LeadingAge Missouri Annual Conference

Update on FHA LEAN – HUD Financing for Senior Living Providers

September 19, 2013

Offering Financial Advice and Solutions to Health Care, Senior Living, and Housing Providers.
Agenda

- State of the Capital Markets
- FHA/HUD Financing Update
- Financing Option Comparison
- Case Studies

- 2008 – 2012 were challenging times….
  - Short-term rates spiked during the financial crisis
  - Credit spreads widened on municipal default predictions and fund outflows
  - Letter or Credit providing banks were downgraded. Many have not returned to sufficient strength
  - The risks of some traditional debt structures were illuminated (specifically letter of credit backed bonds)
Short Term Tax-Exempt and Taxable Rates

Source: Bloomberg
Health Care Credit Spreads Have Tightened

Source: Bloomberg
State of the Capital Markets – Today

- Fast Forward, Mid 2011-2013. The situation has improved…
  - Historic action by the Fed continues to support historically low short and long-term rates (although we are beginning to see rates increase)
  - Credit spreads have narrowed
  - Alternative bank options have emerged (direct purchases)
  - Agency mortgage programs has become very attractive as investors seek high-quality debt offerings (FHA, USDA, FNMA) and borrowers look to eliminate some of the risks of traditional structures
Unemployment Rate Forecast

Source: Bloomberg Survey, September 2013
Fed Funds Forecast

Source: Bloomberg Survey, September 12, 2013
10-Year Treasury Yield Forecast

Forecasts as of Month End

Source: Bloomberg Survey, September 12, 2013
Accessing Capital – The Goals, Needs, or Opportunities

- Disadvantageous existing debt structure
  - Expiring letter of credit or bank downgrade
  - Onerous financial or operating covenants

- Savings or permanency
  - Economic refinance (interest savings)
  - Lock into fixed rates while at historic lows or provide predictable debt service and avoid refinance risk (permanency)

- Campus or organizational expansion
  - A new memory care or Medicare rehab wing
  - Replace an aging facility
  - An entirely new campus in a ripe market to expand the mission
Traditional & Alternative Options

**Decision to Borrow**
- **Traditional**
  - Banks
    - Private Placement or Loan
    - LOC Enhancement
  - Tax-Exempt Fixed Rate
    - Public bond sale on the organization’s credit
- **Alternative**
  - FHA / HUD Mortgages
    - Private mortgage loans insured by FHA/HUD
  - USDA & FNMA Loan Programs
    - Loans made directly or a portion guaranteed
HUD 232 LEAN – Overview

- HUD implemented LEAN program in 2008, to reduce processing time and improve predictability
- LEAN moved the 232 program to the Office of Healthcare Programs in DC
- HUD provides mortgage insurance through the 232 program (not direct loans from government) – HUD insures loans made by private LEAN-approved lenders

### Construction / Sub Rehab

- HUD/FHA 232 Program  
  - New Construction or Sub Rehab of licensed SNFs & ALFs
- HUD/FHA 232/241 Program  
  - 2nd Mortgage Program for expansion of existing HUD-insured Facilities

### Refinance / Acquisition

- HUD/FHA 232/223f Program  
  - Refinance or Acquisition of licensed SNFs & ALFs
- HUD/FHA 232/223a7 Program  
  - Refinance of existing HUD-insured mortgage
HUD 232 Program– Basic Terms

- **Long Term Fixed Rate**
  - Up to 35 year (40 year for construction) matching term/amortization
  - Eliminates refinance/renewal risk

- **Government Guarantee**
  - Eliminates both health care sector and credit pricing spreads
  - “AAA” like debt

- **Fixed Guarantee Fee**
  - Unlike banks, does not consider risk-based pricing
  - 0.65% refinance / 0.77% construction / 0.72% for 241

- **No Financial Covenants**
  - No on-going Debt Service Coverage, Days Cash on Hand or other financial ratio covenants

- **Non-Recourse**
  - Keep “Dry Powder” and silo risk

- **Loan is Assumable**
  - Transfer of Physical Asset (“TPA”) through HUD

- **Low, long-term fixed interest rates**
HUD 232 LEAN Program

- The LEAN program – HUD is no longer the “lender of last resort”
- Demand and lack of staff from 2009-2011 resulted in long “queue”
  - Increased staffing and hired independent contractor (Summit Consulting)
  - Efforts to eliminate the “queue” have been successful
- Current deal timeframe, rates
- Max LTV 80% (programmatic = 85%)
- Third party reports and application process
HUD 232 LEAN – Other Considerations

- Permanency of financing (intended time horizon, prepayment flexibility)
- Senior lien on assets and land
- Replacement reserves
- Master lease
- DACA/DAISA
- AR financing
HUD 232 LEAN – Other Considerations

- Recent Changes:
  - Swaps – permitted to refinance swap termination liabilities up to 10% of the new mortgage amount
  - Quarterly operator-certified financials, applies to existing HUD facilities
  - Non-profit regulatory agreement update
    - Distribution considerations
    - Debt service reserve fund
  - Expanding view on CCRC’s
    - Traditionally capped unlicensed IL units at 25% of total units in a section 232 loan
    - Cap has been removed
      - Must be rental (non-entry fee)
      - Must provide services to “frail elderly”
HUD 232 LEAN – Construction Options

