

Capital Solutions

for Non-Profit Continuing
Care Retirement Communities

RED CAPITAL GROUP®

Seniors Housing & Health Care Finance

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ABOUT RED

RED CAPITAL GROUP, LLC, through three operating companies, provides integrated debt and equity capital to the multifamily, student and seniors housing, and health care industries. Red Mortgage Capital, LLC is: a leading Fannie Mae DUS® lender for both Multifamily and Seniors Housing; one of the nation's most active FHA Multifamily/Seniors lenders (MAP- and LEAN-Approved); a national Freddie Mac Seniors Housing Seller/ Servicer; an active financier of Critical Access, community and rural hospitals; and services nearly \$15 billion of income property mortgage loans. Red Capital Markets, LLC (MEMBER FINRA/SIPC) is: a leader in the trading and distribution of Fannie Mae and Ginnie Mae Project MBS; an active underwriter of developer-driven multifamily housing bonds; and also is remarketing agent for \$1.4 billion in variable rate demand tax-exempt and taxable housing and health care bonds. Red Capital Partners, LLC delivers proprietary debt and equity to the multifamily and health care industries and provides asset management services for RED's proprietary debt and equity investments.

RED CAPITAL GROUP, LLC is headquartered in Columbus, Ohio, employs approximately 200 people and maintains nine offices nationwide. Since 1990, the bankers of RED CAPITAL GROUP, LLC have provided over \$54 billion in taxable and tax-exempt first mortgage debt, mezzanine level capital and equity to multifamily, seniors housing, health care, and other real estate properties nationwide. RED CAPITAL GROUP, LLC is a subsidiary of ORIX USA Corporation.

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Introduction

Continuing care retirement communities, or CCRCs, offer older Americans access to housing, the critical needs of life, and health care services as needed at a predictable cost in a single location. However, operating a business that delivers these services is a complex undertaking where success is often tethered to the uncertain fortunes of the economy and the residential real estate market. As many communities have discovered over the past four years, weak property markets and low retirement savings rates can inhibit unit sales and revenue streams, placing their finances in some degree of operational and financial disequilibrium.

Fortunately, CCRCs have at their disposal a set of tools to address these challenges. Not least among them are financial, capital structure, and active secondary market initiatives that can reduce debt service costs, accelerate unit sales, and better balance community revenues to expenses and long-term obligations.

When bond financing is in place, taking even modest corrective action may require complex negotiations with bond trustees, rating agency analysts, letter of credit banks, investors, and residents. To navigate in these waters, CCRC sponsors and managers may find that the assistance of qualified financial and operational advisors is instrumental to charting a successful course.

The following describes some of the most common financial challenges faced by CCRCs, potential solutions to these challenges, and the contribution to achieving a successful outcome that an experienced financial partner, like **Red** Capital Markets, LLC, can make.

Common Financial Challenges for CCRCs in Today's Market

- 1: Revenue Shortfalls and Actuarial Imbalances
- 2: Actual or Imminent Event of Default
- 3: Letter of Credit Bank Chooses Not to Extend
- 4: Community Renovation or Expansion Projects

Continuing Care Retirement Community Fast Facts

- Approximately 1,900 CCRCs encompassing 601,000 units operate in the United States, accounting for more than 25% of U.S. senior housing units and skilled nursing beds.
- According to the National Investment Center for the Senior Housing and Care Industry (NIC), CCRCs occupancy averaged 89% during the third quarter 2011 (3Q11), approximately 1.3% higher than properties that do not offer an age in place option.
- Approximately 46% of CCRCs levy a significant entrance fee on new residents. Fees range from about \$50,000 to more than \$1 million. The mean and median entrance fees during 3Q11 were \$252,000 and \$209,000, respectively, according to NIC.

Sources: "Today's Continuing Care Retirement Community"; Leading Age, ASHA and NIC, July 2010

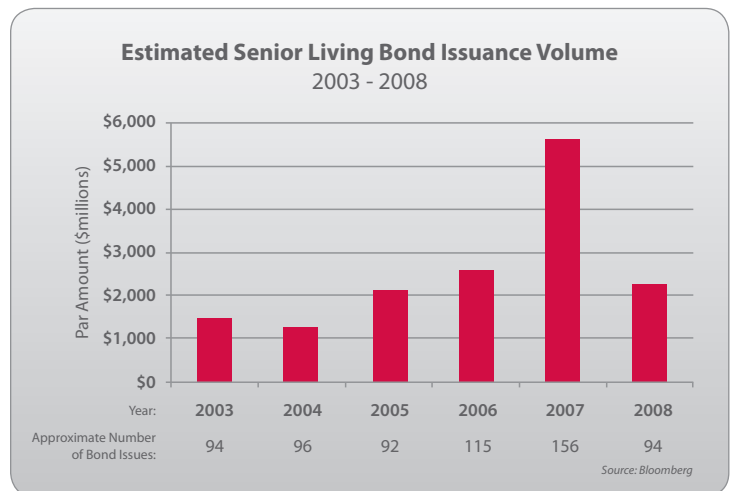
1: Revenue Shortfalls and Actuarial Imbalances

