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### The Seniors Housing Capital Environment: A Discussion with Peter J. Kane



In the latest in a series of dialogues with key players regarding the current capital environment in the seniors housing and care industry, Michael Hargrave, Vice President - NIC MAP, recently interviewed Peter J. Kane, Managing Director, The PrivateBank .

*Private Bank is a leading bank lender to the long term care sector. Can you tell us about the platform from which you lend to the seniors housing & long term care industry?*

**Mr. Kane:** The PrivateBank team totals over 17 professionals that focus mainly in the seniors housing & long term care space. We have a nationwide practice with concentrations in Illinois, California, Texas and Florida. Our core team has roots that go back over 20 years. In 2007 our team was hired by The PrivateBank in conjunction with a strategic growth plan following the sale of LaSalle Bank.

The platform of a commercial bank keeps our underwriting conservative and our track record going back to LaSalle Bank has kept us consistent in the market. Our basic underwriting principles have not changed significantly in the past 10 years. Because of our historical success, consistent senior management and credit monitoring process, we have been allowed to routinely deliver on our commitment to the industry.

Our success in building a portfolio of over \$1.5 billion in seniors housing & long term care exposure has been greatly aided by the migration of not only our entire team intact, but also our former CEO, former Chairman, other senior management and key lending and bank product partners. In total, over 200 former LaSalle employees have joined The PrivateBank and all have had a role in our success over the past four years. Our focus within seniors housing & long term care continues to be the skilled nursing sector. Our client base spans the gamut from publicly traded /large private equity firms to the small regional operator. Our focus has always been to look for the "top tier" operator that not only knows how to provide high quality care but also knows the importance of being well capitalized.

*While overall construction levels in MAP 31 are quite low for seniors housing properties (1.5% of existing inventory which is a cyclical low) as of 3Q11, assisted living properties have seen a slight uptick in construction starts. During the past year, 2,499 units in assisted living properties have started construction in MAP 31, up from the TTM starts pace of 2,286 units witnessed in 2Q11. Do you see any evidence of an uptick in assisted living or nursing home construction? Can you comment on the availability of financing for such projects?*

**Mr. Kane:** Construction of new product in the seniors housing space has been slow over the past few years for a number of reasons. The weak economy is the main driver of the problem and the more specific factors are a direct result of the weak economy. All financial institutions have been affected, which leads to reduced lending capacity for projects. Consumers have been likely to postpone a move to a senior housing project unless the move is need based. Those consumers that do make the decision that is not need based are doing more investigation on the move than they had in the past which is driving a longer sales cycle. In the end we are seeing that existing projects that have a solid reputation are seeing high occupancy levels, while projects that are operated by less experienced operators may struggle and may need to reevaluate their initial investment thesis. Need driven products of AL and ALZ are seeing consistent demand because waiting to make a decision is affecting the family caregiver.

We are seeing many more requests for AL construction projects. The barrier to entry is lower than the skilled nursing industry. The lack of new supply over the last few years has been due to lenders not wanting to take on construction, fill and operating risk in the same transaction. If there were opportunities to finance underperforming properties that were acquired by more experienced operators, those transactions were more likely to get done as the construction and the bulk of the fill risk were already behind the project. As more lenders enter and re-enter the space and the market gets more competitive, the natural progression will be for lenders to move further out on the risk spectrum and take on the trio of risk for new projects. Internally, our organization has decided to limit our exposure to these projects to a percentage of our portfolio.

The demand for SNF new construction projects is limited due to the fact that most states have a CON process for skilled beds, so the projects are for either replacement buildings or newly approved CONs. Financing a replacement building in many cases is easier than a newly approved CON because the existing facility typically has patients that can move over day one and the new physical plant is usually an attraction for higher acuity patients. The construction risk is present, but the fill risk is significantly mitigated by transfer patients and a new physical plant.

The availability of financing for these new construction projects is starting to increase. Lenders have spent the last several years working out troubled loans and cleaning up their balance sheets. In that time all lending institutions have come under additional regulatory pressures. At the same time equity investors are demanding improved returns from the financial sector. The solution is for lenders to start lending. As lenders emerge from the financial crisis of the past several years, they are looking for ways to increase their interest margin by making loans instead of holding Treasuries.

