IN THIS ISSUE
The entrance-fee CCRC sector has been written off about as many times as the skilled nursing sector has, but neither is going away and both are experiencing significant acquisition demand. In the CCRC world, Erickson Living has set its sights on one of the top CCRCs in the country, but one that has defaulted on its debt. Erickson has purchased that debt and hopes to gain control of the operations as soon as possible, but there may be a fight.

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Slowdown For Health Care REITs
Billion-dollar transactions were expected from the health care REITs this year, but with interest rates rising and REIT share prices plummeting, the big acquisitions will be harder to finance. But don’t count them out yet. The REIT population is growing, and deal volume is heavy. Just not for a billion dollars.

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IS THERE TROUBLE IN CCRC LAND?
Not If You Are Erickson Living Leading The Way

Who can forget when Craig Anderson and his SHP Senior Living Services purchased the Devonshire at PGA National CCRC in Palm Beach Gardens, Florida in the summer of 2007? At the time, it was a premier CCRC that was built in 1999 with 327 independent living units, 17 assisted living units, 19 Alzheimer’s units and a 60-bed skilled nursing center. Entrance fees ranged from $222,000 to $687,000, and occupancy was close to 97%. The purchase price was never fully disclosed, but we reported at the time that it was between $160 million and $175 million, or between $380,000 and $410,000 per unit/bed. It remains the highest priced asset ever sold in the seniors housing market, and it was quite the coup for Mr. Anderson.

The problem was the debt, which totaled more than the purchase price. The former Merrill Lynch Capital Healthcare Finance provided $155.2 million in a senior term loan, a $6.1 million senior revolver and a $19.6 mezzanine loan. The debt problem was compounded by perhaps the worst timing in seniors housing acquisition history. Within 18 months, the Great Recession was in full swing, and Florida housing values suffered more than in most states. It was a premier asset in a premier location with a premier slowdown for health care REITs

Three years ago, the health care REITs were changing the face of the seniors housing and care M&A market, with other grumpy buyers fearing they would be priced out of the market forever because of the unusually low cost of capital, especially for the Big Three REITs. Multi-billion dollar deals were rumored, no public company was safe from an acquisition by the REITs, everyone was scratching out numbers to see who was next (including us). And then interest rates started to rise, ...continued on page 1

SLOWDOWN FOR HEALTH CARE REITs
Share Prices Tank, Interest Rates Rise: A Game-Changer?

Health care REITs have had a great run for the past several years, and their investors have had an even better run during the past 18 months, at least until this past May. After hitting 52-week highs across the board in early May, the average REIT share price has tumbled by 27%, with a range between 23% and 32%. August was particularly brutal, with all health care REITs dropping and four by double digit percentages.

...continued on page 24
value, but then things began to unravel for Mr. Anderson when units could not be resold, debt payments were due and creditors came knocking.

While we are not sure how many owners of the various pieces of the debt there have been since 2007, we have to believe the debt is now in the hands of the final owner, an affiliate of Erickson Living. The three main pieces of the debt include the A piece with a current principal balance of $75.0 million, the B piece with a balance of 40.0 million and the C piece with a balance of $46.62 million, according to recent court documents. Although no one will confirm anything, we believe that the debt was purchased by Erickson at an approximately 50% discount to the face value, or somewhere in the neighborhood of $80 million, which seems to be a good deal.

Why the big discount on such a premier asset? Three reasons. First, the borrower has not made a payment in a few years, so the current return on that $80 million investment is a fat goose egg. Second, despite foreclosure proceedings, Mr. Anderson is not leaving, and it is unclear how long it will take to get him out of the building, and how much it will cost. Third, occupancy has plunged from the 97% mark six years ago to below 80%, and, while the Florida housing market has improved, the bad press and lawsuits can’t provide a lot of comfort to prospective residents plopping down a sizable entrance fee. One would think that the holder of the debt would be in the driver’s seat, but in Florida with CCRCs, the state is usually more concerned about the well-being of the residents and not the creditors. And why should Mr. Anderson leave while the cash flow from the CCRC is presumably funding his legal bills?

Mr. Anderson is a survivor, and we would never have predicted that he would win his legal battle with CalPERS, which began in 2008 but flared up in mid-2012. Readers may remember that the giant pension fund was trying to recoup some funds from Mr. Anderson related to three retirement communities in Florida, purchased in a joint venture between CalPERS and Anderson in 2003 (see our June 2012 issue for the details). We recently learned that Mr. Anderson received a total of approximately $70 million from CalPERS, including about $8 million for legal fees, as a settlement payment. Nothing like a win against the huge pension fund to bolster his confidence.
The Providers

<table>
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<tr>
<th>Company</th>
<th>Ticker</th>
<th>Current Price 8/30/13</th>
<th>Adjusted P/E Ratio&lt;sup&gt;(1)&lt;/sup&gt;</th>
<th>% Change from Prior Month</th>
<th>% Change from 1/1/13</th>
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<sup>(1)</sup> Adjusted P/E = (market cap + total debt + capitalized leases - cash)/annualized EBITDAR based on the most recent quarter. The rate used to capitalize the leases is 10.0%.<sup>(2)</sup> The company changed its name from Advocat in March 2013.

and put a smile on his face, not to mention a large amount of cash to keep him going indefinitely, if that is what he wants.

So, what is Erickson and its financial backers going to do? Obviously, they are not going to spill the beans to the press. However, it is also obvious that, as the holders of the debt, they have a claim to the assets secured by that debt and the borrower is certainly in default. Could Mr. Anderson take his “winnings” from the CalPERS battle and use them to fend off Erickson or make a significant debt repayment and provide a return on that $80 million investment? Perhaps, but Erickson is not in it for a short-term gain, and they know that eventually they will gain control of the CCRC, which has been their only interest from the beginning. It’s just a question of when it will happen and how much it will cost. It is not rocket science, and both sides can probably do the math based on some assumptions, which is why we believe that the best path for Erickson is to offer a lump sum cash settlement to Mr. Anderson to get him out. He will obviously hold out for a larger payment, but our advice to Erickson would be to put a drop-dead date on any offer. If it is not accepted in 30 days, as an example, the offer declines by a certain amount or disappears entirely, and they would use the proposed settlement payment for their own legal fees. This is very different from the CalPERS situation as it does not involve disputed appraisals, and it is far from the CalPERS legal strategy that some have privately called “stupid.” Erickson owns the debt, and has many rights as the secured creditor. Our advice to Mr. Anderson is to take the money and run. Tick, tock.

