SKILLED NURSING STOCKS OUTPERFORM

Two Companies Beat Market Averages In A Bullish Year

Many people would like to forget 2013, at least the fourth quarter with the government shutdown and budget chaos, not to mention the horrific roll-out of the Affordable Care Act. It seems that Washington gets little right these days. As always, there is blame on both sides of the aisle. That is why we marvel at what happened in the stock market during this rather tumultuous year, even during the fourth quarter.

The major stock indices hit new records at the end of the year, with the average increase between 27% and 40%. That is not just a good year, that is a great year, especially when there was still so much uncertainty with the government, debt ceilings, unemployment, quantitative easing, interest rates and on and on. Before we get too giddy, it must be remembered that we were here more than five years ago, so while a more than doubling of the value of the market is nice, it was mostly making up lost ground. Still.....it is better than the alternative.

The seniors housing sector, as a real estate class, made it through the Great Recession in better shape, and with better returns, than any other real estate type. That is just one reason why so much capital has been pouring into the sector in the past two years. Invest-

...continued on page 2

SURGING M&A VOLUME IN 2013

A Record Year For Number Of Publicly Announced Deals

The current bull market for seniors housing and care acquisitions began late in the fourth quarter of 2010 and is now in its fourth year with no letup in sight. The fourth quarter alone had 64 publicly announced transactions, which was a record, and we are still counting. And for the first time ever, we have surpassed 200 announced transactions in a single year, and should be near 225 for 2013 when the final tally is completed.

The fourth quarter of 2012 had 61 announced seniors housing and care transactions, and all year we were hearing from various brokers and bankers that the fourth quarter of 2013 might be a record. Not only were they right, but if the several deals that were supposed to close in December, but got pushed out to early 2014, had closed, we would venture to say that 2013’s transaction volume would be a record that could be set in stone, at least until the next bull market. But this bull market is not over,
ing in the shares of the public companies, the few that are left, is quite another matter. Despite the liquidity of public share ownership, the perceived returns in owning the real estate and operations directly, or just the real estate, has returned to center stage for many investors, including private equity. Once the takeover premium was removed (for now) after 2012, and the interest in splitting companies into a REIT and an operating company diminished with the crash in REIT values, investors had to look at other, more traditional reasons to invest in the stocks. The Ensign Group (NASDAQ: ENSG) was an obvious exception to the rule. The problem is that it involves a very different analysis to invest in stocks and is more of a company play and not a “sector” play, which was more at work in the past few years.

In 2012, the entire seniors housing stock sector rose dramatically, with the exception of Assisted Living Concepts, where the financial and operational issues finally surfaced to what should have been a wary investor base (and you thought we were done writing about them). Even the takeover couldn’t pull its shares up from the close to criminal disclosures. The other stocks gained anywhere from 41% to 135% in 2012, with Capital Senior Living (NYSE: CSU) taking top honors in 2012 and being close to the top in 2011. While it was the top “seniors housing” stock in 2013 with a 28% price increase, when the skilled nursing companies are included, it was a distant third. But CSU investors are not complaining with three years in a row of double- or triple-digit returns.

The overall winner in 2013 was Kindred Healthcare (NYSE: KND) with a return of 82%, with most of that coming in the fourth quarter. It is the one company in our universe that has truly evolved into a post-acute care provider, and most people don’t really think of it as a skilled nursing company anymore. This is especially true after its recent divestitures of dozens of SNFs owned by Ventas (NYSE: VTR) as their lease terms came up for renewal. Kindred has one of the largest portfolios of LTACs in the country, and with its acquisition in 2011 of RehabCare Group for $1.3 billion and its growing home health and hospice business, skilled nursing has really become a much smaller part of the company. For now, however, we will keep it in our universe, not least because Kindred’s direction is where we think the skilled nursing sector needs to go to thrive, if not survive.

This was quite a turnaround for a company that was the worst performer in 2012 among the SNF stocks with a -8% return and a rank only above Assisted Living Concepts. Kindred is also the only company in our universe that is shrinking in size, and on purpose. While we would like to say its strategy is finally paying off, KND’s financial performance has not quite caught up with its stock performance. But we have faith. As we have stated before, management is a bit ahead of the times. This is the future where post-acute providers will really be key partners in Accountable Care Organizations, assuming...
The Providers

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(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 is 10.0%. (2) The company changed its name from Advocat in March 2013. (3) The P/E ratio is based on partial Q:3 data.

that ACOs stand the test of time and don’t end up in the dustbin of health care history, like capitated payments of the late 1990s. But it may take several more years. No matter what happens with the ACA rollout, being able to provide quality care at the lowest cost will be a valuable position to be in, and to be able to provide all the care in the full post-acute continuum will be invaluable. While this is what Kindred is counting on, we are still not sure whether the jump in price has more to do with some favorable reimbursement news for LTACs at the end of the year as opposed to the overall strategy. Regardless, divesting less profitable skilled nursing facilities in non-core markets will have the benefit not only of increasing operating margins, but also redirecting management attention to the core business and locations, and not to underperforming properties. One word of caution is that after such a run-up in price, there will always be the risk of profit-taking in the first quarter.

Just behind Kindred with a 63% increase in its share price was The Ensign Group. Unlike Kindred, Ensign increased steadily in value all year long. And unlike Kindred, Ensign has been pursuing a very different strategy. While it has been growing its home health and hospice business, its strategy has been focused on buying turnaround properties, mostly skilled nursing facilities but also some assisted living communities in selective markets. The company tends to pay cash for its acquisitions, and even though many of these properties have low occupancy rates, they are almost all accretive to earnings before the turnaround has begun. And they are usually single-site acquisitions with few if any portfolio acquisitions that we can remember.

