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INSIDE THE WORLD OF SENIOR CARE MERGERS, ACQUISITIONS AND FINANCE SINCE 1948

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TURNAROUND AT HOLIDAY RETIREMENT

After Hitting Bottom Three Years Ago, Prospects Improve

A little over three years ago, we started hearing that things had not gone as planned for **Fortress Investment Group's** (NYSE: FIG) high-priced acquisition of **Holiday Retirement Corporation**, at the time the largest retirement housing company with more than 300 communities and 35,000 units. You will remember that funds affiliated with Fortress purchased Holiday in early 2007 for a then-record price of just over $6.6 billion, or $189,000 per unit, and a cap rate reportedly around 5.5% to 5.75%, which was a shocker at the time. But there were a few other bids within 10% of the winning bid, so FIG was not alone with its valuation. Well, at $6.6 billion they were, and it got a lot lonelier within a few years.

As part of the transaction, and why we believe Fortress "overpaid" for the assets, was the development pipeline of 12 to 15 communities a year which they had the right of first refusal to manage and acquire. In the past, these annual developments were expected to throw off more than $1.0 million of EBITDA each once stabilized, so FIG was looking at up to a $75 million increase in annual EBITDA after six years if things stayed on track. Unfortunately, as we all know, the train fell off the track as the Great Recession brought down the housing market, and many other things,

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QUALITY IS KING FOR ACQUISITIONS

New Report Reveals Pricing Differences By Quality

Last summer we decided to take a look at the seniors housing acquisition market based on the quality of the assets purchased. We used the 24-month period from July 1, 2010 through June 30, 2012 for two reasons. First, the market bottomed out in the first half of 2010, with the first real increase in the volume of higher-quality properties selling in the second half of the year. We also used a two-year period to capture more data points since we were really dissecting the market between assisted living and independent living, and A quality and B quality. The results of the study were released in the August issue.

We have updated the numbers using the two most recent calendar years, and while the differences were not significant since they both overlapped by 18 months, the average A and B price per unit for both assisted living and independent living increased, which makes sense given the improv-

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and Fortress decided not to take any additional buildings when it looked like occupancy levels might take a hit. But as they say, someone's loss is someone else's gain, and the former Holiday management and development team kept on building, and filling, their new developments, and we are sure Fortress management would like to have that additional $75 million of cash flow now, but we will never know if they could have done what the **Hawthorn Retirement Group** team has been able to do.

When Fortress took over Holiday, overall occupancy was about 89%, but after removing those communities opened for only 18 months or less, occupancy was closer to 92%, with 50 communities at 100%. A year after the acquisition, occupancy had declined by about 200 to 300 basis points, which could be explained by some trauma with the management change as well as the beginnings of the financial crisis. But by early October 2009, in the full throes of the recession, the census had plunged to 80%, and six months later we learned that it had dropped below 80% to about 75%. It was during this time period that we called to find out what was going on. All that the now former CEO Jack Callison would say was that 2009 revenues were flat with 2008, withholding any comment on occupancy trends. Since we had a high degree of confidence in our census information, we just assumed there was no benefit to Holiday or Fortress to confirm our data.

Our analysis three years ago (May 2010 issue) showed that, based on rent assumptions and the occupancy numbers we had, the "value" of the Holiday portfolio had declined by well over $2.0 billion within three years of the acquisition, wiping out the FIG equity investment and, using an 8% cap rate (not conservative in early 2010), the value was close to the existing debt on the portfolio, most of which was the approximately $3.8 billion held by **Fannie Mae**. We also calculated and wrote at the time that occupancy would have to reach 90% with much higher rents to approach the original purchase price, again using an 8% cap rate. We used a scenario of increasing census by at least 50 basis points each quarter after an initial stabilizing period, increasing monthly rates by 3% annually, and by the end of 2014 occupancy would be approaching 90% and the debt would be 75% of the value. The impossible dream? We are happy to report that it appears they beat our forecasts by two years in one of the more astounding turnarounds in recent memory.

At the time of the original purchase, we believe that average rents were about $1,900 per month, perhaps a bit lower. Three years ago we heard that average rents had increased to $2,300 per month or higher, with new residents paying even more. That may have had a negative impact on occupancy during the recession. In the years before 2007, many of the residents used their Social Security checks to pay the rent, with little left over. And we have recently heard that Holiday may be getting up to $3,200 per month for one-bedrooms in some locations (50% of the units were one-bedrooms, while 40% were studios when built), and higher for the small number of two-bedrooms. That is certainly above the Social Security check for most people in their eighties. While this is good news in some ways for Holiday, it may also mean that many of the Holiday communities are taking in residents who are much more frail than the typical new resident six or seven years ago. Anecdotally, we had heard that the number of walkers outside the dining rooms had increased substantially about the time that occupancy hit its low in 2010. So while the higher rates mean higher gross revenues, we have to assume that operating costs have increased somewhat proportionally, and that the old Bill Colson rule of thumb of 45% EBITDA margins for new buildings upon

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The Providers

Company	Ticker	Current Price 3/28/13	Adjusted P/E Ratio[1]	% Change from Prior Month	% Change from 1/1/13	52-Week Range High	52-Week Range Low
Skilled Nursing							
AdCare Health Systems	ADK	$4.00	9.4	-10%	-16%	$5.50	$3.00
Diversicare Healthcare[2]	DVCR	5.11	10.7	-7	-4	7.54	4.01
Ensign Group	ENSG	33.40	7.2	7	23	33.70	23.40
Kindred Healthcare	KND	10.53	7.4	-7	-3	12.76	7.60
National HealthCare	NHC	45.72	6.4	-1	-3	50.17	40.75
Skilled Healthcare Group	SKH	6.57	8.7	13	3	8.41	4.97
Assisted/Independent Living							
Assisted Living Concepts	ALC	11.89	16.3	0	22	20.33	6.93
Brookdale Senior Living	BKD	27.88	13.7	1	10	29.92	14.99
Capital Senior Living	CSU	26.43	15.2	15	41	27.90	8.79
Emeritus Corporation	ESC	27.79	14.9	-2	12	30.95	14.24
Five Star Quality Care	FVE	6.69	9.5	6	34	6.72	2.98

[1] 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 was changed from 12.5% to 10.0% effective 1/31/06. [2] The company changed its name from Advocat in March 2013.

stabilization may not be as applicable.