When Erickson finally does take control of operations at the Devonshire at PGA National, it will be from a position of strength. Overall occupancy at the company is now 96%, much higher than the national average, which is still below 90% for CCRCs and would be even lower without Erickson’s numbers. As we have seen, Erickson is looking at acquisitions and is also back in the development game. This is a healthy sign for the CCRC sector as a whole because the bankruptcy filing by the former Erickson created quite a chill in the market, which was compounded by other bankruptcies. And once the legal issues are resolved, we would expect the Devonshire to be back up to Erickson’s corporate average faster than many would believe possible.

Not everything is completely straightened out in the CCRC market, but it never is in any market. Perhaps Mr. Anderson can turn his sights to another distressed Florida CCRC that filed for bankruptcy protection in July with about $55 million of debt. The Jacksonville not-for-profit CCRC, known as Glenmoor, has hired Navigant Consulting to represent it through the bankruptcy process and either negotiate new terms with the bondholders or find a buyer. We don’t know much about the community, other than that it was built in 1999 and that occupancy has...
slipped in the past few years, but not enough to warrant a bankruptcy filing.

In another hit to the not-for-profit CCRC world, Dunwoody Village in Pennsylvania lost its appeal in a tax case where the Pennsylvania Commonwealth Court upheld a lower court’s decision that the CCRC did not qualify for an exemption from real estate taxes because potential residents had to prove they had the financial resources to afford the community before moving in. Therefore, there was a “remote” possibility that the CCRC would have to subsidize a resident who ran out of money, even though that did happen occasionally. In addition, the court ruled that the CCRC did not serve a public purpose, did not benefit a substantial and indefinite class of persons who are legitimate subjects of charity, did not relieve the government of some of its financial burden (no Medicaid patients), and did not operate entirely free of the profit motive, since the top executives received bonuses based on the financial performance of the community.

What is interesting is that none of these concepts is exactly new, so we are not sure why these arguments have not been used before by local taxing authorities. Not that we think that high-end not-for-profit CCRCs should suddenly become local real estate taxpayers, but other municipalities may take notice and use this precedent to strong-arm some CCRCs to start paying real estate taxes. That would certainly be an unwelcome financial burden.

**SENIORS HOUSING ACQUISITIONS**

As we mentioned in our August issue, Care Investment Trust is definitely not out of the seniors housing acquisition market. Last week, Care and New York-based Premier Senior Living purchased two relatively new assisted living communities in New York for $21.9 million, or a robust $219,000 per unit. The two buildings have 51 and 49 units, but the license is for 131 beds. Based on the licensed beds, combined occupancy is 97%, which seems to be driving the value. What is unusual about such a high-value deal is that about 25% of the census is covered by the New York Medicaid waiver program. That just shows how strong the cash flow must be, which we have estimated to be approximately $1.75 million on an estimated $5.5 million of annual revenues. Care will be leasing the properties to Premier for an initial 12-year lease plus two five-year renewal options.

Fresh off its successful sale of 10 properties this summer (see Acquisition Updates on p. 14), Capitol Seniors Housing has partnered with Welbrook Senior Living to
purchase a turnaround property in Riverside, California. The community consists of two buildings, built in 1980 and 1984, that are about the same size and have a combined 212 independent living units. Occupancy was under 70% with average rates close to $1,600 per month. Despite the low occupancy, the community actually made about $700,000 of EBITDA on estimated revenues of $2.8 million. CSH paid $16.25 million for the property, or $76,650 per unit, but the story does not end there.

One of the buildings has a lower occupancy than the other, and it is on this building that CSH plans to spend most of the $5.5 million to $6.0 million they plan to commit over the next eight months. In addition to sprinklering both buildings, they are going to convert the census-challenged building (which happens to be the newer one) to assisted living and memory care, including a secure memory care wing on the first floor. In addition, they are going to build a dining room onto this building that will be serviced by the other building’s kitchen. The lack of a dining room may have been one of the reasons for its lower occupancy. After construction is finished, which is expected to be by the end of April 2014, CSH has conservatively projected it will take up to 18 months to stabilize the building. They will also lose somewhere between 10 and 12 units during the makeover.

Until it is stabilized, CSH is anticipating assisted living rates to be $3,300 per month and memory care rates to be $4,200 per month. Conservatively, first year stabilized revenues and EBITDA should be about $6.2 million and $2.3 million, respectively. That implies a future value as a one-off sale between $135,000 and $150,000 per unit, compared with a $110,000 per unit all-in cost. California-based Integral Senior Living will be managing the community, and CSH has a ground-up development, also in California, that is getting under way with Welbrook. CSH is working on three other developments with different partners in Virginia, New Jersey and Florida. For the Riverside deal, Aron Will of CBRE’s Senior Housing Debt & Equity Finance Group placed a $13.8 million floating rate bridge loan with a California bank that includes three years of interest only and an interest rate today of 2.95%.

Relative newcomer Titan Real Estate Investment Group, through its Titan Senquest Senior Living affiliate, has purchased a 100% independent living community with 180 units in Bryan, Texas from a private equity firm. The community was built in the 1980s and, by the closing of the sale, occupancy had increased from the high 80% area to 93%. There had been another large property in
the market that was leasing up, which put pressure on the census as well as the rates, which had averaged a relatively low $1,500 per month. As the market strengthens, the buyer plans on being able to raise rates as well as control operating costs a bit better. We believe the purchase price was approximately $10.5 million, or $58,300 per unit, and that estimated revenues and EBITDA were approximately $2.9 million and $600,000, respectively. 

CapitalSource Bank provided $8.0 million in mortgage financing for the acquisition, and Ryan Maconachy and Chad Lavender of HHF represented the seller.

