

KMF SENIOR HOUSING INTELLIGENCE
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Background

Welcome to the inaugural issue of Senior Housing Intelligence, a complimentary electronic newsletter. We sincerely hope you will enjoy and profit from this monthly briefing. The goal of Senior Housing Intelligence is to provide senior housing investors with relevant and timely information in order to add value to their investment process and performance.

KMF Senior Housing Investors (KMF) publishes this briefing for clients and potential clients of its investment management group. KMF offers pension funds and other institutional investors separate accounts and a commingled fund to take advantage of the high current returns of stabilized senior housing properties and the negative correlation of these returns with apartments and other real estate segments.

KMF, through its principals, has 16 years of successful experience investing in senior housing properties. KMF's eight principals are led by James Smith, who is also managing principal of Kensington Realty Advisors and Philip Van Syckle, managing director and former real estate and mortgage administrator of the State of Michigan Retirement Systems' real estate investment portfolio.

SENIOR HOUSING INVESTMENT INSIGHTS

KMF's investment strategy in seniors housing is based upon the following key investment insights, that we have acquired as a result of extensive day-to-day experience in the field:

1. The industry has at least 7 major segments, of which 3 have the best risk-adjusted opportunities over the next 7-year period.
2. The supply-demand balance strongly favors senior apartments and independent living properties. The growth in demand in these two segments will exceed supply in the foreseeable future due to the current slow growth in supply, which is constrained by a scarcity of construction financing.
3. The risk-adjusted return favors investment in stabilized properties as opposed to new development. It also favors investing directly in a portfolio of properties rather than an indirect investment in a company.
4. Senior apartments and independent living properties have no health care and therefore can be considered as part of an apartment allocation. The initial empirical research has strongly suggested that the returns of senior apartments and independent living properties are not closely correlated to the returns of traditional multi-family properties, and therefore should increase portfolio return and reduce risk.
5. Diversification by geography and operator is as important in senior housing as in other real estate segments.
6. Competition to acquire for senior properties by institutional buyers is substantially less than that for apartments. This will change as the opportunities in senior housing become apparent to institutional investors. We believe senior housing is now at a point where apartments were 10 years ago. At that time, apartments were not viewed as an institutional investment of choice in real estate, whereas today, they are the number one choice.

7. Demand for these properties is much ascertainable and predictable than for office, retail and industrial properties due to both documented future increases in demographics and the acceptance of this lifestyle by seniors and their adult children. Senior housing is also much less subject to the risk of technology on demand than office and retail.
8. The senior housing CEO's passion and commitment to serving seniors is one of the most important criteria and predictors of operating success. A personal familiarity with the CEO and the executive team of operators that you invest with will produce superior investment performance.

Getting Up To Speed on Industry Segments and Definitions

The following are three very helpful resources for anyone wishing to gain a good understanding of the different industry segments and definitions.

1. The Case for Investing in Seniors Housing and Care Properties

This is an objective look at the business prepared by the real estate research group of PricewaterhouseCoopers.

2. NIC Resource Guide: A Sourcebook for Evaluating, Underwriting and Financing Seniors Housing and Care Properties

In one volume, you can obtain references for virtually everything of value ever published on the different segments of the industry.

3. Journal of Real Estate Portfolio Management, Volume 5-Research on Seniors Housing and Care

This special issue of the Journal has excellent articles, especially one on how to separate the business from the real estate for analytical and valuation purposes.

All three of these resources can be obtained from the National Investment Center for the Seniors Housing and Care Industries (“NIC”) at their website <http://www.nic.org> Click on the “Bookstore”.

The Reality of Demographics and Demand

Understanding what really is driving demand for seniors housing is crucial to successful investing.

Demographic growth is good, but it is over hyped. Demographic growth of the age cohorts that actually move to senior apartments and independent living properties is just a shade under 2% per year. This is twice the growth rate of the overall population; but a 2% growth rate by itself may not entice many real estate investors. However, the growth in acceptance of this lifestyle by seniors has been quite substantial. The penetration rate-or percentage of senior households choosing to actually move and live in senior housing properties has been increasing at about 4% per year. As a result, the overall compound growth rate has been rising about 6% per year for the last 10 years.

We have found compelling evidence from our proprietary research, and research done by the NIC that this will continue well into the foreseeable future. There three significant reasons that we have objectively measured:

1. About 35% of seniors (and their adult children) are still totally unaware of these options.
2. The desirability of this lifestyle is still relatively low, but with documented increases over the last 5 years. Desirability increases simply by more people becoming aware of these properties. Desirability is directly correlated with willingness to move to these properties.
3. Case studies of non-Sunbelt markets such as Minneapolis, demonstrate that the longer seniors are exposed to these properties the more desirable they become, and the higher the percentage of senior households that move to these properties. The national penetration rate has the ability to double over time, based upon the penetration rates evidenced in many specific markets where senior housing properties became established earlier.

Industry Investment News

- Goldman Sach's Whitehall Street Real Estate Fund recently recruited Thilo Best from Holiday Retirement Corporation to run Horizon Bay, which was formed out of Whitehall's investment in Senior Lifestyle Corporation.
- GE Capital Real Estate, after some successful investments in senior housing in the early 1990's has returned to the table. They recently provided financing to Sunrise Assisted Living and are looking at both debt and equity opportunities.

For further information on articles in this briefing or on any aspect of investing in senior housing, please contact Jim Smith at 312-993-7800 smith@kmfseniorhousing.com or visit our website <http://www.kmfseniorhousing.com>

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