Although we know where current occupancy levels are (more on that later), we will now venture into the Twilight Zone of assumptions and estimates, which may differ from reality. If average rents are up to $2,800 per month (which still strikes us as high for what was always considered to be a Chevy product in secondary markets), based on a 90% occupancy level, we have estimated annual revenues at about $1.1 billion and EBITDA at about $425 million using a lower 40% margin. At the time of the acquisition six years ago, the annual EBITDA before capex had been estimated to be between $375 million and $400 million. Using the cap rate that was reported six years ago derives a value of more than $7.0 billion today (based on our assumptions). If Fortress still has the $4.3 million of original debt on the books, it would appear that the disappearing equity investment three years ago has suddenly reappeared. A loss is never a loss until it is realized.

Other than our rate and margin assumptions, which could be off (census is accurate, though), we don't think anyone would buy this portfolio with a 5.75% cap rate, even in today's market of historically low interest rates, decreasing cap rates and an outsized demand by the REITs for large acquisitions. It must be remembered that these are not "A" properties, and most of them are located in "B" markets, and a sub-6% cap rate should be reserved for an institutional quality property in a hard-to-build-in, top market. In addition, that valuation results in a price approaching $200,000 per unit, and that is above replacement cost for these properties, if replacement cost is even a useful metric in this scenario. True, the concept of a portfolio premium should come into play, which it certainly did six years ago, but there are only a handful of potential buyers who could raise the capital necessary for a purchase of this magnitude, not to mention paying a portfolio premium. That handful gets smaller when you remove from the group those capable of buying, but perhaps not interested. These are older buildings with difficult-to-manage resident managers serving an independent living market that is not need-driven, although we suspect that the Holiday census is getting needier by the month.

If our EBITDA assumption is somewhat close (and we really don't have any inside intelligence on this), then it comes down to what cap rate should be assumed. The average independent living cap rate in 2012, based on our statistics and reported in our just-released *Senior Care Acquisition Report* (18th Edition), was 8.0% (7.9% in 2011). While this may seem high, the average quality of some of these communities sold was not that high, and may be more comparable to the Holiday portfolio than Fortress would like to admit. That said, we would have to

assume a cap rate between 7.0% and 8.0%, even though there may be some hungry capital willing to dip below the 7.0% mark, assuming growth, an improving economy and higher rates....just like Fortress did in early 2007. At 7.0%, the value is nearly $6.1 billion (again, based on our assumptions), which is more than enough to pay off the debt, return most of the equity, call it quits and be thankful the scars were not too deep.

Now, here comes the hard part. The likely exit strategies would be to sell the portfolio, most likely to a REIT, or take the company public, either as an operating company or through a newly formed REIT. In theory, a REIT structure would get a higher valuation, but a REIT with one tenant with B properties in the still unpopular independent living market would not be an investment banker's dream, to say the least. One thing is clear, however, and that is that the Fannie Mae debt is coming due in the third quarter of 2014, and part of it has already been extended once (you remember those old pretend and extend days?). Back in 2010 Fannie Mae extended the term of the original five-year tranche to match the other seven-year tranche with a 2014 maturity, and also cross-collateralized and cross-defaulted the two portfolios at the same time. We have to believe that Fannie Mae knew about the occupancy problems and that it would have been impossible to refinance at par three years ago (or anything close to par), so they did what they had to do. The other reality that impacts the decision-making process is that the entities that are invested in the Fortress funds are at the end of their investment horizon, since it has now been six years. In other words, we suspect they want their money back, and sooner rather than later.

Although a bit counterintuitive, Fortress may be in the driver's seat right now, because it knows that Fannie Mae can't (won't) throw them into default in 2014. With the LIBOR-based loan probably with a 3.00% rate right now, the portfolio must be throwing off some decent cash flow if our rent and margin assumptions are close. But merely refinancing the debt is not the issue, because that leaves the investors in the Fortress funds empty handed. Our real guess is that they would like an outright sale, and that they would like to keep on pushing census. Each 100 basis point increase in occupancy yields an additional $100 to $150 million or so in value, and we hear that there is a real push to get above the current level. Therefore, waiting until next year may make sense, especially since no one is predicting a spike up in interest rates any time soon. Whether a sale to a REIT, or a REIT IPO, Fortress needs fresh equity capital to deal with the maturing debt and the equity investors. And it would be easier to refinance a smaller amount of debt than the current outstanding balance.

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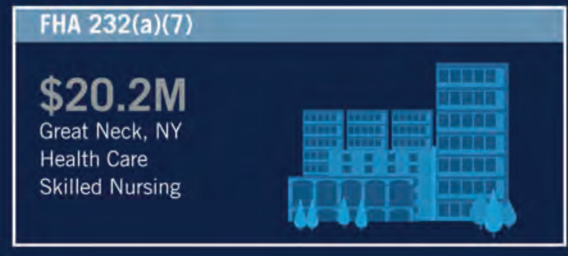

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Other than the Big Three REITs, which may or may not have an appetite, and the only one that keeps popping up in the rumor mill is **Ventas** (NYSE:VTR), Fortress does have a "captive" REIT that is publicly traded. But **Newcastle Investment Corp.** (NYSE: NCT) has a market cap of just $2.7 billion and a high dividend yield of 8.1%. Unfortunately, we just don't see how it could consummate such a large deal with its much higher cost of capital than a Ventas, for example, not to mention the dilution. What a REIT would really like is that old development pipeline, adding 12 to 15 new properties every year, but that has moved away from Fortress, and we believe that the Hawthorn Retirement team is having too much fun building and filling to need anyone's help. But as census and cash flow continue to improve at Holiday, the options for Fortress will improve as well. The fact that the new CEO, Ed Lang, replaced Jack Callison effective March 21 tells us a REIT option may be the most likely. Mr. Lang was most recently the COO of **BRE Properties** (NYSE: BRE), a REIT which he joined more than 10 years ago as CFO, and before that he was CFO of **Health Care REIT** (NYSE: HCN). Now that is cause for some serious speculation.

Getting back to the significant improvement in occupancy from the lows in 2010, in 2012 overall occupancy increased from 89.1% to 89.9%, which is getting close to what it was at the time of the sale six years ago. Out of more than 310 communities, at year end 2012 nearly 85 of them had an occupancy rate of 95% or higher, and 11 of these were at 100%. Not many companies can boast having more than 25% of their communities, especially IL communities, with occupancy above 95%. While a far cry from 2007 when 50 communities were at 100%, management must be happy at the turnaround, to say the least. During 2012, more than 90 communities had an occupancy gain in excess of 500 basis points, but nearly 60 had an occupancy decline in excess of 500 basis points. The good news is that just 6% of the properties had a census below 80% at year-end (compared with an overall average of 75% three years ago), but almost all of them had been higher at the beginning of the year, which means these outliers were not the problem children of the past and may have potential to be turned around depending on what caused the 2012 drop. Three years ago when, admittedly, we were not pleased with the lack of transparency from Mr. Callison, our story about the occupancy plunge was called "Holiday: Beneath The Veil," which was a play on a not-too-complimentary web site by that name dominated by disgruntled former (and current) Holiday employees. We never thought we would be writing a new story, with such good news, so soon. The veil has been lifted, and so far we like what we see. We will have to wait and see who else takes a peek under the veil, what they will find, and what the next chapter will bring.