In the largest transaction of the month, but one that has had some misreporting in the press, Florida-based TJM Properties sold a portfolio of 15 senior living properties in Florida and North Carolina to Newcastle Investment Corp. (NYSE: NCT) for $200.05 million, or approximately $110,500 per unit. Many of these properties had been purchased by TJM over the years for between $45,000 and $65,000 per unit, and often, but not always, involved a turnaround. No financial details have been disclosed, and no one wants to talk about it.

Although a publicly traded REIT, Newcastle is controlled by Fortress Investment Group (NYSE: FIG) and has been slowly building up its seniors housing investments, which today represent a minority of its assets. Late last year, it bought a portfolio of communities in California, Oregon, Utah, Arizona and Idaho from BPM Senior Living for $143.4 million, or $204,500 per unit. At the time of purchase, the average monthly revenue per occupied bed was $4,208, and that had grown to $4,389 by June 30, 2013. Even better, census at the purchase was 87.7%, and that increased to 91.8% by June 30. On the current deal, it looks like Newcastle paid $53.8 million in cash, assumed debt of $52.9 million and borrowed $93.3 million of new debt. We believe that Holiday Retirement Corporation, also controlled by Fortress (for now), will be the new manager. That will be very interesting given that these are not the typical properties that Holiday has experience in managing, as many of these properties are assisted living and memory care communities. Unfortunately for the broker community, this was an off-market transaction.

Speaking of Holiday, over the summer it purchased a 111-unit independent living community in Poughkeepsie, New York for an undisclosed price. An extra unit will be converted into an apartment for a live-in manager, which is how the company historically has managed its properties. In addition, the size fits in with Holiday’s typical community, and while no health services are provided, residents are able to obtain home health care from an outside agency of their choice.

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In another transaction without a disclosed price, Nebraska-based Nye Senior Services purchased a senior living community in Norfolk, Nebraska, which has 76 independent living and 38 assisted living units. Fortunately for Nye, the executive director, who has been at the community for 24 years, will be staying on. Nye Senior Services was founded in 1989 and now has six campuses in Nebraska, three of which are in Fremont.

Buying, selling, financing and managing CCRCs has never been all that easy. When it works, they can be like well-oiled machines, but when it doesn’t, it’s complicated. Just ask the former Erickson Retirement Communities that stopped construction in 2009 on what was supposed to be one of its typical CCRC campuses in Hilliard, Ohio, with more than 1,500 units when all the phases were completed. When the recession hit and Erickson’s own financial bubble burst, leading to its bankruptcy and the auction of the company, this campus was excluded from the sale, and for good reason. At best, about 80% of the first phase of 145 units and the clubhouse had been “completed” on the 87-acre site, for an all-in cost that we have heard may have reached up to $34 million, including the land cost.

The county court ordered an auction of the property to be held this past June 21, with a minimum bid of $9.99 million, or two-thirds of the appraised value. The asset management firm and auction company handling the process, Gryphon Asset Management, had the property reappraised and then lowered the minimum bid to $7.99 million. That seemed to be the magic number, and Westerville, Ohio-based The Windsor Companies stepped in as the only bidder and offered $8.26 million. Windsor is an REO asset management and disposition company that also provides full construction services. However, we believe that this is its first seniors housing asset, if it builds it out as a retirement community.

While the usual suspects looked at the auction offering, there were some reasons we can come up with as to why they did not bid. First of all, the place must have looked like a wreck, as many of the appliances and fixtures had already been auctioned off. Why someone would think that would be beneficial to the larger offering is beyond us. In addition, the county auditor had estimated that the value of the land and building was about $18 million, and that $11 million in back taxes were owed. How an abandoned building would have much value beyond the land, which sold for about $12 million in 2008, is a mystery to us. But the biggest issue, which may have been resolved but that no one will talk about, is the tax increment financing (TIF) that was in place and arranged by the former Erickson.

TIF financing is a cute way to get local subsidized...
financing based on the expected future increases in real estate taxes that will be paid to the local taxing authority as the improvements on the site result in an increase in taxable value. This project was supposed to be worth $100 million when finished, compared to the original land cost which was just one-tenth of that, with a huge increase in property taxes. It is that incremental increase in tax revenues that is supposed to be used to pay off the TIF debt. Some sources have indicated that bankruptcy does not remove the TIF debt liability, which was one of many reasons for not pursuing the acquisition. Was Windsor able to work something out with the local taxing authorities? We don’t know, but they may have had to assume the TIF debt. The only way it realistically could be paid off would be through higher taxes from the higher future value. All we can say is, good luck.

Milestone Retirement Communities has increased in size by nearly 60%, with new management contracts for 10 communities with a total of 1,433 units and beds in Washington, Oregon and California. The communities, with independent living, assisted living and memory care units, are owned by Vancouver, Washington-based Rood Investments. Milestone was founded just five years ago, and it now has 27 communities under management in nine states, 13 of which are managed only; Milestone’s management team has an equity interest in the remaining 14 properties. In addition to the new management contract, Rood Investments is developing a 116-unit assisted living and memory care community in Orangeville, California that Milestone will also manage.

**Skilled Nursing Acquisitions**

While we await news on the two “Covenant” portfolios of skilled nursing facilities that have been on the market all summer, there is still plenty of action to report in the smaller deals, with price ranges between $20,000 per bed and $100,000 per bed. Illinois-based Legacy Healthcare has purchased two skilled nursing facilities with a total of 513 beds for $55.75 million, or $108,700 per bed. They are located in Chicago and Evergreen Park, Illinois. Occupancy was below 60% at closing, but in 30 days the census has increased by 25 patients at one of the properties. Legacy Healthcare, which is known for completing very attractive renovations on the nursing facilities it purchases, is expected to invest up to a total of $4 million in these two properties. Financing for the acquisition was provided by Private Bank, which also included funds to refinance debt on two other properties owned by Legacy.

Not everything can sell for such a high price. Vermilion County sold its 237-bed nursing facility located in Danville to a local owner, whom we believe to be Feiner
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We look forward to seeing you at the NIC National Conference in Chicago.

