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After months of rumors about the potential sale of Holiday Retirement Corporation in order to meet a huge debt maturity next August, a smaller deal took shape over the summer. Ventas finally disclosed that it purchased just 26 properties for $790 million. Is this just the beginning?
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New Development On The Rise
After several years of somewhat limited development in the seniors housing market, there has definitely been an uptick. But is it cause for concern, or have developers, lenders and investors learned any lessons from past mistakes? We think they have, but it is all in the site selection and operations.
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VENTAS BUYS PARTIAL HOLIDAY PORTFOLIO
Smaller Than Rumored, Price Is Second Highest For 2013

One of the fun things about going to the annual NIC conference are the rumors, large and small, that are whispered in the corridors and not so whispered at the bar later at night. Was Jay Flaherty fired from his job as CEO of HCP, Inc. (NYSE: HCP) because he proposed a sale of the REIT to one of its large competitors so he could reap his option gains? Or did he get fired so the board could eventually move forward with a sale to Ventas (NYSE: VTR), which wouldn’t happen with him standing in the way, creating the largest health care REIT in the universe? Did Emeritus not hold analyst meetings at the conference because it was close to an agreement to merge with… Brookdale Senior Living (NYSE: BKD), or Health Care REIT (NYSE: HCN) or Kindred Healthcare (NYSE: KND)? Kindred? Given the promising strategy that Paul Diaz has been following with KND’s clustered market approach, he would receive the next pink slip with that deal. But such were just a smattering of the big rumors discussed with raised eyebrows and constant checking of stock prices and news. As funny as many of these rumors sound, usually where there is smoke there is someone trying to light a fire.

There had been rumors all year that something was going on between...
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NEW DEVELOPMENT ON THE RISE
But Will We See A Repeat Of The Last Building Binge?

There has certainly been a lot of talk recently about all the new development going on in seniors housing. But when we say “seniors housing,” we are really talking about assisted living and memory care. There is a small amount of new construction starting up in the CCRC side of the business, as well as some high-end skilled nursing developments, sometimes with an assisted living component, but we hear of very little true independent living new construction with the exception of a few companies, notably the former boys from Holiday Retirement who kept on building and filling and now have the “Hawthorn Touch.”

Excluding skilled nursing and “senior apartments,” which are defined as age restricted and not providing meals to residents, the existing inventory of senior housing according to the 2013 NIC/ASHA Seniors Housing Construction Trends Report consists of about...
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continued from page 1...

Ventas and Holiday Retirement Corporation. Initially, Ventas and Fortress Investment Group (NYSE: FIG), which controls the Holiday portfolio, could not come to terms on a purchase price for the entire company, but that they were close, or so went the rumors earlier this year. At the NIC conference, there was a “rumor” that 60 or 70 of the top performing Holiday properties were on the market for $1.5 billion or maybe more. It is obvious now that the lines of communication between Fortress and Ventas remained open, whatever the discussions actually were. During the third quarter, Ventas did complete a deal with Fortress, but for just 26 of the Holiday communities with 3,138 units. This was not disclosed until VTR’s third quarter earnings were released in late October. Some of the equity analysts were a bit perturbed that a deal of this size was not disclosed earlier, even though it technically does not meet the materiality requirements of the SEC. All three of the Big Three REITs have taken to only disclosing their transactions as part of each quarter’s earnings release, unless there is a really big one, like Ventas buying Brookdale (oh, there we go again).

The purchase price for the actual deal was approximately $790 million, or $251,750 per unit. This compares with $188,600 per unit Fortress paid for the entire portfolio of 299 properties back in early 2007. This smaller group has an average occupancy rate of 94%, which is at least 300 to 400 basis points higher than the rest of Holiday’s portfolio, which may help explain the relatively high price paid by Ventas. Then again, we are not sure what the “real” occupancy at Holiday is after the fiasco and settlement involving “alleged unlawful marketing of senior housing to veterans.” Very few details were forthcoming on the acquisition, but another shoe from this portfolio may drop in the next few months. In the meantime, we have estimated revenues for the 26 properties to be just under $100 million with an approximate EBITDA of $49.5 million, which results in a 6.25% in-place cap rate. Six years ago the cap rate was 5.75%, which most people thought was too aggressive. But a few of the large REITs were right behind Fortress with offers at cap rates closer to 6.0% at the time, and Ventas may have been one of them.

We say another shoe may drop because, as readers should know by now, Fortress has to do something by August of next year when its approximately $4.5 billion of Fannie Mae debt is due. This may be down to $3.8 billion if all of the $790 million sales price went to pay off the debt. But the sale to Ventas does two things. It makes the sale of the entire company less attractive to another buyer, because a strategic buyer may not want to be saddled with long-term leases on some of the better properties, and a REIT buyer may not want to transact with a company that already has a large REIT relationship. Unless, of course, it is a friendly related REIT, or the same REIT. In addition, because Holiday is growing through acquisition, it appears that Fortress would not mind keeping the portfolio in some shape if it can complete a capital event that accomplishes two things: It has to pay off the Fannie debt, and it has to provide a return to the fund(s) that made the $2.0 billion or so equity investment back in 2007. The five- to seven-year itch is upon them.

The Fortress people are financial engineers and not operating company people (duh). The problems and turnover at Holiday may be a case in point, but so far the financial engineering has not been all that successful. But they may have the last laugh. The third quarter sale to Ventas represented less than 10% of the Holiday properties but yielded proceeds close to 18% of the debt outstanding. Not a bad first step. It shows lenders, buyers, potential landlords as well as the IPO market that there is significant value in the portfolio, which may open a few
more doors as the clock continues to tick (nine months to go). One particular comment by Wes Edens, Co-Chairman and private equity Chief Investment Officer at Fortress (otherwise known as the grand pubah), made on the earnings call of a REIT they have a significant interest in, Newcastle Investment Corp. (NYSE: NCT), was more than interesting and started another wave of rumors. In referring to the seniors housing business, and we quote, “There are also a handful of larger transactions, one in particular that would really be catalytic if we were able to get this sorted out. And if that came in the short term that would probably give us that kind of heft to the business to be a standalone business one way or another.”

