

More on Senior Housing

We follow Welltower (WELL) and Healthcare Services Group (HCSG) in this area, but overall, we despise this whole sector. There has simply been too much supply built more than 10-years (and often 20 years) before it's needed. The property investments in this group are sold on the idea that rent goes up every year so do cash flows. Instead, rents seem to be continually renegotiated down as customers run into problems from low occupancies. The property companies are announcing more deals where they will not receive contracted rent payments with an annual escalator – but will instead participate in the upside and downside of operating these centers and be exposed to low occupancies, maintenance costs, and capital improvement spending.

Last week, another operating company - Senior Care Centers filed bankruptcy. The CEO, Michael Beal became the latest customer of companies like WELL, Ventas, and Sabra to blame high rent expense: “As the entire industry has seen, the leases associated with the communities have become cost-prohibitive. This kind of action [bankruptcy] is absolutely necessary to address those costly leases while continuing to care for our patients and residents.”

The other thing to keep in mind with Senior Care is it operates in Texas and Louisiana where job growth has been strong, warm weather is common, plus there's no income tax in Texas. If Texas facilities cannot pay the rent, there are still problems in this industry in our view. Welltower does not have exposure to Senior Care, but Healthcare Services Group did. Sabra, a competitor to Welltower, owns 38 of the 100 Senior Care properties and announced it is selling them for \$385 million to a private equity investor.

Welltower also announced that Qatar's Investment Authority bought a \$300 million interest in the company and an option to partner on specific future deals. The debate will continue between bulls and bears. In our view, the bulls are far too early, and the operating results reflect low ROI and more continuing problems for several more years. Cash needs are rising as Welltower must fund more operating costs and capital spending for properties to keep

them attractive to even hold occupancy flat. Even Welltower believes that the high rate of churn among residents makes it difficult to ever realize much rent growth from existing residents.

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