

**A Strategic Analysis of Development Opportunities
for Spectrum Seniors Housing**

By

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ABSTRACT

Spectrum Seniors Housing is interested in expanding its development operation into the United States. This project investigates its opportunity by using Porter's Five Forces Framework to analyze the industry and by assessing Spectrum's internal capabilities. Various market entry modes are considered and recommendations provided.

The U.S. marketplace appears promising due to a growing aging population, strong occupancy rates and an insufficient supply of housing. However, it presents challenges which include a shortage of construction labour and affordable land. Spectrum is also challenged by the transferability of some of its operating competencies. Despite the challenges, the opportunities support expansion.

Spectrum should enter the United States with a mixed mode approach of establishing itself as a sole venture subsidiary and then partnering on individual projects through joint venture company creation. It should seek partners with complementary capabilities and initiate ten projects as soon as possible in locations where project returns are greatest.

Key Words: real estate development, seniors housing, U.S. market entry

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Glossary of Useful Definitions

The following definitions are provided to add clarity to the information presented throughout.

Independent Living: A housing segment that appeals to the senior who is less active and views household upkeep as burdensome and challenging. It resembles apartment style living with the addition of congregate amenities and services including meals, linen and housekeeping services, transportation services, recreation activities, emergency assistance and common areas for group activities (Hess, Liang & Conner, 2001).

Assisted Living: A housing segment that offers specialized personal support services to seniors who need assistance with activities of daily living (bathing, dressing, eating etc.) because of increasing frailty or conditions such as Alzheimer's disease, but whose health is not compromised enough to require 24 hour skilled nursing care. These facilities offer the same services as Independent Living including meals, linen and housekeeping services, transportation services, recreation activities, emergency assistance and common areas for group activities in a residential style living atmosphere (Hess et al., 2001).

Continuing Care Retirement Centres (CCRCs): A segment that offers all, or a combination, of Independent and Assisted Living, Skilled Nursing and Condominiums in one location (Hess et al., 2001).

Capitalization (Cap) Rate: A percentage used to estimate the value of an income producing property and the rate at which an investment will pay for itself through its net cash flow. For reference, the lower the cap rate, the higher the property value.

The cap rate is derived from the ratio between a property's cash flow and its capital cost and is calculated accordingly.

$$\text{Cap Rate} = \text{Cash Flow} / \text{Capital (Asset) Cost}$$

Market Cap Rate: A capitalization rate determined by evaluating the financial data of similar properties which have recently sold in a specific marketplace.

Stabilization (stabilized): The point at which a property achieves a predetermined expected occupancy for an established period of time whereby it experiences consistently positive net operating income.

Appraised Value: The value of a development property determined for sale by a qualified real estate appraiser taking into account market cap rates and a property's net operating income. The appraised value is calculated accordingly:

$$\text{Appraised Value} = \text{Net Operating Income} / \text{Cap Rate}$$

1.0 INTRODUCTION

Private pay seniors housing is a \$65 billion dollar industry in the United States and becoming the fastest growing industry sector and the sixth major commercial real estate asset class (Adler, 2007 and Gamzon, 2006, 2007). PricewaterhouseCoopers and the Urban Land Institute touted seniors housing as one of the five best bets in real estate development for 2006 (Napoli, 2006). The market although still somewhat fragmented, is maturing at a consistent pace.

Since bottoming out in 2003 due to developer over building and investor over exuberance in the late 90's, the development of seniors housing in the United States has been modest (Alder, 2007). Confidence in development opportunities has grown as a result of rising occupancy rates in existing facilities, attractive aging demographics and debt and equity financing interest from local and foreign providers (Gamzon, 2007). These industry fundamentals have spurred an interest in development, particularly Independent and Assisted Living housing development ("Seniors Housing Industry Reports Robust Performance, 2006").

The demand for seniors housing is influenced by demographic trends. It is more need driven than lifestyle change influenced not only in the United States, but globally. The demand for seniors housing in the U.S. is expected to grow independent of economic and business cycles and expected to remain one of the most promising and reliable industries throughout the world (Sheridan, 1999). The following investigates development opportunities within the Independent and Assisted Living market for Spectrum Seniors Housing in the United States.

2.0 PROJECT OBJECTIVES

Spectrum Seniors Housing Development Corporation (**Spectrum**) is a Canadian based seniors housing real estate developer. Given its growth objective and current Canadian market conditions, Spectrum is interested in expanding its operation to include the development of Independent and Assisted Living facilities in the United States (**U.S**).

The overall objective of this project is to develop a strategic plan for Spectrum's expansion desire. After a brief background discussion of the company, the project:

- Examines the external factors influencing the seniors housing marketplace and subsequent development activity in the United States. This includes an assessment of macro influences such as government and economic conditions, and micro industry influences using Michael Porter's "Five Forces Framework" (Crossan, Fry and Killing, 2005). Key industry success factors are identified and cultural differences in business practices between the U.S and Canada are discussed with considerations to marketplace competitiveness;
- Assesses Spectrum's internal capabilities and identify key success factors for operating as a development company in the United States; and
- Proposes strategies for entering and operating in the U.S. seniors housing marketplace.

3.0 COMPANY INFORMATION

3.1 Company Background

Spectrum is a private real estate development company with a mission to “House Seniors in Luxury”. Established in 2003, today it is Canada’s largest seniors housing real estate development company with offices in Mississauga, Ontario and Vancouver, British Columbia.

Spectrum has had a strong development track record. As of May 2007, Spectrum’s development portfolio included 81 seniors properties; 17 of which were in lease-up, 11 were sold to Chartwell Seniors Housing REIT (**Chartwell**), 12 were in construction, 20 were under development, and 21 were under development consideration.

3.2 Growth and Expansion

Spectrum’s operation evolved from an organization of dependence to independence. Its initial development properties were dependent on joint venture partnerships with residential builders. Spectrum provided the design, development, programming and operating expertise and shared the risk of debt and equity financing for construction and property lease-up. Today, Spectrum participates with joint venture partners on new developments and develops properties independently. It has matured within the industry and employs skilled professionals to carry out the breadth of its development activities.

Spectrum’s operation has also expanded geographically since 2003. This expansion is a result of joint venture partnerships as well as increased in-house staff assisting Spectrum in undertaking additional development projects independently. Originally starting in the Greater Toronto Area with 3 development sites, Spectrum is now established in British Columbia, Saskatchewan, Ontario and Quebec with recent expansion into Newfoundland, accounting for all 81 properties in 47 rural and urban locations. The greatest proportion of property development has occurred in Ontario and Western Canada.

3.3 Business Scope

Spectrum exclusively develops seniors housing properties. The segments of development include condominiums, independent living facilities, assisted living facilities, long term care centres, or skilled nursing facilities and a combination thereof. Condominium projects

are sold whereas other segments are leased. Spectrum's principal development segments include Independent and Assisted Living where in-house staff expertise is greatest and profits are maximized.

Spectrum's in-house capabilities enable it to design, oversee, manage and control multiple development projects simultaneously. Its skilled employees locate potential development sites, conduct thorough market assessments, navigate municipal requirements, direct design for seniors' needs and operational efficiency, organize financing, and manage project accounting and joint venture relationships.

3.4 Customers

Spectrum develops its product to serve the needs of three customer groups: seniors aged 75 years and older earning \$30,000+ annually, adult children of seniors, and health authorities charged with providing housing and care options for their community elders.

3.5 Competitive Advantage and Strategy

Spectrum competes in its Canadian marketplace through product differentiation and service provision. It offers a mid-level pricing scheme for products with high-end appearance and engages Chartwell's Canada wide operating and marketing expertise to rapidly lease-up its properties for eventual sale.

3.6 Spectrum's Key Success Factors

Spectrum's success in Canada is the result of several factors. First, it identifies key market areas through careful market analysis. Second, it is skilled at designing appropriate and operationally efficient seniors housing facilities. Third, it successfully manages and controls development processes spanning from municipal requirements to construction. Fourth, it can access equity and low cost debt financing for development activities. Fifth, it has strong and experienced leadership familiar with real estate and seniors housing development. Finally, it is skilled at developing and managing long-term relationships with lenders, Chartwell and joint venture partners.

3.7 Property Management

Spectrum maintains exclusive management agreements with Chartwell which encompass marketing, leasing-up and operating its development properties. Chartwell is Canada's largest owner and operator of seniors housing and maintains a strong industry reputation. Recently Chartwell expanded its portfolio to include 58 owned and managed properties in the United States and is now North America's third largest owner and operator of seniors housing. Spectrum also maintains an exclusive development agreement with Chartwell to provide it with new development properties to facilitate the growth of its Canadian portfolio.

3.8 Profit Generation and Current State of Affairs

Spectrum's profits are generated from the sale of its stabilized properties to Chartwell. Profits are a function of current market capitalization rates, property net operating incomes and the costs of developing facilities. Spectrum is currently experiencing challenges developing in Western Canada (British Columbia, Alberta and Saskatchewan) as a result of the following:

3.8.1 Capitalization Rates: Capitalization rates have compressed and reached the lowest levels recorded in Canada (Von Hahn & Hilton, 2007). Although currently attractive, rates are not expected to lower but instead rise as interest rates rise reducing eventual appraised value. The length of development, on average four years, means that Spectrum relies on the long-term stability of values to make investment decisions.

3.8.2 Net Operating Income: Net operating incomes in Western Canada are lower than in Eastern Canada. Net income per suite from Spectrum properties while in lease-up differ geographically and by property segment. Revenues generated from rents (accommodation fees) are lower in Western provinces compared to Eastern provinces. Some expenses, such as labour rates and food costs are greater in Western provinces compared to Eastern provinces. Spectrum is not able to adjust accommodation or labour rates adequately to achieve favourable profits in Western Canada. The inability to adjust rental rates is influenced by housing subsidies and market conditions whereby existing older projects set the rates, allowing only a small premium for new development rates. The inability to down scale labour rates is a function of competition for employees from other business sectors.

3.8.3 Development Costs: Development costs in Western Canada have increased and continue to rise at a rapid rate compared to Eastern Canada. Appropriate land for seniors housing is limited and where available, is costly. Overall, construction costs are uncontrollable as a result of other construction industry type demand. Competing demand and other development priorities include residential construction, infrastructure development associated with the 2010 Vancouver winter Olympics, politically driven highway and public facility improvement agendas and oil sand activity in Alberta. These events are drawing away labour and skill from seniors housing development (Gulli, 2006).

Spectrum is an established but young organization experiencing profit challenges in developing in Western Canada's seniors housing marketplace. It is interested in development opportunities in the United States in an effort to continue its success and avoid being dependent on only the Eastern marketplace, particularly Ontario, where the predominance of affordable and profitable development activity is occurring.

4.0 MACRO ENVIRONMENTAL FACTORS

This chapter discusses the macro environmental factors that impact seniors housing development in the United States. It describes the way State and Municipal government affect the cost of development, as well as the impact of economic conditions on profit.

4.1 Government Influences

4.1.1 State Legislation on Development Requirements

There is no legislation governing the development of Independent Living facilities in the United States. This lack of legislation is due to the fact that there is typically no care service provided to residents (the seniors) or, if care is provided, it is on a private pay basis subject to the risk of the service provider.

There is however State specific legislation governing the development of Assisted Living facilities. States differ in their legislation by specifying unique physical environmental and operating requirements that must be met in order to operate as an Assisted Living facility and to receive a permit to operate. The operating license is awarded to and held by the property manager or operator and not the property developer. It is however the property developer's responsibility to ensure that the physical requirements have been incorporated into the building design.

State regulations for Assisted Living development are not onerous or costly, however, non-compliance with operating requirements will result in the loss of the facility license necessary for operation and industry credibility.

Throughout Canada, Spectrum is experienced with, and subject to, similar environmental and operational requirements.

4.1.2 Municipal Development Control

Control over property development in each community lies at the Municipal level through by-laws exercised by municipal officials. In some locations, City Planners prevent the development of seniors residences in strategic locations, holding land for alternate economic and/or social use. Convincing planners that a seniors development will contribute to the community may take time and require re-zoning and other development approvals. The zoning

and development approval processes can be lengthy and arduous with boards and planners making up the ground rules as they go along (Misonzhnik, 2006). These situations delay development plans and increase development costs. In other locations, planners show a strong interest in serving community needs, such as those involving seniors, and development approvals are easier and quicker to obtain (Siakavellus, 2003).

Spectrum is familiar with the variety of development approval and zoning processes given its development experience in Canada. The processes in the United States are equally unique. An obstacle facing Spectrum will be the costs associated with the extra time required to navigate through, and complete, the rezoning and approval processes in the United States as there may be uniqueness not yet encountered even in Canada.