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Quality Is King For Acquisitions

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ing market. In the two years ended December 31, 2012, the average A independent living community sold for $199,900 per unit compared with $103,300 per unit for a B property. The average cap rate for the A properties was 7.2% compared with 8.3% for the B properties, representing a difference of 110 basis points; the difference was 150 basis points when we first did this analysis last summer. The EBITDA margins on the A properties averaged 37.1% compared with 27.6% for the B communities, which is a major reason for the price differential.

Sales of assisted living communities demonstrated a similar relationship, except the A-quality assisted living properties sold for higher average prices than the A independent living. We believe this is because demand was higher for the need-driven assisted living communities that were built in the past 10 years, and there were many more of these than on the independent living side of the business.

As a result of the housing crisis, many buyers lost interest in the IL market, or were just much more discerning than in the past. In the past two calendar years, assisted living A properties sold for an average price of $240,500 per unit, compared with $111,600 per units for the B properties.

There were some very expensive portfolios that were sold in this two-year period, and just like in the IL sector, there was a wide difference in operating margins that contributed to the nearly $130,000 per unit difference in average price. The average EBITDA operating margin for the A assisted living communities was 34% compared with 24% for the B communities. The cap rate differential was not quite as wide, with an average of 8.3% for the A assisted living and 9.0% for the B properties. Many sellers believe that A-quality assisted living communities should sell with a lower cap rate, and while that does happen, it just didn't come out that way for the entire group.

These and many more statistics are presented in our just published *Senior Care Acquisition Report* (18th Edition), including average prices by quartile for assisted and independent living, as well as 30 charts and graphs on the skilled nursing sector, which we have yet to divide into A and B properties for the primary reason that it is more difficult to classify them since the vast majority are more than 35 years old, and by that fact alone would usually not qualify as an A property without very substantial rehab.

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Assisted Living Acquisitions

MBK Senior Living is an interesting company. It is both a buyer and a seller in this market, although most of the activity has been on the buying side. The company is controlled by a publicly traded Japanese firm, and there is a need to balance growth and profitability, and if taking advantage of the current market with high values and low cap rates means selling a few assets from time to time, well, so be it. The parent company can show a gain, and the net cash from the sale can be reinvested in later deals. Sometimes, MBK can retain the management after the sale, but not if an operating company is the buyer. Such was the case with the recent sale by MBK to **Brookdale Senior Living** (NYSE: BKD) of two primarily assisted living communities in Spokane, Washington, which closed in March. The total purchase price was about $56.1 million, and when the value of some excess land is removed, the net price was about $200,000 per unit.

These properties were built between 1999 and 2003 and have a combined occupancy close to 92%. There is a combination of assisted living and memory care units, plus 20 independent living units in one of the communities. According to our records, one of the properties was purchased by MBK for about $138,000 per unit in early 2007, so the sale represents a nice profit, especially considering that the purchase six years ago was in the middle of the last market peak (we could not find a record for the other one, but we believe it was purchased for more than $160,000 per unit back then).

Financial details have not been disclosed on the current sale, but based on occupancy levels and monthly unit rates, we assume revenues this year will be at least $12.0 million with an estimated operating margin close to 33%, which would be a bit lower than the margin we estimated on the 2007 sale. Back then, there were more IL units, so it would make sense that revenues would increase and margins would decrease as units were converted into assisted living and memory care. This acquisition makes perfect sense for Brookdale, which already owned two communities in the Spokane market. With an additional 275 units in somewhat different local markets within the greater Spokane market, BKD will almost have a dominant position in that market, which will help with rate growth and cost control. Dave Rothschild, Matthew Whitlock and Mary Christian of **CBRE** represented MBK in the sale.

Newly formed **LCB Senior Living** has snagged a $40 million equity commitment from the New York-based real estate private equity firm **Berkshire Realty Ventures**.

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Based in Massachusetts, LCB Senior Living consists of the former management team of **Newton Senior Living**, which was sold to **Lazard Freres** and its **Atria Senior Living** management company in 2005 (subsequently sold to Ventas). The new equity commitment can be leveraged, so that means LCB will be able to acquire or develop over $100 million of senior living communities, focused in the Northeast, but the funds will probably be used mostly as a corporate investment to grow the business and use outside equity sources on a deal by deal basis (see below). LCB is already managing two of its former properties, and the new capital will allow the manage team to achieve some scale. Richard Swartz and Phil Anderson of **Cushman & Wakefield's Senior Housing Capital Markets Group** handled the capital raise and advised Berkshire.

No sooner was this equity investment announced then LCB Senior Living disclosed its first acquisition, purchasing a 50-unit assisted living community in New Hampshire that specializes in Alzheimer's and dementia care. Built 15 years ago, the community has most of its 83 licensed beds full. The purchase price was $35 million, which comes in at a record $700,000 per unit for assisted living deals, but a more modest $422,000 per bed. Apparently, there is some extra space in the building where an additional seven beds can be added, which will bring the numbers down a bit, and the deal came with an extra four acres that can be developed for more units, perhaps traditional assisted living. But to justify that price, per-bed rates at 97% occupancy (which assumes 81 residents) would have to be $6,500 per month with a 35% EBITDA margin, and that assumes a 6.5% cap rate. Equity was provided by **Grosvenor Fund Management** and debt came from **Bank of America**.

A large owner of seniors housing purchased two communities in Oregon at the end of March, and while both were performing solidly, they were quite different from one another. The larger of the two has a total of 112 units, of which 64 are assisted living and 48 are memory care. The community was originally built in 2000 with an addition in 2011, and while occupancy averages close to 95%, it has been at 100%. Revenues and EBITDA were $4.9 million and $1.77 million, respectively, representing a 36% margin. The purchase price was $20.95 million, or $187,100 per unit, and the cap rate was 8.4%. The buyer paid cash, assumed a **Fannie Mae** mortgage, and will keep the same third-party manager that the seller had used. Jeff Binder of **Senior Living Investment Brokerage** handled the transaction.

The smaller transaction, also in Oregon, involved the

sale of a 53-unit assisted living community with a solid occupancy of 93%, but about 50% of that is Medicaid. Built in 1999, the community has 41 studios and 12 one-bedroom units. Revenues and EBITDA were $1.86 million and $630,000, respectively, which seems to confirm that you can make money in the Oregon Medicaid system. The purchase price was $6.8 million, or $128,300 per unit, and the cap rate was 9.3%. Mr. Binder also handled this transaction.

