

■ Investment

Mom and pop investors hop on the seniors housing bandwagon

Non-traded healthcare REITs are raising billions of dollars from an army of small investors in search of healthy returns.

By Joe Gose

Demographic trends and changes in healthcare delivery continue to drive investment in seniors housing and medical properties, and non-traded real estate investment trusts have positioned themselves as a consistent and major source of capital to the industry.

A handful of non-traded REITs currently pursuing seniors housing as well as skilled nursing and other medical facilities have amassed \$6.4 billion in equity in the past few years, according to Shrewsbury, N.J.-based Robert A. Stanger, a real estate investment bank that specializes in non-traded REITs.

The vehicles cater to retail or “mom and pop” investors — often as part of retirement savings — who buy into the REITs through broker-dealers for a typical price of \$10 per share. Brokers generally earn a commission of 7 percent. The REITs typically pay a dividend of about 6 percent to 7 percent, according to Robert A. Stanger.

Non-traded REITs are direct investments, which represent more than \$85 billion in assets under management in over 2.5 million investor accounts, where the average investment is \$30,000, according to the Investment Program Association, an advocate for the industry.

Non-traded healthcare REITs expect the mom and pop investors to keep buying. CNL Healthcare Properties, for example, in February launched a follow-on offering seeking \$1 billion after completing a \$1.1 billion initial raise in late 2014. In February, CNL Healthcare Properties also entered into a \$405 million credit facility



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— expandable to \$700 million — with a consortium of banks.

“There are a lot of new equity sources, sponsors and providers that are entering the space, which is a good thing,” says Kevin Maddron, senior managing director for Orlando, Fla.-based CNL Financial Group, the sponsor of CNL Healthcare. “It’s reflective of the acceptance and understanding of the product versus a decade or so ago. But it’s becoming a little bit more competitive.”

Bidding war for assets

Investor demand for seniors housing drove up the average price of assisted living assets to \$188,700 per unit in 2014, a year-over-year increase of 25 percent, while independent living communities jumped 28 percent over the same period to \$246,800 per unit, according to Norwalk, Conn.-based healthcare prop-



Griffin-American Healthcare REIT III acquired this assisted living property in Mooresville, N.C., along with an assisted living facility in Raleigh in the first quarter, and together the buildings have 124 units. The properties were part of a five-building portfolio, and the REIT expects to acquire the remaining three in the coming months.



CNL Healthcare Properties is developing Wellmore of Tega Cay in South Carolina, which will include 80 assisted living and 24 memory care units. The \$41 million project is expected to open in the second half of this year.



Sentio Healthcare Properties is developing a 207-unit independent living, assisted living and memory care property in Georgetown, Texas. As part of the \$41.7 million construction financing arrangement, Sentio’s institutional equity partner, KKR & Co., provided \$13.6 million in March.

erty research firm Irving Levin Associates.

In 2014, the average assisted living capitalization rate declined 100 basis points from the prior year to 7.7 percent, and independent living cap rates dropped 80 basis points to 7.4 percent, according to the research firm. Both cap rates represent historic lows.

What’s more, non-traded REITs could pump as much as \$30 billion into the seniors housing sector this year, particularly as new entrants target assisted living properties, according to Marcus & Millichap’s Seniors Housing Research Report for the first half of 2015.

All told, non-traded REITs across all property sectors raised more than \$15.6 billion in 2014, down from a record \$19.6 billion raised in 2013, according to Robert A. Stanger. They raised \$3.3 billion in the first quarter this year.

Unexpected turbulence

Last fall’s disclosure by American Realty Capital Properties Inc. that it had committed a \$23 million accounting error is partly to blame for the dip in fundraising in 2014. The non-traded REIT sponsor incorrectly calculated its adjusted funds from operations by \$12 million for the first quarter of 2014 and by nearly \$11 million for the second quarter, leading to exaggerated earnings. (American Realty Capital Properties is part of the non-traded REIT empire built by its former chairman Nicholas Schorsch, who is not accused of any wrongdoing.)

American Realty Capital Properties owns Cole Real Estate Investments, which used to sell up to \$200 million in non-traded REIT shares each month, says Kevin Gannon, president and managing director of Robert A. Stanger. News of the account-

ing error reduced that amount to about \$10 million a month.

Realty Capital Securities is a wholesaler of non-traded REITs for sponsor American Realty Capital, two companies with which officers and directors of American Realty Capital Properties also had relationships. After American Realty Capital Properties announced its accounting error, some broker-dealers working with Realty Capital suspended sales programs, according to Realty Capital filings with the SEC. As a result, Realty Capital sold \$7.4 billion in equity through investment programs in 2014, a 14 percent drop from 2013.