The residential property markets have weakened over the past four years, delaying the sale of homes by prospective CCRC residents and, in turn, slowing CCRC unit sales. Consequently, a number of new and existing communities failed to meet expectations, generating below projected entrance fee and monthly fee income. In addition, the delayed relocation to a retirement community has caused the average age of incoming residents to rise. Older incoming residents are likely to spend less time in low-service cost independent living units before relocating to a more healthcare-intensive setting. As CCRCs often rely on monthly fees from independent living residents to subsidize the higher costs associated with more care-intensive settings, some CCRCs find themselves in actuarial imbalances.

How Red Can Help:

- Change Pricing Strategy or Resident Agreement – Red bankers can help develop and implement a new pricing strategy or change to the residency agreement to encourage prospective residents to move in. As financial advisor, we can conduct an analysis of the impact of proposed pricing changes on unit sales and revenue collections and evaluate how the changes will affect financial ratios and their subsequent bearing on credit ratings and bond covenants.
- Equity Contributions – We can also work with the sponsor to craft an effective means for it to inject new equity into the community. One method includes buying existing community debt in the secondary market at a discount, which can be retired or swapped through the purchase of a new subordinated issue of securities.
- Consultation with Legal Team – Red can review the bond documents and compliance issues and discuss the best course of action with bond counsel, bond enhancement counsel, and issuer's counsel.

- Board and Resident Education – We can help management build support among board members and existing residents for changes to contracts. A Red advisor can help present the impact of proposed fee modifications in clear and concise terms to the board and residents and answer any questions they may have.
- Negotiate with Lenders and Investors – Should revenue shortfalls lead to missed covenant requirements (i.e. debt service coverage ratio requirements, cash requirements, etc.), trustees and/or letter of credit banks generally require borrowers retain an outside marketing or management consultant to examine the existing operational situation and recommend changes to restore compliance. With these recommendations, Red can explain to trustees, credit enhancement providers, and investors the feasibility of management's proposed strategy with revised cash flow forecasts and supporting financial analysis. If consent of a majority of bondholders is required to modify bond documents or approve a forbearance plan, we can analyze the impact of the revised marketing plan on projected cash flows and negotiate on behalf of management with bond trustees, investors, and lenders.



"With housing markets continuing to struggle, the tough operating environment for CCRCs is likely to persist for some time, especially for properties delivered during the past two or three years. Sponsors experiencing revenue shortfalls should consider using all available options to economize on interest costs and create breathing room in this tough marketing environment, including seeking debt service forbearance and debt restructuring."

James Scribner,
Managing Director, Red Capital Markets, LLC

2: Actual or Imminent Event of Default

If forbearance is not an option or if a monetary default is imminent, CCRCs may have to restructure the existing bonds, refinance the debt, or seek acquisition or merger options. A restructuring involves an amendment to the terms of the indebtedness that reduces debt obligations to a manageable level. This objective can be accomplished by the reduction of an interest rate coupon or variable rate margin; forgiving a portion of the debt principal; or extending a sinking fund or scheduled principal payment. Refinancing the debt entails issuing new debt securities, which will pay off the existing bonds and create new terms and interest rates.

If a letter of credit bank is involved, the bank may pursue its own remedies under the letter of credit documents to limit its credit exposure. Potential defenses include seeking an acquisition or merger with a well-capitalized partner with the resources to resolve the bank liability.

How Red Can Help:

- Structure and Underwrite Replacement Debt – We can structure and analyze the restructured or refinancing debt with respect to interest rates, covenant requirements, and payment schedules amenable to both CCRC operators and investors. If new refinancing debt is required, we can distribute the new debt to investors.
- Explore Acquisition/Mergers – If a letter of credit bank pushes for acquisition or merger, we can prepare an investment offering package and solicit suitors. The offering package would include a description of the community, highlights of the market area and competition, and historical and projected financial analysis. Subsequently, Red may distribute the package among our network of investors and negotiate terms and schedules with the interested parties and the receiver or bankruptcy trustee. As this process requires each party to absorb capital losses, negotiations can be difficult and protracted. As financial advisor, we can be instrumental in suggesting an optimal solution that maximizes the returns of all parties and validates the recommendation with financial projections and valuation analyses.

State of the CCRC Sector

- Fitch Ratings and Standard and Poor's deem the growing aging population as a long-term credit strength of the sector. In the short-term, however, the rating agencies believe that the weakened economy and real estate market have contributed to the low occupancy in CCRCs.^{1,2}
- Standard & Poor's reports that although occupancy, uncertain investment returns, and reliance on variable rate debt present challenges, CCRCs can achieve improved financial performance by focusing on operations, debt profile, marketing, contract types, and service lines.²

1 "2011 Median ratios for Continuing Care Retirement Communities," Fitch Ratings, September 20, 2011.

