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SENIOR LIVING

ASSISTED-LIVING COMPANY SHIFTS STRATEGY

By Terry Pristin
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Sunrise Senior Living, a bellwether in the assisted-living industry, has been aggressively selling its Victorian-style properties and transforming itself into a management company.

The company, formerly known as Sunrise Assisted Living, was a pioneer in its field, developing hundreds of properties across the nation aimed at elderly people who need help with their daily activities but do not require the hospital-like setting of a nursing home.

Earlier this year, the publicly traded company became the biggest player in its industry when it acquired Marriott Senior Living Services, an operating company that, unlike Sunrise, did not own most of its the homes that carried its banner. The acquisition more than doubled Sunrise's capacity — from 17,136 residents to 40,465.

Marriott owned only 9 of the 126 properties it operated, so the deal did not add to the real estate portfolio of Sunrise, which is based in McLean, Va. But the transaction was consistent with the company's new strategy to get out of the real estate business. (The Marriott-owned properties themselves were sold to CNL Retirement Properties, a fast-growing, closely held real estate investment trust based in Orlando, Fla.; they will be managed by Sunrise.)

More recently, Sunrise sold 12 of its wholly owned properties and 11 joint venture properties for a total of $311 million to Crescent Capital Investments, the private equity arm of the First Islamic Investment Bank of Bahrain. Under a so-called sale-manageback arrangement, Sunrise has a long-term operating contract as well as a 10 percent interest in the properties.

Sunrise's change in strategy comes as the assisted-living industry is trying to rebound from the crisis of the late 1990's, when, analysts and industry executives say, too many companies entered the market and embarked on a frenzy of overbuilding. Many developers overestimated the demand for assisted living, finding that most elderly people preferred to remain at home as long as possible, resulting in an average move-in age of 83, much older than anticipated. Wall Street quickly lost its enthusiasm for assisted living, and many companies filed for bankruptcy protection.

Consequently, construction has slowed considerably — from more than 32,700 apartments in 1998 to 3,600 in 2002, according to the American Seniors Housing Association, a trade group. In all, there are about 20,500 properties, with 2.27 million apartments. Of these, 90 percent are owned by for-profit companies. The median rent is $2,200 a month, but in some markets, it may be closer to $4,000 a month, and the average stay is two years, according to data compiled by the trade group. Sunrise's average basic rate is $113 a day.

Despite the slowdown in construction, many assisted-living operators are still struggling to fill their properties. The median occupancy rate declined from 86 percent to 83 percent, according to the National Investment Center for the Seniors Housing and Care Industries, a nonprofit research group in Washington. Occupancy rates of less than 83 percent are considered inadequate to generate a return on equity, the organization said. At Sunrise, however, the average occupancy rate is over 90 percent, about five percentage points lower than it was in 1999 but still higher than most.

Paul J. Klaassen, the chief executive and chairman of Sunrise, said that his company decided to change its business model for the same reason that hotel companies like Starwood Hotels and Resorts Worldwide, which controls several hotel chain brands, are selling their properties: to reduce debt and become more attractive to investors, who will pay a higher multiple of earnings for companies that have shed their real estate. Sunrise has reported that it trimmed its debt (excluding leases) to an estimated $232.2 million this year from $457 million last year.

Mr. Klaassen, who founded Sunrise with his wife, Teresa, in 1981, said that withdrawing from the business of owning real estate would enable both the company and its potential investors to focus on its operations. "For a public company, particularly in today's world," he said, "clarity and simplicity are certainly being asked for — even demanded — by investors. We were a bit complicated."

Currently, Sunrise owns 100 percent of 56 communities, a majority interest in 4 properties and a minority interest in 102 communities. It leases 34 communities and manages 147 for third parties. As a result of the Marriott purchase, the company has broadened its focus to include some nursing homes and more so-called independent-living communities for elderly people who do not need as much help as those in assisted living.

By mid-2005, the company expects to divest itself of nearly all of its real estate, Mr. Klaassen said. In some cases, however, the buyer will insist that Sunrise retain a stake of up to 20 percent. One such buyer was the California Public Employees' Retirement System, or Calpers, which has acquired about $300 million worth of Sunrise property, according to the pension fund's adviser, Kathryn A. Sweeney, a principal and portfolio manager at AEW Capital Management in Boston.

The joint venture arrangement gives Sunrise an added incentive to perform well because it shares in the risk, Ms. Sweeney said.

Sunrise is not the only company in its industry to have entered into sale-manageback arrangements. The Capital Senior Living Corporation of Dallas has sold six properties to Blackstone Real Estate Advisors — most recently, Cottonwood Village in Cottonwood, Ariz. — and has a long-term management contract for them as well as 10 percent ownership.

But some experts in senior living said that it might be difficult for other companies to follow Sunrise's lead. Lacking Sunrise's reputation, most senior-living companies would have to settle for management contracts of 3 to 5 years rather than 25, Ms. Sweeney said. "Sunrise has a franchise value," she said, "and the staffing and corporate support and infrastructure setup — much like a hotel company."

Robert G. Kramer, the president of the National Investment Center for the Seniors Housing and Care Industries, said: "The strength of the Sunrise brand may enable it to be successful. That may not translate into success for someone else."

The company's strategy has been heavily criticized by several Wall Street analysts who complain that the company is using its real estate sales to pump up earnings. Dismissing these complaints, Mr. Klaassen said, "We're getting out of the ownership business, so that argument will be kicked into the dustbin of history."

Others who follow the senior living industry say that owning real estate provides a company with flexibility and a chance for greater profits. Without the real estate, said Stephen M. Monroe, the editor of SeniorCare Investor, a monthly newsletter, "you are losing out on the upside."

Mark J. Schulte, the chairman and chief executive of Brookdale Living Communities, said there were arguments on both sides. Brookdale, based in Chicago, owns most of the 63 properties it runs. "We have not formulated a strategy on whether we are going to continue to own the real estate," he said.

But another competitor, Randal J. Richardson, the president of Classic Residence by Hyatt, a privately held company also based in Chicago that owns 18 communities, said it was important to retain ownership to maintain brand consistency. "When you have a lot of different owners," he said, "they have different points of view. Pretty soon, you're not consistent."