4.1.3 Municipal Development Cost Charges

Development cost charges in each municipality influence the decision to move forward with developing a project. In urban settings for example, the development costs charges are higher than rural settings due to higher taxes, densities and utility demand. Furthermore, the charges are greater in more affluent centres. There is often very little negotiation in the cost charges with municipalities.

The development cost charge concept is similar in Canada and equally prohibitive in some locations.

4.2 Economic Influences

4.2.1 Development/Construction Financing

Seniors housing in the United States is considered an attractive and stable market for institutional lenders and private equity investment. Interest has risen as a result of strong industry fundamentals such as aging demographics, high occupancy rates, increasing rental revenues and low capitalization rates. As a result, there has been, and will likely continue to be, an interest and inflow of equity and debt financing from international, national and local sources as there is an appetite to deploy capital to stable markets (Kaplan, 2006, DeLisle, 2007 and "Lenders and Investors Provide Mid-year Review of Seniors Housing and Care, 2006").

Low cost capital is also available for development in the United States. This availability results from the need to deploy capital by multiple providers giving rise to competitive interest rates. Also leading to the low cost capital scenario is the decline in residential construction throughout the United States in general. U.S. lenders can no longer rely on residential mortgage demands urging them to seek other investment opportunities such as seniors housing. However, in some markets, the decline in residential activity has been replaced with non-residential activity such as commercial and infrastructure construction thus re-balancing the lender's mortgage portfolio ("Housing Slowdown Poses Challenge to Bank Loan Growth, 2007").

Construction financing is provided based on floating interest rates. DeLisle (2007) predicts that interest rates will remain flat with a possible decline as a result of the Federal Reserve seeking to stimulate the economy. Today's construction financing rates hover around LIBOR plus 200-250 basis points. Canadian construction lending rates hover around the Bank of Canada's prime rate plus 2-2.5%.

The seniors housing market in Canada is considered equally attractive to institutional and private pay lenders as a result of strong industry fundamentals including aging demographics, high occupancy rates and low capitalization rates. There also is an influx and availability of capital and low cost capital to support activity.

The need to deploy capital and competitive interest rates translates into an avenue from which Spectrum can access equity and debt in the United States. This opportunity may allow Spectrum to undertake more development activity as it can spread its risk with its own equity and that of interested lenders.

4.2.2 Capitalization Rates

Similar to Canada, capitalization rates for seniors housing are at an all time low in the United States (Kaplan, 2006, NIC, 2006). Documented rates collected from a sample of major U.S. Independent and Assisted Living sale transactions in 2006 are identified in **Table 1** below. This and all other tables unless noted otherwise, have been created by the author.

Table 1: Independent and Assisted Living Capitalization Rates

	<u>Low</u>	<u>High</u>	<u>Average</u>
Independent Living	5.9%	9%	7.7%
Assisted Living	6.5%	12.5%	8.7%

Cap rates are determined, influenced and range as a result of inflation, interest rates, physical plant characteristics and property specific economics such as depreciation, vacancies, income recoveries and operating expenses. Newer properties with high occupancies and efficient operations result in lower cap rates. Conversely, older properties, with poor occupancy and inefficient operations result in higher cap rates. Further, the size of a property portfolio influences cap rates; the larger the portfolio, the lower the cap rate.

For single or small portfolio purchases, cap rates in the United States have shown to be lower than in Canada for both Independent and Assisted Living properties. Recent purchases of relatively newly built properties (within the last 7 years) by Chartwell in the United States have had cap rates of 7.0% for Independent Living and 7.5% for Assisted Living. Across Canada, cap rates for individual Independent and Assisted Living property sales have been 7.75% for Independent Living properties and between 7.75% and 8.0% for Assisted Living properties.

4.3 Taxation – Profit Repatriation

Should the ownership of a US-based development property be Canadian, repatriation of profit considerations will be necessary. Depending on Spectrum’s organizational structure, profits could be subject to specific State tax, Federal corporate tax and withholding tax. Should profits leave the United States, Canadian investors may be subject to individual dividend taxation and credit taxation/benefit arising from the withholding tax.

4.4 Macro Environmental Threats and Opportunities

The U.S. macro environment poses several opportunities and threats to development as summarized in **Table 2** below.

Table 2: Macro Environment Opportunities and Threats to Seniors Housing Development

<u>Macro Influences</u>	<u>Opportunities</u>	<u>Threats</u>
Government	No Independent Living Legislation	Municipal Approval Process
	Manageable Assisted Living Legislation	Development Cost Charges
Economic	Available Equity	Rising Capitalization Rates
	Available Capital	Profit Repatriation
	Low Cost Capital	
	Low Capitalization Rates	

Development opportunities identified in the United States seniors housing marketplace appear to be attractive. Minimal development legislation and the availability of low cost financing reduce barriers to project initiation and low cap rates result in worthwhile project undertaking due to highly appraised property values. It is anticipated that there will continue to be private equity and institutional lender interest in this industry sector in future years despite currency depreciation given that the demand for seniors housing is predominantly need driven and demographically influenced.

The most significant threats affecting the development of seniors housing in the United States from a macro perspective include the taxation of profits and municipal specific development cost charges. Both can be identified with advanced research into the market under development consideration for future management.

5.0 MICRO ENVIRONMENTAL FACTORS - INDUSTRY ANALYSIS

This chapter undertakes an industry analysis of seniors housing development in the United States. It considers the buyers of Spectrum's product, the suppliers and supplies influencing development and property sale, substitutes to Spectrum's product and competition from specific industry rivals. Further, it identifies other market conditions such as current housing inventories, development trends, occupancy statistics, property revenues and expenses, and key factors for development success in the United States.

5.1 Buyers

There are three buyers of Independent and Assisted Living housing in the United States and each buyer has a different interest. Buyers include senior citizens aged 75 and older who lease accommodation, adult children with senior parents, and private operators or real estate based organizations developing property portfolios. Institutional lenders represent a subgroup of buyers and will also be discussed.

5.1.1 Seniors and the Aging Population

Seniors 75 and older make up the primary buyer group for Independent and Assisted Living housing. The decision to move into a residence is predominantly need driven and secondarily lifestyle driven. In general, seniors requiring personal support and/or assistance with activities of daily living would seek Assisted Living facilities. Those who are more interested in maintenance free living and social interaction would seek Independent Living. Aside from being need driven and influenced, the decision to relocate to an Independent Living or Assisted Living residence is based upon other considerations including convenience, facility amenities and services, proximity to community amenities, closeness to family or any combination thereof.

Over the years, seniors have become value-oriented with unique needs and lifestyle preferences. They are savvy and particular about the nature and proximity of amenities to which they desire access. Site location, as it relates to the permanent residence of their adult children, is a primary consideration in seniors' facility selection decision (Cobb, 2006). The majority of buyers are single women and there has been an increase in the number of older couples seeking housing.

Seniors in today's marketplace are educated and sophisticated in their lifestyle preferences and expectations. They demand larger apartments, resort style services and facilities as well as individualized attention (Chapman, 2007 and "Aging Business, 2003").

In 2006, there were 18.1 million seniors aged 75+ living in the United States. The following table provides information regarding the predicted growth of the 75+ age category to the year 2035 (U.S. Census, 2005).

Table 3: Population Growth Expected for Americans 75+

<u>Year</u>	<u>Total Population</u>	<u>Population Aged 75+</u>	<u>% of 75+ of Total Population</u>
2006	290,153,000	18,102,000	6.24%
2010	299,862,000	18,561,000	6.19%
2015	312,268,000	19,652,000	6.29%
2020	324,927,000	22,271,000	6.85%
2025	337,815,000	29,038,000	8.60%
2030	351,070,000	32,597,000	9.29%
2035	364,319,000	38,602,000	10.60%

In the coming years, growth in the number of seniors 75 and older is projected both in terms of absolute numbers and as a proportion of the total population. This translates into a strong and growing market base for seniors housing other than the traditional private family residence. For Spectrum, these increasing numbers translate into a demand that can be met with its proposed expansion.

5.1.1.1 Demand for Independent and Assisted Living

Recent market studies in the United States indicate that 14.77% of those 75+ will require housing in Independent Living environments and that 14.75% of those 75+ will require housing in Assisted Living environments (Integra Realty Resources, 2007). Because the decision to enter into these environments is need based, it cannot be assumed that all seniors reaching and exceeding the age of 75 will move into Independent or Assisted Living facilities; the percentages identified reflect national estimates.

The following table identifies the projected demand (in number of seniors) for Independent and Assisted Living units among those 75+ across the United States considering the population projections presented in Table 3 and the percentages of need identified herein.

Table 4: Demand for Independent and Assisted Living in the United States

Year	Independent Living	Assisted Living
2006	1,692,193	1,689,902
2010	1,735,101	1,732,752
2015	1,837,089	1,834,601
2020	2,081,916	2,079,097
2025	2,714,502	2,710,826
2030	3,047,201	3,043,074
2035	3,608,554	3,603,668

Table 4 indicates that the demand for Independent and Assisted Living housing in the coming years will continually increase at roughly parallel rates. In the short term, between 2006 and 2010, there is an expected demand for Independent and Assisted Living each for approximately 40,000 seniors. Between 2010 and 2015, there is an expected need to serve approximately 100,000 seniors in each segment. The data presented demonstrate a strong and growing demand for Independent and Assisted Living housing in the United States.

5.1.1.2 Income and Income Source

Approximately 15% of seniors aged 75 and older have annual incomes in excess of \$30,000 (U.S. Census Bureau, 2006). This amounts to approximately 2,525,000 seniors. Current income sources for those aged 75 and older include a combination of wage or salary income, social security income and retirement income (Gist & Hetzel, 2004). Additional income sources identified from seniors residing in some Independent and Assisted Living residences include financial support from adult children, equity from private residence sale and Medicaid assistance allowing seniors with lower earnings to access these accommodations (Bissell, 2007). It can be assumed that the income sources in the future will be similar to those of today with some variance in allocation and proportion.

Given that Spectrum’s product is geared to seniors with annual incomes greater than \$30,000, there is an available buyer demand to serve.

5.1.1.3 Life Expectancy

Seniors are living longer than in previous years and make up a larger percentage of the current American population. Men are living to an average age of 77 and women to an average

age of 82. This increase can be attributed to improved standards of living, increased awareness of preventative healthcare and advances in medical technology. As a result of the increased longevity, there are more seniors available to take advantage of maintenance free living but also seniors who are becoming more dependent (Bissell, 2007 and Chartwell, 2007). This reality supports the drive to ensure supply for the dependent demand, particularly with respect to Assisted Living.

5.1.1.4 Health Status

In conjunction with increased life expectancy, the health status of many seniors as they age becomes compromised. Eighty percent of all seniors have at least one chronic health problem and 50% or more have two chronic health problems (He, Sengupta, Velkoff & DeBarros, 2005). On average, older females in U.S. seniors housing properties have at least 2 activities of daily living that require assistance and males have 1.8 (Acclaro, 2006). These needs make it harder for seniors to reside alone encouraging them to seek environments that can support their changing and increasing needs. As age increases, assistance with activities of daily living increases thereby increasing the demand for the assistive living housing.

5.1.1.5 Individual Preference

Traditional and culturally defined perceptions of individual capability can influence a senior's interest in moving into an Independent or Assisted Living residence. Some elders prefer to rely on family and home support services (discussed in Section 6.3) as they age; to remain independent and feel self sufficient rather than rely on unfamiliar caregivers. Others believe they do not require supportive services and that they can safely and independently remain autonomous. They may view seniors' facilities as asylums housing the infirm or memory-impaired, and are not inclined to face what they may view as an inevitable reality.

5.1.2 Adult Children

The adult children of seniors make up the second buyer group for Independent and Assisted Living. They often provide financial assistance for their parents' housing and are interested and involved in their parent's housing decision (Cobb, 2006). Adult children are often

concerned for their parent's well being and act as consumer protectors seeking care, service and safety for value.

Adult children and their families often draw the aging parent or relative closer to their area of residence as the senior enters advanced age. There has been a notable migration of seniors into markets with large adult children populations (Bissell, 2007). This migration is more predominant in the United States than Canada.

5.1.3 Alternate Ownership

Alternate ownership such as private operators and real estate based organizations such as Real Estate Investment Trusts, make up the third buyer group of seniors housing properties. Their requirements for purchase include properties that are well built, have stable occupancies and show consistent operating profit.

