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

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BLACKSTONE SIGNS SUNWEST DEAL

Acquisition Is Still Subject To Court Approval And Auction

Depending on whom you were talking with in early January, the deal between **Blackstone Real Estate Advisors** and **Sunwest Management** was going to be signed "any day now." Or, it was a dead deal and Judge Hogan was pushing, along with the Management Committee, for an alternative structure from an alternative buyer. Although we were never too sure who to believe, as far as we were concerned there was still just one deal on the table, and that was the Blackstone offer. There is another one circling, which we will get to in a moment, but during the first two weeks of January, only Blackstone, with its partners **Emeritus Corporation** (NYSE: ESC) and **Columbia Pacific Advisors** (Dan Baty), had pretty much everything in place to finally move forward.

The definitive sales agreement with Blackstone was finally announced on January 19 for 134 properties with 11,096 units for a total purchase price of $1.153 billion. There are 6,175 assisted living units, 2,944 independent living units, 1,782 memory care units and 195 skilled nursing beds. The price is comprised of $235 million of cash and the assumption of $918 million of debt, of which Mr. Baty and his various partners control 30%, or $275.5 mil-

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CONSTRUCTION FINANCING 101

Commercial Banks, HUD and REITs Still In The Market

Everyone has been complaining about the lack of debt financing for acquisitions, or when available, that the terms are too stringent or the equity required is too high. Well, welcome to the new reality, and unless memories are short (again), and lenders recover and return to their aggressive ways in a year or two (which no one is predicting), we will be in a fairly tight debt capital environment for a while. This should make the health care REITs happy, because they have been providing 100% financing for 20 years, arguing that they were always cheaper than the blended cost of debt and equity, and you really didn't need much equity. That was fine unless you wanted to own your real estate.

Borrowers, however, scoffed, when at the market peak it was not unheard of to obtain debt financing from 85% to 110% of the cost of an acquisition when everyone believed the wonderful pro formas. One of the

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count dropping to 52 with a capacity for 63 beds. Management believes they will achieve base rates of $3,500 per month, so at stabilization we have estimated revenues and EBITDA to be about $2.25 million and $750,000, respectively. Based on a total investment of $3.5 million, that would put the future value somewhere between $7.5 million and $8.0 million, or close to $150,000 per unit, depending on cap rate assumptions. That will be up to Virginia-based **Morningside Management**, which will be the new manager tasked with the turnaround. The acquisition was privately financed.

In early January, a local not-for-profit bought a 48-unit assisted living facility in Crete, Nebraska for $3.6 million, or $75,000 per unit. The facility is licensed for 59 beds and was built in 1996 with an eight-unit, 6,375 square-foot addition completed in 2007. There are 12 studios, 26 deluxe studios and 10 one-bedroom units, with rates ranging from $2,290 to $2,980 depending on unit size. Average occupancy is about 80%, but nearly 20% of the census is Medicaid with a $2,155 monthly rate. In-place revenues and EBITDA are approximately $1.33 million and $310,000, respectively, for a cap rate of 8.6% before the buyer works on the census. Mark Myers and Josh Jandris of Marcus & Millichap represented the seller.

Affordable Assisted Living. We all know that Illinois has had a successful affordable assisted living program, with two companies, **BMA Management** and **Pathway Senior Living**, in particular expanding at a rapid pace. We know that one of the primary purposes is to find a place to live for the elderly who cannot afford market rate assisted living facilities, who do not really need the levels of care offered by skilled nursing facilities, but often end up in them and qualify for Medicaid because of a lack of alternatives. We have stated for several years that this is an underserved, and growing, market that providers need to address at some point, especially as the competition for market rate customers escalates. And when run properly, the state programs can be profitable for both the state and the provider, the proverbial win-win in some cases. And unlike in years past, these facilities are not an embarrassment.