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**$755 Million**
Senior Unsecured Credit Facilities
New York, NY

**$120 Million**
Senior Secured Revolving Line of Credit
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**$40 Million**
4-Property Independent Living Portfolio
Michigan (multiple locations)

**$33 Million**
Franklin Park at Sonterra
202-Unit Independent Living and Assisted Living Community
San Antonio, TX

**$18 Million**
Assisted Living Facilities
San Antonio, TX
Harrisburg, PA
Little Rock, AR

**$16 Million**
143-Unit Independent Living Facility
Orem, UT

**$10 Million**
Marquis – Piedmont
Portland, OR

**$24 Million**
HUD Skilled Nursing Facility
Suffern, NY
232-223(f)

**$120 Million**
Lead Arranger & Administrative Agent

**$18 Million**
Assisted Living Facilities
San Antonio, TX
Harrisburg, PA
Little Rock, AR

**$16 Million**
143-Unit Independent Living Facility
Orem, UT

**$10 Million**
Marquis – Piedmont
Portland, OR

**$40 Million**
Fannie Mae

**$18 Million**
Freddie Mac

**$16 Million**
New Construction

**$10 Million**
FHA 223 a(7)

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Healthcare Group and who will partner with Premier Healthcare Management. The purchase price was $3.5 million, or just $14,800 per bed, but it was low for several reasons. The first phase of this facility was built in 1974 with 142 beds, and the second phase was completed in 1979 with 95 beds. Of the total, 45 rooms were four-bed wards, something you just don’t see too often anymore. With occupancy of only 70%, we know that the buyer will be converting many of these rooms into semi-private rooms. The county was losing more than $1.0 million annually on the property, so it was a no-brainer to sell. In fact, the county board voted 23 to 1 in favor of the sale. We heard that the initial bids came in significantly higher until it was discovered how much the facility was in need of repairs. The deal the county agreed to was $3.5 million for the purchase, plus $2.0 million in renovations.

The census was 73% Medicaid, and annual revenues had been about $8.7 million with a loss over $1.1 million. Under the new ownership, we expect revenues to top $10 million with EBITDA growing to $750,000 and then up to $1.0 million. The sale was not without some controversy, however. The county was expecting some employees to lose their jobs, yet apparently 39 people were not retained, more than double the expectation. In addition, they are still negotiating over the accounts receivable, as the county is owed about $1.0 million in Medicaid payments, some of which are as late as 270 days. FNR Healthcare can purchase them at a discount, but the county won’t give them away. Mark Myers, Josh Jandris and Charlie Hilding of Marcus & Millichap represented the seller in the transaction, which closed in early August.

The Myers team at Marcus & Millichap team has also put under contract another county-owned skilled nursing facility, this time in New York. Built in 1975 on eight acres in Canandaigua, the facility’s occupancy has been near 87% and it has also been losing well over $1.0 million annually on revenues of about $5.4 million, prompting the sale. When the facility went on the market, one of the requirements for a sale was that it continue to be run as a nursing facility for at least 10 years. We assume the buyer, New York-based Centers for Specialty Care Group, will want to keep it operating as a skilled nursing facility. However, another requirement to give county residents a preference in admissions may be trickier, depending on availability and diagnosis. The sales price is $2.0 million, or $20,400 per bed, which reflects the age and most likely the funds that will be needed to invest in the physical plant, although unlike the Illinois sale above, that was not part of the final deal.
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Crestview Manor, Inc.  
$14,999,800  
FHA Insured 232/223(l) Refinancing  
June 2013

Panhandle Care Inc.  
$26,400,000  
Senior Secured Credit Facilities  
May 2013

Life Care Centers of America  
$22,800,000  
Senior Secured Credit Facilities  
April 2013

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There were a few sales of nursing facilities in Texas last month. In the first one, Rod Llanos and Doug O’Toole of Marcus & Millichap sold a 62-bed facility in Brenham for $1.275 million, or $20,500 per bed. The low price was because occupancy was just 52% since the owner never certified the facility for Medicaid or Medicare. The local market has a 73% occupancy rate, with one facility at over 90%, so demand will be there when the buyer, a Texas-based company, gets the certification, which we understand will be the first thing they do. Built in 1988, it is apparently the nicest of the three facilities in town, and has nine private rooms and 22 semi-private rooms. The private rates are about $148 per patient day, while the semi-private is $98, which seems like a bargain, even for Texas. With the low occupancy, revenues had been just over $1.3 million with a 7% operating margin. However, with certification, we expect revenues and EBITDA to hit $2.0 million and $200,000, respectively, or better.

Coincidentally, another 62-bed nursing facility in Texas was sold in August. Located in Bedford, it was built about 50 years ago, but did receive some renovations 30 years ago. Occupancy was approximately 80% and we understand it was not making money. The purchase price was approximately $38,000 per bed, but we do not have any of the financial details.

A regional operator used a 1031 Exchange to purchase a 75-bed skilled nursing facility in Knoxville, Iowa. The facility was built in 1966 by the same family who sold it, but there had been some additions and renovations completed over the years. The purchase price was $2.15 million, or $28,700 per bed. Revenues and EBITDA last year were approximately $3.0 million and $190,000, respectively, and occupancy has been about 85%. The buyer, which owns about 10 nursing facilities in the state, should be able to bring some efficiencies to the operations and move the margin up from 6%. At a minimum 10% operating margin, the cap rate based on first year cash flow would be close to 13%. Nick Cacciabando of Senior Living Investment Brokerage handled the transaction.

Diversicare Healthcare Services (NASDAQ: DVCR), formerly known as Advocat, has been making some moves to alter its portfolio for the future. Effective September 1, it reached an agreement with its landlord, Omega Healthcare Investors (NYSE: OHI), to terminate the leases with respect to 11 skilled nursing facilities located in Arkansas. Apparently, the company’s liability costs in Arkansas were significantly higher than those in other states, so it just decided to exit the state, which is understandable. Omega will transfer these operations to other providers of its choice, but we have not yet heard
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who those may be. Part two of the change in the portfolio is the transfer of operations of four skilled nursing facilities in Ohio (3) and Indiana (1) to Diversicare from Catholic Health Partners. The assets include 442 skilled beds, 209 assisted living units and 32 independent living units. Diversicare will be leasing these facilities from a REIT that purchased the assets. Few other details were available.