Kandu Capital is back at it again in South Carolina, expanding its assisted living, memory care and Alzheimer's operations in the state. A few years ago Kandu, and its operating affiliate **Bloom Senior Living**, took over a former **Sunwest Management** property in the town of Bluffton, and at the time we reported them turning this lemon into lemonade. They renovated a moldy empty building, introduced an "independent living-plus" program and created an Alzheimer's and memory care program in a separate building that was so successful it not only filled in three months with a waiting list, but last December they added a 25-unit addition that can accommodate 45 residents.

At the end of March, they doubled down on the market with the acquisition of two properties from Brookdale Senior Living. One of them is also in Bluffton and across the street from Kandu's original purchase there. This particular property, with 43 assisted living and 16 Alzheimer's units, had been underperforming for BKD and was not in one of the company's major markets. The second property is 10 miles away in Hilton Head, and it has 43 assisted living and 15 Alzheimer's units. It was also underperforming , but both properties had average revenues of about $4,000 per occupied unit. Kandu believes that within 12 to 18 months it can stabilize both at 93% or better occupancy with an EBITDA margin between 28% and 30%. When that happens, revenues and EBITDA will be about $5.2 million and $1.5 million, respectively. That translates into a future value between $18 and $19 million, or about $160,000 per unit.

The purchase price was $7.2 million, or $61,500 per unit. Now, we might say this is a case of pie in the sky, but they already accomplished this with the first property in Bluffton, and they will now control about 75% of the memory care market in the combined Bluffton and Hilton Head market. The goal, of course, is to be the provider of choice and expand the feeders into its communities, with the potential to increase rates after the new acquisitions are stabilized. More lemonade anyone?

In a smaller transaction with assisted living (44 units) and memory care (25 beds), **Capital Senior Living** (NYSE: CSU) purchased a community in Nebraska that was built in 2002 and that has a strong 91% occupancy.

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It is unclear the exact number of units, but the web site states there are 69 licensed beds. Based on rates and occupancy, we have estimated revenues and EBITDA to be approximately $2.6 million and $600,000, respectively, or they should be under CSU's management. There is an additional 1.5 acres that can be used for expansion, which will only increase the value of the acquisition. This will be CSU's seventh property in Nebraska, and the purchase price was $6.6 million, or $103,100 per unit. Jeff Binder, Brad Clousing and Ryan Saul of Senior Living Investment Brokerage handled the transaction.

In a few smaller transactions, an Oregon-based operator sold a 69-unit assisted living (54 units) and memory care (15 units) community in New Mexico to a regional owner/operator based on the East Coast. The property was originally built as a hotel and was converted to senior living in 1990 and renovated in 2002 and 2010. The community is located in the far southeastern corner of New Mexico within five miles of the Texas border, and recent occupancy was 90% but it has ranged between 87% and 93%. Revenues and EBITDA were not too bad at $2.14 million and $638,000, respectively, and the buyer paid $3.53 million, or $51,200 per unit. The relatively low price and high cap rate reflect the age and design, not to mention the location, but this little property seems to just hum along. Jeff Binder, Toby Seifert and Matt Alley of Senior Living Investment Brokerage handled the transaction.

In another sale of a converted hotel, Brad Clousing of Senior Living Investment Brokerage sold an empty 129-unit building in St. Petersburg, Florida for $2.0 million, or $15,500 per unit. Originally built in 1971, it was converted to assisted living in the 1990s with additional renovations completed in 2005. The increased debt placed on the property in 2007 was too much to handle, and the lenders foreclosed. The buyer this time is **Senior Management Advisors** (SMA) and its financial partner, **ValStone Partners**. Not only do they have successful turnaround experience, but they also have succeeded in hotel conversions, including one in Florida. The buyers plan on investing significant capital to complete the renovations and rebrand the community, and they expect it to stabilize in three years. While many buyers do not like to purchase non-purpose built properties, sometimes that is where you can achieve the highest returns.

In another more modestly-priced sale, a real estate investment group in New York purchased a 160-unit building in Rochester, New York for $4.3 million, or $26,900 per unit. There are two components: a 118-unit assisted living section with 85% occupancy and a heavy Medicaid census, and a 42-unit elderly apartment section with

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98% occupancy but low monthly rates and no services. Revenues and EBITDA were $3.88 million and $326,000, respectively, resulting in a low cap rate of 7.6%, which we assume is not how the buyers were pricing the acquisition. Ken Carriero of **Colliers International** represented the seller, **LML Associates**.

Independent Living Market

In a transaction that closed at the beginning of the year, and one which exemplifies the higher quality of assets coming on the market, a joint venture between two private equity firms sold an independent living community in Texas for approximately $72.0 million, or just over $418,000 per unit, to **Ventas** (NYSE: VTR). Even though the community opened in late 2009, it was still able to fill the units and is currently 100% leased.

Financial details have not been disclosed, but assuming average monthly revenue per occupied unit in the $4,000 to $4,500 range, we have estimated revenues to be close to $9.0 million. Communities such as this one that are 100% full should be operating with above-average margins, so we have to assume that annual cash flow will be in excess of $4.0 million. Now that the community is full, we suspect that there will be room for some decent rate increases, which could push that cash flow number even higher. We hear that Ventas may move the management of the community over to its **Atria Senior Living** partner. Lisa Widmier of **Vantage Pointe Capital Management & Advisory** represented the seller.

Benchmark Senior Living is the stalking horse bidder for a 168-unit not-for-profit community in Massachusetts that opened in 2009 during the recession and suffered the typical deposit cancellations from many of the would-be residents. From April 2007 through September 2009 they had received a net 105 deposits for the 138 units that were offered. The other 30 units were income restricted with rents between $984 and $1,171 per month and no entrance fee. That is a lot different from the $445,000 to $985,000 entrance fees they were charging for the market-rate units. The total debt that was issued was about $115 million, or $685,000 per unit, of which nearly $29 million has been paid down by the initial entrance fees.

The community's sponsors, **Masonic Health Systems of Massachusetts** and **New England Deaconess Association**, combined contributed $13 million into the project, and finally put the community into bankruptcy protection last month, with occupancy just over 50% and no way to service the debt, which was originally

underwritten by **Ziegler Capital Markets**. Obviously, opening up in 2009 was horrible timing that no one could have predicted, and other communities suffered a similar disaster in those fateful years. But, $685,000 per unit in debt, even in the expensive Northeast, seems high when it is in the middle of the entrance fee range, and almost one-fifth of your units are income restricted.