Two recent transactions in Ohio by two different companies highlight what the trend in that state might be. In mid-January, **Kandu Capital, LLC** and its operating company, **Bloomfield Senior Living**, purchased a 91-unit assisted living facility located in the western suburbs of Cleveland from Sunwest Management for $3.1 million, or about $34,000 per unit. The 20-year old building needed about $500,000 of improvements, including a new roof, which seems to be the story line for many of the Sunwest properties put up for sale. Prior to the sale, about one-third of the units were licensed under the state waiver program, which has a rate of $2,700

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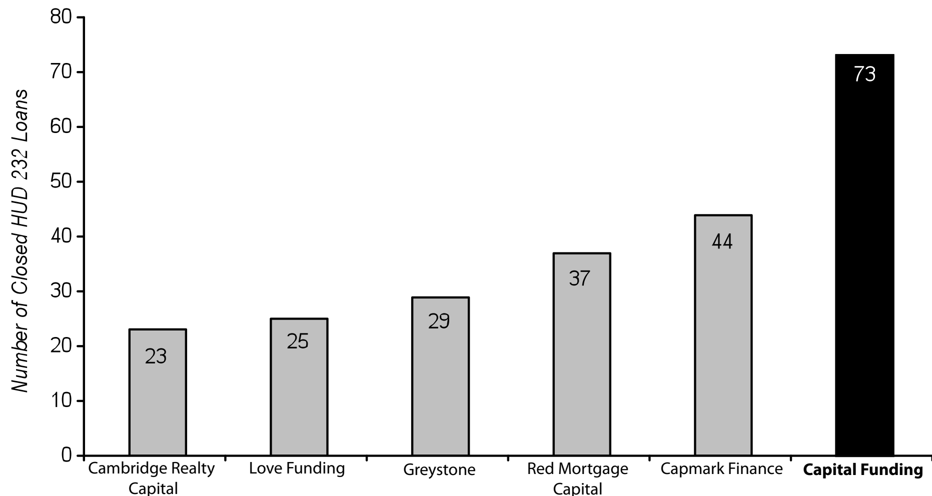

(source: HUD Web site FY 2008 & FY2009)

THE LEADER IN HUD 232 FINANCING

per month, but post-closing, all the units were certified. Occupancy had been just below 70%, but the "market" occupancy is closer to 85% to 90%, which the buyer believes is attainable in 12 to 24 months, especially after the renovations are completed. Trailing 12-month revenue and EBITDA through October 2009 were approximately $1.87 million and $255,000, respectively, which yields an in-place cap rate of 8.2%.

Upon stabilization, and with all the units now licensed under the waiver program, the forecast is for annual revenues to be at least $2.6 million and EBITDA between $700,000 and $900,000. Using the lower EBITDA number and adding the renovation cost to the purchase price, we derive a pro forma cap rate of 19%. In other words, the buyer is expecting to double the value of the property in less than two years, and it is very likely they will. They paid all cash, and we assume they will finance it for an amount above the purchase price once it is stabilized, taking out all their equity. This was a 363 bankruptcy sale, and according to the buyer there had been about $2.0 million of debt and $1.7 million of TIC equity in the building. Jacob Gehl of Marcus & Millichap represented the seller.

In the second Ohio transaction, an affiliate of Illinois-based **Platinum Healthcare, LLC** purchased a 99-unit independent living community that was originally built as a hotel in 1969. Because occupancy had been below 50%, historical financial data is not relevant. The buyer, an experienced operator with more than 15 properties, also likes to turn properties around, which is applicable in this acquisition. A case in point is an assisted living facility in Missouri they purchased a year ago for $3.0 million, or $32,000 per unit, which they believe is worth about $6.0 million today.

This former hotel is also located near Cleveland, but in a completely different market than the previous sale, and has five stories with nearly 62,000 square feet. Of the 30 to 35 residents living in the building at the time of closing, all but a few qualified for the state's waiver program, and Platinum Healthcare plans to convert the entire building to the assisted living waiver program. The purchase price was $2.4 million, but with renovations, FF&E, working capital and interest while filling it up, the total cost to the buyer will be $3.53 million, or $35,600 per unit. Management expects to reach 90% occupancy by the second year, when revenues and EBITDA are projected to be $2.84 million and $920,000, respectively, on an annual run-rate basis. Depending on your cap rate assumptions, that would put the value between $8.5 million and $9.5 million, which will be a tidy return for the buyer. Mark Myers and Jacob Gehl of Marcus & Millichap represented the seller.