Oh my, what large transaction could he be talking about? We question Newcastle’s ability to buy Holiday, or even a large part of Holiday, but you have to admit, that would just be the sort of thing Mr. Edens would try to do. But as you will see below, there is no shortage of acquisition opportunities, large and small, to choose from, and Newcastle needs a few more baby steps before it goes for the kill. Or so we think. From a transaction volume perspective, through the first three quarters, 2013 is ahead of 2012, and when you add in October’s results with more than 20 deals, the year will be robust, to say the least. And November and December are gearing up to be busy months, so watch out. And the Ventas deal for those Holiday assets? It comes in as the second highest priced deal of the year…so far. There we go again.

### The Providers

<table>
<thead>
<tr>
<th>Company</th>
<th>Ticker</th>
<th>Current Price 10/31/13</th>
<th>Adjusted P/E Ratio(1)</th>
<th>% Change from Prior Month</th>
<th>% Change from 1/1/13</th>
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<td>6.87 - 4.44</td>
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(1) Adjusted P/E = (market cap + total debt + capitalized leases - cash)/annualized EBITDA based on the most recent quarter. The rate used to capitalize the leases is 10.0%. (2) The company changed its name from Advocat in March 2013.

### Seniors Housing Acquisitions

Ventas wasn’t the only investor buying independent living communities. Kayne Anderson Real Estate Advisors, a private equity firm based in Florida, has just closed on the acquisition of the Aston Gardens senior housing portfolio in Florida. Although the price has not been disclosed, we believe it is somewhere near $200,000 per unit, which is a haircut from the last time this portfolio traded hands in 2006 at $460 million, or about $238,000 per unit. In that deal seven years ago, GE Healthcare Finance and Sunrise Senior Living joint ventured in a 75/25 deal for the 1,930 units when occupancy was at 95%. It was bad timing in the Florida market before the Great Recession, and occupancy tanked to below 85%. GE subsequently bought out Sunrise and put in Florida-based Discovery Senior Living to operate the portfolio. That turned out to be a great move, and no small wonder since they had been the original managers of the portfolio before Sunrise took over. Today, the portfolio is at 97% occupancy with 82% of the units independent living and 18% assisted living. Quite a turnaround and quite a deal.

The Carlyle Group (NASDAQ: CG) completed the purchase of a 128-unit community that was built in 1982 as affordable seniors housing in Middletown, New Jersey. Because so much time has lapsed, the community no longer has to abide by the income rules for its residents, so just 22 of “affordable” units are still occupied with rents about

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$1,100 per month. The market rate is closer to $2,900 per month. Overall occupancy is just 85%, which actually is not a problem for the buyer because they plan to convert a portion of the studios to assisted living and memory care. There are 96 studios and 32 one-bedrooms, so they have a lot of flexibility with that plan. To successfully execute the plan, Carlyle has hired The Arbor Company. The seller had already completed extensive renovations of the common areas, the kitchen and some of the residential units as it started the transition to market rents. The price has not yet been disclosed, and Ryan Maconachy and Chad Lavender of HFF represented the seller, which was a joint venture between Equity Resource Investments and Boston Communities, both based in Massachusetts.

Sentio Healthcare Properties completed its first acquisition as a result of an initial $150 million funding from Kohlberg Kravis Roberts (NYSE: KKR). Located in Woodbury, New Jersey, this community has a total of 227 units, of which 129 are independent living units, with an additional 57 assisted living units and 41 memory care units. The purchase price was $38.1 million, or $167,800 per unit, and the seller was an affiliate of Capital Health Group and Westport Capital Partners.

Capitol Seniors Housing closed on a $17.0 million purchase of a 100-unit independent living community in Liverpool, New York, near Syracuse. The community was built in 1994 but fully renovated in 2004, and occupancy is 100%, thanks to the management of Spectrum Retirement Communities, which will continue on as manager. Mark Myers of Marcus & Millichap and Ben Firestone, Jacob Gehl and Mike Segal, now with Blueprint Healthcare Real Estate Advisors, represented the seller.

The Salt Lake City office of Marcus & Millichap represented the buyer of a 73-unit senior living apartment community in Salt Lake City. The 78,330-square foot property was built in 2012 and sold for $12.8 million, or $175,300 per unit. All the units have a private patio or balcony, but this is a limited service building.

An unusual campus was sold in late October in Leawood, Kansas. Between 2002 and 2007, 44 independent living villas were built in 11 quadplexes on 13.74 acres. There is a clubhouse with indoor pool, fitness center, lounge and private dining room. Occupancy was just 75%, and based on that revenues and EBITDA were about $1.23 million and $760,000, respectively. The high margin is because there are limited services. The seller was an affiliate of a local Baptist Church Foundation, and the purchase price was $8.0 million, or $181,800 per unit.
In Canada, Chartwell Retirement Residences (TSX: CSH.UN) has purchased a 138-unit community that was built in 2009 but has suffered from low occupancy of 73%. The acquisition will offer some operational synergies with a nearby 126-unit community owned by Chartwell. The purchase price was C$27.0 million, or C$195,600 per unit, and it was financed with a C$15.3 million mortgage bearing an interest rate of 4.35% and cash from CSH’s credit facility.

**Assisted Living Market.** Allen McMurtry and his team at Cassidy Turley recently closed on the last two properties of an eight-community portfolio of assisted living and memory care communities in the Southeast. The buyer was American Realty Capital Healthcare Trust (ARC), and they paid a total of $143 million, or $223,400 per unit. Included in the sale was one development site in Georgia. These properties have an average age of 15 years and overall occupancy was 93%. There are 453 assisted living units and 187 memory care units. ARC will retain the existing manager, Atlanta-based The Arbor Company. While financial data has not been disclosed, we believe the in-place cap rate to be around 6% with some buyers believing that costs could be reduced, sending the cap rate up a bit.

Aviv REIT (NYSE: AVIV) has purchased three assisted living communities in Florida with a total of 200 units and licensed for 310 beds. The buildings are older with renovations completed in the 1980s. Average occupancy was just under 80%. That may improve with the new management. Florida-based Better Senior Living Consulting, with nine assisted living communities under management in Florida, has leased the properties from Aviv for an initial 10-year period and an initial cash yield of 10% plus escalators. Based on the current occupancy, annual revenues and EBITDA were approximately $4.55 million and $1.03 million, respectively. With a purchase price of $13.0 million, or $65,000 per unit, the in-place cap rate was 8.0% which is sure to rise after the new manager makes some changes. Ken Carriero of Colliers International represented the seller.

