased by 20 basis points, as did the median, to 7.2%. The lowest average was in 2015 and 2017 at 7.0%, while the lowest median was in 2016 at 6.5%. The spread between AL and IL cap rates widened to 100 basis points in 2018.¹²

CASE STUDY

Houlihan Lokey was engaged as the financial advisor to one of the nation's largest healthcare real estate investment trusts (the Company) and provided financial advisory and a strategic review for a portfolio of housing and care properties for seniors across the nation, which included a new ground up development. Houlihan Lokey's analysis included an assessment of the properties on an as-is basis, multiple tax strategies, as well as potential exit strategies. The engagement included an in-depth analysis of the various operating components of the properties, focused market research relevant to each operating segment, and the development of financial projections.

In another recent situation, Houlihan Lokey was engaged as a financial advisor to provide an estimate of market rent for ground up developments being contemplated by a nursing care operator in the southeastern United States. Houlihan Lokey performed an in-depth financial analysis of the properties, their development costs as well as their intended markets to develop a fully supported market level rent analysis.

These situations highlight Houlihan Lokey's unique capabilities to execute on complex real estate situations with a focus on operationally complex assets and subject matter expertise in the housing, care, and healthcare space for seniors. Our team of valuation professionals coordinated to provide timely and highly relevant advice to the Company.



Valuation Services Offered by Houlihan Lokey

Portfolio Valuation & Advisory Services

- Portfolio Valuation & Advisory Services
- Structured Product Valuation & Pricing Services
- Derivatives Valuation & Risk Management
- Valuation Governance & Best Practices
- Securitization & Regulatory Compliance
- Fund Manager Valuation
- Fund Recapitalization & Transaction Opinions
- Portfolio Acquisition & Divestiture Services

Real Estate Valuation & Advisory Services

- Real Estate Valuation & Advisory Services
- Real Estate Entity Valuation
- Real Estate Due Diligence & Modeling
- Real Estate Debt Valuation
- Fixed Asset Valuation
- Market Analysis
- Fairness & Solvency Opinions
- Purchase Price Allocations
- Portfolio Valuation
- Estate & Gift Tax Valuation
- Dispute Resolution & Financial Expert Opinions
- Property Tax Valuation



Houlihan Lokey holds an indirect minority stake in Leonardo & Co. S.p.A., an investment bank with an office in Milan.

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