



Restructuring of Continuing Care Retirement Communities

February 3, 2016

Representing the Distressed CCRC

I. Board Governance and Liability Issues

A. Not for Profit

1. Single site
2. Sponsored or system
3. Restricted or Charitable Use Funds

B. For Profit

C. Resident Issues

1. Entrance fees / Marketing

Representing the Distressed CCRC *(cont'd)*

II. File or Not?

- A. Decision dictated either by relief needed or response to creditor action
- B. Liquidity Needs
- C. What is the goal of the restructuring effort
 - 1. Permanent fix
 - 2. Need to ensure future viability
 - a. Capital needs
 - b. Resident obligations

Representing the Distressed CCRC *(cont'd)*

III. Out of Court Issues

- A. Necessary consent levels
- B. Bond v. Bank issues
- C. Tax free nature of bonds (NFPs)

Representing the Distressed CCRC *(cont'd)*

IV. Filing an 11 for a CCRC

A. Communication

1. Residents
2. Regulators
3. Media

B. Unique First Day Issue

1. Entrance fee escrow

C. Resident Committees

Representing the Distressed CCRC *(cont'd)*

V. Plan Process

A. Reorg or Sale

1. Debt level
2. Cash needs
3. Entrance fee obligations

B. Sale Issues

1. Entrance Fee refunds
2. Attorney General and Regulator issues (363(d))
3. Why higher may not be better
4. Importance of bid procedure qualification requirements

Representing the Distressed CCRC *(cont'd)*

C. Plan Issues

1. Residents as a class
2. Absolute Priority rule
3. Valuation issues

CCRC Capital Structure

- Not-For-Profit CCRC
 - Tax Exempt Bond Debt backed by irrevocable letters of credit and interest rate swaps
 - short term letter of credit-backed variable rate debt and long term fixed rate debt
 - fund construction costs and operating losses during the stabilization and “fill-up” period
 - CCRC’s repayment obligations are usually secured by liens on the CCRC’s assets, revenues and entrance deposits paid by the residents
 - ability to tie construction risk with fill-up risk with long term operating risk presents special underwriting challenges

CCRC Capital Structure *(cont'd)*

- Entrance deposits fund debt service during the start up period. When stabilization is achieved, the operating surplus is used to meet debt service obligations
- Reserves
 - bond documents usually restrict the indenture trustee's use of the reserved funds and do not permit the funds to be used to fund the working capital needs of the CCRC

CCRC Capital Structure *(cont'd)*

- For-Profit CCRC
 - Conventional construction financing generally tied to entrance deposit collateral (phased to hedge risk); take out financing tied to fill-up
 - Integrated legal structure makes use of additional financing for a “piecemeal” approach to access more available credit (e.g., carve out SNF or AL unit) difficult to achieve

Challenges Presented by Capital Structures

- Bondholder consent provisions
- Bank syndicate consent provisions
- Differences in creditor objectives and perspectives (LOC banks vs. bondholders: LOC issuers are often motivated to support the facility at some level to avoid or delay a default)
- Shared collateral pledges and different time horizons lead to tension between variable and fixed interests
- Use of 100% debt financing leads to early stress if thinly capitalized or unmotivated sponsor
- Nature of publicly traded debt leads to challenges
 - Distressed debt buyers

Potential Restructuring Alternatives

- Debt exchange (with cancellation of indebtedness income)
- Structured, long-term forbearance
- Covenant relief and conditions
- Bifurcation of debt structure
- Equity infusion (manager; joint venture partner)
- Additional collateral, sponsor guaranty
- Subdivision of facility (unbundling SNF or AL)
- Sale or other strategic transaction
- Bankruptcy: 363 sales, pre-packs and plans

Recognizing Distress Early

- Early Warning Signs of Distress
 - Are key assumptions holding true?
 - Occupancy Projections vs. Actual Results
 - Market Penetration
 - Cash Burn Rate
 - Comparable Trends



Managing Restructuring Process

- Communication of up-to-date accurate information is key
 - Informational advantage
 - Some information disparities attributable to bondholders' reluctance to obtain material non-public information that restricts trading
- Default Waivers and Forbearance Agreements
 - Use time productively
 - Kicking the can usually is not effective
 - “zero budget” review of operations and finances
 - Modifications of Residency Agreements
 - Review loan and security documents
 - Attempt to correct any documentation issues, but be mindful of avoidable transfers

Managing Restructuring Process *(cont'd)*

- Governance Issues
 - Many CCRCs are governed by boards that include residents who may not be best positioned to understand and advance the restructuring process
 - Management may not be qualified to execute a turnaround
 - Consensus Chief Restructuring / Turnaround Officer can give comfort to lender group

Managing Restructuring Process *(cont'd)*

- Business Plan
 - Is stand-alone turnaround based on a new set of assumptions/projections feasible?
 - Operational changes
 - Conditions to lender concessions
 - Equity infusion / Sponsor guaranties
 - Management changes
 - Modification of resident contracts
 - Hope certificates