Massachusetts-based LCB Senior Living recently

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closed on the acquisition of a 60-unit Alzheimer’s facility located in Rhode Island. The facility opened in 2009, so we are not sure whether the low occupancy of just under 60% was a result of the timing of the opening or that there was an out-of-state third party manager operating the facility. Quite possibly both were a factor. But LCB has plans to stabilize it, and our guess is that they will be in a hurry. The purchase price was just over $183,000 per unit, reflecting the new construction and not the current financial performance. Wells Fargo Bank provided $8.6 million in bridge financing which is for three years with two one-year extension options, with interest only for the first three years. The structure makes sense to give LCB plenty of time to stabilize the property and produce a few solid years of cash flow before refinancing it. LCB’s joint venture partner, Prudential Real Estate Investors, invested close to $3.9 million of equity in the deal. The total of $12.3 million of financing was arranged by Richard Swartz, Jay Wagner and Aaron Rosenzweig of Cushman & Wakefield’s Senior Housing Capital Markets Group.

National Health Investors (NYSE: NHI) purchased a 63-unit assisted living community at the end of the month for $9.0 million, or $142,800 per unit. The seller was a local mom and pop and occupancy was just 80% at the property, which was built in 1999. NHI has leased the community to a current tenant, California-based Chancellor Health Care. The community is located in the Baltimore suburbs and current average rates are about $4,000 per month, which appear to be below market. We have estimated in-place revenues and EBITDA to be approximately $2.8 million and $700,000, respectively, but we believe after some changes are made with an additional $500,000 of funding from NHI for renovations, EBITDA will grow to at least $950,000 in 2014 and higher in later years. Chris Urban and Don Ambrose of San Diego-based Ambrose Capital represented the seller.

A 48-unit assisted living community in Spring Hills, Kansas was sold at the end of October for $7.0 million, or $145,800 per unit. The property was built in 2006 and 2010 and has 40 assisted living units and eight dedicated Alzheimer’s units. Overall occupancy runs at 100%, but about 15% of the census is Medicaid. Revenues and EBITDA in 2012 were running at about $1.9 million and $675,000, respectively, which results in a cap rate of 9.6%. An affiliate of NorthStar Realty Finance (NYSE: NRF) was the purchaser. Mark Myers of Marcus & Millichap and Ben Firestone, Jacob Gehl and Mike Segal, now with

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Blueprint Healthcare represented the seller.

A private investor who is new to the senior living space made his first investment with the purchase of a 45-unit assisted living community in Texas that was built in 2002 and licensed for 50 beds. The building has an eight-unit memory care wing, and overall occupancy was 92%. This acquisition actually closed in late August, with Leonard Lucas of Love Funding providing Love’s first balance sheet bridge loan in the amount of $4.6 million, with the $4.92 million HUD take out occurring in late October. The purchase and sale agreement was about to expire and since the borrower had already been approved by HUD, but could not get funding in time to close, Love Funding stepped in and helped the buyer get the deal done. The estimated purchase price was $5.5 million, or $122,200 per unit, and the buyer has hired the seller and previous operator, Texas-based Sodalis Elder Living, to manage the property.

Let’s hope three times is the charm. About 15 years ago, a local hospital in Ohio built a 61-unit assisted living community in Middletown for approximately $10.0 million, or about $164,000 per unit. Of the total units, 21 are for memory care. The hospital then sold it to Rittenhouse Senior Living in 2008 for $6.0 million, which then sold it to a local Kentucky owner/operator, Diederick Van der Velde, for approximately $4.0 million in late 2012 after not being able to turn it around. We hear that this Kentucky operator was able to turn it around, and apparently did so quite quickly. It looks like he teed it up for sale in just 13 months and Capital Senior Living (NYSE: CSU) will hopefully be the final owner, at least for a while. No price has been disclosed yet, but if the seller was able to increase the occupancy to 95% with average rates of $4,000 per month, using a 28% operating margin and an 8% cap rate would yield an estimated price near $9.5 million, which would make sense given the original construction cost.

In nearby Michigan, Evans Senior Investments closed on the sale of two small assisted living communities located in Fenton and Lake Swartz. They were built in 1998 and 2001 and have a combined total of 39 units. The two properties are located about 15 miles apart, and the combined occupancy is 95%. Revenues and EBITDA are about $1.4 million and $365,000, respectively, which yields a cap rate of 12.8% based on the purchase price of $2.85 million, or $73,100 per unit. The high cap rate reflects the small size of the buildings with no economies of scale. A regional owner/operator was the buyer.

Moving down to Florida, a small local operator with
a few Florida properties purchased an older assisted living facility in Hollywood, Florida. The 52-unit facility, which is licensed for 105 beds, was originally built as a hotel in the 1960s, but was converted to assisted living in the 1980s when an addition was completed. Occupancy is close to 97% (based on beds), but the majority of the residents are funded under the state’s “diversion” program (Medicaid). Revenues and EBITDA were $2.2 million and $460,000, respectively, and the purchase price was $5.7 million, or $109,600 per unit, yielding an in-place cap rate of 8.1%. John DeMarco and Gary Smith of the Smith DeMarco Group at Re/Max Executive Realty in Hollywood represented the seller, and this was his only senior living asset.

In neighboring Alabama, Bradley Clousing and Matthew Alley of Senior Living Investment Brokerage just closed on the sale of a 42-unit assisted living and memory care community that was built in 2009 and was the only asset of a local partnership that wanted to exit the business. Located in Jacksonville, which is in the northeast part of the state, this property has 27 assisted living units and 15 memory care units (SCALF). Occupancy was a bit low at 79%, and annual revenues and EBITDA were close to $1.2 million and $255,000, respectively. The seller had an active CON for nine additional SCALF beds, and apparently the buyer, a regional owner/operator making its first foray into Alabama, will utilize these beds as soon as they can activate them. The purchase price was $3.5 million, or $83,300 per unit, representing an in-place cap rate of 7.3%.