While Diversicare is trying to get its portfolio in order for future growth, one of its disgruntled shareholders, Covington Investments, has issued another open letter to shareholders reiterating its all-cash offer at $8.50 per share, which represents a 63% premium to the closing price at the end of August. Covington complained about the decline in revenues, occupancy, Medicare census and adjusted EBITDA. These arguments have fallen on deaf ears in the past, so we don’t expect much of a reaction from management. But that is quite a nice premium.

**Acquisition Updates and Other News**

Four months ago we wrote about a rumored sale of a high-quality portfolio of 10 senior living communities in five states. We have heard through the grapevine that the majority of the sales have closed with a few of them still pending, and it all should be settled by the end of the third quarter or early into the fourth quarter. These properties had been purchased by Capitol Seniors Housing (CSH) and its joint venture partner over the past two years, and they were all built between 2000 and 2008. Timing is everything, and it helps when two key ingredients are put together. First, the cash flow of these properties increased from the time CSH purchased them to when they were sold. Second, cap rates declined during that time period, especially for portfolios of Class A properties. On most of the original purchases, the cap rate ranged between 7.0% and 7.7%, according to our historical records, with at least a 100 basis point drop on the re-sale. Based on what we have heard, the price may have reached $270,000 per unit for the portfolio, versus just above $190,000 per unit for CSH’s average cost basis on all 10 properties combined. We figure that about one half of the increase in value came from higher cash flow, while the other half came from a lower average cap rate. These properties are continuing to improve on census and rates, so despite a lower cap rate this time around, they will continue to improve for the buyer. Timing was important for a third reason, as CSH escaped the 120 basis point rise in the 10-year Treasury rate, something other sellers are wishing they had been able to achieve. For now, we hear that CSH is back in the hunt for more acquisitions, so who knows what they will do for an encore. If you hear anything, please let us know. Stay tuned.
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California loans will be made pursuant to a Finance Lenders Law License from the Department of Business Oversight.
In its continuing push to be the post-acute provider of choice in its 21 “integrated care markets,” Kindred Healthcare (NYSE: KND) has signed an agreement to purchase Western Reserve Senior Care, a Cleveland, Ohio-based primary care physician practice that specializes in delivering care in home-based settings, including assisted living and independent living communities. Western Reserve’s physicians, nurse practitioners and nurses provide primary care, specialty care and urgent care services to seniors who can’t leave their homes. The founder of the practice will join Kindred as VP of Medical Affairs and will become the Chief Medical Officer for Kindred at Home.

In the Cleveland market, KND has two LTACs, three nursing and rehab facilities, one co-located hospital-based subacute unit, two assisted living communities and two home health locations. That just about covers it. The acquisition is expected to close by the end of September. Kindred also announced some changes to its credit facilities, which provide the company with some added financial flexibility, eliminate some restrictions on future acquisitions, extend the maturity to 2018 and increase the credit capacity. It looks like we may be seeing more acquisitions before the end of the year.

Who says the financing market is boring? Certain interest rates may have jumped by more than 100 basis points over the summer, but that is not stopping consolidation among lenders as well as among providers. Last month we reported on the acquisition of CapitalSource Bank by a larger California-based bank, and this month it is Capital One Bank that is in the news. Its parent company announced an agreement to purchase Beech Street Capital for an undisclosed amount. Beech Street is a privately-owned national originator and servicer of Fannie Mae, Freddie Mac and FHA real estate loans. Founded in 2009, Beech Street originated approximately $4 billion in loans in 2012 and services a portfolio of approximately $10 billion. This will be a nice complement to Capital One’s multi-family and seniors housing platform and will make it a top five originator, as well as one of the few entities to provide a wide variety of balance sheet and non-balance sheet lending platforms for its customers.

One company has been taking advantage of what many consider to still be relatively low interest rates. Colorado-based Spectrum Retirement has been busy recapitalizing its portfolio of retirement communities and selling a few that don’t fit in with its long-term plans. Over the past few months we have reported on the sale.
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of three communities in the Pacific Northwest that had a Medicaid component, as well as the sale of three others with a Medicaid component that it managed for a third party. Recently, the company has refinanced about $185 million of debt, on top of about $75 million financed earlier in the year. But first, a little background.

Back in 2006, the founders of Spectrum, Jeff Krause and John Sevo, partnered with Kimco Realty (NYSE: KIM) and built nine properties, which became part of Kimco’s Preferred Equity Program. They were the first and only seniors housing company to participate in the program. Spectrum bought out three of the communities late last year, and has now bought out its partner’s equity interest in the remaining six and refinanced the existing debt on those six properties with a $124 million loan arranged by Astrid Kramarz of Bank of the West. Other banks in the loan syndication included Compass Bank, Colorado Business Bank and Raymond James Bank, N.A. These communities are located in Kansas, Missouri, Illinois and Arizona. Since Kimco was winding down its Preferred Equity Program, the timing was right on many fronts, including relatively low interest rates and strong valuations.

In a second transaction, Spectrum and a private equity partner refinanced a portfolio of four independent living communities in Michigan with a total of 440 units. Key Bank had provided a bridge-to-agency loan a few years ago, which allowed the partnership to take advantage of a substantial discount offered by the then existing lender, Capmark Bank. Key has now refinanced that bridge loan with a $40.4 million loan through Freddie Mac. Prior to this loan, Spectrum had done about $150 million in financing with Freddie Mac. Finally, Spectrum obtained a $19.7 million loan from BBVA/Compass Bank to refinance two other properties, and, as we were going to print, they were about to close another refinancing. In addition, Spectrum has another $115 million of properties under construction. The bottom line is that Spectrum is not only taking control of its destiny, but is also hedging that interest rates are not going to see much downward movement in the near term, thus locking in its capital structure and costs for several years to come. Not a bad strategy in today’s market.