How they work

Like publicly traded REITs, non-traded REITs raise capital, purchase properties, report to the SEC and pay out 90 percent of taxable income to shareholders in the form of dividends. Non-traded REIT shareholders have no market for their securities, however. While in certain circumstances shareholders may redeem or sell a limited amount of stock after a holding period, non-traded REITs generally aim for a liquidity event after seven to 10 years by either listing the vehicles on an

Regulatory proposal casts shadow over offerings of non-traded REITs

Investment professionals have debated the merits of non-traded REITs for years. The lack of shareholder liquidity, upfront investment fees of up to 15 percent, and potential conflicts of interest among sponsors and management teams are often cited as drawbacks. For those reasons, non-traded REITs have come under the scrutiny of the Financial Industry Regulatory Authority (FINRA) and other regulators.

Yet proponents have argued that non-traded REITs shield share value from stock exchange volatility. That favorable characteristic and a typical dividend yield of around 6 percent to 7 percent continue to attract investors.

But the non-traded REIT industry now faces more headwinds. In April, the Department of Labor, under the Employee Retirement Income Security Act, issued a proposal that would require broker-dealers that sell securities to an investor through a tax-preferred retirement account put the client's interests ahead of their own. In other words, broker-dealers would assume the role of a fiduciary. The proposal also could reconfigure how broker-dealers are compensated, among other changes.

Currently, broker-dealers must adhere to a suitability standard, which requires them to make



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investment recommendations that they "reasonably believe" are in the client's best interest in terms of financial needs, objectives and circumstances.

The department is seeking comments on the proposal through July 6. Securities industry organizations such as the Investment Program Association (IPA) and Securities Industry and Financial Markets Association, as well as Republicans and even some Democrats, are concerned that the rule could hurt small investors.

"If the rule holds, we think it's going to have a tremendously negative impact on middle class investors — the people they're trying to help," says Kevin Hogan, president and CEO of IPA. "A lot of folks will not get advice."

In a note to shareholders of NorthStar Asset Management Group, a sponsor of non-traded REITs, FBR capital markets analyst Daniel Altscher said that

the 75-day comment period, a potential watering down of the proposal and an implementation period that was likely at least 18 months away won't interfere with non-traded REIT offerings for some time. Altscher says that in the interim, the offerings may even lead to more aggressive capital raising campaigns.

— Joe Gose

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exchange or selling the assets.

But a controversial U.S. Department of Labor proposal that in some cases would require broker-dealers to assume a fiduciary role when marketing non-traded REIT shares could hinder offerings (see sidebar, page 45). For now, non-traded REIT executives are taking a wait-and-see attitude.

"Could it reduce the fundraising in our industry? It very well could," says Danny Prosky, president and COO of Irvine, Calif.-based Griffin-American Healthcare REIT III, which launched in early 2014 and has raised \$1.9 billion. "Would you have fewer players within the industry? That might be the case."

Staying the course

Potential regulatory shifts aren't about to change strategies among non-traded healthcare REITs, which in addition to CNL Healthcare and Griffin-American III include NorthStar Healthcare Income and Sentio Healthcare Properties. American Realty Capital Healthcare Trust III in September also launched an offering for up to \$3.1 billion and

A major force in healthcare real estate investing

Non-traded healthcare REITs have captured a steadily growing share of funds over the past few years, accounting for 21 percent of all capital raised in the non-traded REIT sector in 2013, 33.4 percent in 2014 and 41.7 percent through March 2015. Here's a sampling of some of the most recent capital campaigns. (M = Millions; B = Billions; NA: Not applicable — no data to report)

	2013	2014	YTD 3/15	Cumulative*
Closed funds				
American Realty Capital Healthcare Trust II Inc.	\$187.1 M	\$1.9 B	NA	\$2.0 B
Sentio Healthcare Properties Inc.	NA	NA	NA	\$127.0 M
Griffin-American Healthcare REIT III Inc.	NA	\$910.9 M	\$933.0 M	\$1.8 B
Total closed	\$187.1 M	\$2.8 B	\$933.0 M	\$4.0 B
Effective funds				
American Realty Capital Healthcare Trust III Inc.	NA	\$1.0 M	\$15.3 M	\$16.3 M
CNL Healthcare Properties Inc.	\$381.1 M	\$556.0 M	\$181.2 M	\$1.3 B
NorthStar Healthcare Income Inc.	\$108.6 M	\$854.2 M	\$129.2 M	\$1.1 B
Total effective	\$489.8 M	\$1.4 B	\$325.7 M	\$2.4 B

*In some cases, the cumulative figures reflect funds raised in an offering before 2013. Data excludes dividend reinvestment plans

Source: Robert A. Stanger & Co.



"The healthcare space has proven out that if you raise money in non-traded REITs and deploy it into assets, you can find an exit at a premium to what you raised," says Kevin Gannon, president and managing director, Robert A. Stanger.

in February announced that it had raised the minimum \$2 million to break escrow.