In addition, while Kindred has been trying to reduce its exposure to leased assets, in the fourth quarter Ensign announced its intention to split into an operating company and a REIT (CareTrust), which gave the stock price an initial pop. But the share price has only increased by about 8% since September 30. When the split is completed, Ensign’s annual lease payments will increase from $13.6 million to approximately $72 million, even though its interest expense will decrease to almost nothing, at least initially. The new fixed lease expense will be a financial burden, but the company will have plenty of cash flow to cover it (more than a 2.0x coverage).

The market’s reaction may have been cooler than many expected for a few reasons. First, the timing was unusual because REIT share values had dropped so much since last May. The REIT “premium” was almost gone by the time Ensign made its announcement, and health care REIT stocks in general continued their slide after the announcement. Second, investors do not like single-tenant REITs, and while we are sure CareTrust will seek to diversify its assets to an extent, management has already
stated that CareTrust will help finance Ensign’s continued growth. In addition, diversifying at reasonable acquisition prices will not be easy with a record number of public and private REITs going after some of the same transactions. Ensign has developed a reputation for being able to turn around properties from which most others, especially the public companies, have shied away. Will the new REIT want to finance these on behalf of Ensign, without obtaining the economic benefits that would accrue to such turnarounds with a RIDEA structure? We don’t know, but for shareholders it would appear that the benefit will remain with the operating company for now.

Finally, Ensign was a small cap company before the split, and now shareholders will own two even smaller small cap companies, and our guess is that some of them will not want to own CareTrust because if they did, they would have already been investing in health care REITs. We still think over the long term, and with sufficient growth for both companies, this will be a win for shareholders who keep both companies. But the transition will not be without its bumps. We just hope Ensign can continue with its opportunistic acquisition strategy where it seems to be without peer.

So, two skilled nursing companies, or at least companies that don’t focus on the private pay seniors housing market, were the market leaders in 2013, something that no one would have predicted at the beginning of the year. And a third company, National HealthCare Corporation (NYSE: NHC) came in fourth with a price rise of 15%. There is no single answer that we know of, but for starters, with the economic recovery there has been less pressure on Medicaid rates, and Medicaid is still the payer for two-thirds of nursing facility residents. But more importantly, investors may be understanding the economic importance of skilled nursing in the post-acute arena as we head into the future of health care delivery.

Even though there will be increasing pressure on Medicare rates, prices of skilled nursing facilities have been rising as investors and operators are unlocking the value of the real estate (or the license), understanding that skilled beds with Medicare utilization are worth 3x to 6x those beds with Medicaid utilization, despite the Medicare reimbursement risk. If a skilled nursing facility has a good subacute program, or is in a market that is underserved for subacute care, there can be real pent up value.

One may say that the SNF sector has been downtrodden for so long that any good news is beneficial, but at some point the low-cost provider will be compensated.
Assisted living went after the skilled nursing sector 15 years ago, plucking those customers that had no other choices or, and this is more realistic, offering potential customers something they had not been offered before. But that is a private pay business where people come to live, not get better and return home, which is what skilled nursing has become. The better SNF operators are in a very good position to do their own plucking right now, but obviously higher up on the acuity scale. Are public equity investors really thinking this way? Probably not, but the private investors certainly are.

As the number of decent sized publicly traded skilled nursing companies continues to shrink, it will be increasingly difficult to make any generalizations about the market. This is certainly as true for the private pay seniors housing market, where we are now left with just four publicly traded companies. As we mentioned earlier, Capital Senior Living was the leader of this pack in 2013 with a price increase of 28%, followed by Five Star Quality Care (NYSE: FVE), up 10%, and Brookdale Senior Living (NYSE: BKD), up 7% for the year after a 7% collapse in December. The sole company decreasing in value last year was Emeritus (NYSE: ESC), which dropped a disappointing 13%. So, in a surging stock market, as well as a surging acquisition market, not one of these companies even matched the overall market in total return. What’s up with that?

As usual, there is no simple answer, except the obvious one: that this sector got way ahead of itself in 2012 with returns way above market averages, as investors thought they were all acquisition targets either by REITs or private equity firms, or could be broken up into a REIT and operating company structure much like Ensign. Corporate values were being discussed with net asset values based on unrealistic cap rates that were applied with what seemed to be a disregard for varying property quality and operating margins. And when health care REIT share prices hit the skids, those takeover premiums disappeared faster than the ObamaCare backers.

That is more of the macro explanation, and while true, there are other factors at work. First of all, there has been an uneven change in occupancy at the public companies, and the increases have not been as strong or steady as investors had expected given the improving economy, housing market and net worth of their potential customers with the stock market surge.

Second, with the increase in development, investors
are concerned that this will have an even larger impact on census in 2014 and beyond as these new communities begin to open and compete for some of the same customers. One side of the argument is that an existing community can compete on price since its cost basis is generally going to be lower, which means its capital cost will be lower. But with the improving economy and a financially healthier customer, that customer may be worried less about cost and more about amenities when making the decision to move.

Third, investors may be realizing that there is more to seniors housing than pretty buildings with indoor pools and ice cream parlors. It is health care, especially as the sector gets more involved with memory care and Alzheimer’s. And that spells operational risk and a bull’s eye on your back such as what happened with Emeritus last summer with the Frontline attack piece (part 2 is now out). Fourth, we are down to just four companies and only one of them has a market cap above $1.0 billion (Emeritus is at $1.0 billion after its decline).

All of these things combined result in a more tempered attitude about the sector from a public equity point of view. The same is not true, however, for the private investment market, which is as hot as ever with more buyers than ever. But that is another story.