In other “big story” news, with the purchase of Assisted Living Concepts (ALC) by TPG completed at the beginning of July, the private equity firm is wasting no time. In late August, they hoped to close on a $250 million CMBS financing secured by 79 ALC properties with 3,702 units in 10 states. This 79-facility portfolio has an
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occupancy rate of 78.1% (compared with 49.4% for the remaining 130 properties, and net cash flow of $47.8 million, which equals a 39.0% operating margin after a 5% management fee and a $525 per unit replacement reserve. Even though this 79-facility group has a better occupancy than the rest of the company, we still find it hard to believe that it has an operating margin higher than any other assisted living company, but with an occupancy rate that is 10 percentage points lower than the industry average. These numbers were based on the trailing 12-month results ended March 31, 2013, which in theory have included the beefed up staffing and training costs. An average of four new employees per building should have put a dent in the margins, but somehow they still remain unrealistically high. We assume they will drop when the new CEO, Jack Callison, starts investing in technology and a revamped sales and marketing effort. However, if successful, the initial dip in margins should reverse course as occupancy increases. The loan is expected to be priced at LIBOR plus 350 basis points for the first two years, and increased by 25 basis points if the borrower extends the loan for a third year. There are two additional one-year extensions. We question whether this is the right seniors housing portfolio for the Street to bring to the CMBS market at this point in time. But J.P. Morgan Chase obviously disagrees.

Getting back to the remaining 130 properties with an average 49.4% occupancy as of March 31, 2013, this group had a negative cash flow (no surprise there). This low occupancy represents the real challenge, and perhaps opportunity, for the new management. Assuming an average of about 45 units per property, this is the group that would need to find an average of 20 residents to bring the stabilized occupancy up to 92%. That will not be easy, and while it is doubtful that any of the new development we are hearing about is in ALC’s markets, or even competing at their price point, finding that many new residents will be tough. If they do, Mr. Callison’s star will certainly be shining bright.

HUD Market. Even with the slowdown in new approvals before the new fiscal year begins on October 1, the HUD market continues to be active with more than $275 million of closed deals to report on. Heidi Brunet of Berkadia Commercial Mortgage closed two loans totaling $33.5 million for Lytle Enterprises (and you thought the Lytles retired). The first HUD loan is secured by a 114-unit assisted and independent living community in Los Angeles that is 92% occupied. The $186,800 per unit loan has a relatively low 61%
loan-to-value. The second property is located in Petaluma, California, and has 87 assisted and independent living units, but occupancy is lower at 83%. The loan-to-value for this mortgage was 74%. Leisure Care operates both facilities for Lytle Enterprises. In a separate deal, Ms. Brunet and Rob Affleck arranged a $10.1 million HUD loan secured by a 70-unit skilled nursing facility in Bellevue, Washington. The 35-year loan has an interest rate of 3.35% (must have locked that in before the rate rise) and the facility is 100% occupied.

Capital Funding Group (CFG) had a busy month with several HUD refinancings with average annual savings of about $60,000. Included in the loan production were two skilled nursing facilities in California with $6.39 million of loans, two in New York with $17.48 million, three in Washington with $19.9 million and one in Maryland with $9.5 million. In a non-HUD deal, CFG had an $8 million participation in the financing of the acquisition of most of the Elderwood Senior Care assets in New York by Post Acute Partners which closed in July (see August issue, page 10). That deal involved 17 properties and included skilled nursing, assisted and independent living.

Housing & Healthcare Finance closed approximately $85 million in HUD loans in August. Six of the loans were for skilled nursing facilities in New Jersey and one in Florida. Perhaps the most notable was the last loan, $29.56 million in construction financing to build a 115-unit assisted living community in Scarsdale, New York, which is located in Westchester County. This will be the town’s first assisted living community, and the developer went through years of negotiations and litigation with the various municipal entities to finally get it approved. While we don’t know how much NIMBY was involved, anyone in the business knows how difficult it can be to develop in Westchester and neighboring Fairfield County, which is often why these communities, once built, are so successful. The loan comes to $257,000 per unit and $218,000 per licensed bed.

Lancaster Pollard has been helping its clients save money with HUD refinancings. LP’s Chris Blanda refinanced three skilled nursing facilities in Indiana at interest rates well below 4% for a combined annual debt service savings of more than $161,000. In addition, he refinanced a 41-unit assisted living community that was built with HUD funding in 2000, refinanced with HUD in 2005 and then refinanced again last month, reducing the interest rate by 220 basis points and saving the borrower $39,000 annually. This comes off a busy July, in which Lancaster completed a total of $110.8 million in seniors housing loans, most of which were with HUD.
Love Funding’s Len Lucas closed on the refinancing of two skilled nursing facilities in Texas for a total of $19.3 million, or $67,000 per bed. One of the properties is located in Round Rock and has 160 beds, while the other one is in New Braunfels and has 128 beds. In the past six months Mr. Lucas has closed eight HUD loans. In another deal, Artin Anvar closed a $7.24 million refinancing of a 100-bed skilled nursing facility in Seattle, Washington. The facility was established in 1977 as a not-for-profit, and the organization has grown to include 23 medical clinics, 18 mental health outpatient offices and three residential drug and alcohol treatment centers; these were not included in the refinancing. The new 33-year loan has saved the organization more than $215,000 in annual debt service. Separately, Cambridge Realty Finance had a busy month, closing six HUD loans totaling more than $60 million in four states.

Agency Deals. In one of the larger deals to date, Berkadia Commercial Mortgage originated a $172.1 million financing with Freddie Mac for a portfolio of four seniors housing communities with 873 units owned and operated by Brookdale Senior Living (NYSE: BKD). The communities are located in Illinois, Missouri, New York and Ohio and have 716 independent living units and 157 assisted living units. The seven- and 10-year loans were floating rate with 30-year amortizations, and they had loan-to-values between 59% and 75%. The loan amount came to $197,100 per unit, perhaps reflecting the 92% average occupancy rate. Meanwhile, Berkadia’s Lisa Lautner closed a $14.5 million Fannie Mae loan for an acquisition in Missouri by Capital Senior Living (NYSE: CSU). The 12-year, fixed-rate loan had a 75% loan-to-value and a 30-year amortization. Ms. Lautner also completed a $4.5 million bridge loan for CSU through its proprietary bridge lending program. The two-year floater was used for the acquisition of a community in Indiana, where the company is seeking to obtain a formal assisted living license.