The stalking horse bid of $30 million, or $217,000 per unit (excluding the 30 income restricted units), seems aggressive on the face of it, but if the local housing market has improved since 2009 like it has in most parts of the country, the winning bidder could have a successful turnaround. And it is likely that those entrance fees will come crashing down to move the needle on census. Benchmark would have to net an average of just $480,000 per unit sold to pay off the entire purchase price if no one else shows up. That would be nice.

Skilled Nursing Market

The Ensign Group (NASDAQ: ENSG) just closed on the purchase of three skilled nursing facilities in Texas. They include two facilities in Victoria with 56 beds and 152 beds, and one in San Marcos with 129 beds. Overall occupancy is about 52% with an 11% private pay and 7% Medicare census, so there is plenty of room for improvement, which is what Ensign likes to do. Despite the occupancy problems, the overall group was reasonably profitable. With 2012 revenues of about $10.6 million, the EBITDA operating margin was just under 12%. The price was just $7.1 million, or $21,100 per bed, which reflects the old age (40 years) of the buildings and the fact that the 152-bed facility had an occupancy rate of just 25% even though its sister facility with 56 beds in Victoria was at 95%. Matthew Alley and Ryan Saul of Senior Living Investment Brokerage handled the transaction.

The Ensign Group closed on a fourth skilled nursing facility in Texas. The 150-bed facility was originally built in 1963 with a major renovation completed in 2001. Even though occupancy was only 65%, it was reasonably profitable because of the larger than average size. Revenues were about $5.6 million and with a 12% operating margin, so the performance was actually not too bad. The purchase price was $4.5 million, or $30,000 per bed. Located in Amarillo, ENSG should be able to improve on the 7% Medicare census, which will send the cash flow higher. This is what Ensign does, as most of its acquisitions involve underperforming or low-occupancy buildings that they turn around. When they are already turning a decent profit, it just makes the process all that easier. Matthew

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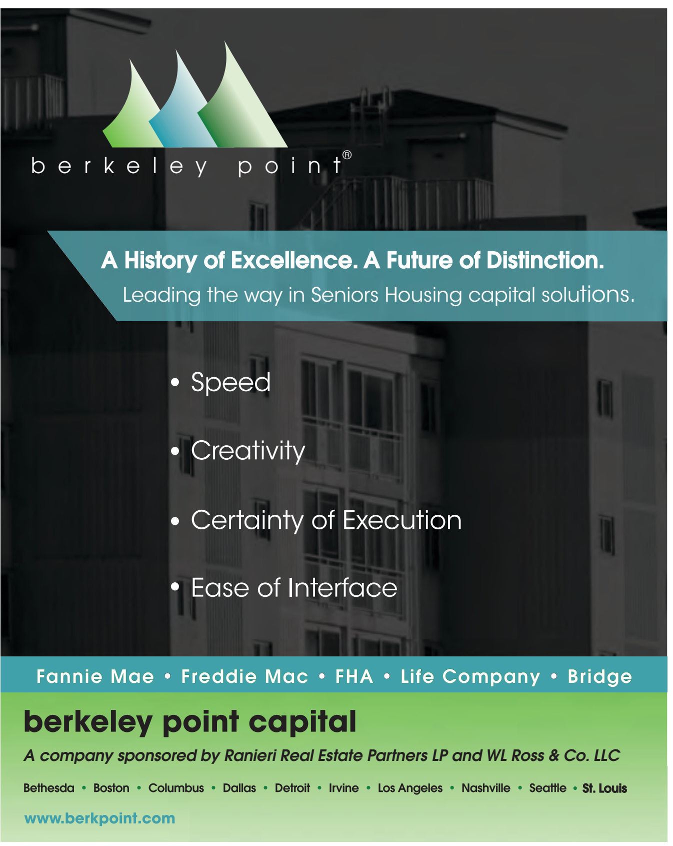
Alley and Ryan Saul of Senior Living Investment Brokerage also handled this transaction.

Diversicare Healthcare Services (NASDAQ: DVCR), formerly known as **Advocat** and one of the smallest publicly traded companies in the senior care sector with a market cap of just $31 million, has announced an agreement to purchase five skilled nursing facilities in Kansas for $15.5 million, or about $35,000 per bed. Annual revenues are about $24 million, and while profitable, we believe the portfolio can be improved upon significantly; management stated that the deal will be accretive to earnings.

We believe that EBITDA may be just over $2.0 million excluding one facility that has been losing money, and that the other four have a quality mix close to 30% based on census. **The Private Bank** will lead the financing of the acquisition, which is expected to close in the second quarter, and Grant Edwards of **Healthcare Realty Brokerage** represented the seller. This is the largest acquisition in recent years by the company, and apparently will mark the beginning of a new growth spurt by acquisition. This has been a sleepy company with some dissident shareholders who have wanted to sell the company or grow it. It looks like they will finally get the latter.



New Jersey-based **Tryko Partners** purchased a 97-bed skilled nursing facility in Pennsylvania for $6.3 million, or approximately $65,000 per bed, from California-based **Signature HealthCARE**. The facility was built in the 1960s and while occupancy had been above 85%, by closing it was closer to 82%. It is located directly across the street from the local hospital, and while the Medicare census was already an attractive 22%, Tryko may be able to improve on that. They plan to spend up to $500,000 on some upgrades, and they believe after those are completed, combined with more local management, there will be significant upside. In-place revenues and EBITDA were approximately $8.55 million and $370,000, but they believe conservatively that EBITDA will double to $740,000 in the first year and that by the second year revenues and EBITDA could hit $9.45 million and $1.65 million, respectively.

Chris Hyldahl and Mark Myers of **Marcus & Millichap** arranged the lease of a 69-bed nursing facility in Indiana which has a focus on ventilation care, with about 30 patients out of the total census. The facility also has some independent living in addition to serving the more traditional post-acute patients. The Chicago-based operator that is now leasing the building for five years has an option to purchase the real estate.

Acquisition Updates

Last May, a joint venture between **Harrison Street Real Estate Capital** and **The Engel Burman Group** announced the purchase of five assisted living communities in New York (Long Island) from **Bristal Holdings**, a joint venture between **Chartwell Seniors Housing REIT** and **ING Real Estate Australia**. The price was $290 million, or $453,000 per unit ($379,600 per bed). Engel Burman had developed these several years earlier, sold them and is basically buying them back at the same price while retaining the management. We actually thought the transaction closed late last year, but the "final" deal includes two additional properties, both on Long Island. One is the Bristal at Lynbrook, which has 122 units and 147 beds and was sold separately by ING for $28.0 million, or $190,500 per bed. Then there is The Bristal at East Northport, which has 118 units (136 beds), and was contributed to the new joint venture with a value of $52.0 million, or $382,350 per bed. This was developed by Engel Burman and opened in 2012 and is already 100% leased.

