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MARKETS

Property Deal Banks on Health-Care Spending

NorthStar Will Buy a Property Company That Stands to Benefit From Policy and Demographic Changes

By ROBBIE WHELAN

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Evergreen & Wellspring retirement community in Cincinnati is part of a portfolio of health-care-related properties NorthStar bought. *American Healthcare Investors*

In early May, David Hamamoto surprised analysts on a conference call with his declaration that his company, NorthStar Realty Finance Corp. , wasn't interested in acquiring a large real-estate company it had pursued for months.

Tuesday morning, NorthStar switched course, announcing it would buy the company, Griffin-American Healthcare REIT II, in a cash-and-stock deal that values the company at $4 billion, including about $600 million in debt.

The deal is one of the biggest the health-care real-estate sector has seen in years.

What changed since Mr. Hamamoto, NorthStar's chief executive, pronounced the deal dead? Price. In early May, during the final stages of a bidding war, the price of Griffin-American had risen to roughly $4.26 billion, including debt, according to people familiar with the negotiations. That was too rich for NorthStar.

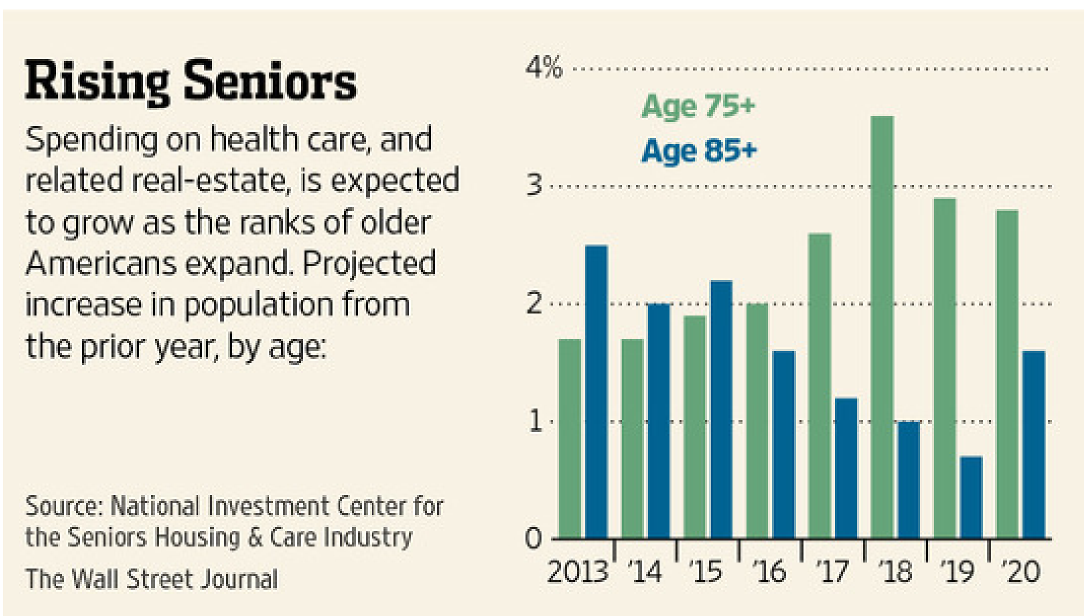
"I said…that we weren't going to buy the portfolio. That was true at the time, given what we were led to believe the pricing was going to be," said Mr. Hamamoto on a Tuesday conference call discussing the deal with analysts. "As things evolved and the process changed, the factors lined up in our favor."

The price of the deal fell because a company controlled by prolific deal maker Nicholas Schorsch, which had emerged as the top bidder, dropped out, paving the way for Mr. Hamamoto to come back with a lesser bid.

Mr. Schorsch's company, American Realty Capital Healthcare Trust Inc., had offered $12.50 a share for Griffin-American, which works out to $3.66 billion, not including the assumption of Griffin-American's debt, according to people briefed on the terms of the deal. By late May, the company had entered into exclusive negotiations with Griffin-American's independent board.

But in June, Ventas Inc., a giant health-care REIT that also at one point had been in the running to buy Griffin-American, swept in and bought Mr. Schorsch's company for $2.6 billion in stock, leaving Griffin-American suddenly without any suitors.

The Griffin-American portfolio was put back out for sale, and, by early July, NorthStar had entered exclusive talks to buy the company. Mr. Schorsch, the executive chairman of ARC Healthcare, didn't return phone calls seeking comment.



Griffin-American, which began life in 2009 as Grubb & Ellis Healthcare REIT II Inc., owns a 295-property portfolio of senior housing, hospitals, nursing facilities and medical office buildings in North America and the U.K. The company is structured as a nontraded real-estate investment trust, meaning it is publicly owned but its shares aren't listed on a stock exchange.

The deal comes amid a broader consolidation in the health-care-real-estate industry. As interest rates have remained low and the economy has begun to recover since the downturn, commercial real-estate values have risen across most asset types, shrinking the yields investors can earn on property investments.

But there still are yields to be had in health-care properties: According to Green Street Advisors, the average capitalization rate, or cap rate, on health-care properties—a common measure of yield used in the commercial real-estate industry—fell to 6.82%. That is down from 7.18% a year earlier and from 9.69% five years ago, when commercial-real-estate prices were reeling from the financial crisis. But the cap rate on health-care real-estate still is roughly 1.5 percentage points higher than that of apartment buildings or office towers. Falling cap rates indicate values are rising.

Investors have taken notice, and many have migrated from investments in retail, residential and office properties, where yields are lower, into buying properties that are seen as more risky, such as health-care facilities, because they offer higher yields.

"There's an increasing institutionalization of health-care properties," said Daniel Bernstein, an analyst who follows health-care REITs for Stifel Nicolaus & Co. "It's an asset class that wasn't as widely invested in five or 10 years ago, because there wasn't a lot of data on it, not a lot of comparisons. But they've been very stable through the recession, and they've seen benefits from demographics and health-care reform."

NorthStar was co-founded by Mr. Hamamoto, a former Goldman Sachs Group Inc. general partner who co-headed the bank's real-estate-principal investment business, in 2003.

NorthStar initially focused primarily on real-estate debt, making loans on commercial and multifamily properties, investing in real-estate-related debt securities and buying some properties leased to single corporate tenants. Over time, the company invested more in health-care-related properties, and it began to focus more on buying property portfolios.

"We consciously made a decision three years ago to focus on equity real-estate investing," Mr. Hamamoto said in Tuesday's call. "Equity investments are less cyclical than the debt business."

NorthStar executives and spokesmen didn't return calls or emails seeking further comment Tuesday.

With the Griffin-American transaction, NorthStar's real-estate assets are expected to rise from $6.2 billion to $10.2 billion, and the company indicated Tuesday it plans more acquisitions.

Investors are also interested in buying health-care properties including hospitals, clinics, senior- and assisted-living properties and nursing centers, for a number of reasons. An aging population and broader access to medical care, because of the recent health-insurance overhaul, have increased demand for these types of facilities. The National Investment Center for the Seniors Housing & Care Industry estimates the number of individuals 75 years old and above will grow from 19.8 million in 2014 to 23.2 million in 2020, while the number of Americans 85 and older is predicted to grow from 6.2 million to 6.7 million.

Write to Robbie Whelan at robbie.whelan@wsj.com