The expectations for property purchasers in the United States are the same for property purchasers in Canada. As a result, Spectrum generally focuses on meeting all three objectives during its development and lease-up process.

5.1.4 Buyer Sub-Group - Institutional Lenders

Institutional lenders are considered a buying group with respect to determining whether or not a development project merits financing. Although their influence is not as significant as that of senior citizens and adult children, if a development project is not appealing to lenders, financing cannot be obtained, and without private capital, cannot commence. In order to finance developments, lenders must be satisfied that: projects are undertaken by experienced professionals, developers have positive relationships with other lenders, there is a market demand for the product, the operation will be operationally profitable to ensure loan re-payment and there are cost control measures in place during construction (Bodamer, 2002).

Spectrum will likely be able to satisfy American lenders. It has seniors housing and property development expertise, existing experience with Canadian lenders and the ability to ensure cost control and management.

The overall buying group for Spectrum's product is large with a high level of sophistication and expectation Spectrum will need to satisfy in order to be successful. Buyer

characteristics and expectations in the United States are equally prominent to those in Canada. Given that buyers are value driven, they can exercise a high level of discretionary power in determining if Spectrum's product meets their specific needs.

5.2 Suppliers and Supplies

The ability to develop a project and sell it to an interested buyer at a profit is dependent upon those who carry out various aspects of the development and construction processes, those who operate the property after completion, and the supplies necessary to build the product. For the purposes of this project, suppliers are defined as trade labour, building professionals and property managers, and supplies include raw materials and land. The following discusses the current state of affairs in the U.S. construction industry.

5.2.1 General Construction Industry Activity

The construction industry in the United States has experienced episodes of instability resulting from residential single family housing demands and low interest rates. It is now undergoing stabilization. Residential and multi-family housing construction activity has declined while non-residential construction activity in the areas of healthcare, manufacturing, transport and waste disposal has increased (Chang, 2007, CIT, 2007, Rick, 2007 and Shuster, 2007). The decline in residential activity is the result of over-supply due to low interest rates. Non-residential construction activity can expect to show steady increases as a result of aligning infrastructure needs with usage (Shuster, 2007). Independent and Assisted Living is considered residential, rather than healthcare and is impacted by the variables discussed next.

5.2.2 Cost of Construction

The cost of seniors housing construction in the United States is lower than that of Canada. Lower costs are a function of lower trade labour wage rates and lower cost building materials due to more available supply. The following table compares costs per square foot associated with an average 100 unit wood framed building in the United States and Canada. The costs presented combine hard (materials and labour) and soft costs (pre- opening operating and marketing expenses, financing charges and furniture, fixtures and equipment) and are relatively consistent within the regions identified.

Land values are not included in the costs per square foot identified below as they are influenced first by geography then availability. The cost of a parcel of land in, or close to, an urban setting is more costly than a similar sized parcel in, or close to, a rural setting. In locations where there are several parcels of land available for development, the cost of each parcel is generally lower than similar sized parcels in areas where there is a limited supply of developable land.

Table 5: Construction Cost per Square Foot

	Western Canada	Ontario	United States
Cost per Square Foot	\$182-\$224	\$138-\$201	\$106-\$160

As identified above, the cost of construction in the United States is lower than either Western Canada or Ontario. Ranges of costs are provided as there are differences within regions that influence costs namely unique site conditions and varying municipal development costs charges. Ontario was included for comparison as Spectrum's concentration of development occurs predominantly in Ontario and it presents a relevant comparison to Western and United States construction trends.

5.2.3 Building Trade Labour

There is a general shortage of trade labour available to carry out current construction activity in the United States (Chang and CIT, 2007). Despite the fact that residential construction has slowed resulting in job loss, and non-residential construction has increased leading to job creation, there is no net gain or loss anticipated in the already limited trade labour pool. Given the industry-wide demand for labour, trades people often relocate to secure the highest paying job (Rick, 2007). The labour shortage represents the number one problem facing the construction industry as a whole.

The shortage of labour is highly problematic for developers as it forces delays causing developers to miss critical milestones leading to budgetary overruns. These events ultimately culminate in loss of credibility with suppliers, financiers and buyers damaging reputation and jeopardizing future project feasibility (Higgins, 2007).

5.2.4 Building Professionals: Building Contractors

Qualified and reputable building contractors critical to overseeing the construction aspects of development are in short supply. This is an outcome of increased market activity whereby qualified contractors can select more lucrative opportunities leaving less qualified builders available. It is not uncommon for contractors to take advantage of the industry demand and increase their fees, driving development costs higher (Carpenter, 2007). However, it is the reputable contractors who can ensure labour availability and bring along dedicated and skilled trades capable of delivering projects on time and on budget.

5.2.5 Building Professionals: Designers and Engineers

The general increase in construction activity leads to a shortage of seniors industry qualified design professionals. Architects and building engineers specialized in the design of seniors housing are often competent in other construction sectors (Chang, 2007). The volume of work can become such that many firms are operating and serving clients at capacity and are either unable to accept more work, or unable to meet developer deadlines and expectations. The latter compromises timelines and total project cost.

The current transition in construction activity and limited labour availability could restrict Spectrum from developing in certain market areas throughout the United States. Like building contractors, Spectrum will not be able to effectively manage this component of the process without established and trusted returning relationships.

5.2.6 Building Managers/Operators

In the United States, successful seniors housing operators are experienced in marketing, ensuring the provision of necessary and expected services, and attaining expected operating incomes. These scenarios represent a strong business model for developers and attract not only seniors and their adult children, but also investors who eventually purchase the property based on efficiencies and strong occupancies (Cobb, 2006). There are several property operators in the United States skilled in managing Independent and Assisted Living properties (**see Appendix A**). Many of these operate nation-wide and have multiple management properties within their portfolio. Management contracts are competitive as each operator aims to increase their

management portfolio size and gain overall organizational operating efficiencies in various regions.

Spectrum is not involved in managing properties but through analysis of its existing developed properties, is familiar with operating parameters and has established operating, marketing and profit expectations. It will have a variety of operators to select from to manage its properties and assist in their eventual sale in the United States.

5.2.7 Raw Material Supplies

In previous years, the increase in residential construction as well as other construction activity led to short supply in materials driving material cost upwards. These material shortages included lumber, concrete and materials used to create steel in addition to other construction specific commodities and prices rose uncontrollably by 10% to 15%. Although still in short supply, and expected to remain so as a result of anticipated construction activity, raw material pricing has stabilized and can be expected to increase only 2-5% in the coming years barring any unforeseen major events (DeLisle, 2007, Shuster, 2007, "2007 Annual Industry Forecast, 2007").

This predictability is beneficial for Spectrum as it can anticipate and control its construction supply costs. Establishing relationships with reputable contractors would assist in controlling material pricing as these contractors will have consistent and long term relationships with whom they conduct ongoing business.

5.2.8 Miscellaneous Supplies

The decline in residential housing activity presents some benefits to seniors housing developers in terms of available inventories. Some suppliers may have excess inventories of flooring, appliances, windows, doors, furniture and others which comprise significant costs centres in a construction project. With supply exceeding demand, suppliers will be compelled to offer these inventories at a reduced cost in order to sustain operations (Rick, 2007).

5.2.9 Land

5.2.9.1 Land Availability

The ideal Independent and Assisted Living seniors housing facility is located in any of three locations: close to adult children (rural or urban), in active urban settings with rich lifestyle amenities, or in tranquil residential settings close to easily accessible lifestyle amenities.

A challenge facing developers is land availability. This is particularly problematic in urban centres where active seniors are interested in remaining part of a thriving community; without developable land and alternate housing options, they are forced to leave the community as their needs change ("Mixed User Fever, 2007", Misonzhnik, 2006 and Sperber, 2005). Available land has become limited due to increased retail and apartment demand (McLinden, 2007). Further, in affluent residential areas where adult children often reside, available land is non-existent or subject to restrictive zoning requirements limiting development capability (Coy, 2007).

However there is some relief in residential settings for seniors housing developers. As a result of the decline in residential housing demand, many residential home builders accumulated significant land with the expectation that the housing boom would continue. They now maintain excess inventories in developing areas often with associated carrying costs. Land owners are now dumping these inventories at losses to improve cash flow, allowing others in the marketplace to secure land at reduced costs (McLinden, 2007, "Home Builders Seen Cutting Back on Land Purchase in 2007", DeLisle, 2007).

5.2.9.2 Land Affordability

Available land for seniors housing developments across the United States in key locations is often expensive. The costs can at times be prohibitive to project initiation although the market demand may be strong. In many urban centres higher land costs are prevalent due to escalating apartment and commercial construction ("Aging Business, 2003" and DeLisle, 2007). Compounding already high land costs is natural inflation associated with increased demand for real estate in general (McLinden, 2007). It is unlikely that land costs will decline in urban areas.

In Canada, Spectrum faces similar challenges in locating appropriate and affordable land for development. Attaining land from residential developers seeking to improve cash flow will be the most viable method for Spectrum to keep land costs low in the United States.

Local construction activity and the limited availability of trade labour, building professional, raw materials and affordable land represent significant barriers to entry into the U.S. marketplace for Spectrum.

5.3 Substitutes – External Supports

There are three substitutes to Spectrum's Independent and Assisted Living product in the United States. These include home health and social support services, home environment support, and physical environment support services.

5.3.1 Home Health and Social Support

Spouses, family members, visiting volunteers and home healthcare agency services address many of the social and minor health needs of seniors living in their own homes. This encourages seniors to age in place often beyond their capabilities, for longer periods of time delaying their entry into an Independent or Assisted Living residence.

5.3.2 Home Environmental Support

Family members and environmental service providers such as painters, gardeners and general contractors are available to assist seniors with maintaining their existing residences. These supports also encourage seniors to remain in their own homes for longer periods of time again delaying their entry into Independent or Assisted Living facilities.

5.3.3 Home Adaptation

With recent innovations in creating adaptable living environments, seniors can remain in their own residences for longer periods of time because they can modify their environment to meet their changing needs. Such innovations include ramps, in-house elevators, off-site emergency call services, height leveling kitchen and washroom counters and accessible shower units.

5.3.4 Traditional Familial Responsibility

The housing and care of elders in some cultures had traditionally been a family affair. Asian and Hispanic cultures for example house and care for their elders in family homes, with daughters and daughter-in-law(s) being the primary caregivers, in response to perceived familial obligation. Given the growing trend of women working and/or remaining in the workforce for longer periods of time out of desire or the need for double income support, familial caregiving is becoming less common as well as expected. The change in obligation is encouraging seniors and adult children to consider alternate housing options.

The substitutes discussed influence seniors because they are generally low cost and generally readily available with the exception of traditional caregiving. This has been experienced by Spectrum in Canada where the situation is similar.

5.4 RIVALS

There are local and national rivals in the United States serving the middle income Assisted and Independent Living demand.

5.4.1 Local Rivals

5.4.1.1 Existing Independent and Assisted Living Facilities

In most communities, there are existing Independent and Assisted Living facilities in operation. These facilities may have an established positive reputation which draws local demand. There may also be 'new builds' or buildings which have recently been completed and are in the process of lease-up where Spectrum may be entertaining the idea of a development project. These facilities may absorb available demand or concurrently be vying for senior clients from other facilities.

5.1.1.2 Local and State Wide Developers

Within communities and/or individual states, there are real estate developers who build small portfolios of seniors housing. They are often localized to one or more States to manage their scope of project control.

5.1.1.3 Local Mom and Pop Developers

In most communities there are 'mom and pop' developers who build one facility to benefit the community in some regard. They typically do not have experience in building or operating seniors housing and these businesses are family-run.

5.4.2 National Developers

5.4.2.1 Independent Living

There are two nationally known Independent Living seniors housing developers in the United States targeting the middle income senior, Holiday Retirement Corp. (Colson & Colson) and Senior Lifestyle Corporation. These entities develop facilities in areas with demand and available land. Holiday Retirement Corp. has an established reputation spanning the United States. Seniors Lifestyle Corp with its Autumn Green development, has recently emerged as a national rival and is steadily expanding throughout the United States (Stribling, 2005 and 2007). Both have an experienced and knowledgeable development team proficient in the same functions as Spectrum.

5.4.2.2 Assisted Living

There is one nationally known Assisted Living Developer, Sunrise Seniors Housing ("Sunrise Senior Living, 2005"). Sunrise develops mid to high-end Assisted Living properties in locations throughout the United States where it identifies a need and has available land. Sunrise has an experienced and knowledgeable development team proficient in the same functions as Spectrum.