Surging M&A Volume In 2013
continued from page 1...

and one of the big differences is that in the past two years it has not been dominated by large transactions. The average deal size in 2013 was 50% of what it was in 2011, and the Big Three REITs, other than the $790 million acquisition of a portfolio of Holiday Retirement Corporation properties by Ventas, were much less involved in the market in 2013 than in past years. They have been replaced by the smaller public REITs and the non-traded REITs, which accounted for about one-third of the announced transactions in 2013, many of which were arm’s length deals and not simply sale/leaseback financings.

The increase in the dollar volume of the publicly announced transactions kept pace with the increase in number of deals, with a 17% increase in dollar value to $10.7 billion compared with an 18% increase in deal volume (so far). Because the market has not been dominated by large transactions, the breadth of the market is about as deep as we have seen it, and we don’t see that changing as the number of players does not appear to be shrinking. There are some frustrated buyers out there because they are getting squeezed out of deals by better capitalized bidders, but some of them are finding off-market deals, often with repeat sellers who find comfort in dealing with a known

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Most of the large transactions involve assisted living or independent living portfolios, but skilled nursing is still quite active, representing about 40% of the transactions and nearly half in December. Most of the SNF deals came with above-average prices in December, but in the seniors housing side of the business, the majority of the sales at the end of the year were at below-average prices. While we do not have our acquisition market statistics available for the full year, such as average price per bed and unit and cap rates, to name a few, there is nothing to lead us to believe that there will be too many differences from 2012. The interest rate spike that started in May certainly took its toll on REIT share prices, but it did little to dampen acquisition appetite. And with the 10-year Treasury back up to 3.0% at year’s end, which is the highest it has been in more than two years, it is rational to assume that there would be an impact on cap rates. The problem is that other real estate investors, still used to lower cap rates in their markets, are coming into the seniors housing market (again) and are putting the brakes on a rise in cap rates, forgetting that this is an operational business with an increasing amount of health care provided to a frail population. Alas, memories are short, and all markets are cyclical, even those that supposedly have no cycles.

**Seniors Housing Acquisitions**

As we mentioned, the smaller public REITs and the non-traded REITs were extremely active in 2013, and December was no exception. And most of these REIT transactions last month were arm’s length, meaning that the seller did not lease the property back from the REIT. A case in point was the late December sale of a 125-unit independent living community in Milford, Ohio that was built in 2008 by a local commercial and residential developer but suffered from low occupancy below 70%. The community has mostly one- and two-bedroom units with rates from $2,100 to $4,100 per month. The sale actually was of the loan held by a major bank, with a principal balance of about $16.1 million, and NorthStar Healthcare (NYSE: NRF) together with Arizona-based Watermark Retirement Communities purchased it for $15.6 million, or $124,800 per unit. With the low occupancy, in-place revenues and EBITDA were approximately $2.7 million and $550,000, respectively. But there is a significant need for assisted living in the market, and Watermark plans to convert about 35 units to AL, which should solve the occupancy problems quickly. When Watermark stabilizes the community, revenues and EBITDA should increase to

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$5.6 million and $1.9 million, respectively, in two to three years, which represents an achievable 34% margin. Aron Will of CBRE arranged non-recourse, three-year bridge financing in the amount of $10.5 million, with 24 months of interest only and an all-in interest rate of 3.85%. Carl Mittendorff of Watermark guided the transaction, and there are a few more joint venture deals coming soon between the company and NorthStar. Mike Pardoll of Marcus & Millichap represented the seller in the transaction.

The deal of the month has to be the sale of a 184-unit retirement community in Katy, Texas for $71.25 million, or $387,200 per unit, to American Realty Capital Healthcare Trust. This is a Class A property that was built in 2009 by Formation Development Group that originally had 158 units. In 2013, 20 memory care units and six assisted living units were added, so the total now stands at 126 IL units, 38 AL units and the 20 memory care units. Occupancy has been at or above 98%, and the new units, which were 92% pre-leased and started opening in November, have almost completely sold out, which is quite a statement on the demand as well as the sought after location in this suburb of Houston. Monthly rates are strong, with one-bedroom IL rates ranging from $3,128 to $5,405, and two-bedrooms ranging from $4,600 to $5,999. The AL rates start at $3,266 for a one-bedroom plus any care service charges (there is one two-bedroom AL at a much higher rate). And memory care starts at $4,100 for a semi-private and $6,200 for a private unit.

The purchase had to be made based on year one forecasts with the new memory care and assisted living units factored in, which makes sense given the strong occupancy before the addition and that they were almost completely pre-leased. As it turns out, that was the right call since they are now almost sold out. Estimated revenues and EBITDA for 2014 are about $10.9 million and $4.775 million, respectively. That represents a high 43.8% margin, which can be justified by the high occupancy, high monthly rates and majority of IL units. It also translates to a 6.7% cap rate, and while we believe that is a good market cap rate for a trophy property with interest rates at a two-year high, we would not have been surprised if it was 10 to 20 basis points lower. This should be a long-term keeper for the buyer, which will keep The Arbor Company in place as the manager since it would seem hard to do much better with the property. The seller was represented by Ryan Maconachy and Chad Lavender of HFF, who said there was very strong interest in the purchase.

Senior Housing Properties Trust (NYSE: SNH) closed on the acquisition of a 68-unit community in Ve-
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rona, Wisconsin that has 48 assisted living units and 20 memory care units. The purchase price was $12.0 million, or $176,500 per unit, and Five Star Quality Care (NYSE: FVE) will be the new operator. Further details were not yet available. Mike Collins of Senior Care Realty represented the seller.