Each Bristal community usually has a certain number of "suites" with a common living room and kitchenette with two separate bedrooms so two unrelated people can live there with some privacy as well as companionship. Engel Burman is making a major development push, having opened a community in White Plains, New York six months ago that is now 50% occupied, another building under construction in Armonk, New York that will open at year end and a third in New Jersey that will also open late this year. In addition, the group has eight land deals under contract for further expansion. Their communities usually combine assisted living with memory care. **Grandbridge Seniors Housing** closed a $194 million **Freddie Mac** assumption as part of the overall deal.

The sale of **Assisted Living Concepts** (NYSE: ALC) appears to be on track, despite some rumors last month that the buyer, private-equity firm **TPG**, might try to re-trade the deal to a lower price after finishing due diligence. We now think this is unlikely because TPG had been in the mix since late 2011 when the sales process began, and although they dropped out in January 2012, they asked to re-join the bidding process 10 months later on November 15, 2012, submitting a verbal bid in December with a range of $11.00 to $13.00 per share. Coincidentally, the December issue of this newsletter stated that ALC would sell for $11.00 to $13.00 per share, if it sold. Hmmm.

As it turns out, there were 16 separate parties involved in the bidding process over a 17-month period,

most of which were REITs and private equity firms (no surprise). When we first started reporting on the "rumors" of a sale in the first quarter of 2012, the highest bids were coming in at $20.00 to $21.00 per share, which tells us they really didn't understand the assets and the problems, and there were four different buying groups at the time making offers. That quickly dropped to $13.00 to $15.00 after the firing of CEO Laurie Bebo and the lease settlement with Ventas in the second quarter.

There was a necessary hiatus during the summer of 2012, but when the bidding picked up again in September at the lower levels, it was really down to one of the original bidders (a private equity firm and a partner) and two others, plus a pension fund that made a cameo appearance at $13.50 to $14.00 share. In the middle of November, the private equity firm and its partner withdrew from the bidding, as had the others, and three days later TPG rejoined the process. In December the private equity firm came back in, and for the next three months, these were the remaining two bidders, with bids getting down to $10.50 per share cash plus $1.00 in a contingent payment, until in February **Citi**, still representing ALC through the entire process, told TPG it had to be $12.00 per share to get a deal done. A week later, the ALC board went under an exclusivity period with TPG, and a week after that the competing bidder came in at $12.00 with no contingencies. By then it was too late, and TPG had locked up the deal, which was signed on February 25.

Other Transactions

In addition to buying four skilled nursing facilities in Texas last month, The Ensign Group purchased a home health and hospice agency in Clarkston, Washington from **Tri-State Memorial Hospital**. The purchase was paid for with cash, and it is the fourth such purchase so far this year in the home health and hospice sector for ENSG.

Whoops. A year after purchasing **Doctors Express**, a national urgent care franchise system with 49 urgent care centers when purchased in 2012, Ensign Group has decided to sell the business to Alabama-based **American Family Care, Inc.**, which has 37 clinics in Alabama, Georgia and Tennessee. Ensign will retain five of the clinics in the greater Seattle, Washington area, and hopes to expand in this market. Apparently, the business took more time and money than expected, so a decision was made to sell. We always thought it was a bit of a stretch strategically for the company. Sticking to your knitting, even in this changing health care environment, can serve you well, and Ensign knows how to fix turnarounds.

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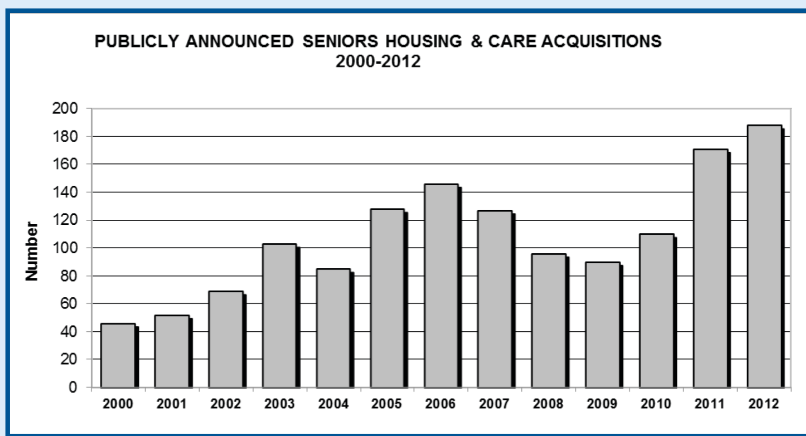

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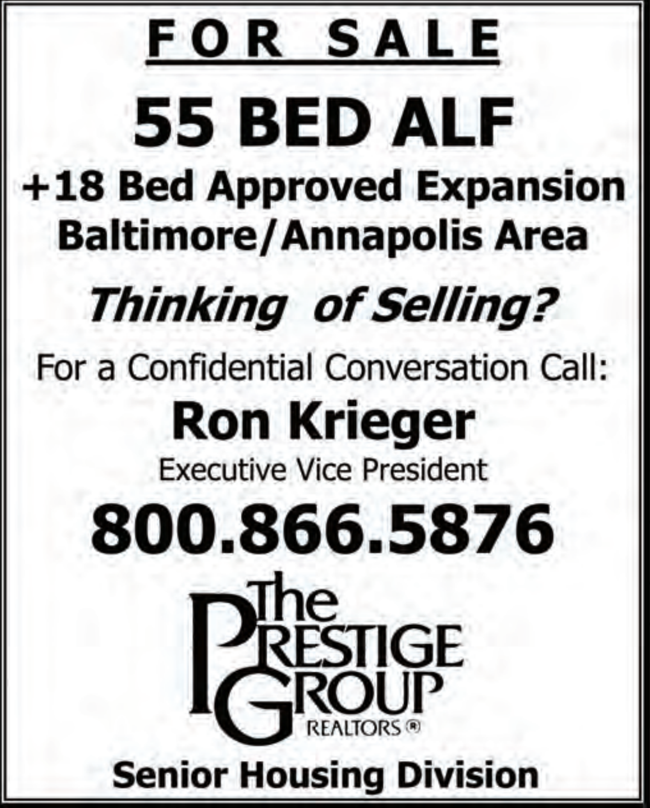
Financing News