There is a market for properties large and small. Pamela Pyms of Denver-based Pyms Capital Resources represented the seller of a 36-unit assisted living facility in Colorado Springs, Colorado. Built in 1985, the facility participates in the PACE program and runs at 100% occupancy, about 85% of which is Medicaid. It was the seller’s only senior living asset, and it is the first senior living asset of the buyer, newly formed TrustCare. The buyer obtained financing from a bank in Pueblo, Colorado with an SBA guarantee. The purchase price was $1.81 million, or $50,300 per unit, and came with a cap rate of 15%, which seems appropriate given the size and census. Two months ago, Ms. Pyms represented the seller in the $19.5 million sale of an 82-unit community in Colorado to MBK Senior Living.

**Skilled Nursing Acquisitions**

It has been a little slow in the skilled nursing acquisition market, and while we are not sure if it relates to all the dysfunctional issues in our nation’s capital and the
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uncertainty that it creates for anything that relies mostly on government reimbursement, the environment can’t help. Despite these problems, buyers continue to see opportunity, especially with underperforming properties. Such was the case for New Jersey-based Tryko Partners, LLC and its recent acquisition of a 159-bed skilled nursing facility in Danvers, Massachusetts. Built in 1972, this facility has occupancy of 84% with a 91% Medicaid census. One of the problems is that of the 65 patient rooms, 37 are triples which limits the marketability to the private pay and subacute market. Tryko will decrease the number of triple rooms as part of its renovation plans. The facility was operating at just below breakeven on $10.3 million in revenues in 2012, but a few years ago was producing over $700,000 in cash flow.

Tryko paid approximately $4.0 million, or $25,200 per bed, but plans on investing up to $2.0 million in improvements. This will include converting a section of the building into a 30-bed subacute unit, adding a 1,500 square foot gym and developing a specialized Alzheimer’s program. This will take Tryko’s basis up to about $38,000 per bed, which is still cheap for Massachusetts, especially if it can fill the 30-bed subacute unit. The company is expecting it will take up to two years to bring the overall census to the low-90% or mid-90% level, with a Medicare census approaching 13%. At that time, EBITDA should be at least $1.0 million, but the real target is $1.5 million to $2.0 million as they change the reputation of the facility in the local market. The low end would still be a good deal for them, and not too difficult to hit, but the high end would certainly be a home run. One of Tryko’s existing banking relationships funded the acquisition. Mark Myers of Marcus & Millichap and Ben Firestone and Mike Segal, now with Blueprint Healthcare Real Estate Advisors, represented the seller, one of the national REITs.

Another mom and pop operator is now out of business, this time in Independence, Kansas. For a long time, the sellers operated a 55-bed skilled nursing facility that was built in 1969 and a 40-bed residential care facility that was built in 1962 and 2000. Occupancy was fairly high at 95%, with annual revenues and EBITDA of just under $4.0 million and about $325,000, respectively. At a combined purchase price of $3.25 million, or $34,200 per bed, the in-place cap rate was 9.9%. The buyer was a large regional operator with a significant presence in Kansas and a home office less than 20 miles away, so we assume they will bring some operating efficiencies to the facility and increase the cash flow to at least a 12% margin. Nick Cacciabando and Jeff Binder of Senior Living Investment Brokerage handled the transaction.
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In another turnaround transaction, but one with less potential than the Massachusetts nursing facility above, a Texas-based operator purchased a 115-bed nursing facility in Lufkin, Texas, which is located in the eastern part of the state. Originally built in 1919 but with additions and improvements along the way, it will still need some physical plant improvements. The good news is that it is located a block away from a major hospital in town, which is where we assume the buyer sees opportunity and where the out-of-state seller just could not capitalize on that location. The facility had a negative 3% margin on revenues of $5.9 million with occupancy of only 77%, mostly because 75% of the census was Medicaid, with VA (15%), private pay (5%) and Medicare (5%) making up the rest. The purchase price was $2.0 million, or $17,400 per bed, and the acquisition was funded by a local community bank, with Matthew Alley of Senior Living Investment Brokerage handling the transaction.

In the case of another local owner retiring from the skilled nursing business, but perhaps moving on to the assisted living side, a mom and pop owner is selling their 120-bed facility in Montgomery County, New York to a group of investors who have owned nursing facilities in New Jersey and Connecticut. Occupancy has been high at 95%, which is typical for New York, but we do not know how profitable it is. The county sold it eight years ago for a low price and we believe the current sellers turned it around. According to local reports, the sale is going through for about $75,000 per bed, and is expected to close by the end of the year.

New York-based Personal Healthcare, LLC has agreed to purchase a 120-bed SNF in Utica, New York from the Carmelite Sisters for the Aged in a transaction that will not close until sometime late next year because of New York’s archaic change of ownership procedures. The purchase price has not been disclosed yet, but the buyers operate seven nursing facilities in New York and Massachusetts that range in size from 80 beds to 183 beds.

Updates. In a transaction announced a few months ago, Aviv REIT (NYSE: AVIV) closed on the purchase of four skilled nursing facilities in Ohio (3) and Indiana (1) from an affiliate of Catholic Health Partners. The purchase price was $35.9 million, or about $52,500 per bed, and Aviv has leased the facilities to Diversicare Healthcare Services (NASDAQ: DVCR). Separately, Prestige Healthcare closed on the acquisition of 15 properties in Michigan from Medilodge Group. The purchase was funded by LTC Properties (NYSE: LTC) and Evans Senior Investments represented the seller.
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New Development On The Rise

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526,000 IL units, 331,000 AL units and 80,000 memory care units in the 100 largest MSAs. So there are about 1.3 times as many IL units as there are AL and memory care (MC) combined. But, according to the report, when you look at units under construction as of March 31, 2013 in these same 100 markets, there were about 8,500 IL units but twice as many AL and MC units at 16,500. What is odd is that we really don’t hear about the IL development, mostly the AL and MC, even though most of the new IL units are in predominantly IL communities.

What worries some people is that the AL/MC under construction represents about 4.0% of inventory, while the IL is only 1.6% of existing inventory. We all know that assisted living and memory care are need driven, and that the need is only going to grow with the aging population. But the big question is, how many of that aging population are going to be able to afford what is becoming increasingly expensive as more bells and whistles are added to the new developments, and as acuity levels continue to rise in the new and existing properties? No one really has a good answer to that question, other than the residents will use their assets to afford it or to supplement their income, or that their children will pitch in to help pay for it. All of this may be true, but some units will get filled and others will not.