Summit Healthcare REIT closed its first deal after its name change from Cornerstone Core Properties REIT. Summit purchased a 40-unit assisted living community in Redding, California from a not-for-profit owner for $3.5 million, or $87,500 per unit. It was built in 1992 and occupancy has been at 100% with average rates of $4,200 per month. A rate increase goes into effect February 1, and we have estimated annual revenues and EBITDA to be about $2.2 million and $430,000, respectively. Summit is leasing the community to an affiliate of Compass Senior Living pursuant to an initial 10-year lease with an annual yield of 8.5% before escalators.

Aviv REIT (NYSE: AVIV) closed on the purchase of an unusual property for the REIT, but one that we think will work out very well in the long term. Minnesota Masonic Homes decided to sell its large rental CCRC in New Hope, Minnesota, as it would like to focus on its other properties. The community, known as North Ridge, has 124 independent living units, 73 assisted living units and a whopping 351 skilled nursing beds. Occupancy at the community is stabilized, and the SNF unit is at 95%, which is incredible for such a large number of beds. The community obviously takes nursing patients from outside the CCRC. According to filed financial statements, 2012 revenues and EBITDA were about $36.8 million and $2.5 million, respectively. We suspect that staffing and benefits run higher than average, and that with new management the operating margin will reach at least 10% in the first year and increase from there. According to local sources, the purchase price was close to $40 million, or about $73,000 per bed/unit. Aviv will be leasing the community to Florida-based Mission Health, which currently manages 13 senior care properties in four states. Bill Mulligan and Kevin Carden of Ziegler represented the seller.

CNL Lifestyle Properties closed on the purchase of a 238-unit community in Aurora, Colorado for $29.9 million, or $125,600 per unit. The community was originally built in 1987, and then 41 cottages were added in 2009 and it underwent a $1.0 million renovation in 2010. It has independent living, assisted living and memory units, and occupancy in early December was 84.5%. Aurora is located outside of Denver, and Colorado-based MorningStar Senior Living will continue to manage
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the community for CNL. MorningStar has 21 properties with 2,552 units under management, including six others in the Denver area.

**Sentio Healthcare Properties** completed its second acquisition pursuant to its investment agreement with **Kohlberg Kravis Roberts** (NYSE: KKR). The 85-unit assisted living and memory care community, located in the Dorchester neighborhood of Boston, Massachusetts, is licensed for 108 beds and reached 97% occupancy in October. The property is a former 19th century mill building that was completely renovated in the mid-1990s with total square footage that averages nearly 900 square feet per unit. Sentio paid $15.55 million, or $182,900 per unit, for a 95% interest, with the seller keeping a 5% interest. Rates are high, with assisted living one-bedrooms ranging from $5,500 to $5,700 per month, while the memory care units average just above $6,700. This is the first institutional partnership for this particular seller, and Sentio wants to grow the relationship with more transactions. This is similar to its first deal with the KKR partnership (discussed in the November issue) where they want to help finance the growth of private companies where they like the operators. Sentio is looking for other companies to partner with.

In the Massachusetts deal, Aron Will of **CBRE Capital Markets** arranged $10.88 million of **Freddie Mac** debt with a 10-year maturity and interest only for 48 months.

In some non-REIT transactions, **Capital Senior Living** (NYSE: CSU) closed on the purchase of four communities in two separate transactions. Three of the properties are in Indiana and one is in South Carolina, and both of the sellers have previously sold to CSU. There are 257 assisted living units, 83 memory care units and 48 independent living units for a total of 388 units. The purchase price was $64.9 million, or $167,300 per unit. In-place revenues were approximately $14.7 million, and although not disclosed, we have estimated EBITDA to be approximately $5.8 million. Occupancy was above 95% for the four properties combined, and the deal will be accretive to 2014 earnings. The acquisition was financed with $49.3 million of 10-year non-recourse debt with an interest rate of 5.56%, or about 260 basis points over the 10-year Treasury. Separately, two months ago CSU closed on the purchase of a 68-unit assisted living and memory care community in Milford, Massachusetts. Occupancy had recently hit 97%, and a third building had been added to the campus in 2006. Allen McMurtry and his team at **Cassidy Turley** represented the seller, who had developed the property and managed it.
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Not to be confused with the buyer above, Capitol Seniors Housing (CSH) closed on the purchase of what is now a 153-unit senior living community in Peachtree City, Georgia that has been evolving to meet the needs of the market. Originally built in 2008 with 145 independent living units, in 2012, 26 of these units on one floor were converted to 34 personal care units. Seven more units have subsequently been converted because these units are now 100% occupied with a waiting list. Overall occupancy is 93%, and it is expected that 20 or so of the remaining 112 IL units may be converted this year. In-place revenues and EBITDA are approximately $5.6 million and $1.5 million, respectively, but with the coming changes in unit mix, we estimate future revenues and EBITDA to be closer to $6.8 million and $2.5 million, respectively. The purchase price was $33.0 million, or $215,700 per unit, and CSH has hired Atlanta-based The Arbor Company to manage it. Mike Pardoll of Marcus & Millichap represented the seller.

Mr. Pardoll also represented the seller of an 87-unit assisted living community in Spartanburg, South Carolina. This community was built in 1999 and is licensed for 99 beds. Sunwest Management purchased the property in 2006, and the lender eventually took it over, hired a third party manager and then sold it in 2010 to a private investor. Occupancy has suffered and was below 60% at the time of the current sale with average rents of $2,400 per month. Revenues and EBITDA in 2013 may have been close to $1.8 million and $500,000, respectively, but we assume that the buyer, North Carolina-based Meridian Senior Living, will be ramping up the census with some sorely needed marketing. The purchase price was $8.25 million, or $94,800 per unit. Contemporary Healthcare Capital provided $7.55 million in senior mortgage debt, a $1.4 million mezzanine loan and $900,000 in preferred equity, all to be used for the acquisition, renovations, working capital and closing costs.