Additionally, NorthStar Healthcare began a \$700 million follow-on offering in February after attracting \$1.1 billion in its initial raise. NorthStar Healthcare closed out its initial offering by

selling an average of \$10 million in securities per day over the first couple of weeks in January, according to comments made by David Hamamoto, chairman and CEO of New York-based NorthStar Asset Management, the sponsor of NorthStar Healthcare and other non-traded REITs, during the company's fourth-quarter earnings call in late February. The follow-on offering was already attracting buyers, he added.

"We anticipate capital raising to substantially pick up momentum in the remainder of 2015, given the very high demand we experience for this product and the appetite for exposure to the healthcare sector," said Hamamoto during the earnings call.

The equity-raising success among the companies has largely paralleled a recent spate of lucrative non-traded REIT exits. In the healthcare sector, Chicago-based Ventas early this year paid \$2.3 billion for American Realty Capital Healthcare Trust, a non-traded REIT that listed on the Nasdaq in April 2014. In December New York-based NorthStar Realty Finance completed its \$4 billion acquisition of Griffin-American Healthcare REIT II.



"I think the buying has been aggressive across seniors housing — both in independent living and assisted living," says Danny Prosky, president, COO, Griffin-American Healthcare REIT III.



"There has been a huge increase in the amount of capital raised by institutional investors in our space, yet it's still a very fragmented industry," says John Mark Ramsey, president and CEO, Sentio Healthcare Properties.

Additionally, in February, American Realty Capital Healthcare Trust II announced its intent to list on a national exchange in the second half of 2015 after wrapping up a nearly two-year, \$2.1 billion offering in late 2014.

"The healthcare space has proven out that if you raise money in non-traded REITs and deploy it into assets, you can find an exit at a premium to what you raised," says Gannon. "So, right now there's a nice little tailwind at the back of the non-traded healthcare REIT fundraising."

The robust fundraising also indicates an increasing comfort level with a product that not long ago was considered a niche even in the alternative asset space. While non-traded REITs typically cater to retail investors, the gravitation of institutional investors toward healthcare properties has boosted the sector's visibility, says John Mark Ramsey, president and CEO of Orlando, Fla.-based Sentio Healthcare Properties.

In fact, Sentio enlisted private equity behemoth KKR & Co. as an institutional partner in 2013 after raising \$132 million in a retail equity offering from 2008



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through early 2011. KKR committed to fund Sentio with up to roughly \$159 million through the periodic purchase of convertible preferred shares.

In one of its latest transactions, KKR in March provided \$13.6 million to the company to help finance the construction of a 207-unit independent living, assisted living and memory care project in Georgetown, Texas.

"There has been a huge increase in the amount of capital raised by institutional investors in our space, yet it's still a very fragmented industry," says Ramsey. "It might be a bit of a stretch to call the healthcare sector mainstream. But from an institutional standpoint, it's much closer than it was a decade ago."

Opportunity-driven

Rather than assembling portfolios with a pre-determined mix of seniors housing and other healthcare properties, non-traded healthcare REIT executives say they're searching for the best available opportunities and proven operators.

Over a six-month period that ended March 31, Griffin-American invested the bulk of \$627.7 million in a 42-building portfolio heavy on medical office. The portfolio includes five assisted living communities. The company also has executed \$509 million in agreements to purchase more healthcare properties.

"We tend to look for the best risk-adjusted returns in each asset class, so the portfolio mix is dependent on what's out there in the marketplace," says Prosky. "I think the buying has been aggressive across seniors housing — both in independent living and assisted living."

Meanwhile, CNL Healthcare's \$2 billion portfolio includes 55 seniors housing properties and 47 other medical properties. Sentio lists 26 seniors housing assets — primarily assisted living — among its \$408 million portfolio of 31 properties.

"We like to stay flexible in our ability to manage our allocations as opportunities come up, and that has clearly led to a seniors housing focus over the last couple of years," says Ramsey. "The optimal outcome is driven by what the market seems to suggest."

The Sentio and CNL Healthcare seniors housing portfolios also feature development projects. In addition to its community in early development in Georgetown, Sentio is building two assisted living facilities in Blue Springs, Mo., and The

Villages, Fla., which are expected to open in the coming months.

CNL Healthcare recently opened two seniors housing projects and anticipates opening four more over the next 12 months. The latter group includes the \$41 million Wellmore of Tega Cay in South Carolina, a community that will feature 80 assisted living and 24 memory care units when

it opens in the second half of the year. The company also is seeking value-add deals.

"We look for opportunities in the underserved markets where we think we can bring in an experienced operator or a reposition strategy," says Maddron. "We'll continue to look for those situations where we can add incremental value." ■

About the writer

Joe Gose is a freelance writer who has covered commercial real estate for 16 years. He reports on industry development, finance and trends.



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