Platinum Healthcare has decided that hotels, distressed or otherwise, will be very good conversion candidates for future assisted living Medicaid waiver facilities in Ohio and Indiana. Obviously, the more distressed the hotel, the lower the price with more room to allocate funds for renovations as part of the conversion to assisted living. The company is targeting hotels with 100 or more rooms, and may be closing on an additional property in Indiana in a few months. The key, of course, is to keep your capital costs relatively low since the revenue rate is somewhat fixed. In the two Ohio acquisitions discussed above, the all-in cost after renovations will be under $40,000 per unit for both properties, which is why they make so much economic sense. The operations side of the business has to deliver, of course, but life is less stressful at a price point that is a fraction of replacement cost.

INDEPENDENT LIVING MARKET

The independent living market has always been the smallest of the three main sectors of seniors housing and care, even with the blurring of the line between assisted living and independent living with "services," whether provided in-house or from outside agencies. And the line is further blurred with so many IL communities adding assisted living units or redesigning floors for assisted living. Most newly built communities tend to have some portion allocated to assisted living, even though the number of newly built IL properties is slowing to a crawl. Today, potential sellers of high-end retirement communities do not believe they will obtain full value in the market, partly because of the cap-rate disconnect, and partly because there is still a perceived discount on anything not "need-driven" until the housing market and economy make some real progress. Despite these problems, there are opportunities in the market if you know how to find them, and are willing to take a little risk.

In another Sunwest Management sale, sold out of receivership, Kandu Capital, LLC purchased a 79-unit independent living property in South Carolina for $3.154 million, or $39,900 per unit. This community was built in 2000 and had a recent occupancy rate of just 80%. Rates were low, at an average of $2,000 per month, and with the problems at Sunwest 3,000 miles away, we suspect not much attention was paid to the property. Based on the first six months of 2009 annualized, revenues and EBITDA last year were close to $1.33 million and $200,000, respectively, which yields a cap rate of 6.3%. At the height of the market

a few years ago, that would be somewhat aggressive for a small community, even with some upside on the census. When stabilized at 90% occupancy and rates at $2,100 per month, Kandu's forecast is revenues and EBITDA of $1.8 million and $433,000, respectively, yielding a 13.7% cap rate. The margin is low, but the building is relatively small, and the economies of scale come into play with part two of the acquisition.

Adjacent to the main building (and included in the purchase price above) is a 23-unit, 19,000 square-foot memory care facility that was never opened due to, we are told, mold problems. Kandu's management believes that total remediation costs will be just $50,000, but it was $50,000 that Sunwest and its receiver couldn't afford, not to mention the cost to lease it up. They are projecting monthly rates of $4,500 and when stabilized, annual revenues and EBITDA are projected to be $1.08 million and $560,000, respectively. We look at this as a "buy one, get one free" type of a deal, but this doesn't happen very often. On a combined basis, the community will have stabilized revenues of about $2.9 million and EBITDA of just under $1.0 million. Assuming management can get it done, meaning fill the empty units, the cap rate one would apply to that future cash flow does not matter, because it will be worth triple what they paid for it, and possibly more if cap rates don't rise too much. Anyway, in this market dominated by a lot of talk of pricing disconnect, it's always nice to see someone be able to turn someone's lemon into sweet lemonade. This is one we will want to check in on in a year or two to see if they beat the forecasts.

The University of Alabama (UA) recently announced it will be purchasing a 159-unit campus on 24 acres next to its campus in Tuscaloosa that had defaulted on its $51 million of debt. Built in 2005 by a not-for-profit set up by Tennessee-based **Cooperative Retirement Services of America**, the campus has 137 units and 22 patio homes on land that UA had leased to the original developer. Although it was not planned this way, UA now has a completed campus theoretically worth $40 million, and they will be paying $9.5 million for it, or just $60,000 per unit. All in a day's work.

Last September we reported on our first "double-wide" sale, and we thought it would be our last. Wrong. **National Home Communities**, based in Arizona, purchased a 478-space senior manufactured housing community in Hudson, Florida for $20.5 million, or about $42,900 per space. The 478 sites puts it in the top 5% of Florida's largest manufactured

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