A private partnership based in Memphis, Tennessee recently purchased a 50-unit assisted living facility in Naples, Florida. Built in 1997, the community had occupancy of approximately 80% with rents that were up to $3,280 per month for the 42 studios and up to $3,750 per month for the eight one-bedrooms. In-place revenues and EBITDA were $2.07 million and just over $200,000, respectively, but the buyer has hired Florida-based Superior Residences, and we suspect they will be able to increase the census and cash flow. The purchase price was $5.6 million, or $112,000 per unit, and the buyer assumed a $3.3 million HUD mortgage. Bradley Clousing and Patrick
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Burke of Senior Living Investment Brokerage handled the transaction.

A private company based in St. Louis purchased a 58-unit community in Warrenton, Missouri that was built to assisted living specifications in 2000 but the developer never applied for the Certificate of Need. Consequently, it opened as independent living and subsequently went into receivership in 2013. At the time of the current sale occupancy was just 75% and revenues were only $1.0 million. The buyer has hired Missouri-based Provision Senior Living to manage the property, and if they can get occupancy to 90%, EBITDA could reach $500,000. The buyer may apply for an assisted living CON which, if successful, could boost monthly rents by $1,000.

In another receiver sale, a local doctor in Ohio purchased a 98-unit senior living campus that includes assisted living. Built in 1995, the campus includes eight detached buildings on four acres in what are designed to be home-like settings. There are 24 IL units, 50 AL units and 24 Alzheimer’s units. Occupancy was just above 80%, and revenues were $2.63 million with an 8% operating margin. There are some obvious operating inefficiencies with the eight building format, so we hope that the good doctor knows what he is doing. Mark Myers and Joshua Jandris of Marcus & Millichap, together with Blueprint Healthcare Real Estate Advisors, represented the seller.

Integral Senior Living has been hired as the manager of a new community that just opened in Newport Beach, California. The community has 185 units, of which 40 are independent living and 145 are assisted living, with 40 of those AL units part of a memory care wing. Santa Ana, California-based Nexus Cos. was the developer, and the total cost was $62 million, or $335,000 per unit. It is Newport Beach, after all.

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More than $500 Million in Seniors Housing Transactions in 2013

SOLANA AT CINCO RANCH
Sugarland, TX

NEW ENGLAND SENIORS PORTFOLIO
Franklin & Acton, MA

CSH SENIORS HOUSING PORTFOLIO
Various, U.S.

STONEBRIDGE AT CASTLE HILLS
Lewisville, TX

BRIDGES AT MISSION
Mission, TX

LIBERTY RESIDENCE
Wadsworth, OH

REGAL POINTE
Middletown, NJ

HIGHLAND HOUSE
Wichita, KS

WALDENBROOKE ESTATES
Bryan, TX

FOREST MANOR HEALTH CARE CENTER
Hope, NJ

KAPLAN PORTFOLIO
Various, U.S.

CARRIAGE HOUSE ASSISTED LIVING
Dallas, TX

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DEBT PLACEMENT  INVESTMENT SALES  EQUITY PLACEMENT  ADVISORY SERVICES  LOAN SALES  LOAN SERVICING
do. Revenues and EBITDA were about $9.2 million and $1.8 million, respectively, and there is an adjacent assisted living facility which the seller also sold, but to a different buyer. The purchase price was $13.0 million, or $101,500 per bed, which reflects the high quality mix, and the cap rate came in close to 14%. Ryan Saul of Senior Living Investment Brokerage handled the transaction.

Although not sold at quite as high a per-bed value as the previous transaction, **Brinton Woods Senior Living** purchased the 75% interest in an 82-bed nursing facility in Baltimore, Maryland that it did not own. In 2008, Brinton Woods purchased a 25% interest in the facility and took over management as part of the agreement, turning around what had been an underperforming asset.

The value for a 100% interest was approximately $7.5 million, or close to $91,000 per bed, based on approximately $5.6 million for the 75% interest purchased. Revenues and EBITDA in 2012 were $8.2 million and $880,000, respectively, with occupancy of 90%. The occupancy and EBITDA slipped a bit in 2013. While there is a healthy 17% Medicare census, there is very little private pay. The purchase was financed by a bank in Pennsylvania. Brinton Woods operates four nursing facilities and has a fifth under letter of intent.

A New York investor has purchased three skilled nursing facilities and has hired the same New Jersey-based company to operate them. In the first transaction, the buyer purchased an 85-bed nursing facility in Oakmont, Pennsylvania for approximately $5.95 million, or $70,000 per bed. The facility was originally built in 1952 and was renovated in 1992. Occupancy has been near 87% with a 33% quality mix. The Medicare rates were unusually low, so with annualized revenues in 2013 of about $7.2 million it was operating at just above breakeven after a 5% management fee. With the current quality mix, it should be operating with at least a 10% operating margin. The new manager operates in Ohio, Pennsylvania, Massachusetts and New Jersey, so presumably they will bring some local expertise. Mark Myers and Joshua Jandris of Marcus & Millichap represented the seller.

In the second transaction, the same buyer purchased two skilled nursing facilities located in Cohasset and Lexington, Massachusetts with a combined 224 beds. One of the facilities has just 72 beds with occupancy of 74%, while the other facility has 152 beds and was operating at an 87% occupancy rate. In 2012, they had a combined loss in excess of $1.0 million on revenues of $16.0 million. Under new management, pro forma revenues and EBITDA could reach $17.4 million and $1.5 million, respectively,
within a year. But given the purchase price, we assume the buyer has higher expectations over time. Myers and Jandris represented the seller on this transaction as well.