Managing Restructuring Process *(cont'd)*

- Strategic Transactions
 - Challenges of out-of-court sale
 - Requires resolution of intercreditor issues
 - Bondholder consents
 - Buyer may prefer free and clear Section 363 sale
 - State Regulators
 - Many state CCRC laws require advance notice and in some cases approval of any transaction or refinancing where the regulators believe reserves are jeopardized or fees may increase
 - Restrictions on use of endowment funds
 - Some states require notice and approval of any change in management, structure, substantial change of control

Managing Restructuring Process *(cont'd)*

- Strategic Transactions *(cont'd)*
 - Religious Affiliation
 - More than half of CCRCs have a religious affiliation, and many of them lease their premises from such religious organizations. Leases frequently require that the mission of the CCRC must be aligned with that of the landlord. In some instances, this can create a challenge in transferring ownership of the facility.
 - Reserved consent rights give sponsor veto rights over certain extraordinary transactions, which may be used to prioritize mission over creditor interests

Managing Restructuring Process *(cont'd)*

- Public Relations Affect Value
 - Current and potential residents
 - Every step should be viewed through the prism of how current and potential residents will perceive it and react to it
- Lender Liability Concerns
 - Close involvement without crossing the line

Managing Restructuring Process *(cont'd)*

- Pre-packaged or pre-negotiated plan best route
 - Obviate 100% bondholder consent requirement
 - Lender working group
 - Build consensus among holders to achieve 2/3 of amount and > 50% in number
 - Resolve intercreditor issues early
 - Resident Issues
 - From a secured creditor's perspective, unless there is either a compelling reason to cease operations and liquidate the CCRC or there is confidence that a sale of the business without the assumption of entrance fee liabilities is achievable, then depending on the specific terms of the resident contract, the secured creditors may not challenge the treatment of entrance fees as ordinary-course

Managing Restructuring Process *(cont'd)*

- Debtor-in-Possession Financing / Use of Cash Collateral
 - Typically, no unencumbered assets
 - Defensive DIP financing
 - Milestones for sale / plan confirmation
 - Escrow of new entrance deposits
 - Procedure for return of existing / new entrance deposits
 - Exclusion of post-petition deposits from post-petition liens
 - Requiring that sale procedures provide for qualified bidders to assume all residency agreements without modification

Mitigating Risk to CCRC Lenders

- Sound Governance and Management Expertise
 - Board composition
 - Management experience and track record
- Is pricing consistent with the market profile?
- Does the model have sufficient flexibility to withstand short-term stress?
 - Housing market downturn sensitivity
 - Various residency payment options (life care, rental, hybrid)
 - Pricing flexibility
 - Capital expenditure reserves
- Sponsor Commitment
 - Equity
 - Guarantees

Conclusion

Recently, nonprofit CCRC bondholders, a relatively discrete and concentrated group of investors, have demonstrated a willingness to reorganize distressed CCRCs instead of urging a sale through the bankruptcy process, perhaps because they had been affected by disappointing recoveries in asset sales. As reorganizations generally yield better returns, this may be an encouraging sign to all constituents.

Considerations

- Contract Types
 - Extensive Care Contract (Type A)
 - Modified Contract (Type B)
 - Fee-For-Service Contract (Type C)
- Community Age
- Community Expansion
- Multiple Phase Consideration

Considerations *(cont'd)*

- Scope of Resident Draw – Primary Market Area or Destination
- Pre-Sales/Deposits
- Location
- Source of Debt Service Payment

External Factors

- **Competitive Landscape**
 - Project and Market Penetration Rates are indicators of the number of age and income qualified people necessary to be captured to stabilize the project or the market as a whole
 - Generally a Project Penetration Rate above 10% and a Market Penetration Rate above 25% are considered High
 - Consider entrance fee and rental CCRC's
- **Real Estate Trends**
 - Majority of new residents sell their homes prior to moving into a CCRC
 - Relationship between entrance fees and median home sale prices

External Factors (cont'd)

- Regulatory Environment
 - State specific
 - Impact on ability to accept new residents
- Legislative Changes
- Other Lenders

Internal Factors

- Occupancy
 - Slow Fill
 - Declining Occupancy/Increasing Turnover
- Operating Margins
 - Declining
 - Consistent with Increasing Occupancy
- Cash on Hand
 - Investment Funds
 - Operating Reserves
 - Sponsor Funds
 - Entrance Fees

Internal Factors (cont'd)

- Working Capital Aging
 - Accounts Receivable
 - Accounts Payable
- Capital Expenditures
 - Delayed
- Entrance Fee Refund Payments
 - Delayed
 - Settlement Agreements

Internal Factors (cont'd)