While the market has yet to feel the full impact of the new development, primarily because it is really just picking up steam as far as openings, one of the problems will be the $250,000 and higher per-unit cost to build many of these new properties, which is definitely at the high end of the acquisition market values. During the last decade, we heard many providers sort of relishing, in a perverse sort of way, new competition coming into their market because they could beat them on two counts. One, their capital cost was much lower, so they had better flexibility on pricing that the new guy on the block did not have with his new construction. Two, they had their reputation to market (assuming it was a good one), and as we all know, health care is local, and once you are known as a quality provider, that tends to count for more than the common area finishes, the unit sizes and the indoor pool, at least for assisted living and memory care. And let’s not forget about food.

But having lived through the last overbuilding fiasco, there are several differences this time around. First of all,
there seems to be more equity involved in most, if not all, of the new developments. Whether from private equity firms (which are funding a lot of the projects these days and is not known for being stupid money), high-net worth investors or just developers’ own cash, the 110% leverage of the past just does not fly in most cases. There are no more “black-box” financing structures that morphed into “grey-box” deals more than 10 years ago, and no one is trying to open one new property a week (like the former Alternative Living Services which became Alterra). You just can’t find competent staff to do that, as they found out. Today, the companies that have decided to continue their development programs or start new ones are really looking at five to six per year as the upper end, if they can find the sites. The only one we believe is exceeding this is Hawthorn Retirement Group, but given their track record, no one doubts their ability. They are just too good.

In addition to the equity, the debt is also more conservative this time around. Bank lenders are coming back into the market, but they know there are many people inside and outside their organizations watching every step of the way. There is nothing like a banking crisis to provide a certain level of caution. The other thing that is different is that the assumptions are less aggressive in terms of fill-up, more by underwriting necessity than what the developer really thinks. Consequently, the projects are sometimes overfund, meaning that the combined debt and equity is more than necessary to fund the actual fill-up time, which should be faster than the underwritten number of months.

Finally, from what we have heard, the site selection process has become more refined than 10 years ago, and certainly than the late 1990s when often times a wealthy Zip Code was all they needed. Although many people talked the talk back then, and assisted living was relatively new (at least the types of communities that were being built), the required level of sophistication was just not there all too often. There was certainly a bit of the “if we build it they will come” syndrome, and in too many cases they stopped coming. But today, with fewer developments per company, a stronger site selection process, more equity and more conservative assumptions, on top of the slowdown in development during the Great Recession, there should be smoother sailing than the last time around. There will be bumps and unfilled properties in some markets, but the key to success will always be management and the quality of the operations. Just look at Legend Senior Living. It has seven of its 16 assisted living communities in Florida, and those Florida properties almost uniformly have the highest monthly rates in their respective markets, and across the seven there may be only a handful of empty
units, if that. That is 99%-plus occupancy. But that is not true for the competition. Site selection may have helped for these new buildings, but you have to walk the walk to remain full at high rates. Legend does not accept 93% as a goal or “stabilized” occupancy, and you just have to ask yourself why the industry average is 10 percentage points below that of Legend. It’s the operations.

All the focus has been on assisted living and memory care development, but as we mentioned, the largest existing segment is independent living. While Hawthorn continues to hum along, there is a smaller company that seems to have found the right formula as it grows its IL portfolio. Lincoln, Nebraska-based Resort Lifestyle Communities (RLC) has nine stabilized independent living communities with six under various stages of development, including three where construction has started, and more on the drawing board. Unlike many companies, they are not looking to grow a particular region, but target the largest 100 MSAs in the country and through a refined approach look for the best market for their particular product, which from a price-point basis is close to Holiday Retirement but from a quality and cost to build, at a higher end. Their properties are currently in Nebraska, Kansas, Missouri, Texas and Tennessee, with future openings in Georgia, Ohio, Florida, and Arizona. One might say that the geography makes no sense, but according to management, it’s all about site selection. Why build a community 100 miles away if it is not the best market for your product? They have a point.

The company has developed a stable of more than 100 investors who put up the equity for the new development, typically about 20% of the cost, and bank construction debt funds the rest. They have used Key Bank, Wells Fargo, First National Bank of Omaha and Union Bank, among others. The typical community has between 120 and 140 units, with 60% one-bedrooms, 30% two-bedrooms and a few studios and three-bedrooms. They have found that about 30% of the units are double occupied upon move-in (couples), but over time this decreases to 22%.

On average, they raise a total of $25 million per development, but it really depends on the size. And the investors must like the fact that they do not charge a development fee. They forecast an operating margin of 55%, and upon stabilization they use a conservative 8.5% cap rate on EBITDA, which usually results in an equity value of $12 million to $14 million above the debt. That leaves plenty of room for the construction take out financing, and the high returns to investors. With one exception, those
communities open for at least two years have an average occupancy of just about 94%, well ahead of the national average.

For RLC’s stabilized properties, that has resulted in IRR’s to the investors ranging from 14% to 30%, with most above 20%. It is no wonder that these investors keep coming back. But many lenders and investors still seem wary of the IL product after the recession, given that it is not need-driven, which seems to be the sweet spot these days. But in one of RLC’s new communities in Tennessee that opened August 1, it is already at 55% occupancy and growing. Perhaps not need-driven, but it was certainly “want-driven” to fill more than 60 units in three months. And residents are moving in from the competition, which says a lot. We bring all this up, and use RLC as an example, because assisted living and memory care are the hot developments right now because they are “needed,” but they still need to be built in solid locations. Perhaps RLC is taking advantage of the lower interest in IL developments and finding great markets that match their product when no one else is even looking. As long as they remain disciplined in their site selection process, and they keep on providing investors with returns in the mid-20% area, this company will continue to grow and we may be talking about the “RLC” touch one of these days.

TURNAROUND TIME

A few years ago, we started a column covering turn-around situations. While the high-priced, low-cap rate deals tend to get the glamour, readers know that there are many acquisitions with somewhat low values and in-place cap rates that are basically irrelevant. We always hear about how occupancy will go from 70% to 93% in less than 12 months, cash flow (if any existed) will double or triple and the value will be at least twice what the buyer paid for the property (or so we estimate). We are sure readers are often suspect as to how real these projections are and how the new owner will actually accomplish the feat. After all, if it was so easy, why didn’t the seller do it as opposed to suffering through years of minimal or negative cash flow?