2 "U.S. Not-For-Profit Senior Living Providers: Scanning the Horizon for Brighter Skies," Standard & Poor's, October 6, 2011.

CCRC Developer Files for Chapter 11 Bankruptcy Reorganization

- In 2009, a developer of 19 CCRCs filed for Chapter 11 bankruptcy protection, citing slow sales and an inability to restructure more than \$1 billion of unsecured corporate debt.
- Affiliated communities had \$510 million of taxable and tax-exempt municipal securities outstanding.
- The parent company was acquired at auction by a private equity fund.
- Two affiliated Illinois CCRCs sought and were granted forbearance from debt service requirements until alternative sources of capital could be identified.
- After being acquired at auction, the communities changed entrance fee pricing and the entrance fee reimbursement policy, guaranteeing a 90% reimbursement upon re-leasing / re-sale of the unit, down from 100% previously.
- Both properties now are highly occupied, financially stable and widely held to be outstanding contributors to the general welfare of their respective communities.

Sources: SeniorCare Investor, May 2010, Chicago Tribune, April 13, 2010

3: Letter of Credit Bank Chooses Not to Extend

The terms of bank letters of credit often expire prior to the maturity date of the bonds or on the date by which bonds are expected to be fully repaid with entrance fee income. Increasingly, banks are electing not to exercise their extension options; instead, they are requiring issuers to find an alternative provider or to aggressively seek a negotiated settlement.

How Red Can Help:

- Solicit Alternative Providers – Similar to our services in petitioning potential acquirers/merger partners, we can develop a “request for bank enhancement or financing” package to solicit interest from other banks for a replacement letter of credit or take-out of the existing debt.
- Equity Contribution – Red can help providers determine whether their cash on hand can be used to pay off the letter of credit enhanced debt or if the cash would be better used to purchase the outstanding debt in the secondary market at a discount.
- Develop a Refinancing Plan – Refinancing the bonds is also an option under this scenario. We can structure and underwrite a variety of refinancing plans for management to consider. Once a plan is selected, we can guide management through the financing process and bring the new financing to market.

“When the time comes to choose a financial advisor or investment bank to resolve a complex, multifaceted challenge, it makes sense to choose a partner with all the necessary capabilities in house, including bond structuring and placement expertise; deep secondary market knowledge; and a balance sheet and the willingness to bring it to bear with urgency to bridge a situation to the finish line. Red is one of a small number of players in this space that have all the tools.”

Matthew O’Grady,
Managing Director, Red Capital Markets, LLC

4: Community Renovation or Expansion Projects

CCRCs often identify renovation or expansion projects to update its community, create economies of scale, and/or better serve the needs of the market area and its residents. The issue of new debt to finance the proposed project may need existing bondholder approval.

How Red Can Help:

- Review of Additional Debt Tests – We can examine the “Additional Indebtedness” provisions in the bond documents and perform historical and projected debt service coverage tests to evaluate the impact of the proposed expansion project on the credit quality of the existing debt. Our work can determine whether the proposed project will result in a credit downgrade or otherwise impair the interests of existing bondholders and demonstrate the feasibility of the project to sponsors and other key stakeholders.

- Oversight of Document Drafting and Coordination of Bondholder/Lender Consent – The issue of new indebtedness will call for a supplemental indenture, which requires the approval of a majority of bondholders and lenders. We can liaise with the legal team, investors, and lenders to any potential conflicts between the proposed financing and document amendments to the existing documents. We can also coordinate the collection of bondholder/lender approvals to reach the required percentage of consent.

Conclusion

Continuing care retirement communities can be effective vehicles to ensure access to quality retirement housing and long-term care for older Americans. By the same token, tax-exempt financing issued for CCRCs may offer attractive tax-advantaged, risk-adjusted return opportunities to fixed income investors.

CCRCs are complex entities, however, and their ability to service long-term debt may be affected by the condition of residential real estate markets, health care and operating cost escalation, and regulatory changes. Although defaults and foreclosures have been rare in the sector, a number of communities are experiencing revenue shortfalls and actuarial imbalances, and many will be compelled to employ creative capital solutions to remain independent and pursue their social missions.

Fortunately, CCRC sponsors and residents have at their disposal a variety of options to resolve or improve these situations. Employing these tools can be a daunting prospect, but assembling the right team of experts can significantly increase the probability of achieving an agreeable outcome. The seniors housing and healthcare professionals at Red Capital Markets, LLC and Red Capital Partners, LLC stand prepared to assist CCRC sponsors seeking financial options with industry-leading advisory, underwriting, investment banking, and secondary market/trading expertise as well as the capital resources necessary to bring good ideas to practical fruition.

Give us a call.

See what we can do for you.

Learn more and sign up to receive email news and updates by visiting www.redcapitalgroup.com

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