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*According to the 3Q11 NIC/RCA transaction report, the four quarter rolling cap rate on nursing home properties was down 180+ bps from one year ago. What are you seeing with regard to SNF pricing trends and are you seeing any impact from the Medicare cuts in pricing metrics?*

**Mr. Kane:** In general we believe that the nursing home market values in a 12.5% to 14.5% range. Newer high quality assets that have a proven track record can achieve the low end of the cap rate spectrum with the majority of the market in the 13% and higher level.

The decline in cap rates based on a transaction report may indicate that there were transactions that occurred where poor performing assets were acquired for a price based on potential performance rather than actual performance. In essence buyers may have "overpaid" for assets that were underperforming with the plan of improving operations to have the price make sense within a short time period.

The nursing home industry has many lower performing operators that are learning that they do not have the necessary scale and information to compete effectively. The success of the nursing home business relies on the ability to bill third party payors appropriately and to control costs. Without the appropriate technology and infrastructure, information on admissions and care levels (revenue side) as well as daily staffing levels and other costs (expense side), operators will struggle to make the correct decisions. On a daily basis, operators need to be able to ensure that a building is not overstaffed and that enough supplies are on hand to care for their residents. Larger operators have made the investment in their information systems that can provide real time data on census, staffing levels and supplies to optimize costs relative to revenues.

The Medicare cuts have absolutely had an impact on the values of nursing home properties. Operators are attempting to mitigate the cuts through changes in mix and making themselves more efficient on the cost side. Ultimately the pricing of skilled nursing assets is based on actual performance of the facility or facilities plus any improvements that a buyer can implement. The amount of value the buyer wants to pay the seller for the buyers improvements will be a function of how bad the buyer wants to buy. A buyer that wants to pay a seller for their own improvements can drive the price up and the cap rate down. If the buyer has a large infrastructure already, the incremental overhead for the acquisition target is usually factored into the price, which can also distort the cap rate.

### NIC Research Insights Home Prices Continue Bouncing Around the Bottom

Recent data continue to show the economy is improving on most fronts, with the largest exception possibly the residential housing market. Data released through 2011Q3 show home prices continuing to oscillate near the lows established earlier this year. In 2011Q3, the U.S. Home Price Index was essentially flat compared to the prior quarter, but down approximately 4 percent from a year ago and 31 percent from the peak in 2006.



Source: S&P/Case-Shiller Home Price Indices

Distressed sales, at 28 percent of existing home sales transactions, as of November, continue to account for a large share of existing sales. The continued sizable distressed sales market likely will continue putting downward pressure on home prices for some time. While affordability remains at record levels, the continued economic uncertainty is likely holding back would be home buyers.<sup>1</sup>

1. Source: National Association of Realtors

### NIC MAP Update

Save 50% off Select NIC MAP Reports Through December 31, 2011

From now until December 31, 2011, purchase any 3Q11 NIC MAP report through our [online store](#) and receive 50% off each report purchased\*.

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**NICMAP**  
Market Briefing

Sunday, March 25, 2012  
11:30 a.m. - 1:30 p.m.  
Boca Raton, FL

NIC MAP will present a regional market briefing covering the southeast region.

Gain insight into the operating performance and supply/demand characteristics of seniors housing properties.

[Click Here for more information and to register.](#)

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*\*This offer is not valid toward the purchase of the 3Q11 RCA-NIC Seniors Housing & Care U.S. Quarterly Report.*

### Seniors Housing & Care Industry Calendar

**January 2012:**

- 15-17 [ASHA](#) Annual Meeting, Dana Point, CA
- 17 **NIC Executive Committee & Conference Planning Committee Meetings, Dana Point, CA**
- 17-19 NMHC Annual Meeting, Boca Raton, FL
- 26 **4Q11 NIC MAP Data Release & Subscriber Webcast**

**February 2012:**

- 8-11 [NAHB](#) International Builders Show, Orlando, FL

**March 2012:**

- 14-15 [PREA](#) Spring Conference, Boston, MA
- 25-27 **Skilled Nursing Investment Forum and Seniors Housing Regional Symposium 2012, Boca Raton Resort, Boca Raton, FL**
- 25 **NIC MAP Market Briefing, Boca Raton Resort, Boca Raton, FL**

**(denotes NIC Events)**

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