• 232 new construction/sub rehab:
  • More equity, proven owner/operators, exceptionally strong market studies
  • 25-35% “equity” required
  • HUD prefers SNFs (ideally replacement) and ALZs over ALFs – HUD is sensitive to new AL construction in states with high single family mortgage default rates
  • Davis-Bacon prevailing wage requirement

• Repairs and renovations as part of a refinancing:
  • Up to 15% of appraised value
  • Double square footage rule

• 241 Supplemental Loan update:
  • Supplemental loan program used for substantial renovations/expansions
  • 90% LTC
  • No prevailing wage requirement if not used during original construction
Traditional Structure Comparison – Tax-Exempt Unenhanced

- Tax-Exempt bonds issued to the market on provider’s own credit strength
- Rated or Non-rated
- Term: 25-35 years
- Rates: Credit and market driven
  - 2010 – 2012 were challenging times for the Muni Markets
  - Mid 2011 – Today, the market has materially improved
- Other considerations
  - Timing (3 – 4 months)
  - Financial Covenants
Traditional Structure Comparison – Bank Private Placements

- Tax-Exempt bonds structured and privately placed (sold) to a bank or banks
- Term: Market and credit driven, typical 3-10 years
- Amortization: 20-30 years
- Rates: Fixed or variable, and deal specific
- Other Considerations:
  - Timing (2 – 3 months)
  - Financial Covenants
  - Ancillary Business
Alternative Structure Comparison – USDA Loan Programs

- **USDA Community Facilities ("CF") Program**
  - For the long-term takeout of construction projects (outside construction financing required)
  - Direct Loans – 4.625% for 40 years (as of 10/1/2013)
  - Guaranteed Loans – up to 90% guarantee on a bank loan
  - Populations of 20,000 or less
  - At most 50% refinance

- **USDA Business & Industry ("B&I") Program**
  - Like CF, permanent funding
  - Guaranteed Loans – 80% from $1-5MM, 70% from $5-10MM, 60% greater than $10MM
  - Populations of 50,000 or less with preference given to < 25,000
  - Can do 100% refinance
Alternative Structure Comparison – FNMA Loans

- A mortgage loan made by a private sector mortgage lender, guaranteed by FNMA
  - Refinance or acquisition with only minor construction funded
  - Seniors and affordable housing assets (max. 25% skilled nursing units)
  - Max. 75% LTV
- Term: Up to 12 years
- Amortization: Up to 30 years
- Other Considerations
  - Fast (closing in 30-60 days)
  - No financial covenants
  - Non-recourse to a parent organization or foundation
Case Study – *HUD 232 Refinance of LOC Enhanced Tax-Exempt Bonds*

- Single-site CCRC
- Existing Structure = $9MM in LOC enhanced variable rate bonds fixed with and interest rate swap
  - Enhancing bank recently downgraded, causing need to restructure
  - Also desired to fund a major renovation and therapy expansion
- The FHA program provided permanent financing at historically low fixed rates (<3.00%)
- Allowed the renovation to be funded through the refinance program
- Funded the unwind liability associated with the existing interest rate swaps.
- FHA mortgage was concentrated on the higher acuity (SNF/ALF) leaving the IL villas unencumbered from any debt.
Case Study – Bank Placement: Construction → FHA Refinance

• 105 Unit Stand-Alone ALF
• Aging 49 Bed SNF
• Short Term Goal:
  • New 20 Unit AL Memory Care
  • Replacement SNF
• Tax-Exempt Bonds sold directly to regional bank after competitive bidding process
  • Funded construction of replacement SNF (all private units) and AL Memory Care Wing
  • 5-Year Term / 27-Year Amortization
• Long-Term Goal:
  • Refinance the debt into a long-term fixed rate debt through FHA 232/223(f) program 3 years after receipt of certificate of occupancy
Case Study - *FHA for Renovation of Existing Physical Plant*

- Existing 153 Bed SNF
- Plan:
  - Reduce Facility to 133 Beds
  - Substantial Renovation of Four Wings
    - Private Rooms
    - Expanded Therapy Space and Administrative Space
    - Exterior Remodeling
- FHA Section 232 Substantial Rehabilitation
  - Funded rehabilitation projects
  - Refunded existing LOC-backed variable rate bonds
  - 27.75 Year Term and Amortization
  - Low long-term fixed rate
- Result: Achieved organizational goal of 75:25 ratio of fixed-variable rate debt
Summary

• The HUD LEAN programs continue to provide efficient access to capital to senior living providers across the credit spectrum with several benefits:
  • Low, fixed rates
  • Extended term and amortization
  • Non-recourse
  • No financial covenants
  • Flat guarantee fee (not risk based pricing)
• Allows borrowers to eliminate some of the risks of traditional structures
• Change to LEAN processing has improved the consistency and predictability of the program
• Organizations should explore both traditional and alternative structures in tandem, arriving at the structure best suited for their organization
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