Private equity moves boldly on acquisitions, development

The Solana at Horsham, near Philadelphia, is a new assisted living and memory care project developed by Formation-Shelbourne Senior Living Services and private equity firm Capitol Seniors Housing.
Amid fierce competition for high-quality seniors housing assets, buyers see upside in management firms and new development.

By Jane Adler

Private equity firms investing in seniors housing are placing a new emphasis on proven operating partners. While real estate fundamentals are slowly improving, the deep recession underscored the need for smart operators to maintain occupancies and hold the line on rental rates. Choosy consumers with multiple housing options aren’t going to pay for bad service.

In some cases, investors are even scrapping the traditional business model of passive real estate ownership, opting instead to purchase management companies outright. Earlier this year, for example, Health Care REIT sold the management business of Sunrise Senior Living for $130 million to a group of private equity buyers, including KKR & Co., Coastwood Senior Housing Partners LLC, and Beecken Petty O’Keefe & Co. The business included the management contracts on 282 Sunrise communities.

In March, New York-based Berkshire Realty Ventures LLC provided $40 million to help fund the formation of LCB Senior Living, a new owner/operator company run by the former managers of Newton Senior Living, a seniors housing operator in the Northeast.

TPG Capital’s purchase of struggling Assisted Living Concepts for $280 million was finalized in July. TPG, based in Fort Worth, Texas, is one of the nation’s largest private equity firms. Bolstering operations will be crucial for a successful turnaround, sources say.

“Private equity is looking at seniors housing as more than just real estate,” says Matt Ryan, director of the healthcare group at investment bank Houlihan Lokey in Chicago. “There’s a lot of upside in operations.”

Search for a niche

In general, seniors housing investments made by private equity funds have been on the upswing. Private buyers accounted for 34 percent of all U.S. property and portfolio sales $2.5 million and above in 2012, up from 8 percent the previous year, according to data compiled by New York-based Real Capital Analytics (RCA) and the National Investment Center for the Seniors Housing & Care Industry, headquartered in Annapolis, Maryland.

Still, the majority of the property buyers are public companies, particularly the big real estate investment trusts. In fact, public companies bought 50 percent of the seniors
Small investors help Caddis Partners jump-start new venture

While big Wall Street firms grab headlines with a push into seniors housing, small private investors still function as the backbone of many property deals.

Healthcare real estate developer Caddis Partners entered the seniors housing market in 2011 with equity raised in part from physicians who had previously invested in medical office buildings developed by the company. “As we grow, the overwhelming majority of our physician and non-physician limited partners want to keep investing with us,” says Matt Mattox, executive vice president and partner at Caddis.

The alliance grew from a long-standing relationship. Dallas-based Caddis was conceived in late 2007 as an independent, full-service healthcare real estate investment and development company. One of Caddis’ initial engagements was to manage the real estate needs of a large physician practice with about 500 providers, most of whom practiced in the Dallas-Fort Worth area. “We were their outsourced real estate department,” explains Mattox.

Caddis managed lease negotiations and created a strategy to develop buildings to encircle the market and also to consolidate specialists in certain locations. “That spurred a lot of development activity,” says Mattox. It also spurred interest from individual physicians to invest in the medical office buildings alongside other equity sources.

During the next 24 months, Caddis plans to invest $100 million to develop seniors housing. The goal is to have 10 assisted living/memory care projects open or under way by this time next year.

Who’s buying seniors housing properties and portfolios?

Public companies, particularly the big real estate investment trusts, accounted for nearly 50 percent of the property and portfolio sales $2.5 million and higher within the U.S. seniors housing and care industry in 2012. Their dominance continues this year. Meanwhile, private buyers accounted for 35 percent of the market in 2012, up from 8 percent the previous year.

Assisted Living Concepts has slightly more than 200 assisted living buildings with 9,000 units in 19 states. The company owns most of the buildings.

TPG has other interests in the older adult housing market. In June, TPG invested $135 million in AV Homes Inc., a single-family home developer that also builds active adult communities for people age 55 and older through its Vitalia brand.

Industry veteran Jack Callison was appointed chief executive officer of Assisted Living Concepts on July 11, the day the sale to TPG closed. Callison most recently served as CEO of Holiday Retirement Corp., a provider of independent senior living communities. He was previously president of U.S. operations at the giant multifamily owner and developer Archstone.