We have not seen many equity offerings from the public companies, despite their relatively high recent prices, so we were initially surprised when we learned that **Emeritus Corporation** (NYSE: ESC) had decided to sell nearly 7.8 million shares. But as it turned out, most of the shares were from a selling shareholder, a fund managed by **Apollo**, with the rest from a few management insiders, including the recently reclusive Dan Baty. The share price, however, dropped by 14% from its recent high as a result of the announcement. Some analysts thought the sale by Apollo of shares that were acquired several years ago when it sold a portfolio company to Emeritus removed some "overhang" on the market and would help with market liquidity in general. Other investors didn't see it that way, which is why the shares dropped. And the decline had little to do with the large punitive damages against Emeritus for alleged poor patient care in one of its communities in California. Still, there is the opinion, shared by **Deutsche Bank**, that subsequent to the drop, Emeritus shares were undervalued. In fact, Deutsche Bank has a target price of $35.00 per share, compared with a recent price below $26.00, while **Stifel Nicolaus** has a target price of $32.00. The underwriters exercised their overallotment option as part of the secondary, so an extra $31 million will be used to pay off some high-rate debt, increasing earnings slightly. While the recent drop in price may represent a buying opportunity, the entire sector got a little overheated in recent months and may need a breather.



Speaking of equity, we have learned that **Fillmore Capital Partners** had to provide some additional equity to its skilled nursing portfolio company, **Golden Living**, to make sure the operator didn't break any loan covenants. Golden Living had apparently tried to relax a total debt to EBITDA coverage ratio test of 5.0x, hoping to increase it to 6.5x. Supposedly, Golden Living offered the lenders a 100 basis point increase in pricing plus a 25 basis point fee on the $1.4 billion in total debt, which is LIBOR based. That wasn't enough for a majority of the lenders, so back to the drawing board. Golden Living has been trying to refinance up to $500 million of its debt with HUD, but it remains elusive for the time being.

Skilled Healthcare Group (NYSE: SKH) may finally get its chance at the HUD trough, however. In mid-March the company announced that HUD informed SKH that it will resume processing the company's pending application for approval of up to $460 million in new HUD debt secured by up to 78 skilled nursing facilities. A little regulatory problem in California temporarily derailed the process, but it is now on track and SKH has submitted the application fees for the first $100 million of

debt. Approximately each $100 million of debt refinanced with HUD will save the company about $4.0 million in annual interest expense. That should help with staffing.

As usual, there was a fair amount of HUD financing completed in March. **Capital Funding** closed a total of $98.4 million in HUD loans, all of it refinancing existing debt. The properties included 13 skilled nursing facilities in nine states and three assisted living communities in Virginia (2) and Maryland (1). The assisted living financing saved the borrower more than $550,000 in annual debt service, while a $25.77 million financing secured by four SNFs yielded annual savings of $544,000.

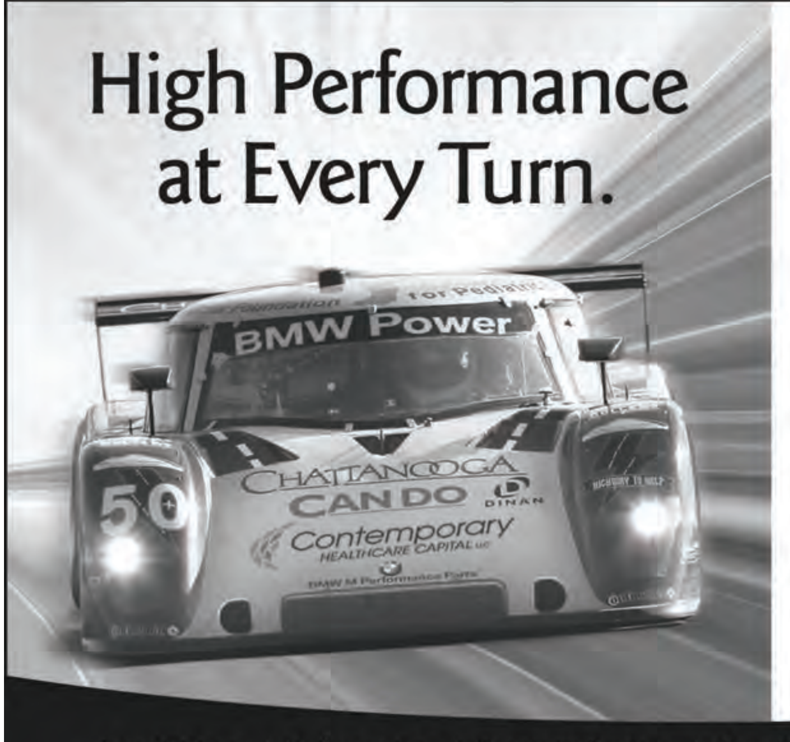
Red Capital Group closed about $29.5 million of financings in March, including the refinancing of a Red bridge loan made last December to allow the borrower, an affiliate of **Pioneer Health Group**, to acquire a 109-bed skilled nursing and assisted living facility in Arizona. The new HUD loan was for $6.88 million and refinanced the $5.96 million bridge loan with extra funds for capital improvements. Red also closed two loans for assisted living communities in Nebraska and Connecticut in the amount of $18.7 million plus a $3.98 million loan secured by a 135-bed skilled nursing facility in Wisconsin.

Kass Matt of **Lancaster Pollard** closed on the HUD refinancing of one of the earlier Alzheimer's facilities in the country, which opened in 1987 in Cincinnati, Ohio. Operated by **The Health Care Management Group**, the new loan for $7.5 million refinanced two HUD loans and resulted in over $100,000 in annual debt service savings. Separately, **Sims Mortgage Funding** closed two HUD refinancings, one for $12.8 million secured by a 100-unit assisted living community in New Jersey, and the other a $9.53 million loan secured by a 111-unit assisted living community in Louisiana. Both refinancings took less than six months to complete and resulted in savings of 300 basis points.

In other deals, Matthew Whitlock and Matt Kuronen of **CBRE** recently closed a $6.75 million **Fannie Mae** loan secured by a 139-unit assisted living community in California. The property is 92% occupied and the all-in rate for the seven-year loan was 4.23%. Separately, **Capital One Bank** announced it provided a three-year, $19.5 million loan to **Revera Health Systems** to refinance senior debt on eight skilled nursing facilities in Maryland, New Hampshire, New Jersey and Vermont.