A private company based in Missouri just closed on a 75-bed skilled nursing facility that was built in 1999 and is located in Illinois about 50 miles southeast of St. Louis. The facility had a low Medicaid rate of $101 and average occupancy just above 90%. Three strong offers were received within 10 days, and the final price was $4.3 million, or $57,300 per bed, which is not too bad for southern Illinois. Revenues and EBITDA were approximately $5.2 million and $660,000, respectively, resulting in a 15% cap rate. Patrick Byrne of Senior Living Investment Brokerage handled the transaction.

A regional not-for-profit has sold its 97-bed skilled nursing facility in Brackenridge, Pennsylvania for $4.75 million, or just under $49,000 per bed. The facility was built in 1972 and has just 247 square feet per bed. The overall census was 90%, with a quality mix of 34%. Despite this, the operating margin was just 2.5% on revenues of $7.96 million. The seller had used a third party manager, so perhaps with the new owner, which is based in New York and will also operate the facility, there will be more of an incentive to boost the cash flow. We hope so, since the current cash flow does not warrant that price. Toby Siefert and Ryan Saul of Senior Living Investment Brokerage handled the transaction.

An out-of-state-owner from North Dakota sold its 130-bed nursing facility in Council Bluffs, Iowa in a sale that should have been done a few years earlier. At one time, the facility was earning an 8% margin on revenues of $6.5 million. Then some trouble hit, including landing on the federal Special Focus list for a year. As a result, it turned cash flow negative and sold for just $2.5 million, or $19,200 per bed. The Atlanta-based buyer apparently has a history of turning around troubled facilities, and it will help that this facility is located near two hospitals. Mark Myers and Joshua Jandris of Marcus & Millichap represented the seller.

A group of 26 investors decided to sell their investment in a rural Illinois 62-bed nursing facility that also had an eight-unit independent living building (go figure). The nursing component was built in 1977 and runs at 93% occupancy, while the IL component was built in 1998 and had three vacancies. The investors sold the campus to the existing manager, an Illinois-based private company, in a stock sale which may have resulted in a lower price. It sold for a little more than $1.4 million, or $20,200 per bed/unit.
Revenues were $2.7 million but the current profits were not sufficient for a market cap rate. Ryan Saul of Senior Living Investment Brokerage handled the transaction.

Aviv REIT closed on an interesting transaction in Ohio with multiple tenants. The campus includes an assisted living community that will be leased to Maplewood Senior Living, an existing Aviv tenant, with an initial cash yield of 8%. Also on the campus is a skilled nursing facility and an LTAC that will be leased to Cardinal Care Management, a new tenant, with an initial cash yield of 9.8%. As part of the transaction, Aviv has the right to build a new LTAC. Aviv also purchased a specialty hospital in Indiana that will be leased to Physician’s Hospital, an existing tenant, with an initial cash yield of 10.0%. The total purchase price for these transactions was $44.9 million, but no other details were disclosed.

Healthtique Group recently closed on its 10th property and fourth in Florida. Located in Ft. Walton Beach, the 60-bed nursing facility is situated on a larger retirement community campus where the new owner did not want the task of running the skilled nursing portion. Healthtique will be leasing the facility, which has an occupancy rate of approximately 85%.

**Acquisition Updates**

Last August, CNL Healthcare Properties announced its planned purchase of 21 senior living communities with 2,186 units for $457.3 million, or $209,200 per unit. On December 9, CNL closed on 12 of the properties with 1,404 units for $302 million. These have an average age of 7.3 years and the management will be split between Prestige Senior Living, which will take over eight of the properties in Oregon, and MorningStar Senior Living, which will manage two in Idaho and one each in Nevada and Montana. Prestige operates 73 properties throughout the Pacific Northwest and MorningStar has 20 properties.

Newcastle Investment Corp. (NYSE: NCT) closed on its acquisition of the Holiday Retirement portfolio on December 24, but it appears as if one community dropped out, so the total is now 51 communities. NCT used approximately $320 million of equity and $720 million of debt, which includes funding closing costs. Separately, National Health Investors (NYSE: NHI) closed on its acquisition of 25 Holiday communities for $491 million on December 23.

Two old legal battles came to an end in the last month of the year. In the first one, Devonshire at PGA
National, the prominent CCRC in Palm Beach Gardens, Florida, was finally purchased by Erickson Living and Redwood Capital by way of purchasing the secured property debt and the mezzanine debt secured by the ownership interests in the operating entities. We understand that the former owner, Craig Anderson and his affiliates, did walk away with some cash as part of the settlement. Cain Brothers advised Erickson and Redwood through the process. In the second battle, Leonard Grunstein finally lost his fight against his former friend, partner and client, Rubin Schron, with regard to control over a portfolio of 170 skilled nursing facilities that were part of the former Mariner Health Services. Grunstein pleaded guilty to perjury in the third degree and has resigned from the New York State Bar and will never be able to re-apply. The perjury relates to whether the funding of a $100 million loan from Schron to Grunstein ever happened. It appears as if Grunstein will get a slap on the wrist for a sentence, so we will see him again. But it looks like Grunstein and his partner Murray Forman have already started turning over their ownership interests, at least in the Maryland SNFs, to Terapax, Inc., which is controlled by Tony Oglesby.