You may remember a few years ago when Kandu Capital and its operating affiliate, Bloom Senior Living, took over an ailing Sunwest Management property in South Carolina that appeared to be a dog with a capital D. The campus included an empty building with major mold problems, struggling census and a local reputation that few buyers would want to tangle with. As we wrote back then, they turned this lemon into lemonade, adding 23-units of Alzheimer’s care in January 2011 which filled in three months. They then added 25 more Alzheimer’s

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units in January 2013 and these are almost full. They have independent living, assisted living and Alzheimer’s care on the campus, and it is humming along and became the market leader.

It is one thing to turn a property around in a market, but to try to do it again within a few years, and with two separate properties, is either sheer madness or brilliance. Or, it is understanding your market, what makes it tick and having the confidence in your ability to properly run these types of communities. Last March, the same group purchased an additional property in the same town as the first one (across the street, actually) that had 43 assisted living units and 16 Alzheimer’s units. The second property in this acquisition was 10 miles away and had 42 assisted living and 15 Alzheimer’s units. These two communities were underperforming but had average revenue per occupied unit of just under $4,000 per month. Combined occupancy was just 73% compared to almost 100% for Kandu’s existing property. The combined purchase price for these two buildings was $7.2 million, or $62,000 per unit, and the buyer projected to hit stabilized occupancy of 93% within 12 to 18 months and annualized EBITDA of $1.5 million. Well, there are some things that just don’t turn out as planned.

Today, the community across the street from Kandu’s existing property is 100% occupied with an average revenue per unit of nearly $4,200 per month. The other one is not performing as well, with occupancy of “only” 95% and average revenue of $3,520 per unit. With the census now approaching 100%, they expect to start pushing rents for move-ins to a higher level and closer to the $4,000 mark that the sister community is able to achieve. At the end of April, this community was at 64% occupancy, so it has increased by 30 percentage points in just six months. The other property went from 82% to 100% in the same six-month period. So management beat the 93% stabilized census target, and did it with six to 12 months to spare. Better yet, we have estimated annualized EBITDA at just about $1.5 million, and that is before any rate increases.

So, what is the value today? Pick your cap rate, but we will be conservative with 8.5%, which results in a $17.6 million value, or just over $151,000 per unit. Not a bad return.

So how does an out-of-state company accomplish such a feat? First of all, turning around the first property that was purchased a few years ago must have helped their reputation tremendously, since they hadn’t operated anything in the state before (or within hundreds of miles). And being a family-owned company didn’t hurt the marketing effort. In addition, renaming and rebrand-
ing that first community removed any former taint that may have been in the local market, and they had a very aggressive initial marketing campaign. Then, basically taking out one of their competitors in the market with the two-property acquisition went a long way to establishing them as the provider of choice, and having management get more involved with the local operations helped. The initial property still has a heavy independent living and what they call IL-plus mix (81 units, representing 63% of that campus), and that has worked well as a feeder to the two newer acquisitions, even though it has been just six months. Of course, some capital improvements were involved, but they were not the drivers of the increased census as is so often the case with other turnarounds. And the seller’s key staff remained in place, but were given the flexibility and tools needed to get the job done as opposed to being restricted as so often happens with a corporate office 1,000 miles away. Although we are sure Kandu could sell these at a price close to our estimated value above, there is little reason to do so right now as they build up their portfolio. Besides, they can take 100% of their equity out (plus some) with a financing, and the future returns will be all gravy (or in this case as well, sweet lemonade).

**Financing News**

In some ways, it would have been better if the recent government shutdown had occurred before the end of the fiscal year, at least for HUD borrowers, because HUD had already reached its $25 billion total commitment author-

ity before the end of the third quarter and some rationing began to take place in the waning weeks. But according to Steve Ervin, Senior Vice President of Berkadia Mortgage Capital, when the $25 billion in commitment authority for the 2013 fiscal year was set, no one thought it would ever be reached, especially since that was the largest amount ever committed. It was the historically low interest rates before May that basically changed the scenario, as 2.5% to 3.5% all-in cost of funds was low enough for it to make economic sense even for those borrowers who had a significant prepayment penalty. And according to Ervin, it was the commitment authority ceiling that was much more disruptive than the government shutdown, even though HUD did try to get every commitment out the door before October 1. And contrary to what most of us thought, with a skeleton staff, HUD did close some loans in October, prioritizing those that would be the most harmful to the borrower if they did not close on time.

As for 2014, the commitment authority is once again set at $25 billion, and
because we still don’t have a federal budget, the HUD lending authority will be set on a pro rata basis from October 1 to January 15 of next year. It is expected that the backlog of deals that were delayed should be cleared up by mid-December, but with interest rates still 100 basis points higher than they were in early May, it is unclear exactly what that will do to demand for HUD loans, other than making refinanceings uneconomical for some borrowers. The uncertainty may also keep some borrowers out of the HUD market, just like the interest rate uncertainty is causing some buyers of the HUD guaranteed debt to demand higher rates in the market. While we are sure all the HUD lenders would have had even better years if not for the commitment ceiling problem, it was still a banner year, and Berkadia informed us that in the seniors housing market they should complete between $300 and $400 million of HUD loans this calendar year, plus $400 to $500 million of Fannie Mae and Freddie Mac debt, which combined was higher than in 2012. As for 2014, they would like to see a total of $1.0 billion.

Despite the commitment authority ceiling and the government shutdown amid other dysfunctions in Washington, D.C., the HUD LEAN program did set a program loan production record with a total of $5.82 billion completed for the fiscal year ended September 30, 2013, or about 6% higher than in the previous fiscal year. A total of 766 loans were closed by 49 different lenders, but for the second year in a row Lancaster Pollard had the largest loan production with 118 loans in 25 states totaling $811.7 million, or 13.9% of the total program dollar volume. We expect the full rankings to be released by HUD shortly, but it was a great year for every HUD lender.