5.4.2.3 Continuing Care Retirement Centres

There are three national CCRC developers whose projects include Independent and Assisted Living facilities. These developers are Erickson Retirement Communities, Pulte Homes (formerly known as Del Webb Communities), and Life Care Services L.L.C ("Seniors Housing, 2006", "Del Web Communities, 2006", Gertner, 2002 and Peck, 2006). Although these facilities are located within communities that also offer condominiums, Alzheimer's and/or skilled nursing services, they present as rivals because their housing continuum offers seniors an opportunity to remain in one location to the end of life rather than having to relocate as care needs increase.

These developments require a significant amount of land and when developed, are done so on a grand scale to benefit from efficiencies and meet a variety of lifestyle and care needs. These developers are considered large scale due to their integration of multiple housing offerings at one site. Each has an experienced and knowledgeable development team proficient in the same functions as Spectrum.

There are a number of seniors housing developers in the United States that represent existing market rivals. These competitive conditions are similar in Canada and familiar to Spectrum.

5.5 Other Market Considerations

Several other market factors influence the development of Independent and Assisted Living housing in the United States. These include current housing inventories, housing development trends, occupancy statistics and property revenues and expenses influencing appraisal property values.

5.5.1 Current Independent and Assisted Living Inventories

Seniors housing inventories suggest that there is an insufficient supply to meet the need identified in Table 4. As of 2000, there were 705,376 Independent Living units and 777,801 Assisted Living units in operation in the United States (Bissell, 2007). Since then, there has been an addition of 50,071 Independent Living units and 27,480 Assisted Living units into the marketplace (Schless and Kramer, 2006). The total number of known units for each housing segment as of the end of 2006 is presented in **Table 6** below.

Table 6: Inventory of Independent and Assisted Living Units in the United States (2006)

	Units
Assisted Living	805,281
Independent Living	755,447
Total	1,560,728

The data above indicate that based on the current demand for Independent and Assisted Living estimated from Table 4, there is a deficient supply of both housing segments in the United States which corresponds with an opportunity for development.

The data collected from the identified sources addresses nationally provided information from operators up until 2000 and from 75 major metropolitan cities thereafter. It is uncertain if the data collected prior to 2000 included rural areas throughout the United States and as a result, the inventory may be underestimated.

5.5.2 Seniors Housing Development Trends

Since 2000, there has been modest development of Independent and Assisted Living properties. The number of new units and subsequent properties has been extrapolated from existing data covering 75 major metropolitan cities across the United States and is shown in **Table 7** below (Schless and Kramer, 2006). The total number of properties per metropolitan area was calculated based on an Independent Living property having an average of 156 units and an Assisted Living property having an average of 93 units (Blumenthal, Hands, Herman, Levy, Mullen, Schless, Weiss and Whitlock, 2006).

Table 7: Independent and Assisted Units and Properties Developed Since 2001

Year	Independent Living Units	Independent Living Properties	Assisted Living Units	Assisted Living Properties
2001	7,820	50	4,344	46
2002	5,803	37	3,224	35
2003	7,747	50	4,304	46
2004	8,689	56	4,827	52
2005	8,677	55	4,820	52
2006	11,335	72	5,961	64

On average, not every major metropolitan city (of 75) has had a new Independent or Assisted Living property developed within it since 2001. For example, in 2001, there was a new Independent Living property developed in only 50 of the 75 metropolitan centres identified. The table information provides an idea of the development trend activity within metropolitan locations, identifying them as potential development locations as the aging population continues to grow and seniors migrate towards amenities and adult children.

5.5.3 Occupancy Statistics

Occupancy rates in operating properties and their trends over time help assess local demand. Occupancy rates within existing Independent and Assisted Living facilities have been increasing since the late 1990's in the United States. In 2006, several seniors housing operators

reported their properties' occupancy statistics and the average occupancy rates for both housing segments are shown in **Table 8** below (Blumenthall et al, 2006). The values presented have been increasing alongside the addition of new inventory described in Section 6.5.1.

Table 8: Independent and Assisted Living Occupancy Statistics

Independent Living	93.8%
Assisted Living	90.7%

Separate occupancy data collected from Chartwell (which did not participate in the above described data collection), indicated strong average occupancy rates of 95% in its Independent Living facilities and 90% in its Assisted Living facilities (Chartwell, 2007). Older properties typically have lower occupancy rates as newer products draw clients. However, Chartwell's U.S. portfolio includes properties that range in age between 7 and 20 years. Chartwell's and the other industry high occupancy rates identified suggest that there remains a strong demand for seniors housing across the country despite property age.

5.5.4 Operating Revenues and Expenses

As mentioned, property appraised values are a function of cap rates and net operating income. Operating incomes are predominantly generated from revenues received from property rental accommodation. Additional or secondary income is generated from care services and second occupant charges.

Table 9 below identifies the range in suite rental rates across Chartwell's portfolio in the United States and Canada. Chartwell's rates are offered as they represent industry averages given Chartwell's position in the overall seniors housing marketplace, and can be relied upon for middle of the road rates as evidenced by Chartwell's occupancy report. One and two bedroom units are used as a benchmark as these and not studio units are more likely to be developed given the changing sophistication and expectation of buyers.

Table 9: Rental Rates for Independent and Assisted Living

	Western Canada	Ontario	United States
Assisted Living: 1 Bedroom	\$1650-\$2700	\$2795-\$4795	\$2800-\$5070
Assisted Living: 2 Bedroom	\$2290-\$3600	\$3050-\$6660	\$3380-\$6229
Independent Living: 1 Bedroom	\$1875-\$2750	\$2950-\$3095	\$3000-\$4100
Independent Living: 2 Bedroom	\$2200-\$3180	\$3800-\$3950	\$3400-\$5770

As shown in the above table, rental rates are generally higher in the United States than in Ontario and Western Canada. Rates are lower in Western Canada as a result of public funding programs that are easily accessible to seniors driving private owner/operator rental rates down. Ontario is not affected by public funding options and can command higher rates within its marketplace. The Independent and Assisted Living housing addressed in this project is typically private pay based in the United States naturally leading to higher rental rates. In considering the range differences, older properties generally offer lower rental rates compared to newer properties in order to remain competitive within certain locations. Further, the more urban central a property, the higher the rental rates to compensate for higher property tax dedications compared to rural centres.

Operating expenses are composed predominantly of property labour costs, food cost, building repair and maintenance, property taxes and insurance and mortgage payments. These expenses significantly impact net operating incomes in Independent and Assisted Living environments.

Expenses as a percentage of total revenue and net operating income also as a percentage of total revenue, are presented in **Table 10** below. These values were collected from Chartwell's portfolio of properties in Canada and the United States.

Table 10: Property Expenses and Net Operating Income

		Western Canada	Ontario	United States
Independent Living				
	Expenses	34%-62%	45%-57%	45%-76%
	Net Operating Income	38%-66%	43%-55%	24%-55%
Assisted Living				
	Expenses	52%-79%	40%-82%	55%-76%
	Net Operating Income	21%-48%	60%-18%	24%-45%

The range in expense values is large and there is overlap in the percentages found in Western Canada, Ontario and the United States. Values range according to building age and size. Higher expenses are associated with older buildings commonly requiring more repair and maintenance than newer properties. Properties with less than 120 units are often not as efficient with respect to staff to resident ratios, driving labour costs and subsequent property expense

upwards thereby lowering overall net operating incomes. It can be assumed that newer properties with more than 120 units would likely have lower expenses than those which are older and have less than 120 units.

The U.S. market generally commands higher rental rates than the Canadian market but experiences similar expense outcomes. In considering Spectrum's profit interest, higher rental rates are necessary to achieving higher net operating incomes.

Key realities such as low housing inventories, strong occupancy statistics, un-paralleled development activity to meet demand and higher rental rates suggest there are development opportunities in the United States.

5.6 Barriers to Entry

There are five predominant barriers to market entry for Spectrum of which four which have, or will be discussed. First, there is a lack of appropriate and affordable land upon which to develop. Second, changing government policy can negatively influence design criteria driving development costs upwards. Third, rivals and new entrants can consume available demand pools. Fourth, unavailable design professionals delay project initiation allowing others to consume the available demand.

The remaining barrier to entry is the cultural difference in business practice between American and Canadian corporations and employees. This difference can compromise market entry and/or sabotage overall market success (Evans, Lane & O'Grady, 1992).

Corporate Difference: Corporate culture either supports or compromises the attainment of new strategic goals and direction, influencing the extent of competitiveness possible (Grey and Gelford, 1990). Canadian corporate culture is thought to have strong work expectations and balance personal accountabilities with compensation practices thought to be more equitable, competitive and performance based than those of the United States. Canadian corporations also foster lateral and vertical communication, as well as a high standard of business ethics compared to the United States.

However, Canadian corporations have fallen behind on key organizational success requirements compared to U.S. counterparts. They are thought to have less clarity about

strategic direction with less defined goals. As a result, corporate leadership is less able to influence individual performance, manage internal conflict and dictate decision making quality compromising the ability to be industry leaders. Further, Canadian corporations are thought to be less innovative and have lower external responsiveness to change with less internal sense of urgency and pace of carrying out activities. Overall, corporate vitality and management drive is inhibited by conservative goal setting (Grey and Gelford, 1990).

These differences do not necessarily apply to all corporations but are worthy of consideration from a competitive standpoint. Corporations in the United States are potentially more aggressive in their business activity which poses a significant threat for Spectrum entering an unfamiliar market.

Individual/Employee Differences: Individually, Canadians and Americans are thought to vary on various cultural dimensions with respect to business activity. Americans are deemed to be more competitive and have a greater commitment to winning than Canadians which manifests into aggressive and risk taking behaviour. They are also more action and achievement oriented claiming more control over their career destinies than Canadians (Evans et al., 1992). Finally, Americans are perceived as having greater commitment to work ethic and being more work-related individualistic in their drive to achieve greater success in the workplace (Ali and Falcone, 1995).

Similar to corporate differences, individual differences do not apply to all Canadian and American development personnel but if prevalent, may both benefit and undermine Spectrum's success in the United States. For example, should Spectrum wish to hire employees or contract with individuals or firms within the United States, more aggressive, competitive and achievement oriented personalities will assist Spectrum in competing in a similar marketplace. However, if Spectrum chooses not to hire U.S. employees, or contract with U.S. firms, its Canadian employees may be too passive, possibly compromising organizational success.

5.7 Key Success Factors

There is no universal formula for success in developing seniors housing in the United States. However a review of various seniors housing developers' experiences in addition to other

real estate market developers and industry engineers, identified that there are three consistent factors that contribute to success. The **quality of a location** presents the first success factor (Cobb, 2006, Lee, 2003, Porter, 1989, Stribling, 2005 and Duke, Isley, O'Neill, Slade and Finney, 2005). Proximity and access to main transportation corridors and community amenities are critical considerations in addition to locations close to concentrations of adult children, classic retirement meccas and urban settings. The second factor includes engaging a **proven seniors housing operator** to manage the development property (Cobb, 2005 and Bodamer, 2002). This will ensure that the property is properly marketed, seniors are well served and that operations are profitable enticing construction lenders and alternate buyers. The third factor includes ensuring that there is **sufficient demand** in the location of interest to justify the development of a new property (Stribling, 2005).

5.8 Summary Micro-Environmental Threats and Opportunities

The opportunities and threats facing seniors housing development in the United States discussed are summarized in **Table 11** below.

Table 11: Industry Opportunities and Threats to Development

<u>Opportunities</u>	<u>Threats</u>
Strong Seniors Demographic	Home Health, Social & Environmental Support
Growing Aging Population	Availability of Trade Labour
Demand for Assisted/Independent Living	Cost of Building Professionals
Available Capital	Availability of Building Supplies
Affordable Capital	Unknown Rivals in Locations of Interest
Available Building Operators	Lack of Appropriate Land
Industry Experienced Building Operators	Lack of Affordable Land
Annual Undersupply of Housing	Individual Perceptions
Strong Occupancy Statistics	Availability of Building Professionals
Higher Rental Rates	
Stabilized Material Cost	
Land Dumping	
Excess Supply Inventories	
Cost of Trade Labour	

Several factors encourage seniors housing development in the U.S. These include: an aging population with longer life expectancy and increasing need for support, an available and attractive lending market, the availability of experienced building operators who understand the seniors market and can ensure efficient operations, a current undersupply of Independent and Assisted Living housing, strong occupancy statistics within existing operating properties, high rental rates, land dumping, excess supply inventories, predictable material costs and low trace labour costs.