FINANCING NEWS

You need patient capital for CCRC development, and that is what The Westminster Funds has been in its joint venture with Life Care Services. The joint venture has just arranged financing for its fifth CCRC development, and this one is expected to cost about $161 million to develop. Located in Plymouth, Minnesota, the LCS/Westminster partnership is expected to break ground soon on the 195 independent living units and 14 garden homes. Included on the campus is a health care center with skilled nursing, assisted living and memory care. The community, known as Trillium Woods, is expected to open in the summer of 2015. The construction financing is being provided by Bank of America as lead and administrative agent, together with Bankers Trust of Des Moines, Iowa and TCF Bank. The debt financing is expected to be about $105 million (65%), with a sizeable slug of about $56 million of equity (35%). You just don’t see that kind of equity put into developments too often, and that is just one reason why this joint venture has been so successful.

Capital Funding Group (CFG) closed out the year with a few large deals. In New York, CFG
closed eight HUD loans to refinance skilled nursing and assisted living facilities with a total of 1,001 beds, for a total loan amount of $78.26 million. It also closed on a HUD refinance of a 136-bed SNF in California in the amount of $3.14 million, with annual savings of more than $47,000. In Wisconsin, CFG negotiated a HUD Mortgage Modification to lower the interest rate on an existing $4.63 million HUD loan for a 152-bed SNF, resulting in annual savings of $37,000. Finally, the lender provided $17.575 million of bridge financing for a 250-bed skilled nursing facility in New York that is expected to be refinanced with HUD in the future.

Not-for-profit Providence Life Services, based in Illinois, had $43 million of outstanding variable-rate, tax-exempt debt which was held by multiple banks. One of the issues with not-for-profit systems is when the debt is owed by the “Obligated Group,” and not specific to the property. Steve Kennedy of Lancaster Pollard walked them through the HUD option, which was new to them since like many not-for-profits, Providence Life had only tapped the tax-exempt bond market. Lancaster was able to arrange $34.3 million of HUD financing at a low, long-term fixed rate, secured by a mix of skilled nursing and assisted living facilities in Illinois and Michigan. Not only did this eliminate interest rate risk for Providence Life, but one of the banks stayed in as the accounts receivable lender for all of the facilities. It also left the Obligated Group with less than $10 million of recourse debt.

Beech Street Capital closed on a $7.9 million HUD loan that refinanced a 120-bed skilled nursing facility in East Haven, Connecticut owned by Apple Health Care. Originated by Josh Rosen, the existing loan had 21 years left on it, and the new loan extended that to 33 years with annual savings of more than $270,000 coming from the longer term and a lower interest rate. Meanwhile, Brett Patrick of Johnson Capital closed on a $5.0 million HUD loan to refinance a 101-bed skilled nursing facility located in Butte, Montana.

Berkadia Commercial Mortgage has closed recently on a few financings for some of the publicly traded companies. Heidi Brunet and Lisa Lautner closed on an $8.4 million Freddie Mac loan for an Emeritus Corporation (NYSE: ESC) 98-unit assisted living community in Brea, California, and a $5.85 million Freddie Mac loan for another Emeritus community located in Whittier, California with 73 units. Both loans are seven year floaters with 30-year amortizations and 72% loan-to-values. Meanwhile, Ms. Lautner closed on two separate Fannie
REITs

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>TICKER</th>
<th>CURRENT PRICE 12/31/13</th>
<th>CURRENT DIVIDEND YIELD</th>
<th>CURRENT DIVIDEND STATUS(1)</th>
<th>2013 % CHANGE</th>
<th>52-WEEK RANGE</th>
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<tr>
<td>Aviv REIT(2)</td>
<td>AVIV</td>
<td>$23.70</td>
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<td>Beg. Jun-13</td>
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<td>HCP, Inc.</td>
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<td>National Health Investors</td>
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<tr>
<td>Omega Healthcare Investors</td>
<td>OHI</td>
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<td>6.4%</td>
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<td>25%</td>
<td>38.41</td>
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<tr>
<td>Newcastle Investment Corp.(3)</td>
<td>NCT</td>
<td>5.74</td>
<td>7.0%</td>
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<td>6.00</td>
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<tr>
<td>Sabra Health Care REIT</td>
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<td>5.2%</td>
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<td>Senior Housing Properties Tr.</td>
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<td>Universal Health Realty</td>
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<td>Ventas</td>
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<td>5.1%</td>
<td>Inc. Dec-13</td>
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<td>84.11</td>
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</table>

(1) As of ex-dividend date. (2) Aviv REIT went public at $20.00 per share on March 21, 2013, and the 2013 % change in price is from the IPO price. (3) NCT prices and dividend rate were adjusted for the spin-off of New Residential Investment Corp. effective May 2013.

Mae loans on behalf of acquisitions completed by Capital Senior Living (NYSE: CSU) in the third quarter of 2013. The loan totals were approximately $19.5 million, and Lautner also closed on an $8.5 million bridge financing enabling CSU to acquire a 64-unit assisted living and memory care community in Georgia. The two-year loan is floating rate and interest only.

In some balance sheet lending, Contemporary Healthcare Capital has provided an $18.5 million senior mortgage loan and a $3.0 million mezzanine loan on two skilled nursing facilities in California. The funds were used to complete the acquisitions as well as to fund closing costs. Separately, MidCap Financial provided $62.0 million in non-recourse debt to Skilled Healthcare Group (NYSE: SKH) to refinance 10 skilled nursing facilities that will eventually be taken to HUD. The loan is priced over LIBOR and has a current interest rate of 6.7%. In addition, MidCap provided a $5.0 million revolver to SKH.