REITs

At the expense of sounding like a broken record, again, share prices of the health care REITs moved up



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another notch in March, hitting new highs and turning in one of the best quarters in recent memory. There seems to be almost unlimited demand for the shares, and despite an unflattering article in *Forbes* about **Ventas** (NYSE: VTR) that came out six months after a very flattering story, VTR was up more than 3% in March and 12% for the quarter. The more recent *Forbes* article was so inaccurate in the first two paragraphs, where it talked about supply catching up to demand and how competitors Brookdale Senior Living and Health Care REIT increased the number of units owned, like that is threatening to Ventas, "while **Elmcroft Senior Living** added over 14,000 units." Really? That would be hard to explain to management when they operate just 8,500 units in total. The REITs are doing just fine, including Ventas, and not to be a party-pooper, but everything is cyclical and it won't always be so rosy for the health care REITs. Today, however, there aren't many other places we would like to be.

That is just one reason why **Aviv REIT's** (NASDAQ: AVIV) recent IPO was so successful. The company ended up selling a total of 15.18 million shares, priced at $20.00 per share, for net proceeds of $278.8 million. The shares immediately jumped by 10% and hit a high of $24.67. **Morgan Stanley**, **BofA Merrill Lynch** and **Goldman, Sachs** were the joint book-running managers for the offering. In other financing news, **Sabra Health Care REIT** (NASDAQ: SBRA) sold 5.0 million shares of 7.125% preferred stock priced at $25.00 per share. The proceeds will be used to pay down its secured revolving credit facility, which has been used a lot for acquisitions in the past year. **Jefferies**, **Citigroup** and **Merrill Lynch** were the book-running managers, while **Raymond James** and **Stifel, Nicolaus** acted as co-managers. Ventas sold $500 million of seven-year, 2.7% senior notes priced at 99.942%. That kind of capital cost certainly provides some flexibility in pricing acquisitions.

On the deal front, **HealthLease Properties REIT** (TSX: HLP.UN), affiliated with Indianapolis, Indiana-based **Mainstreet Property Group**, is purchasing 13 properties for $141.7 million, or $144,900 per unit/bed. Four of the properties are skilled nursing with 355 beds, eight are assisted living and Alzheimer's facilities with 563 units and there is one standalone Alzheimer's facility with 60 units. Six of the properties are triple-net leased to affiliates of North Carolina-based **Meridian Senior Living** and seven to Ohio-based **Saber Healthcare Group**. When the transaction is completed, HealthLease will have 28 properties with 2,909 units in five states and two Canadian provinces.

REITs

Company	Ticker	Current Price 3/28/13	Current Yield	Dividend Status[1]	2013 % Change	52-Week Range High	52-Week Range Low
Aviv REIT[2]	AVIV	$24.06	NA	NA	20%	$24.17	$22.10
Care Investment Trust	CVTR	6.75	8.0%	Res. May-11	-10	7.60	5.38
HCP, Inc.	HCP	49.86	4.2	Inc. Feb-13	10	49.91	37.81
Health Care REIT	HCN	66.91	4.4	Inc. Feb-12	9	67.92	52.40
Healthcare Realty Trust	HR	28.39	4.2	Dec. Mar-10	18	28.50	20.71
LTC Properties	LTC	40.73	4.6	Inc. Aug-12	16	40.80	30.41
National Health Investors	NHI	65.45	4.2	Inc. Mar-13	16	67.18	47.16
Omega Healthcare Investors	OHI	30.36	5.9	Inc. Jan-13	27	30.53	20.14
Sabra Health Care REIT	SBRA	29.01	4.7	Inc. Feb-13	34	29.14	13.37
Senior Housing Properties Tr.	SNH	26.83	5.8	Inc. Oct-12	13	26.86	19.83
Universal Health Realty	UHT	57.71	4.3	Inc. Dec-12	14	58.50	37.60
Ventas	VTR	73.20	3.7	Inc. Mar-13	13	73.22	53.94

[1] As of ex-dividend date. [2] Aviv REIT went public at $20.00 per share on March 21, 2013, and the 2013 % change in price is from the IPO price.

Other News

One of the worst things a publicly traded company can do is announce a delay in reporting its earnings, especially when it is the fourth quarter and year-end earnings report. It especially hurts when the reason is because the company has to restate its financial statements for the previous three quarters because of errors in those quarters. Such was the case in March with **AdCare Health Systems** (NYSE: ADK), a small skilled nursing company that has been growing by leaps and bounds with acquisitions.

Apparently, for the second and third quarters, $21.2 million of debt, consisting of three separate credit facilities, was classified as long-term debt when it should have been classified as a current liability. Not a big deal other than resulting in a major change in working capital ratios, but it is lenders who are most worried about that, and ADK's lenders should have figured it out anyway, especially if it was their debt. There were also some errors in accounting methodology that related to some expense items, but these seem to be relatively minor. The company's audit committee is talking with the former CPA firm, **Battelle & Battelle LLP**, as well as its current outside auditor, **KPMG LLP**. In some cases, this type of news can send a company's shares plunging, but ADK dropped by only about 10%.

Perhaps one of the problems is that the company is trying to grow too quickly. There hardly seems to be a month when an 8-K is not filed either announcing an acquisition, a change in acquisition terms or a delay in the anticipated closing of an acquisition, with more money required to be deposited with the seller. A case in point is the February agreement to purchase two nursing facilities in Tennessee for $28.0 million. On March 14, we presume to keep the deal alive, AdCare had to release its $100,000 deposit to the seller (so now it is non-refundable) and put down an additional $50,000 deposit. This was done to extend the closing date to April 30 and give ADK the ability to extend it further to May 31.

Now, these dollar amounts are not that significant, but it just seems that the company ties up acquisitions before it gets all its ducks lined up. This is not the first time there have been changes or delays disclosed, and we don't believe it will be the last. It may be part of the company's negotiating strategy, and they have closed on more acquisitions than most of its peers, but it just seems to be a bit sloppy, kind of like the accounting policies and practices. Our guess is that KPMG will demand a tighter ship.

They may be needing a tighter ship as the "sequester," unless disagreements are resolved, will be costing the skilled nursing sector more than $750 million in reduced Medicare payments per year, accoding to one study. Effective April1, 2% across the board cuts to Medicare providers began. But will that be all? Stay tuned.

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Juniper Communities, LLC
$13,750,000
Senior Term Loan
January 2013

Regency Nursing and Rehabilitation Centers, Inc.
$5,600,000
Senior Term Loan
January 2013

Portfolio Skilled Nursing Company
50 Skilled Nursing Facilities
$51,321,000
Senior Term Loan and Revolver Participation
December 2012

We know how to clear the way for an opportunity. Our industry expertise and efficient loan process allow us to get deals done. And backed by our solid balance sheet and lending power we deliver flexible solutions for any size and type of skilled nursing or senior housing facility. Whether you're expanding, diversifying, or responding to the reimbursement and regulatory environment. We can get things done. Give us a call to get on board.

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