Several factors however challenge development in the United States by directly influencing project cost and property lease-up. Shortages of available and building professionals to undertake development projects and limited building materials in addition to appropriate, available and affordable land represent cost threats. Common substitutes such as family and community support services, individual perceptions of independence and known and unknown developers who draw local demand represent lease-up threats.

6.0 MACRO and MICRO ENVIRONMENTAL ASSESSMENT SUMMARY

The macro and micro assessment provided thus far is summarized in **Table 12** below and provides Spectrum with an overall view of the opportunities and threats associated with expanding its operation into the United States.

Table 12: Macro and Micro Environment Opportunities and Threats

	<u>Opportunities</u>	<u>Threats</u>
Macro Environment		
Government	No Independent Living Legislation	Municipal Approval Process
	Manageable Assisted Living Legislation	Development Cost Charges
Economic	Available Equity	Rising Capitalization Rates
	Available Capital	Profit Repatriation
	Low Cost Capital	
	Low Interest Rates	
	Low Capitalization Rates	
Micro Environment		
	Strong Seniors Demographic	External Supports
	Growing Aging Population	Availability Trade Labour
	Demand for Housing	Cost of Building Professionals
	Available Capital	Availability of Building Supplies
	Affordable Capital	Unknown Rivals
	Available Building Operators	Lack of Appropriate Land
	Experienced Building Operators	Individual Perceptions
	Undersupply of Housing	Availability of Building Professionals
	Strong Occupancy Statistics	
	High Rental Rates	
	Stabilized Material Cost	
	Residential Land Dumping	
	Excess Supply Inventory	
	Cost of Trade Labour	
	Individual Culture: Competitive & Achievement Oriented	Individual Culture: Competitive & Achievement Oriented
	Individual Culture: Strong Work Ethic & Sense of Individualism	Individual Culture: Strong Work Ethic & Sense of Individualism
		Corporate Culture: Aggressive Achievement Oriented

7.0 INTERNAL CAPABILITY ASSESSMENT

Spectrum's success in the United States will be influenced by its ability to manage and overcome external forces as well as its ability to transfer and capitalize on key internal capabilities. The following identifies key organizational success factors for development companies in the United States and subsequently assesses Spectrum's strengths and weaknesses in relation to these factors.

7.1 Key Development Industry Success Factors

There is no universal formula for successfully developing seniors housing in the United States from an internal capability stand point. However, several consistent and long-term success factors have been identified from seniors housing and real estate developers and sources knowledgeable in U.S. market entry and success.

7.1.1 Market Assessment

Developers must be able to undertake thorough market assessment as the first step in determining development potential and ensuring the profitability in various locations. This requires access to individuals capable of locating and identifying appropriate land parcels, ensuring demand through demographic analysis, assessing existing housing supply through feasibility studies and tracking competitive local development activity (Sperber, 2005, "Seniors Housing, 2006", Harris, 2004 and Mudgins, 2005).

7.1.2 Customer Knowledge

Customers within different geographic locations may have different needs and preferences. Therefore, a development's functionality must be specific to the needs of the seniors within the area of interest (Duell, 2004, Lee, 2003 and Porter, 1989). Such needs could be amenity, service or care specific. Developers must investigate the needs specific to customers in each community to ensure that the end product is appropriate.

7.1.3 Industry Experience and Knowledge

It is critical for developers to have, or have access to, individuals with experience and knowledge of the seniors housing, development and construction industries (Duell, 2004, Lee, 2003, "Building Success From the Ground Up, 2005", Porter, 1989 and Sperber, 2005). Seniors

housing experience would include knowledge of accessible and adaptable housing design requirements, as well as operationally efficient spatial design programming. Creating a quality asset requires an understanding of the social, physical and psychological needs of seniors and the administrative demands of management through research and attention to detail (Cobb, 2006, Srinivasen, 2006, Madsen, 2003 and Bodamer, 2002). Development experience would include understanding planning requirements, organizing consultants and coordinating financing. Construction experience would entail understanding and managing labour and material trends, managing budgets and constructing the end product.

It is also necessary for developers to have, or have access to, experienced and efficient building managers/operators. These are critical for ensuring occupancies through effective and appropriate marketing that culminate in stabilization as well as profitable operations through efficient cost management.

7.1.4 Leadership and Management

Success in development is driven by focused and well disciplined leadership. Development leadership entails entrepreneurial spirit with project execution capability as well as the ability to be innovative and flexible with opportunities and changing market conditions. Given that different locations present unique characteristics, it is important for developers to respond to change by focusing at certain times, on the end product thereby avoiding “cookie cutter” development efficiencies (Madsen, 2003, Porter, 1989, Duke et al, 2005, Srinivasen, 2006, Sperber, 2005 and “Seniors Housing, 2006”).

7.1.5 Reputation

Developer reputation to some extent, acts as a success factor as it establishes credibility in the eyes of prospective buyers (Madsen, 2003, Srinivasen, 2006, and Sperber, 2005). This factor is mostly beneficial for institutional lender and alternate buyer confidence.

7.1.6 Access to Capital

The ability to undertake development activity is contingent upon the developer having access to capital and being well capitalized (Duke et al., 2005, Madsen, 2003, Srinivasen, 2006, Lee, 2003, Misonzhnik, 2006 and Stribling, 2005). Equity requirements for lending vary

depending upon how comfortable and familiar lenders are with the developer; the less familiar the greater the equity or guarantee requirement. Further, developers must be able to access existing capital to manage cost over-runs or leverage for other development opportunities.

7.1.7 Relationships and Alliances

Success in the development industry in the United States is dependent upon having strong industry relationships and alliances with primary suppliers and related organizations (Duke et al, 2005 and Sperber, 2005). Relationships and/or partnerships allow access to resources including land, capital, financing, specialists, labour and knowledge one could not necessarily obtain independently or be successful without.

7.2 Key U.S. Market Entry and Operation Success Factors

7.2.1 Developed Strategic Plan

A developer's success in the U.S. is influenced by how focused and well-defined the corporate strategic plan is for market entry and within-market activity (Evans et al, 1992). An entry plan must be identified within the overall corporate strategic plan to highlight its importance among other corporate objectives and have similar or complementary objectives to those of the overall organization. Further, the plan must identify target markets as well as financial and market objectives. This will provide the organization and the market expansion initiative with clear direction in the U.S. marketplace.

7.2.2 Organizational Stability and Commitment

Organizational stability and commitment are critical factors for U.S. market success (Evans et al., 1992). The home operation must be stable prior to expansion. This would entail having an established and functional organizational structure, specified operating policies, procedures and systems, and formal strategies for expansion or new development. Further, there must be readily available and committed management and financial resources for a U.S. market initiative as well as senior management commitment and sense of ownership.

7.3 Spectrum's Internal Strengths

7.3.1 Market Assessment

Spectrum has an in-house team that focuses on, and conducts, market assessments. The team successfully identifies appropriate land parcels and current and possible future competitors as it assesses local demand and supply. Further, it engages third party organizations to validate its findings.

Spectrum's capabilities in this dimension are transferable to the U.S. as long as it engages third party local assessments for the validation of its findings.

7.3.2 Customer Knowledge

Spectrum's success to date has been based not only on its ability to locate appropriate development sites, but to also provide the necessary services and amenities desired by its primary buyer, seniors. It conducts extensive market research to determine what seniors value and expect, rather than assuming all seniors have the same needs. This approach is transferable to the U.S. marketplace but findings should be further validated by local market third parties.

7.3.3 Industry Experience – Seniors Housing and Development

Spectrum has knowledge and experience in seniors housing and development. Its team is made up of individuals with expertise in seniors housing design and seniors housing operations. Further, Spectrum has extensive experience with land selection, research, municipal planning and zoning procedures. The seniors housing and development requirements in Canada and the United States are similar. The skill set identified is considered transferable as long as individuals from the Canadian team are directly involved with the planning and development of the properties in the United States.

7.3.4 Management and Leadership

Spectrum's leadership is entrepreneurial based. The CEO and all senior managers encourage innovation to manage development costs and meet unique customer demands. Experimentation and flexibility are supported as long as benefits and risks have been adequately identified through due diligence. The Spectrum team is self-managing and production centred. Goals are consistently met and the team works cooperatively across departmental boundaries.

These strengths are easily transferred as long as a senior manager, or the CEO, is included as part of the U.S. development team.

7.3.5 Access to Capital

Spectrum can raise equity through its own asset base as well as from interested investors, or joint venture partners. In spite of its unfamiliarity to U.S. lenders, Spectrum will not face difficulty accessing construction financing due to its reputation in Canada and a lender's general interest in financing projects. Over time, with increasing credibility and an increase in its U.S. asset base, it will likely be able to access lower cost capital benefiting future development.

7.3.6 Alliances and Relationships

Spectrum has one relationship within the United States that will assist it in creating successful development properties. This relationship is with Chartwell's U.S. based operating entity, Horizon Bay which currently carries a strong operating reputation throughout the United States. Assuming Spectrum engages Horizon Bay as its property manager, Horizon Bay can assist Spectrum in favorably marketing its properties and managing effectively to derive expected income and appraisal values.

7.3.7 Developed Strategic Plan

U.S. entry and operation has been considered and developed on a preliminary basis. It is however not integrated in the corporate Spectrum strategic plan. In order to give substance to the U.S. opportunity, Spectrum will need to consider the information provided in this report to establish how it could effectively compete in the U.S.

7.3.8 Organizational Stability and Commitment

Spectrum is organized functionally with key department heads leading its business efforts. Activities are well coordinated and each department is properly resourced to carry out operating activities. Spectrum's small size allows it to be sensitive to its customers' needs and quick in its decision-making. All upper level management are knowledgeable in their area of direct responsibility with competencies in other functional departments. These capabilities can be transferred to the U.S. in varying degrees depending on the extent of Canadian involvement in U.S. development projects

Management has confirmed its commitment to developing properties in the United States and is prepared to commit the necessary human and financial resources to this undertaking.

7.4 Spectrum's Internal Weaknesses

7.4.1 Industry Experience - Construction

Spectrum has theoretical knowledge of the construction industry in the United States but no direct experience with it. As construction is the most costly component of project development, it must be managed appropriately to ensure the proper product is delivered, that costs are managed and timelines met.

7.4.2 Reputation

Spectrum maintains strong and positive relationships within the Canadian seniors housing community and among Canadian financial lenders. However, it is not known within the U.S. seniors housing community or as discussed, among U.S. financial lenders.

7.4.3 Access to Capital

Spectrum will likely not experience difficulty accessing capital through construction financing as discussed, however, it may have difficulty securing low cost capital. Given its newness to the U.S. market, should Spectrum undertake development activity independently, it could expect to pay interest rates of LIBOR plus 250-300 basis points and/or provide guarantees uncommonly provided by established developers. Over time, with increasing credibility and an increase in its U.S. asset base, it will likely be able to access lower cost capital benefiting future development.

7.4.4 Alliances and Relationships

Spectrum will not have initial alliances or relationships within the U.S. seniors housing or construction communities.

7.4.5 Organizational Stability

Given that Spectrum is three years old, it has matured to the point where systems and processes are now being finalized and formalized. However, there remains incomplete system integration across the organization.

7.5 Internal Assessment Summary

An investigation of seniors housing and real estate development industries within the United States identified several key organizational success factors. In order to assess Spectrum's success in expanding its operation, an internal capability assessment as it relates to the identified success factors was undertaken. Weaknesses that could challenge success and strengths that could be transferred to support success are summarized in **Table 13**.

Table 13: Internal Assessment of Spectrum's Capabilities

Strengths	Weaknesses
Market Assessment	Industry Experience – Construction
Customer Knowledge	Reputation
Industry Experience – Seniors Housing	Operational Systems and Processes
Industry Experience - Development	Construction Alliances
Leadership and Management	Lender Alliances
Management Commitment	Access to Low Cost Capital
Resource Commitment	Undefined Strategic Plan
Access to Capital	
Operational Alliances	
Preliminary Strategic Plan	

Many of Spectrum's internal strengths are transferable to the U.S. marketplace with the assistance of third party local validation and key Canadian personnel forming part of the American development team. However, there are internal weaknesses that Spectrum cannot resolve independently which without resolution, could hinder its success. Managing the strengths and overcoming the weaknesses will be discussed with the intention of providing Spectrum with a platform upon which to consider expansion into the United States in the following sections.

