

# Checking the **PULSE**

Health Care REIT is  
raising up its visibility in  
the medical arena

BY CHARLES KEENAN

**A**s Americans grow older, **Health Care REIT** (NYSE: HCN) stands poised to capitalize on the rising demand for senior housing and related health services. With increasing numbers of Americans reaching their golden years, Health Care REIT is laying the groundwork to be a visible player well into the future of a changing medical landscape. The goal: meet the demands of investors by providing class-A real estate and stable cash flows with cost-conscious, customer-focused services across the senior population.

“We believe in combining very high-quality assets with strong operating teams,” says George Chapman, chairman and chief executive officer of the Toledo, Ohio-based REIT. “Delivering high quality and cost effective care leads to investment success in senior housing and health care.”

To be sure, Health Care REIT, with a portfolio of 641 properties in 38 states, has provided a steady stream of returns for investors over the years, placing an emphasis on a conservative balance sheet, investment-grade ratings, and tight underwriting of its tenants. The company partners with regional operators, helping them grow by focusing on the ability to provide quality care to patients and residents.



George Chapman

GLENN TRIEST

## In the Sweet Spot

The company's focus has rewarded investors over time. Since its debut in 1970, Health Care REIT has paid dividends for 150 consecutive quarters through the fourth quarter 2008. The company has generated average annual total returns of 14.5 percent for the three years ended Sept. 30, compared with 8.5 percent for other health care REITs, according to NAREIT data.

Health Care REIT, along with other REITs in its sector, has held its own as a defensive stock in the face of the financial meltdown and deterioration of the stock market. Overall, health care REITs had dropped 31 percent year to date through Nov. 30, versus a fall of 47 percent for all REITs and 39 percent for the S&P 500.

"Health care REITs have the advantage of being in one of the sweet spots in the economy," Chapman says. "Shareholders are looking for ports in the storm. They are looking for defensive stocks with some growth component."

Demographics also play in Health Care REIT's favor. "The elderly are driving growth in senior housing and health care," Chapman adds. "That growth is only going to become stronger in eight to 10 years."



## Diversified Models

With longer average life expectancies, Health Care REIT is planning that seniors will wish to live in facilities that allow residents to "age in place," accessing the continuum of care in one location as their health care needs change. These properties include combination facilities, which offer two or more levels of care, such as independent living, assisted living, skilled nursing and dementia.

The properties also include "continuing care retirement centers" (CCRCs), which have a combination of detached homes, an independent-living facility, an assisted-living facility and possibly a skilled-nursing facility on one campus. They also offer more amenities and services, including wellness, fitness and other activities.

Health Care REIT is also diversifying, having expanded recently into medical office buildings and acute care facilities. That initiative is driven by the fact that people are living longer, aided by technological and pharmacological advances, making less invasive surgical procedures the emphasis of health care delivery. To better serve this population, health systems are constructing facilities that are more accessible, focusing more on decentralizing their services and improving how customers can access those services.

"Hospitals and other health care facilities are expanding to the suburbs, moving away from downtown urban areas, with consumer friendly medical office buildings and outpatient settings," says Scott Estes, chief financial officer at Health Care REIT. "If you don't adapt your portfolio to the way health care is changing, you will be left behind."

Approximately two-thirds of Health Care REIT's portfolio at mid-year 2008 consisted of a mix of various properties along the aging spectrum, from independent living communities, to assisted-living and skilled-nursing facilities, to specialty-care facilities. Medical office buildings are about one-third of the portfolio. Approximately two-thirds of the portfolio relies on private payments—rather than government sources such as Medicare and Medicaid—helping insulate the REIT from potential changes in public policy down the road.

"They have a lot of different ways to grow," says Philip Martin, managing director of real estate equity research at **Cantor Fitzgerald**. "It is a very diversified business model that can grow through real estate cycles."

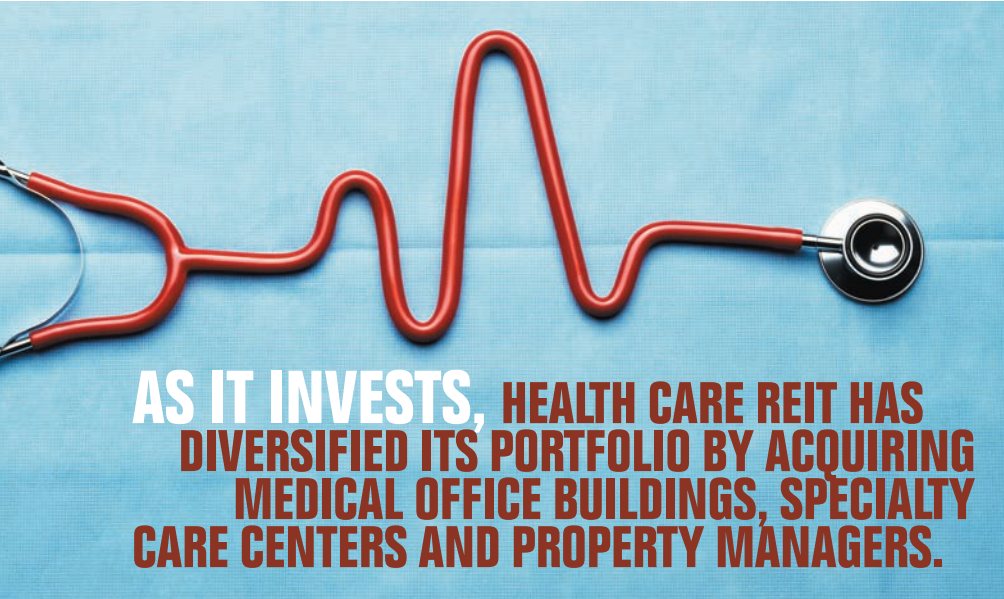
## Springing Forward

These days, Health Care REIT has emphasized development, with a pipeline Sept. 30, 2008, of \$1.4 billion committed to properties in senior housing, specialty care and medical offices. The commitment appreciably outpaces those of Health Care REIT's peers, representing

