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Senior Living

Tapping Senior Living Equity in a High-Value Market

A combination of low interest rates, increasing occupancy, and stable cash flows have created a favorable environment in the long-term care industry. Many regional and national operators are aggressively bidding up the values of nursing home and assisted living properties in their quest to achieve scale through growth by acquisition. Higher property values have created considerable “paper equity” for existing owners that can be monetized through sale, or alternatively through the use of financial leverage by borrowing against these higher values.

This spring, Lancaster Pollard introduced the **EquityTap** loan program, which allows the extraction of facility equity through higher-than-typical loan-to-values, while providing pricing at levels more consistent with lower leveraged loans. How is this done? The program takes advantage of the highly efficient securitization and institutional investor markets, which have become increasingly comfortable with the credit characteristics of long-term care properties. Historically, institutional investors have avoided long-term care properties due to their higher operational intensity and exposure to government payor and regulatory bodies, characteristics not possessed by the more traditional real estate investment classes.

The same stability that has driven long-term care property values higher in recent years has helped shift thinking on this industry sector. However, what is truly making the **EquityTap** program possible is Lancaster Pollard’s willing-



ness to hold a “first loss” position equal to 15 to 20 percent of each loan underwritten within this program. While this bifurcation of the loan is not visible to the borrower, whose loan documents reflect a single loan and loan payment, the retention of what amounts to a subordinate loan position by Lancaster Pollard effectively “credit-enhances” the loan, substantially increasing the security to the institutional investors who buy the loans.

Lancaster Pollard’s comfort level in holding this higher-risk “first loss” position is driven by its uninterrupted 20-year experience in underwriting long-term care and senior living debt.

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“The past twenty years have seen considerable change in the competitive landscape, in the reimbursement and regulatory environment, and in the delivery of long-term care services,” Brian Pollard, Managing Director of Lancaster Pollard, said. “While the highly dynamic characteristics of this sector will continue well into the future, we recognize that proactive and highly competent management focused on resident care seem to weather the challenges nicely. It is largely about management to us, and a demonstrated history of successful operations while delivering quality care is a key component of our underwriting.”

In crafting the program, Lancaster Pollard also recognized the importance of a non-recourse loan structure that would eliminate the need for personal guarantees by the ownership. “At a minimum, guarantees can be a nuisance that impact personal credit and borrowing capacity, and in the worse case, can substantially impact wealth that may have accumulated outside the business,” Pollard said. “If a borrower were choosing to extract their facility’s equity by either sale or financial leverage, the leverage option would have to be a non-recourse structure to put the two options on the same plane. We felt the ability to pull equity out of the facility on a non-recourse basis while retaining the potential upside of continued ownership would have considerable appeal.”

Additional key features of the **EquityTap** program include:

- Loan-to-value ratio of up to 85 percent
- Unrestricted equity extraction
- Flexible loan terms
- Up to 30-year loan amortization

EquityTap can also be used to increase the debt on a property as a bridge to eventual refinancing through HUD programs, which continue to produce the lowest borrowing cost available to long-term care facility owners. HUD programs allow high leverage that can be comparable to the **EquityTap** program, but HUD limits the new loan amount to the cost of refinancing existing indebtedness. Therefore, facilities that have little debt in relationship to their value will have their HUD loan limited by the cost to refinance. **EquityTap** will allow the facility’s debt to be properly leveraged and seasoned prior to application to HUD.

EquityTap is available only for the refinancing or acquisition of stabilized long-term care facilities, and it is only one financial tool that can be considered for strategic financial structuring. Choosing the most appropriate financial structure first requires having access to various financial options, whether they be federally- or commercially-enhanced or traditional. Owners and operators should evaluate every financial decision in the context of its long and short-term impact on their properties.