Stuart Oswald of NorthMarq completed a Freddie Mac refinancing of a 140-unit independent and assisted living community in Tacoma, Washington. The loan amount was $19.5 million, or $135,400 per unit. The first phase of the community was built in the late 1980s, with a second phase added in the mid-1990s. A portion of the proceeds will be used to convert several independent and assisted living units to memory care (a familiar theme these days). In addition, the borrower will be able to utilize Freddie Mac’s acuity mix conversion program, which allows for further changes to the level-of-care unit mix over the term of the loan. Separately, Jeff Ringwald of Oak Grove Capital closed on a fixed rate, $11.14 million Freddie Mac loan that financed an 88-unit senior living community in Beaverton, Oregon.
Balance Sheet Loans. GE Capital, Healthcare Financial Services announced it provided $60.0 million in financing to ValStone Partners to refinance a portfolio of 19 senior living properties with 802 units. The five-year floater comes with up to an additional $6.0 million available for capital expenditure drawdowns, a nice feature for ValStone and its operating partner, Senior Management Advisors. Most recently, in early 2013 the two joint venture partners purchased two large communities in Delray Beach, Florida that they are going to reposition and re-brand under their “Grand Villa” umbrella.

Through one of its wholly-owned funds, Contemporary Healthcare Capital has provided a $4.5 million senior loan and a $1.25 million mezzanine loan to finance a 54-bed memory care facility located in Green Valley, Arizona. The proceeds will be used to refinance existing debt, provide working capital and pay closing costs. The two loans come to $106,500 per bed.

In addition to the Freddie Mac deal above, Mr. Oswald of NorthMarq closed on a $9.271 million mortgage with a regional bank that refinanced two independent and assisted living communities in Texas, with a total of 140 units. The four-year loan has a 25-year amortization, and the interest rate is more than 200 basis points lower than the previous debt. In addition to refinancing the existing debt, part of the proceeds will be used to convert some of the AL units in one of the buildings to memory care.

CapitalSource Bank recently disclosed that it provided a $51.0 million loan to TL Management to finance the $64.0 million acquisition of nine skilled nursing facilities in Texas with a total of 969 beds. Two of the facilities opened in 2012 and have all private room suites. The five-year loan has a high 4% interest rate and was closed by Jeff Hawkins of CapSource.

In another bank financing deal, Herbert J. Sims was able to place a $19.175 million loan for the phase II expansion of a CCRC in Wilmington, North Carolina. The expansion will include 27 independent living units, a wellness center and indoor pool, a new auditorium and the renovation of existing areas of the community. Sims was able to secure a 10-year loan at a fixed rate of 3.09%, which was about 140 basis points lower than the next lowest equivalent proposal. In addition, the loan was structured with a second note that was floating rate, benefiting from the current historic low short-term interest rates, with the flexibility to pay it down with new entrance fees. Construction has already begun.

It’s always nice to see a seniors housing loan or two placed with a life insurance company. Such was the case...
with a recent financing completed by Greystone & Co, on behalf of a national provider. The $11.25 million, 18-year self-amortizing loan had a fixed rate in the neighborhood of 4.5%. The 120-unit independent living community is located in the Northwest, and the non-recourse loan provided interest rate lock protection at loan application.

**Tax-Exempt Market.** Although the recent rise in taxable interest rates have also impacted the tax-exempt market, deals have continued to get done even as municipal bond funds experience a net cash outflow. Ziegler closed on a $45.84 million, 30-year fixed rate bond issue for Magnolia Manor Obligated Group, a not-for-profit based in Georgia. The provider operates campuses in six Georgia communities that have a combined six cottages, 316 independent living units, 146 assisted living units and 557 skilled nursing beds. Separately, Cain Brothers served as the placement agent for $7.7 million of tax-exempt bonds that were structured as a direct bank purchase. This placement was used to redeem bonds that were issued in 1990 with a 2020 maturity. The current funding is for 25 years, so it extends the maturity by 18 years, and the variable rate debt has a current cost just under 2%. In addition, the borrower was able to secure the release of a trustee-held debt service reserve fund. The borrower is a not-for-profit CCRC in Santa Ana, California that is an affiliate of The Christian and Missionary Alliance.

**Slowdown For Health Care REITs**

*continued from page 1...

...at least on the longer end of the curve, which has seen a 125 basis point jump in just three months. Short-term LIBOR rates are still basically close to zero, but for how long no one knows.

Before anyone gets their knickers in a knot about the REITs, let’s be clear about something. They are not going away. It may not make economic sense today to do those billion-dollar acquisitions of public companies, but it may in the future. Doing big transactions just for the sake of getting bigger is no longer acceptable. Non-accretive deals, especially big ones, would incur the wrath of investors, but who’s to say that acquisition values won’t come down, especially as the recent spike in interest rates winds its way into cap rates. That will have more of a correlated impact on seniors housing values than on skilled nursing facilities, which for 20 years have seen little change in cap rates regardless of where interest rates have gone.

In addition to the interest rate issue, there is another more subtle factor that may have caused investors to be more cautious in their outlook for health care REITs. There have been several reports from NIC that construction starts, especially for assisted living and memory...
care, have accelerated, and in some markets the new development, as a percentage of existing inventory, has doubled. A simplistic and reasonable view is that as these developments start filling, they will put census and rate pressure on existing properties, some of which are owned by REITs in their RIDEA structures where they are counting on increases in operating cash flow to be greater than the traditional lease escalators. Although it was premature from this perspective, the weaker-than-expected second quarter occupancy numbers from the public companies added some fuel to this theory. However, we are hearing that third quarter occupancy may surpass expectations, which makes some sense.