Lancaster has a HUD pipeline of more than $1.4 billion, and is off to a good start so far. Ever sinceHUD interest rates dropped to the low single digits, we have been asking why more not-for-profits have not been tapping the HUD market over tax-exempt bonds. Acknowledging that there are certain benefits to the tax-exempt market, such as higher loan-to-values, HUD can still be quite an alternative. Lancaster closed a few such loans recently, including the refinancing of one skilled nursing facility and one assisted living facility owned by an affiliate of Baptist Homes, Inc. The two loans totaled $9.1 million, or $54,800 per bed, and were arranged by Chris Blanda of Lancaster. Meanwhile, Kass Matt used HUD to refinance tax-exempt bonds of Lutheran Social Services of Central Ohio. With a 30-year term and a low interest rate, the $4.6 million of new debt provided the borrower with more than $700,000 for repairs and improvements and more than $1.2 million for a replacement reserve account for the 130-bed skilled nursing facility.

On the for-profit side, Matt refinanced a 150-bed skilled nursing facility in Ohio, with the funds used to expand the facility’s therapy and memory care space and other renovations, and it resulted in annual debt service savings of nearly $125,000. In Illinois, Steve Kennedy closed an $8.7 million HUD loan to refinance a 72-unit assisted living community. The loan represents an annual savings of more than $210,000 in debt service payments for the borrower.

Capital Funding Group (CFG) closed on a $6.576 million HUD loan on an 88-bed skilled nursing facility in South Carolina that refinanced a bridge loan CFG put in place, allowing for the timely acquisition of the property. CFG also completed HUD financing for six SNFs and one ALF in New York with a total of 1,001 beds for a total loan amount of $78.2 million.

Infinity Health Care Management was one of the lucky ones. Working with Joshua Rosen of Beech Street Capital, the company was able to refinance two skilled
nursing facilities in Illinois with 415 beds in a $27.8 million funding with HUD. Infinity had a rate lock that was set to expire at the end of October, so the team worked with the HUD offices during the government shutdown and got the deal done. This was the second portfolio Infinity has done with Beech Street this year, bringing the total to more than $83 million. Separately, Capital One Financial Corporation (NYSE: COF) just closed on its purchase of Beech Street.

Cambridge Realty Finance has been busy. It completed a refinancing of a 158-bed skilled nursing facility in Missouri for $14.9 million, or $94,900 per bed, plus a smaller $3.1 million loan in Missouri to a 111-bed nursing facility at $27,900 per bed. The Chicago-based lender also closed a $3.66 million HUD loan, or $29,800 per bed, to refinance a 123-bed nursing facility in Mattoon, Illinois, as well as a total of $13.5 million to refinance three assisted living facilities in California that have a total of 263 beds. The loans averaged $51,300 per bed.

Johnson Capital has recently closed a few HUD loans, including a $7.6 million financing for a 101-bed skilled nursing facility in Pennsylvania and a $2.0 million loan for a 40-bed assisted living facility in Oregon.

In the bridge to HUD business, Housing & Healthcare Finance closed a $5 million bridge loan to refinance the existing debt of a 118-bed skilled nursing facility owned by AdCare Health Systems (NYSE: ADK). We are not sure if this got caught up in the commitment authority problems or if AdCare wants some time to improve the cash flow of this property before obtaining permanent financing.

In other agency deals, Monique Bimler and Martin Mbeteni of KeyBank Real Estate Capital arranged an $8.5 million loan through Fannie Mae to finance an Alzheimer’s facility in Turnwater, Washington. The borrower was Vancouver, Washington-based JEA Senior Living, which owns and/or operates 29 facilities in 12 states.

Balance Sheet Loans. GE Capital, Healthcare Financial Services is having a solid year in seniors housing finance. Although the lender does not publicize many of its deals, GE expects to do about $2.5 billion in health care lending this year, with about $2.0 billion of that in seniors housing and care. GE expects to do at least that amount in 2014. The big difference between now and six or seven years ago is that they are doing three times as many individual deals each year, approximately 70 or so, that...
may average about $30 million each, compared with an average of over $100 million each in the past. In a recent survey GE completed, the most important financing need that came up was for acquisitions (52% of respondents) followed by construction (36%). For areas of growth by property type, it was no surprise that 62% of the respondents listed assisted living, followed by memory care (41%), with skilled nursing the least cited area for growth at just 13% of the respondents.

One example of an under-the-radar loan by GE Capital involved the refinancing and repositioning of four properties in Texas. About 18 months ago, Cambridge Investment and Finance Co., a subsidiary of Cambridge Realty Capital, purchased four underperforming senior living properties with 298 units in Texas from Emeritus Corporation (NYSE: ESC). Since then, the properties have been managed by Dallas-based 12 Oaks Senior Living, and occupancy has increased by 24% to 92%. A new certified memory care center has been added at one of the communities, and part of the proceeds of the current refinancing will be used to add 75 licensed beds across the portfolio. GE Capital provided $28 million in financing to repay the borrower’s first mortgage and mezzanine debt, as well as to fund the future expansion and other improvements. The LIBOR-based floater has a five-year term. The Cambridge-owned properties operate under the name SunRidge Senior Living, and Cambridge currently owns 16 communities.

Balance sheet lending has certainly been the name of the game lately for construction financing. Red Capital Partners closed on a $20.6 million construction loan to fund the development of a new 75-unit assisted living and memory care community in southern California that is licensed for 90 beds. The loan amount comes to $275,000 per unit. It is southern California, after all. Apparently, it is the first purpose-built community in the Sierra Madre area in the past 10 years. It is anticipated that the five-year, non-recourse loan will be refinanced with a permanent loan by Red Mortgage Capital. The borrower is Kensington Senior Living.

Cushman & Wakefield’s Senior Housing Capital Markets Group has arranged $44.6 million in construction financing for two new senior living communities that will be built in Connecticut. The debt financing is from M&T Bank with joint venture equity from Prudential Real Estate Investors. Both properties are being developed by Massachusetts-based LCB Senior Living, and the first one, where construction started in August,
is in South Windsor and will have a total of 80 units of independent living, assisted living and memory care. It is expected to open in the fall of 2014. The second property will have a similar unit mix with 74 units in Avon and is expected to open in late 2014. Richard Swartz, Jay Wagner and Stuart Kim of Cushman & Wakefield worked on these financing transactions.

It seems if you want mezzanine financing to get your deal done these days, two choices are Contemporary Healthcare Capital (CHC) or Herbert J. Sims. CHC provided $2.315 million in mezzanine financing, on top of a $14.5 million construction loan, for a 107-unit assisted living community in northern California. Meanwhile, Herbert J. Sims raised $2.4 million to help Athena Health Care Associates buy a skilled nursing facility in Rhode Island. Sims created an entity which issued the taxable bonds to Sims’ accredited investors, and the proceeds were then invested as a preferred equity investment in the entity that was buying the 166-bed facility. And the demand for those taxable bonds? Oversubscribed by investors looking for yield.