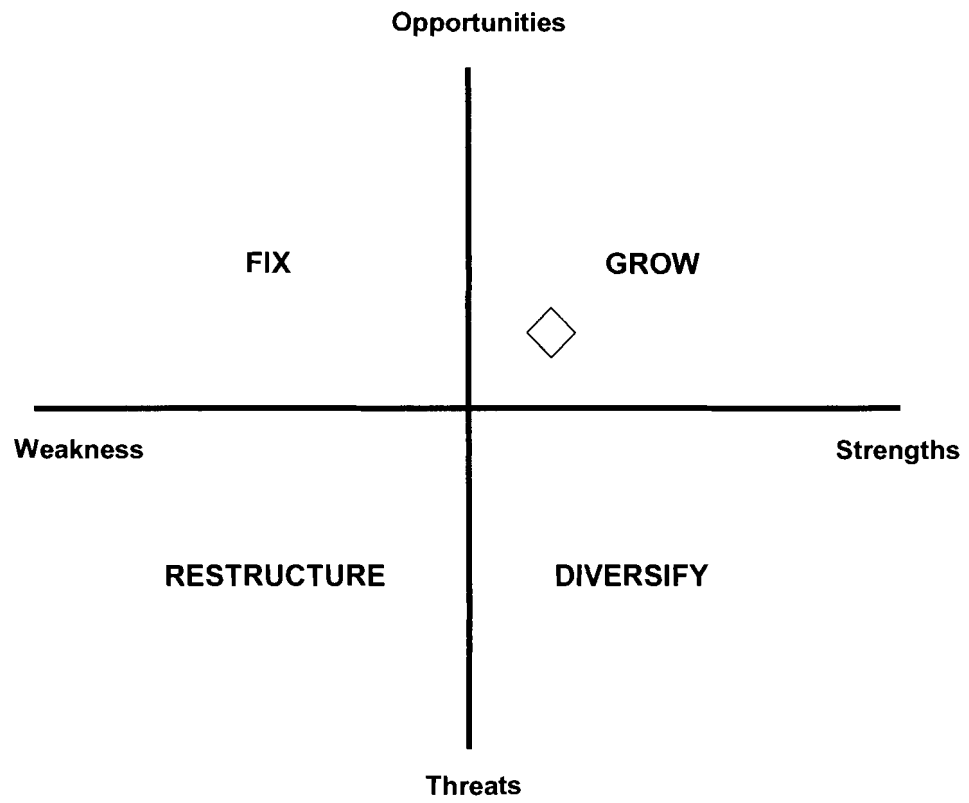
8.0 S.W.O.T SUMMARY

Figure 1 below identifies Spectrum's current operating position as it relates to its ability to enter and operate in the U.S. marketplace (Abramson, 2007). In developing the graphical representation, it was assumed that each strength, weakness, opportunity and threat identified bore equal weight in influencing Spectrum's expansion success. The summation of the variables in each category created a sense of where Spectrum's operation rests today in terms of its need to Fix, Restructure, Diversify or Grow in order to successfully enter and operate in the United States.

Based on the analyzed opportunities, threats, strengths and weakness, Spectrum's position is weighted towards Growth more so than towards Fix, Restructure and Diversify (identified by the diamond). This suggests that Spectrum could pursue entry and operation in the United States, but must consider market conditions and manage and resolve its internal weaknesses. It is evident that there is a need to first address those variables that skew Spectrum's position towards Fix and Restructure. Spectrum will need to overcome its construction industry inexperience, incomplete operational systems and undefined strategic plan; alliances, reputation and low cost capital challenges can be resolved over time as Spectrum establishes itself within the marketplace.

Many of the threats associated with the need to restructure are market driven with the exception of corporate and employee cultural considerations. Threats such as lack of labour and materials or available and affordable land cannot be overcome and instead, will need to be creatively managed through other development considerations. Cultural differences could be overcome by appreciating upfront that there may be differences between Canadian and American business practices which could impact Spectrum's ability to participate competitively.

Figure 1: Spectrum's Current Operating Position



9.0 Entry Mode Alternatives

Entering the United States marketplace for any organization is synonymous with an organizational start-up; there is little infrastructure in place, the market is somewhat unknown and there is considerable risk. As a result, the entry mode must be carefully thought out. Although there are several variables favouring and discouraging various entry modes, the central trade-off between alternatives often lies between risk and control (Arnold, 2003). Low intensity entry modes, such as those with low financial and resource commitments, minimize risk, particularly financial risk, but also minimize control. Conversely, control can be gained by higher intensity entry modes such as those with significant financial and resource contributions but carry greater risk for the entering organization.

Several entry strategies relevant to real estate development in a foreign market have been deduced from an investigation of entry strategies used by international construction firms (Chen, 2005 and Chen and Messner, 2005). These strategies are proposed for consideration as entry into the United States is considered foreign and/or international, and construction company market entry is considered to be similar to, or to share similar characteristics with real estate development company market entry. The following discusses the market entry modes available.

9.1 Available Mode Alternatives

Strategic Alliance: Strategic Alliances are long-term, intra-corporate associations without an affiliated organization, incorporated subsidiary or partnership. They are based on trust and respect used to further common interests. Firms agree to share resources, technology, profits and supplement each other's needs over long periods of time or across many projects.

The benefits of Strategic Alliances include reduced investment risks, pooled resources, protected assets, gaining of efficiencies and information, quick reaction to market changes and improved competitiveness as a result of the alliance's positioning in the marketplace of interest. This platform is used to enter a number of countries and a wide range of markets. Strategic Alliances carry mutual entry character, whereby each partner can enter the other's market under an alliance agreement. The alliance does not always undertake project execution and therefore may require a third party to build a project.

Joint Venture (JV) Project: This is a joint venture on a project by project basis also known as a consortium or contractual joint venture. It is a vehicle whereby profits and responsibilities are assigned to each party according to a contract of services provided by each and the entity exists for the sole purpose of completing a specific project. There can be many venture partners in any given project within this scenario, each contributing to the overall objective.

The entities forming the venture can structure the relationship on an integrated or non-integrated platform. Integrated structures involve staff from both organizations forming a single project team responsible for all duties and sharing equally in profits and losses. A non-integrated structure assigns each organization duties to carry out independently and assigns profits and losses according to the work completed. Each entity can remain within their respective country while conducting business together in either one's country.

The advantages of this mode of entry include quick agreement development, flexibility and mobility within the foreign market, cost saving's using host country partner infrastructure and liability limitation. The challenges faced by this entry mode include locating a partner that is progressive and compatible with the business expectation of the entrant and that has the market savvy for success. Finally, within this entry mode, there are often many partners none of which have majority control.

Joint Venture Company: A joint venture company is the combination of two legally separate entities joining legally to form a corporation or partnership. One party, the foreign partner, can be based out of its own country, while the other is located in the country where the venture is to take place. Both entities can also be based out of the same country. This venture is created for individual projects rather than multiple projects and the independent entities or partners involved within the company, are not generally prohibited from forming other joint venture companies providing there are agreed upon geographic business boundaries.

Both partners invest and engage in various decision making activities according to the venture agreement. Each also contributes equity, resources, intellectual knowledge, materials, equipment, labour and other criteria based on the partnership agreement and receives

corresponding benefits also in accordance with the partnership agreement. The entities bring complementary capabilities and resources to the partnership.

Sole Venture Subsidiary: This is the most direct entry route into a foreign country. It does not involve partners or special contractual arrangements. It is an independent venture whereby the organization sets up and operates its own entity in the foreign country.

The benefits and challenges endured by this entry are obvious upon execution. The benefits include the organization's flexibility and control in managing and protecting its own practices and interests. This assists with rapid expansion and ensuring that the most acceptable resources are in place. The challenges with a sole venture subsidiary include market unknowns and associated risks of losing one's entire investment due to inexperience within a particular marketplace. This option, although quicker to establish than a JV company, is more costly and complex to establish.

Representative Office: This entry mode is a quick and simple way of establishing a formal presence in the marketplace and becoming familiar with it. However, this entity is prohibited from engaging in direct profit-making business activities. Instead, a Representative Office could engage in research, communication, promotion, contract administration and negotiation activities on behalf of the head office in the home country. The benefits of this option include simple and flexible set-up and shut down as well as facilitating the pursuit of future business and potentially upgrading to a Branch Office or Sole Venture Subsidiary.

Branch Office: This entry mode is another elementary means of establishing a presence in a foreign country. The Branch Office allows an organization to undertake business and profit related activities. This mode can continue to utilize the supervision and support of the parent organization. The legal structure of this mode however exposes the parent company in the host country to liability should any civil charges be brought against the Branch Office.

The above modes of market entry can exist independently, co-exist, and/or convert into other modes suggesting that there is transferability and compatibility between them. This is an important consideration as entry into a foreign market may necessitate a step by step or combined entry approach, rather than a single entry mode option.

9.2 Summary of Entry Mode Alternatives

The following table summarizes the advantages and disadvantages of each of the entry modes discussed for Spectrum's consideration.

Table 14: Entry Mode Alternative Summary

Entry Mode	Advantages	Disadvantages
Strategic Alliance	<ul style="list-style-type: none"> • Long Term Affiliation • Undertake Many Projects • Reciprocal Market Entry • Share Resources and Risk • Supplement Each Other's Needs • React Quickly 	<ul style="list-style-type: none"> • No Structured/Legal Entity • Requires a Third Party for Project Implementation
Joint Venture Project	<ul style="list-style-type: none"> • Legal Entity with Limited Liability or Partnership Capability • Individual Projects Undertaken • Profits & Responsibilities are Assigned • Flexibility & Mobility in Marketplace • Cost Savings via Host Infrastructure • Simple Formation 	<ul style="list-style-type: none"> • Compatibility with Partner may be Problematic • Multiple Partners for Individual Projects
Representative Office	<ul style="list-style-type: none"> • Establish a Quick Formal Presence • Learn about the Marketplace • Simple and Flexible Entry • Easy to Close • Can Lead to other Forms of Entry 	<ul style="list-style-type: none"> • Inability to Engage in Direct Profit Making Business Activities
Joint Venture Company	<ul style="list-style-type: none"> • Investment and Decision Making is Shared • Legal Entity Formed • Shared Contribution • Complementary Capabilities 	<ul style="list-style-type: none"> • Competition Between Partners in the Marketplace – Resolved with Market Split
Branch Office	<ul style="list-style-type: none"> • Establish a Quick Formal Presence • Learn about the Marketplace • Simple and Flexible Entry • Easy to Shut Down • Can Lead to other Forms of Entry • Can Engage in Direct Profit Generating Activity 	<ul style="list-style-type: none"> • Liability Complications • No Legal Status
Sole Venture Company	<ul style="list-style-type: none"> • Complete Organizational Control and Flexibility • Expand as Quickly as Desired • Legal Status 	<ul style="list-style-type: none"> • Lengthy, Complex and Costly Set Up

10.0 ASSESSMENT OF ENTRY MODE ALTERNATIVES

This chapter assesses the foreign market entry alternatives discussed according to the key success factors identified in Chapter 9. It then evaluates the alternatives in terms of the perceived risk and level of control each poses to Spectrum upon entering and operating in the United States.

10.1 Assessment According to Key Success Factors

The key success factors for developing seniors housing properties in the United States that relate specifically to market entry are outlined below. Table 15 identifies whether or not each success factor can be achieved with the respective alternative discussed at the commencement of market entry. Developing or obtaining the success factor via entry mode described is identified with an 'X'.

Table 15: Success Factors vs. Entry Mode Alternatives

Success Factors	Description	Strategic Alliance	Joint Venture Project	Representative Office	Joint Venture Company	Branch Office	Sole Venture
Market Assessment	<ul style="list-style-type: none"> • Identify Location • Identify Demand • Identify Supply 	X	X	X	X	X	X
Customer Knowledge	<ul style="list-style-type: none"> • Identify Customer Needs & Preferences 	X	X	X	X	X	X
Industry Experience & Knowledge	<ul style="list-style-type: none"> • Construction • Development • Seniors Housing 	X	X	X	X	X	X
Leadership & Management	<ul style="list-style-type: none"> • Disciplined Leadership • Response to Change 		X		X		X
Reputation	<ul style="list-style-type: none"> • Credibility 	X	X		X		
Access to Capital	<ul style="list-style-type: none"> • Accessing Capital 	X	X		X		X
Alliances & Relationships	<ul style="list-style-type: none"> • Lender Alliances • Industry Alliances 	X	X		X		

Through each entry mode, Spectrum will be able to meet its market assessment, customer knowledge and seniors housing and development industry experience and knowledge success factor requirements. These success factors are currently within Spectrum's team core capabilities (with the caveats discussed). However, Spectrum is not able to achieve the remaining success requirements on its own, as identified with all other entry mode options.