- Marketing/Sales
 - Messaging
 - Multiple Contact Types/Refund Options
 - Sustained Discounts/Let's Make a Deal
- Management
 - Turnover in Senior Positions

Internal Factors (cont'd)

- Healthcare Center
 - Patient Mix
 - Billing and Collection of Third Party Receivables
 - Inefficient Design
 - Survey Results
 - Independent Marketing Effort

Managing the Process

Parties have Differing Interests and Need to Stake Out Goals and Push Agenda Forward

- **Multiple Constituents Include:**

- Bondholders and Other Secured Creditors
 - e.g., L/C Lenders
- Sponsor
- Board
- Management
- Residents
- Regulators

Managing the Process (cont'd)

- **Sponsor**

- Relationship to Community

- On Campus
- Ground Lease
- Single Site or Part of Multiple Sites

- Ability to Obtain Support/Concessions

- Source of Bridge Funding/Liquidity Support
- Reduction/Deferral Lease Payments
- Reduction/Deferral Management Fees

- Leverage Against Sponsor

- High Visibility
- Other Facilities
- Connection to Residents

Managing the Process (cont'd)

- **Board/Management**

- How Active and Sophisticated is the Board?
- Board's Fiduciary Duties
- Concerns With Residents
- Ability to Educate the Board
- How Entrenched is Management?
 - Consultants
 - Replacements

Managing the Process (cont'd)

- **Residents**

- How Active/Organized are the Residents?
- Need for Some Communication
- Balance with any Workout Strategy

- **Regulators**

- How Active are the Regulators?
- Ability to Assist in the Process

Inter-Creditor Issues

The Commercial Banking Institutions and Fixed Rate Bondholders

- **Differing Interests/Goals Between Banks and Fixed Rate Bondholder**
 - Long Term vs. Short Term
 - Reserve/Performing Loan Requirements of Banks
 - Current Status in Market – e.g., Exiting Sector
 - Inter-Bank Group Issues

Inter-Creditor Issues (Cont'd)

- **Rights Under Bond Documents**

- Rights to Entrance Fees – Default vs. Non-Default
- Rights to Direct Remedies/Accelerate
- Single Lien Held by Master Trustee (shared pari passu) or Separate Liens
- Fees and Expenses of Banks
- Trustee's Advance Rights

- **What to Watch Out For**

- Bank's Retention of Consultants
- Use of Entrance Fees to Pay Down Fixed Rate Bonds
- Bank's Negotiating with Borrower

Goals/Exit Strategies/Solutions

- **Assessment of Problem:**

- Operational Issues – Operating at Positive Cashflow Exclusive of Debt Service
 - Inexperienced or poorly performing management
- Market Demand
 - Slow fill-up
 - Competition
 - Extent of PMA
 - Issues with marketing team

Goals/Exit Strategies/Solutions (Cont'd)

- Liquidity Issues
 - Maturity of L/C Credit
 - No ability to refinance
 - Operationally negative cashflow
- **General Approaches**
 - If operationally cashflow positive and operational/management issues
 - Management/Marketing issues
 - Revenue/expense assessments
 - Short/medium term forbearance

Goals/Exit Strategies/Solutions (Cont'd)

- If Market Demand is an Issue/Too Much Debt
 - Assessment of debt structure
 - Assessment of affiliation process vs. restructure
 - Maximize through restructure - i.e., right size the balance sheet
- If Operationally Negative
 - Move forward with affiliation process sooner than later – delay will only decrease value

Goals/Exit Strategies/Solutions (Cont'd)

- **Assess Issues Sooner than Later**

- If Warning Signs of Distress, Organize Sooner than Later
- Build in Time to Assess
- Be Leary of Statements, such as: “*We are involved in a discrete affiliation process*”
- Avoid Bank Control of Process

Goals/Exit Strategies/Solutions (Cont'd)

- **Key Negotiation Issues Re: Restructuring**

- Cash Available
- Timing of Restructure
- Debt Sizing – Current vs. Deferred Pay
- Term of Debt/Maturity
- Allocation/Division of Entrance Fees/Cashflow
- Put Rights
- Default Rights Including Remedies/Interest

Goals/Exit Strategies/Solutions (Cont'd)

- Structure of “CAB” or “B” Piece
- Voluntary Bond Exchange vs. Bankruptcy Process
- **Key Issues Re: Sale/Affiliation Process**
 - When Does Process Begin?
 - Coordinated Process to Full Market
 - Discrete Process can have Negative Impact
 - Need for Sale in Bankruptcy vs. Other Procedures
 - TIP Process

Goals/Exit Strategies/Solutions (Cont'd)

- Receiver Process
- Consensual Foreclosure Process
- Bankruptcy/Sale Process
 - Stalking Horse Value
 - Bid Procedures/Break-Up Fees
 - Resident Issues
- Likely Interested Parties
 - Non-for-Profit Operators
 - For Profit Operators
 - Operator/Investor partnerships



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