approximately 20 percent of the value of its portfolio, estimates Rosemary Pugh, a senior associate at **Green Street Advisors**. That compares to an average of 6 percent among other health care REITs in the sector.

"The company's executives have a vision where senior housing is going," Pugh says. "Many will agree over the long run it's on target."

The question is the short-term, Pugh adds. The weakening housing markets might make it tougher for seniors to sell their homes to pay an entrance fee to a community. However, Pugh also notes Health Care REIT has plenty of factors in its favor, with a long history of development and a track record of success with past projects.



## AS IT INVESTS, HEALTH CARE REIT HAS DIVERSIFIED ITS PORTFOLIO BY ACQUIRING MEDICAL OFFICE BUILDINGS, SPECIALTY CARE CENTERS AND PROPERTY MANAGERS.

Part of that success has to do with Health Care REIT's choice of operating partners, many of whom are established companies in their own right, including Emeritus Corp. and Brookdale Senior Living. The company had 69 partners in mid-year 2008, with no single provider representing more than 6 percent of the portfolio and the top-10 operators comprising about 40 percent.

Health Care REIT helps its operating partners free up capital by doing sale leasebacks, allowing them to monetize non-core assets. When working with these operators, the company expects repeat business given the upfront due diligence it must perform. Consequently, as part of its selection, Health Care REIT looks for tenants that focus on quality of services first, rather than those emphasizing pure profit no matter what the cost.

"We tend to support operators who are very well organized and deliver cost effective, quality care," Chapman says. "Profits naturally follow."

### New Additions

Increasingly, Health Care REIT is backing operators that place these facilities within larger communities that provide access to health care, retail and a broader population base. Combination facilities and CCRCs made up 30 percent of the portfolio on Sept. 30, up from 27 percent at the end of 2007.

"The company has been able to grow its portfolio but also divest itself of properties on occasion to move toward the combination facility structure," says Richard Anderson, a senior analyst at **BMO Capital Markets Corp.** "What it wants are campuses that have various levels of service in terms of the health care that they provide."

Medical office buildings and specialty care facilities also make up a significant part of the portfolio, representing 34 percent of the portfolio as of Sept. 30. Combination facilities, CCRCs and medical facilities have also dominated the REIT's gross investment activities of recent. Specialty care facilities made up 42 percent of acquisition volume, while medical office buildings

account for 28 percent and combination facilities 23 percent. In contrast, stand alone facilities in areas such as independent living, assisted living and skilled nursing comprised just 5 percent of acquisitions.

"The days of stand-alone nursing facilities may be coming to an end," Chapman says. "We favor skilled nursing combined with assisted living, and possibly dementia as well. These combination platforms drive more revenue by attracting a higher quality pay mix of Medicare and private pay. Consumers prefer multiple levels of service, which is a big plus for occupancy."

Health Care REIT had attempted to take a big step forward by announcing a tentative deal in September to acquire a 90 percent interest in 29 senior housing

properties from Arcapita Inc. for \$644 million, but it canceled the agreement after due diligence, citing changes in the capital markets. The deal would have given Health Care REIT 28 combined facilities, operated by Sunrise Senior Living Inc., one of the country's leading senior housing operators. While the deal fell through, Chapman notes more chances will come down the road. "We will continue to pursue new investment opportunities in the senior housing and care industry, and are committed to prudently allocating capital throughout all economic cycles," he says.

As it invests, Health Care REIT has diversified its portfolio by acquiring medical office buildings, specialty care centers and property managers. It bought Windrose Medical Properties and Trust in 2006 for \$1 billion, adding medical office buildings and acute care centers to the mix. It followed last year with a \$300 million purchase of another 17 medical office buildings and Paramount Property Management Group from Rendina Co., a real estate company based in Florida and California.

Another strong point for the company is its management team. When Chapman came on board in 1992, the REIT had \$226 million in assets. President Raymond Braun joined in 1993. Fred Farrar, executive vice president, came to the team as a result of the purchase of Windrose, which he formerly led.

"Their management team is among the strongest in the REIT industry," Martin says. "There are a couple of people on the team that could run their own company."

As health care delivery continues to evolve, management will follow the market, Chapman says. The company sold off \$98 million worth of assets in 2007 and \$70 million in 2006, with the bulk being stand-alone facilities in assisted living and skilled nursing.

"We have always been active asset managers," Chapman says. "We really feel our experience in the industry has allowed us to challenge operator assumptions and to identify problems often before they do." ♦

*Charles Keenan is a contributor to Portfolio.*

HEALTHCARE  REIT

HEALTH CARE REIT, INC.  
ONE SEAGATE, SUITE 1500  
TOLEDO, OH 43604

T: 419.247.2800

F: 419.247.2826

[WWW.HCREIT.COM](http://WWW.HCREIT.COM)