The most appealing entry modes at this stage of evaluation are joint venture projects and joint venture companies. These options provide Spectrum with the complete set of success criteria for a strong market start assuming the partners will have organizational compatibility.

The sole venture market entry alternative meets many of the success factors required and can also be considered as a viable entry choice. However, this entry mode poses some hardship to Spectrum at the outset of market entry and general project initiation. The absence of construction experience, a solid reputation and limited, if any, lender or industry relationships, will likely slow development activities and add costs for the first couple of projects.

The remaining entry options, Representative Office, Branch Office and Strategic Alliances, are not ideal alternatives for market entry and industry start. They do not provide Spectrum with enough project leadership and management, reputation, access to capital and industry or lender alliances. The Representative Office will not be entitled to conduct profitable business and the Branch Office will not have established operating credibility. Strategic Alliances, although potentially providing a number of success factors which Spectrum on its own does not have, is a non-committal and incomplete option for a development company's general objective of executing projects.

Joint Venture Projects, Joint Venture Companies and Sole Venture Subsidiaries present reasonable entry modes for consideration. Many, if not all internal success factors can be achieved and projects delivered through these modes.

10.2 Assessment According to Risk and Level of Control

As discussed, the central trade-off between entry mode alternatives lies between risk and control. For the purposes of this project, risk is defined as the possibility of suffering harm or loss; the greater the risk, the greater the likelihood an investment could be lost. Control is defined as

being able to direct or influence decisions at minimum, 50% of the time. The following table identifies the risk and control Spectrum can expect to assume in carrying out development activities in the United States via entry modes described.

Table 16: Risk and Control with Entry Mode Alternatives

	Strategic Alliance	Joint Venture Project	Representative Office	Joint Venture Company**	Branch Office	Sole Venture
Risk	Shared* or Increased	Shared or Reduced	None	Shared	Increased	Increased
Project Control	Shared or Reduced	Shared or Reduced	None	Shared	Increased	Increased

* Assumes 50%

** Assumes a 50/50 partnership.

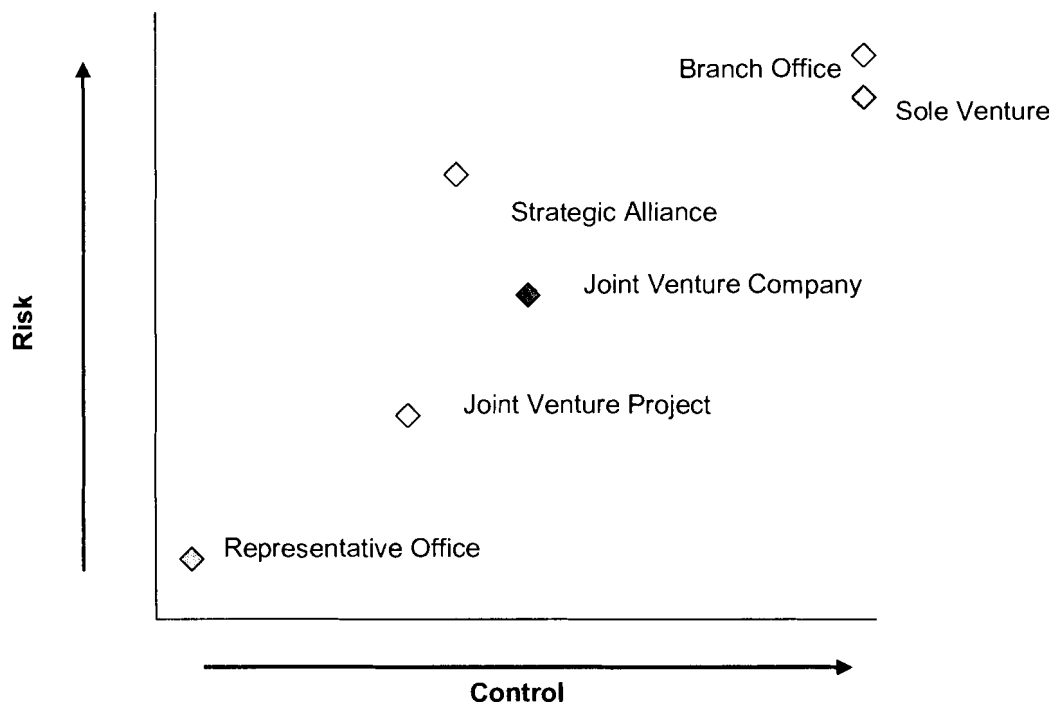
The level of risk and control Spectrum can expect to assume in entering the United States naturally varies by mode. Strategic Alliances offer shared or increased risk and shared or decreased control, as they are non-committal and informal relationships that may require others to execute. The financial and resource commitment could be lost by a third party charged with executing the project as could control of the project. The Joint Venture Project involves at least two partners who only have control over the services they provide and are exposed to the risk related to their service contribution. Generally, there would be many partners and control would be minority. Entering the United States as a majority project partner is, however, subject to the challenges discussed later with respect to sole venture activity. The manner in which control and risk is divided within a Joint Venture Project initiative varies, and as in most cases involving a foreign market, Spectrum, would assume less than 50%. A Representative Office carries no risk or control as it is not undertaking business activity. The Branch Office does undertake business activity, providing it with 100% control while simultaneously exposing Spectrum's home operation to 100% of the risk due to its non-liable nature. The Joint Venture Company provides Spectrum with 50% of the risk and control and assumes a complementary character with its venture partner where profits, decisions and losses are equally shared. The Sole Venture option provides

Spectrum with the greatest amount of control as it would enter the United States as an independent entity managing its own business practices. The Sole Venture option, however, presents Spectrum with considerable risk compared to all other entry modes, with the exception of the Branch Office, as it is deficient in experience, reputation and alliances described earlier.

It may be helpful compare the risk and control associated with each entry mode visually.

Figure 2 below reasonably places each entry mode on a risk/control scale (Arnold, 2003).

Figure 2: Graphical Representations of Entry Mode Risk and Control



In evaluating the risk and control dilemma, the joint venture company appears to offer a level of comfort valuable to an organization entering a market it is not entirely familiar with. The risks are shared to minimize investment loss, and there is opportunity to gain knowledge from which to draw when undertaking projects independently.

11.0 ENTRY MODE RECOMMENDATIONS

Based on information presented in Chapter 11 and 12, the following conclusions and recommendations are drawn with respect to the most appropriate entry strategy Spectrum could explore in expanding its operation in to the seniors housing marketplace in the United States.

11.1 Recommended Entry Mode

Three of the six entry modes discussed are not considered appropriate for Spectrum's U.S. development intentions. Although a Strategic Alliance could provide most of the key success factors currently deficient in Spectrum, it does not necessarily offer Spectrum the commitment to execute projects in the United States, as it may require the engagement of a third party to do so. The introduction of a third party reduces control and increases risk as a result of diminished control. Regardless of the inability to complement deficient success factors, the Representative Office although beneficial in increasing market presence, cannot conduct business activity and would therefore act merely as unnecessary overhead to Spectrum operations. Finally, the Branch Office, although able to conduct business activity, is deficient in offering some of the necessary success factors and exposes Spectrum's home operation to the liability associated from civil charges. This represents a greater risk than with any other modes discussed as the others would insulate the home operation from liability.

The Joint Venture Project entry mode is not necessarily the most ideal entry alternative but could be considered a secondary entry option. This mode of entry, assuming that a compatible partner(s) is engaged, could overcome Spectrum's internal weaknesses, but limits its ability to control activities and make decisions. This is because partners are merely contributing project services as opposed to equity.

Even though it presents a high level of risk, the Sole Venture Option is a reasonable entry mode because it provides Spectrum with the greatest amount of control over its development intentions. Spectrum would be able to control its management and project processes similarly to that of its Canadian operation. Its internal weaknesses however, would introduce significant risk namely those associated with construction inexperience, an un-established reputation and limited

alliances which it would be insurmountable in the short term. Spectrum may consider the increased amount of control however enough to compensate for the created risk however.

The creation of a Joint Venture Company for individual projects is an attractive U.S. entry strategy for Spectrum. The partner best suited would be one with construction experience and existing professional, labour, material and lender relationships or alliances enabling it to carry out development projects within established time frames and at affordable prices. This option provides Spectrum with balanced risk and control in as much as its investment is equal to that of its partner. The partner in this case can also provide the internal success factors Spectrum is lacking and allowing Spectrum to benefit and/or learn from the partner in terms of developing credibility, establishing industry relationships and experiencing first hand U.S. construction activity.

As previously noted, some entry modes can exist independently, co-exist or lead into one another. Based on the consideration of all relevant issues, Spectrum's entry into the market should be in the form of a Sole Venture and a Joint Venture partner formation. Through this entry mode mix, Spectrum can achieve the greatest amount of control possible for a company inexperienced in a foreign marketplace while benefiting from shared risk. By establishing a sole venture, it can establish its reputation on the coat tails of its joint venture partner which can offer shared risk, construction intelligence and alliance formation. It can maintain control of its own systems and business practices while engaging in several joint venture partnerships, eventually leading to undertaking independent development activity once the necessary success factors are acquired. Fortunately, this co-existence is familiar to Spectrum as it participates on the same operating platform in Canada.

11.2 Additional Considerations for Marketplace Entry

Regardless of which entry mode Spectrum decides to undertake, there are five considerations which will support and sustain Spectrum's organizational success and objectives in the United States. These considerations, identified next, should be met with seriousness and commitment.

1. Spectrum should focus efforts on seeking development locations where there are manageable development cost charges and where residential builders are dumping land inventories to locate not only attractive sites, but affordable sites.
2. Spectrum should consider engaging Horizon Bay as is property operator or focus on hiring an operator experienced in efficient operations and effective in marketing to seniors and their adult children. There will be a need to ensure that services provided are appropriate and that they offer value greater than that provided by market substitutes. Marketing messages will need to encourage independence and demystify the perceptions of seniors housing in order to overcome traditional thoughts of institutional living.
3. Spectrum should enhance its in-house development team with staff experienced with the nuances of the U.S. seniors development industry. This would include individuals familiar and experienced with the overall marketplace, customers and construction industry.
4. Spectrum should resolve the weaknesses of its operating systems, processes, and corporate strategic plan. Operating systems and processes should be complete and well integrated throughout the organization prior to U.S. entry. The strategic corporate business plan should have well defined and focused objectives identifying the importance of the U.S. initiative among others within the organization.
5. Spectrum should consider further investigating and learning about the possible difference in business cultures in real estate development between Canadian and American organizations. By appreciating and accepting any differences and similarities, Spectrum can remain or become competitive.

12.0 MARKET ENTRY IMPLEMENTATION CONSIDERATIONS AND PROFITS

Chapter 14 addresses the implementation of the entry plan into the United States considering key growth markets, timing of market entry, the identification of joint venture partners, annual anticipated operating expenses, scale of market entry, equity investment, anticipated development profits, and a base of operations.

12.1 Key Growth Markets - Geographic Focus

As described in Table 3, 6.24% of the American population is aged 75 years and older. The point of determining key growth markets was to identify locations where the average age of those 75+ was greater than that of the general American population 75+, in addition to locations where available occupancy statistics suggest an existing demand.

Fifty states were analyzed according to their percentage of seniors 75 and older. In Florida, West Virginia and Hawaii, 8% of the state population is 75+. While in Maine, Montana, North and South Dakota, Pennsylvania, Rhode Island and Wisconsin 7% of their population base is 75+ (Kaiser, 2005). These states present starting points for investigating demand and shortage of supply for Independent and Assisted Living housing.

Several U.S. States have undergone detailed market analysis to identify seniors housing development potential, focusing on occupancies (Bissell, 2007). States with development potential consider local property occupancy statistics greater than 90% and income levels greater than \$25,000. States identified with potential include: Massachusetts, Illinois, Texas, Colorado, Michigan, Florida, California, New York and Arizona. Analysis of the data identified twelve cities with significantly strong occupancies. These cities are identified in **Table 17** below.

Table 17: U.S. Cities with Strong Independent and Assisted Living Occupancies

Location	Independent Living	Assisted Living
Boston	98.9%	97.9%
Chicago	93.9%	91.7%
Dallas	92.7%	95.1%
Denver	97.7%	100.0%
Detroit	96.3%	93.3%
Houston	97.0%	97.4%
Los Angeles	95.4%	94.7%
Miami	95.0%	94.3%
New York	97.0%	96.4%
Phoenix	96.4%	96.1%
San Francisco	98.2%	97.9%
Tampa	97.7%	96.1%

Occupancies in the cities identified in Table 17 are strong, as evidenced by percentages of no less than 91.7%. This suggests that there is a demand for both Independent and Assisted Living housing in certain locations throughout the U.S.

