

Summer 2011 – Midwest Market Update Economy & Skilled Nursing Facility Trends

Economy

The national and Midwest economies are still struggling to recover. In May 2011, we attended the Midwest Lenders Conference in Cleveland, Ohio and listened as Mark Sniderman of the Federal Reserve Bank of Cleveland gave his presentation. Some highlights:

1. The national economy is growing, but slowly.
2. The Midwest economy is similar, but mixed by industry.
3. Inflation is currently elevated but it is a temporary situation. Historically, inflation trends at about 2.5% per year.
4. The housing market still has many hurdles to overcome (defaults, stringent requirements for loan applicants, etc.). Home price-to-income ratio of 3:1 was typical until 2002-2006 when it went up to 4:1, which added to the housing industry problems.

Skilled Nursing Facility - Update & Trends

Census Mix Trends

Skilled Nursing Facilities (SNFs) continue to deflect most of the problems of the economic downturn as they are need-based rather than driven by lifestyle choice. When long-term skilled nursing care is required, care/safety concerns trump the desire to remain at home and be faced with costly home health care services. In the Midwest, the trend in SNFs is the continuing focus on short-term rehab (Medicare and private insurance). Operators are renovating and turning 4-bed and 3-bed units into 2-bed and 1-bed units to attract more referrals. We have recently appraised a few smaller facilities (less than 60 beds) that are only accepting short-term rehab residents as opposed to long-term "traditional" private pay and Medicaid residents. Even such small facilities that lack economies of scale are able to turn a solid profit due to the higher Medicare and private insurance reimbursement rates.

Medicare

The increased Medicare RUGs rates that went into effect October 1, 2010 have owners/operators excited about increased profitability. In our experience, the new Medicare rates have resulted in increased average RUGs rates of about \$50 to \$100. This can have a dramatic affect on profit and hence value. However, this was not likely the intended result of the federal Medicare program and we feel that RUGs rates might be decreased for the next cycle (October 1, 2011).

Recent Transactions (Prices Per Bed & Cap Rates)

The metro markets remain best characterized by few sellers and many buyers. Our broker friends report multiple quick offers on solid SNF assets. In the Chicago Metro market, such assets can command prices per bed between \$70,000 and \$100,000. In 2011, a notable sale was the Ballard Nursing Center in Des Plaines that sold for \$95,238 per licensed bed at a cap rate of 9.2%. While that price per bed is driven by the many active buyers in the market, the 9.2% cap rate is well below the typical 12% to 13% range. More rural, downstate SNFs tend to sell at higher cap rates in the 12.5% to 15% range resulting in lower prices per bed due to lower achievable rates. Lastly, our Midwest conventional lender contacts report a willingness to work with long-time stable borrowers on acquisitions but have been cautious on new clients. HUD's Section 232 Lean program (mortgage insurance) continues to be active and in high demand, though older buildings with 3-bed and 4-bed units face more underwriting scrutiny/challenges.