Callison has his work cut out for him. Assisted Living Concepts’ portfolio currently has an average occupancy rate of 60 percent, well below the industry average of approximately 90 percent.

“TPG is excited about this opportunity,” says Callison, noting that TPG’s investment provides the capital needed to make changes at the company. “There’s real opportunity to add value here.” To boost occupancy, the initial focus will be on employee training and improved information technology systems, says Callison. The
objective is to provide a high level of care to residents and also to create an operating platform to enhance productivity.

“We have high-quality assets,” emphasizes Callison. The typical facility in Assisted Living Concepts’ portfolio contains about 45 units, a sufficiently small size to create a homey atmosphere that appeals to consumers and encourages relationship building between staffers and residents.

New development highlights operations

Berkshire Realty Ventures invests in real estate operating companies. The New York-based fund manages hotel and medical office building platforms.

About two years ago, Berkshire decided to jump into the seniors housing industry after analyzing the market and recognizing a need for well-built properties. Rick Swartz, co-head of the seniors housing capital markets group at the Boston office of Cushman & Wakefield, advises Berkshire and introduced its executives to former managers of Newton Senior Living, which was sold in 2005 to Atria, a large public company.

“They were going back into business putting together a new company and we felt they had the experience to execute on the ground,” says Berkshire senior partner Larry Ellman.

Berkshire made a $40 million equity commitment to the company, LCB Senior Living, with a focus on acquisitions and ground-up development in the Northeast. LCB, based in Norwood, Massachusetts, will manage its own properties. “We wanted a partner with operations experience,” says Berkshire’s Ellman.

LCB already has a pipeline of projects. In March, the company made its first acquisition, a $35 million assisted living facility, the Arbors of Bedford, in Bedford, New Hampshire. Grosvenor Fund Management provided joint venture equity.

A new ground-up development by LCB is under way in Watertown, Massachusetts. The company recently closed on a development site in Windsor, Connecticut. LCB has several other development sites in Connecticut under contract.

The buildings will feature 75 to 90 units, a mix of 75 percent assisted living and 25 percent memory care. Ellman expects each new project to include different equity partners.

“We like development,” says Ellman. While the big REITs gobble up stabilized properties in strong markets at cap rates below 7 percent, Ellman projects a levered internal rate of return on new developments of just above 20 percent.

In today’s climate, other private equity firms prefer development while keeping a close eye on operations. Washington, D.C.-based Capitol Seniors Housing is a private equity firm that partners with The Carlyle Group and Harvard Management Co., the endowment investment arm of Harvard University.

Capitol recently opened a new project, the Solana Horsham, in the Philadelphia suburb of North Wales. The developer is Formation-Shelbourne Senior Living.

Capitol Seniors Housing has several other projects under way: two in...
the Washington, D.C. area, one in Southern California, and another in Florida. “We think we have a good model,” says Scott Stewart, managing partner at Capitol. “We know the operators.”

Listed among Capitol’s operating partners are well-known names such as Brookdale Senior Living, Life Care Services and Chelsea Senior Living. “Operations require attention,” says Stewart.

Brookdale operates The Solana at Horsham. The $19 million project includes 30 assisted living units and 46 memory care units. In addition to activities and programs, Brookdale will provide on-site therapeutic services, including physical, speech and occupational therapy.

Private equity’s focus on development could change in the upcoming months, however, sources say. Investor psychology has shifted since Federal Reserve Chairman Ben Bernanke indicated that the government’s bond buying program could ease in the near future, a move that would push up interest rates.

The gap between cap rates and 10-year U.S. Treasury yields has already narrowed since Bernanke’s comments. That could lead to less competition for existing properties from the big REITs as their cost of capital rises. “The pendulum is swinging from sellers to buyers,” says Stewart.

That doesn’t change the importance of operations, however, says Stewart. “You may have great sticks and bricks on the corner of Main and Main, but if you don’t have the right operator it won’t work.”

The Solana at Horsham, above, opened recently near Philadelphia, offering assisted and memory care. The Residence at Riverbend, below, is under way in Ipswich, Massachusetts, and opens next summer.

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Jeff Patterson
T 949.500.6211
Irvine
patterson@ARausa.com

Cody Tremper
T 214.420.3105
Dallas
tremper@ARausa.com

arausa.com/seniorhousing

About the writer

Jane Adler is a freelance reporter who has covered seniors housing for more than 10 years. She reports on the industry and consumer trends.