Aron Will of CBRE has arranged non-recourse construction financing on behalf of a joint venture between Capitol Seniors Housing and Welbrook Senior Living to build a new 70-unit assisted living and memory care community in Torrance, California that is licensed for 78 beds. This will be the first phase, and phase two is expected to have an additional 45 units. The $12.05 million floating rate loan includes a three-year interest-only feature and the floating rate spread is in the mid-300s. Non-recourse funding for new construction isn’t all that common, and CBRE received three proposals that were all non-recourse.

Midcap Financial has secured an additional $200 million in a credit facility led by Wells Fargo Capital Finance, with three new banks added to the lending group. The total credit facility is now $800 million. In mid-October Midcap purchased two mezzanine debt tranches related to outstanding debt of Sava Senior Care, and with the new capital capacity, they expect to close a substantial amount of their pipeline by the end of the year.

Tax-exempt market. Not many developers/operators will sink a lot of their own funds in a new development, especially a rental CCRC in Michigan, without having any construction or permanent financing lined up. But that was the situation for an affiliate of Riverview Health in Gross Pointe Woods, Michigan, for a 243-unit/bed community that broke ground in the beginning of 2013. HJ Sims stepped in to close the funding gap after the owner had already invested about $9.25 million of his own equity in the project. The for-profit owner was able to raise part of the funds with a $17.32 million, 30-year tax-exempt bond issue because 20% of the 77 IL units were set aside for people meeting the income test of 50% of the median area income. An additional $10.0 million in 15-year taxable bonds were sold by Sims for the portion of the project that was not eligible for tax-exempt financing. About 35%
of the total debt was sold to Sims’ retail investors, with the rest to institutional buyers and bond funds. When finished, the 9-acre community will have 77 IL units, 80 assisted living units and an 86-bed skilled nursing center. It is expected to open in the first quarter of 2014. On the same site, Riverview Health has also completed 26 of 40 IL cottages that are sold as condos, and all have been sold.

**REITs**

Although you can’t tell by looking at the REIT stock chart, every single REIT in our universe jumped in price in October, ranging from 1.3% for HCP, Inc. (NYSE: HCP) to 16.9% for Sabra Health Care REIT (NASDAQ: SBRA). Other double-digit increases came from Aviv REIT (NYSE: AVIV), National Health Investors (NYSE: NHI) and Omega Healthcare Investors (NYSE: OHI). The recent 50 basis point drop in interest rates didn’t hurt, but REIT performance has also given investors renewed confidence. Both VTR and HCP increased their earnings guidance for 2014, something that always gives a little goose to the share price.

Both Omega and LTC Properties (NYSE: LTC) announced increases in their dividends, with LTC increasing its payout by 9.7%, an unusual jump. During October Omega sold 2.5 million common shares at $30.00 per share with Jefferies LLC as the underwriter. Meanwhile, LTC has committed $19.6 million to an existing tenant, Anthem Memory Care, to build two free-standing memory care communities in the Denver, Colorado market, one with 60 units and the other with 56 units. LTC has also entered into a pipeline agreement with Anthem whereby LTC will have the exclusive right to finance any seniors housing acquisitions or development projects through May 2018. The one caveat is that Anthem will be limited to five communities under construction at any one time.

HealthLease Properties Real Estate Investment Trust (TSX: HLP.UN) acquired a 123-unit skilled nursing and assisted living facility located in Lexington, Kentucky from Health Care REIT (NYSE: HCN) and leased it to Louisville-based Trilogy Health Services. The purchase price was $14,123,350, or $114,800 per unit, and the property has 54 skilled nursing beds, 34 assisted living units and 35 memory care units. Annual rental income is expected to be $1.2 million, for an 8.5% yield. Separately, HealthLease sold a 132-bed nursing facility in Valparaiso, Indiana to Trilogy for $11,469,996, or $86,900 per bed.

Senior Housing Properties Trust (NYSE: SNH) purchased a 60-unit assisted living community located in Jefferson City, Tennessee for $9.9 million, or $165,000 per unit. The seller was a mom and pop, and SNH has hired Five Star Quality Care (NYSE: FVE) to manage it. The community was built in 2001 and has 40 assisted living units and 20 memory care units in a separate building. It has been 100% occupied with a waiting list for many years. Robert Black and Sean McNee of the San Diego office of Cassidy Turley represented the seller. Separately, in August SNH signed an agreement to acquire a 68-unit assisted living community in Verona, Wisconsin for $12.0 million, or $200,000 per unit. When the transaction closes, Five Star will also be the manager of this property.

Sabra Health Care REIT has reduced its exposure to skilled nursing facilities to 70.6% from 82.1% and its exposure to Medicaid and Medicare reimbursement to 58.3% from 68.4% with the recent acquisition of a hospital and a $110.0 million mortgage loan secured by another hospital, both in Texas. Both hospitals are managed by Vibrant Healthcare.

**People on the Move**

Beech Street Capital has named Ginger Petroff as Vice President of originations for the seniors housing group in the Chicago office, coming from Red Capital Group….Scott Cousino has joined England & Company, a boutique investment bank, as a Managing Director for health care banking. Most recently he was with Stifel Nicolaus….Tommy Ryan has joined the Salt Lake City office of Healthcare Finance Group as a Senior Vice President of business development….Vero Beach, Florida-based Watercrest Senior Living has hired Michele Thompson as Vice President of operations. Thompson has worked at Horizon Bay, Brookdale Senior Living, HarborChase and Arden Courts….Tim Hekker, CEO, and Lori Alford, COO, have formed Avanti Senior Living and will break ground in early 2014 on two new developments in Texas.

In Memoriam. Abe Gosman, an industry pioneer and, at one time, the CEO of three publicly traded NYSE companies including a health care REIT, an assisted living company and a physician medical group company, died on October 21. He was a friend going back many years, and according to Abe, our founder, Irving Levin, sold him his second nursing facility way back in the day. He was a giant in the industry known for his Midas touch, but fell on hard times in the end. Our thoughts and heart are with his family.