Additional market studies, undertaken in 2007, identified another six cities with unmet Independent and Assisted Living demand. These cities include: Atlanta, Minneapolis, Orlando, Riverside, Seattle and Washington (Integra Realty Resources, 2007).

A number of U.S. market studies identify potential development locations which can assist Spectrum in selecting markets to enter. Spectrum should focus its development program in markets where it can achieve the greatest profits, rather than attempt to localize developments which present marginal profits.

12.2 Market Entry Timing

Chapter 6 describes the local and national competitors Spectrum can expect to face throughout the United States. The baby boom and associated aging population phenomenon is known in the United States as other developers are developing Independent and Assisted Living housing in the marketplace. Further, as seniors housing is becomes the nations fastest growing industry sector and the sixth major commercial real estate asset class, interest is stirring among others. Spectrum should consider entering the marketplace as soon as possible as other developers seek appropriate and affordable land with similar intention. The demand varies with location and is often satisfied once, meaning that seniors do not often move even if a new facility

is developed. Within all communities, Spectrum should strive for a first mover advantage to assume available demand before rivals do.

12.3 Identifying Joint Venture Partners

Spectrum can identify joint venture partners for development activity through two avenues. First, it can approach Chartwell's U.S. management affiliate, Horizon Bay for insight regarding reputable development entities, as well as its Canadian partners who may have existing relationships or connections in the United States marketplace. Second, Spectrum can research development entities and make initial contact on its own. The next stage of joint venture partner interview would involve visiting the development sites potential partners developed and assessing the overall quality of the final product. Subsequent credibility investigation can occur once Spectrum is confident that the initial criteria are met and that there is compatibility between themselves and the potential partner. Spectrum should locate joint venture partners throughout the United States, so that it can tap into the most lucrative markets with local partners who can manage and oversee local construction activity.

12.4 Spectrum Operating Expenses

With the Joint Venture Company entry mode approach, Spectrum will need to establish an operating base and employ professionals to carry out its intended development activities. The number and type of employees to be hired is dependent on the scope of responsibilities Spectrum undertakes as part of its partnership arrangement. Generally, Spectrum would be responsible for organizing financing and general project accounting activities. Together, Spectrum and its partner would undertake municipal planning and design activities. The joint venture partner would manage the construction aspect of the project.

Spectrum would require a small team to undertake its partnership responsibilities and to align with the Scale of Entry discussed in Section 14.5. It should consider employing an executive level manager such as the Chief Executive Officer or President of Development from the Canadian office, two project managers (one local to the U.S. and one from the Canadian office), two administrative employees and one accountant. **Table 18** below identifies the

corporate expenses Spectrum is likely to assume in the first 5 years of operation in the United States starting in 2008.

Table 18: Projected Spectrum Operating Expenses

		Year 1 (2008)	Year 2 (2009)	Year 3 (2010)	Year 4 (2011)	Year 5 (2012)
Start Up		\$ 55,000	\$ -	\$ -	\$ -	\$ -
General	Office Lease	\$ 36,000	\$ 36,000	\$ 36,000	\$ 36,000	\$ 36,000
	Communication	\$ 7,500	\$ 7,725	\$ 7,957	\$ 8,195	\$ 8,441
	Equip. Lease	\$ 5,000	\$ 5,150	\$ 5,305	\$ 5,464	\$ 5,628
	Supplies	\$ 2,200	\$ 2,266	\$ 2,334	\$ 2,404	\$ 2,476
	Insurance	\$ 3,600	\$ 3,708	\$ 3,819	\$ 3,934	\$ 4,052
	Miscellaneous	\$ 4,000	\$ 4,120	\$ 4,244	\$ 4,371	\$ 4,502
		\$ 113,300	\$ 58,969	\$ 59,658	\$ 60,368	\$ 61,099
Salaries		\$ 450,000	\$ 463,500	\$ 557,405	\$ 574,127	\$ 671,351
Benefits		\$ 90,000	\$ 92,700	\$ 111,481	\$ 114,825	\$ 134,270
		\$ 540,000	\$ 556,200	\$ 668,886	\$ 688,953	\$ 805,621
Total Operating Expenses		\$ 653,300	\$ 615,169	\$ 728,544	\$ 749,320	\$ 866,720

Three assumptions underly the expenses presented above. First, operating costs are expected to increase by 3% annually accounting for inflation. Second, start-up costs are a one time expenditure necessary for establishing an operation and include furniture, communications systems, security etc. Third, in year 3 and 5, additional project managers are hired to undertake more development projects. All values above and next are in U.S. dollars.

12.5 Scale of Market Entry

For the purposes of reducing risk, ensuring efficiency, maximizing investment and establishing an industry presence, Spectrum could consider beginning its development program with 10 projects in the key markets identified. One project manager can effectively manage five projects with the aid of a part time development assistant; fewer projects lead to an inefficient use of time and resources, whereas more projects can become overwhelming compromising deliverables. Further, the expenditure associated with employing an additional project manager for another five projects is minimal compared to the potential gain in profits associated with undertaking ten projects. In order for Spectrum to eventually become an independent developer,

it will need to establish a presence in the marketplace and can do so with a greater number of projects in development.

12.6 Equity Requirement

The equity required for undertaking ten projects is derived according to the following assumptions for all ten projects.

- Building size will be approximately 140,000 sq.ft. and include 120 units with a market prescribed one and two bedroom mix;
- The cost of construction is \$140.00 per sq.ft.;
- Land cost will be \$3,000,000;
- Total project cost will be \$24,000,000 (rounded up); and
- Spectrum's equity requirement will be 7.5% of total project cost under a joint venture scenario.

Table 19 identifies Spectrum's total annual project equity requirement. After year two, it is expected that Spectrum will undertake five additional projects for a total of 15 in year three and four, and 20 projects in years 5 and 6 at a rate of one project manager for every five projects.

Table 19: Spectrum's Equity Responsibilities 2008-2013

('000s)	Year 1 (2008)	Year 2 (2009)	Year 3 (2010)	Year 4 (2011)	Year 5 (2012)	Year 6 (2013)
# of Projects	10	10	15	15	20	20
Equity Required	\$ 18,000	\$ 18,000	\$ 27,000	\$ 27,000	\$ 36,000	\$ 36,000

12.7 Spectrum Annual Investment

Given the projected operating expenses and likely equity requirements for undertaking development activities presented, Spectrum will need to obtain and allocate the following amount of money to its U.S. initiative for the years 2008 to 2013.

Table 20: Spectrum Annual Investment

('000)	Year 1 (2008)	Year 2 (2009)	Year 3 (2010)	Year 4 (2011)	Year 5 (2012)	Year 6 (2013)
Equity Required	\$ 18,000	\$ 18,000	\$ 27,000	\$ 27,000	\$ 36,000	\$ 36,000
Operating Exp.	\$ 653	\$ 615	\$ 729	\$ 749	\$ 867	\$ 904
	\$ 18,653	\$ 18,615	\$ 27,729	\$ 27,749	\$ 36,867	\$ 36,904

12.8 Anticipated Development Profit and Returns

The timeline anticipated for Spectrum's development projects is expected to be 4.25 years. Activities during this period are allocated accordingly: 1 year for land purchase, municipal planning and design, 1.5 years for construction, 1.5 years for lease up, and 3 months for operating stabilization and subsequent property sale. Given this timing, Spectrum can expect to realize profits in year 4 (2011).

The profit Spectrum can expect to earn through its development activity in the United States is identified in **Table 21** below. These values have been derived from the following assumptions grounded in the information presented thus far, with some additional clarification. The assumptions include:

- Each development project consists of an average of 120 units;
- Each development project is expected to have a total project cost of \$24M;
- Average rental rate per project suite is \$3750/month;
- Net operating income (**NOI**) is 45% of property revenues;
- The cap rate applied to the property NOI is 7.5% to establish its appraised value;
- Spectrum's pre-tax profit is 50% of the total profit as it is an equal joint venture partner;
- A corporate tax rate of 40% is applied to Spectrum's pre-tax profit to determine after tax profit; and
- Profits are expected to remain within the United States.

The values in Table 21 below represent combined values of the total number of projects completed estimated for each year starting in 2008. For clarity, the values in year 4 represent the sale of the 10 development properties initiated in year 1 (2008) and the values of year 5 reflect the number of development projects initiated in year 2 (10 projects).

Table 21: Spectrum U.S. Project Profits

	Year 4 (2011)	Year 5 (2012)	Year 6 (2013)	Year 7 (2014)	Year 8 (2015)	Year 9 (2016)
(,000)						
Property Revenue	\$ 54,000	\$ 54,000	\$ 81,000	\$ 81,000	\$ 108,000	\$ 108,000
Net Operating Income	\$ 24,300	\$ 24,300	\$ 36,450	\$ 36,450	\$ 48,600	\$ 48,600
Appraised Values	\$ 324,000	\$ 324,000	\$ 486,000	\$ 486,000	\$ 648,000	\$ 648,000
Total Project Cost	\$ 240,000	\$ 240,000	\$ 360,000	\$ 360,000	\$ 480,000	\$ 480,000
Total Project Profit	\$ 84,000	\$ 84,000	\$ 126,000	\$ 126,000	\$ 168,000	\$ 168,000
Spectrum's Profit	\$ 42,000	\$ 42,000	\$ 63,000	\$ 63,000	\$ 84,000	\$ 84,000
Equity Invested	\$ 18,000	\$ 18,000	\$ 27,000	\$ 27,000	\$ 36,000	\$ 36,000
Spectrum's Total Profit	\$ 24,000	\$ 24,000	\$ 36,000	\$ 36,000	\$ 48,000	\$ 48,000
Profit After Tax	\$ 14,400	\$ 14,400	\$ 21,600	\$ 21,600	\$ 28,800	\$ 28,800

Spectrum's return on its equity invested after tax is 80%.

The end values will be most influenced by the various market conditions discussed throughout this report namely changing cap rates and costs of construction.

12.9 Base of Operation

Given that there are opportunities across the United States, Spectrum should consider establishing a centralized office to facilitate ease of travel by project managers. Direct air travel to various locations will save time and increase organizational efficiency; a location with international airport status is preferable. Spectrum could consider Texas and Colorado as possible operating hubs, specifically Dallas, Austin or Denver.

13.0 CONCLUSION

The purpose of this project was to investigate the U.S. seniors housing market for development opportunities on behalf of Spectrum Seniors Housing, as its development opportunities in Western Canada are diminishing. A macro and micro analysis of the United States marketplace, as well as an assessment of Spectrum's internal capabilities, was completed. Based on the information collected, it was determined that Spectrum is in a growth position and should consider entering the United States to develop its Independent and Assisted Living product.

Spectrum's entry into the United States should follow its current Canadian operating model of both sole venture and joint venture company status. This scenario presents Spectrum with an element of shared risk within a market it is not overly familiar with while also providing a position of development control from which to make decisions and influence outcomes. Spectrum has internal weaknesses which it must overcome prior to market entry and it will need to establish key organizational success factors over time, such that future development projects can be handled as sole venture initiatives.

There are several locations Spectrum can consider for immediate development activity. These locations are throughout the United States and will vary in profitability. Spectrum should consider starting its development program with 10 projects in high demand areas where profits are greatest. The timing of its entry should be in the near future in order to absorb demand in key growth areas.

The information presented describes current conditions and is subject namely to changing economic conditions. As Spectrum continues to consider development activity in the United States, it should anticipate that conditions can change in the time that it takes to design, build and lease-up a property. Although these conditions are not necessarily different from those in Canada, a foreign market initiative is subject to additional risk and forecasting will help to develop realistic timelines and budgets for planning and risk mitigation purposes.

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Appendix A: U.S. Seniors Housing Property Managers

<u>Building Managers/Operators</u>
Brookdale Living Communities
Sunrise Senior Living
Holiday Retirement
Professional Community Management
Life Care Services
Erickson Retirement Communities
Sunwest Management
Emeritus Assisted Living
Atria Senior Living Group
Five Star Quality Care
Horizon Bay Senior Communities
Merrill Gardens
Assisted Living Concepts
Capital Senior Living
Evangelical Lutheran Good Samaritan Society
Senior Lifestyle Corporation
ACTS Retirement-Life Communities
Summerville Senior Living
Leisure Care
Classic Residence by Hyatt
Brightview Senior Living
Presbyterian Homes and Services
USA Properties Fund
Century Park Associates
Covenant Retirement Communities