The reality is that REIT acquisition activity has not slowed down at all in terms of the number of deals. It is just the dollar value that is lower because the mega-deals make less sense from a valuation perspective right now. But every single REIT, large and small, is looking at every acquisition possibility, and several have been funding development pipelines (as long as they are not in their RIDEA markets). There are more private REITs doing seniors housing acquisitions today than ever before, and our guess is that despite the share price troubles of the publicly traded REITs, the number of private REITs will continue to grow. We have already had one REIT IPO this year, Aviv REIT (NYSE: AVIV), and another that seems to be transforming itself into a seniors housing REIT, Newcastle Investment Corp. (NYSE: NCT). Newcastle is controlled by Fortress Group (NYSE: FIG), and while we thought that perhaps the gnomes at FIG would try to parlay NCT into a big enough player to take Holiday Retirement Corporation off its hands by the 2014 debt maturity, that seems highly unlikely, and not just because of its 12.9% dividend yield (which might make it an attractive investment opportunity, if the dividend doesn’t get cut). Newcastle has made two seniors housing acquisitions above $100 million each in the past 12 months.

What we really think will happen is that the REITs will merge or acquire each other, despite the apparent investor dislike of Ventas’ (NYSE: VTR) acquisition of Nationwide Health Properties for $7.4 billion in 2011. There are not any more health care REITs of that size to be acquired (obviously excluding the Big Three), as five of the public REITs have current market caps of $1.5 billion or less, helped by the recent plunge in their values. In addition, there are all those private REITs that at some point will be looking for an exit strategy, and a sale is more certain than an IPO. Although overhead at the smaller REITs is relatively small, cutting that out would be an obvious saving for the buyer, and it may just be cheaper than buying properties in the open market today. But a deal has to be accretive by much more than a few pennies per share, otherwise it won’t make much sense. Not to start any rumors, but one place to look would be those REITs

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Despite the rise in capital costs, the smaller public REITs and the private REITs are having no problem finding and financing acquisitions, and over time it may be the development pipelines they are funding that will drive up their values. After all, bringing the average age of your portfolio down can’t hurt, and we have not heard of any fill-up problems, at least not yet. No one can predict where interest rates will be heading, especially since the recent spike was unexpected and not forecasted to begin until at least after the 2014 mid-term elections. This was just one of the reasons why we believed we would be in the longest bull market the seniors housing and care M&A market had ever seen. It may still be, and if it is, don’t count out the health care REITs just yet.

**Recent REIT Transactions.** We don’t see health care REITs doing too much mortgage financing these days, but sometimes you have to look beneath the covers to get all the details. **LTC Properties** (NYSE: LTC) has entered into an agreement to provide $141 million of mortgage financing to **Prestige Healthcare** to help Prestige buy 15 properties with 2,092 licensed skilled nursing beds and 24 independent living units in Michigan. The seller is **Medicalodges**. Trailing 12-month occupancy is about 84%, so there is some real upside on census, and the EBITDAR margin is around 10%. Of the total loan, approximately $126 million will be funded in the fourth quarter when the acquisition by Prestige closes, with additional forward commitments of $12 million for capital improvements and up to $3 million for short-term working capital. Over the next 12 years, depending on a variety of metrics, there could be additional loan proceeds of up to $40 million, but limited to $10 million per year. In addition, Prestige will have a one-time option to prepay up to 50% of the loan without penalty, and under certain circumstances, LTC Properties will have an option to purchase the portfolio for $178 million. The 30-year loan (yes, 30 years) is interest-only for the first three years, with a rate of 9.41% for the first five years. While that may seem high, our bet is that the loan will be funding the entire purchase price, much like a sale/leaseback financing. This structure seems to have it all in terms of flexibility and relationship. One of the reasons for using a loan and not a traditional REIT lease is because under Michigan’s Medicaid reimbursement protocols, the capital component of the Medicaid rate would be decreased with a lease, while, with a loan, it will get factored in. In this environment, there is little reason to have your rate decreased by the state. While the properties are in the greater Detroit metro market, none
are in Detroit itself. Evans Senior Investments is representing the seller in the transaction, which is expected to close in the fourth quarter of this year.

CNL Lifestyle Properties has purchased two senior living communities for $45.85 million, or $199,300 per unit. One community was built in 2008 in Bozeman, Montana, and has 107 independent and assisted living units plus 24 IL cottages with a solid occupancy of 94%. The entire community is licensed as Level A assisted living, which allows the provider to have both assisted and independent living residents. The second property was built in 2005 in Jacksonville, Oregon. It has 37 independent living units, 51 assisted living units and 11 cottages with overall occupancy of 95%. Both properties will be managed by an affiliate of Radiant Senior Living, which operates 13 senior living communities in Oregon, Washington and Montana.

North Dakota-based Edgewood Real Estate Investment Trust has purchased four senior living communities in South Dakota and has leased them to Edgewood Group LLC. The seller was a joint venture between Sanford Health and The Evangelical Lutheran Good Samaritan Society. The properties are all small, with a total of 90 assisted living units in Mitchell, Sioux Falls and Watertown, plus 24 independent living units on the Watertown campus. Overall occupancy is about 88%, which means there are just 14 empty units among the four buildings. Despite being built between 1995 and 2001, the buildings are in “immaculate” condition. Assisted living rates are between $3,300 and $3,400 per month. Edgewood Group, founded in 1992, now operates 47 communities in seven states, with the largest concentration in South Dakota (10), Idaho (9) and Minnesota (7). No financial details were disclosed, and a local Sioux Falls broker represented the seller.

Moving up to Canada, Chartwell Retirement Residences (TSX: CSH.UN) purchased a 109-unit retirement community in Kamloops, British Columbia that opened in 2012 and has a current occupancy of just 52%. The purchase price was C$21.5 million, or C$197,200 per unit, and the property is located on eight acres and has expansion potential for an additional 80 to 90 units once the first phase is filled. The deal was financed with cash, plus a C$11.8 million five-year mortgage with a 3.65% interest rate. This acquisition will complement Chartwell’s 97-unit community in the Kamloops area.

In Memoriam. Last week, the senior care industry lost one of its pioneers and major personalities. Andre Dimitriadis, who founded LTC Properties in 1992, died after a long illness. Prior to founding LTC, he was the CFO of the former Beverly Enterprises, at the time the largest skilled nursing company in the country, and he held the same position at American Medical International and Western Airlines. Among his many accomplishments, he held a Masters degree in computer science from Princeton University and a Ph.D. in Economics from New York University. Our thoughts are with his family.
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