REITs

Oh my, what a year not to be a REIT investor. After a great 2012, when all the health care REITs increased in value and all posted double-digit total returns that ranged from 12.2% to 90.6% (inclusive of dividends), 2013 was a year to forget, at least for many of them. Only five health care REITs increased in price during the year after the REIT market plunge of last summer, and only six posted positive returns after dividends are included. And this was in a year where the major market indices were up nearly 30%. Only three health care REITs posted double-digit returns in 2013, and one of the smaller REITs, Sabra Health Care REIT (NASDAQ: SBRA), posted the second highest total return (+26.6%) in 2013 after posting the best return in 2012 (+90.6%). And in this case, size did matter, but being small has actually helped their returns, and their market penetration.

The leader of the pack in 2013 was Omega Healthcare Investors (NYSE: OHI), with a total return of 32.7%. Omega has a market cap of $3.7 billion, and still focuses on the skilled nursing sector at a time when most of the health care REITs are touting their diversification from government-reimbursed properties. Omega also completed the largest skilled nursing acquisition of the year at just over $500 million. Perhaps it is not a coincidence that the few publicly traded SNF stocks performed better than the private pay seniors housing companies. Close behind Sabra in the number three spot was Aviv REIT (NYSE: AVIV), a newcomer that went public last March at $20.00 per share. It also has had an historical focus on skilled nursing, but has been expanding into seniors housing, as has Sabra. Omega is the largest of these three by a factor of three, but they are all much smaller than the Big Three. This means there are more acquisitions in the market that can move the earnings needle which in turn moves the valuation up. When you have a market cap of $15 billion
or higher, there just aren’t that many meaningful deals that are accretive. That is one reason why we believe we will see acquisitions of the smaller REITs, both public REITs and the non-traded REITs, by the larger REITs, even though that will make future accretive acquisitions even more difficult.

The Big Three REITs, which had decent returns in 2012 but were still in the bottom half of the group, were in the real bottom in 2013 with negative total returns (see box on page 21) and double-digit price declines. Their cost of capital had been so low, with the ability, or so it seemed, to be able to go after any acquisition, no matter the size, and have it be accretive because, well, they were the kings of the castle. And then Ben Bernanke opened his mouth. But even before that spike in interest rates, there was some concern about how they were going to maintain their growth rates. Let’s face it, shareholders did extremely well by Health Care REIT (NYSE: HCN), HCP, Inc. (NYSE: HCP) and Ventas (NYSE: VTR) over the years, but investors began to question the ability to grow, about what the increase in new development would do to their portfolios, especially the new RIDEA partnerships where they were no longer clipping coupons (lease payments) but would go with the ebb and flow of rising or falling census and cash flow. Not that anyone is too concerned about the financial stability of these REITs, and certainly not us, but double-digit growth rates may be difficult other than by purchasing other REITs. And with the growth, and aggressiveness, of the non-traded REITs, they will certainly become targets, and the Big Three will be exit strategies.

Speaking of exit strategies, one of the fastest growing non-traded REITs, American Realty Capital Healthcare Trust, has filed to go public on a national exchange under the symbol “HCT.” Management started a process last spring with regard to strategic alternatives to maximize shareholder value. The timing is interesting because of what has happened to REIT values since last spring, and while ARC has completed a significant amount of seniors housing acquisitions since late in 2012, valued at more than $400 million, its market capitalization will put it at the very low end of the publicly traded REITs. While small may be good from an ability to put high growth rates on the board, the liquidity for its shares will be minimal unless it has a massive acquisition being teed up with the IPO. Unfortunately, we have not heard any whispers of one, although we do expect some additional acquisition news from ARC in the coming weeks, so stay tuned.

In other REIT news, we have decided to add Newcastle Investment Corp. (NYSE: NCT) to our health care REIT coverage and stock table because it has clearly decided on a growth strategy in the seniors housing market. It has a market cap of $1.7 billion and a dividend yield of 6.9%, matching Senior Housing Properties Trust (NYSE: SNH) with the highest yield in our universe. Our only reservation is the involvement of and control by Fortress Investment Group (NYSE: FIG), with its control of Holiday Retirement Corporation, its investment in Brookdale Senior Living (NYSE: BKD), and its ownership of another operating company that appears to be growing. There are just too many moving parts and potential for conflicts of interest, and the best guess is that FIG will do what’s best for FIG.

Finally, even though double-digit growth rates may be difficult for the Big Three REITs, there are no financial or liquidity issues. As an example, Ventas had its credit rating recently upgraded to BBB+ by Standard & Poor’s from BBB, and in December it closed on a new $3.0 billion unsecured credit facility that is comprised of a $2.0 billion revolving credit facility priced at LIBOR plus 100 basis points, a $200 million four-year term loan and an $800 million five-year term loan, both priced at LIBOR plus 105 basis points. Now for some acquisitions.

People on the Move

Grandbridge Real Estate Capital has hired Meredith Davis as vice president of its seniors housing and healthcare finance group and she will be based in Birmingham, Alabama. She has been in the seniors housing finance business for more than 15 years. Separately, Chicago-based Cambridge Realty Capital has hired Brian Riordan as its new manager of business development. Meanwhile, Cambridge Realty’s Jeff Davis has joined the board of directors of recently-formed Blueprint Healthcare Real Estate Advisors, which is also based in Chicago. Finally, Kindred Healthcare (NYSE: KND) announced that its chairman of the board, Eddie Kuntz, will be retiring from the company at the conclusion of its annual meeting. He came to Kindred in the late 1990s, first serving as COO, then president and then CEO from 1999 to 2003. He helped guide the company through some tumultuous times, including a corporate reorganization and a major rent reset with Kindred’s landlord, Ventas. He was always a gentleman, and a smart one no less, and seemed to always keep his cool under fire. We will miss “Fast Eddie,” as he was affectionately called by some friends.