

LTC: From Main Street to Wall Street

Financiers playing new game after 1990s disruption

BY JOHN ANDREWS

Over the past 25 years, the long-term care industry and its financial sponsors have grown up together. In fact, they've matured to the point where they have nearly as much perspective as the residents they both serve.

As local nursing home operations grew into regional and national chains, lenders followed suit. And when the industry diversified into distinct new markets such as assisted living, the financial community developed new products specifically for the new sectors. This longtime symbiotic relationship has caused both to become smarter and more sophisticated, veterans from both sides say.

Bill Shine, executive vice president of GMAC Commercial Mortgage's healthcare group, is known as "the godfather" of nursing home financing. He says horizons were much smaller in 1980.

"Back in the late 1970s and early '80s, the industry was — with the exception of one or two public companies — mostly locals and regionals with five or fewer facilities," said Shine, of Birmingham, AL. "Savings and loans were the dominant financiers, doing a tremendous amount of tax-exempt financing. Each state had its own small investment banker — in our area it was Hugo Marx and Company."

A senior vice president with SouthTrust Bank at the time, Shine said the S&L bankruptcy crisis of the mid-'80s "dramatically changed the landscape" for nursing home operators.

"For the first time, you had public equity coming in," he said. "There was a tremendous influx of equity capital and concurrently, commercial mortgage-backed securities, in addition to traditional bank financing."

Lacking knowledge

Provider access to capital was "very limited" a quarter-century ago, noted Norman Estes, president and CEO of Tuscaloosa, AL-based NHS Management. In 1980, Estes was assuming leadership of the family business from his father, James. At



Lenders — and providers — have gained new insights into long-term care's dynamics during the past quarter century. The result has led to a record amount of financing over the last two years.

that time, the company had 12 nursing facilities, all in Alabama. Its holdings have since grown to 40 facilities, which are located throughout the Southeast.

In Estes' view, lenders held tight purse strings due to a lack of understanding about the dynamics of the long-term care industry.

"The [savings and loans], banks and bond issuers were all trying to grasp the nature of the properties, which were considered a single-purpose entity because the buildings really couldn't be used for anything else," Estes said. "That made lenders standoffish. They didn't have the expertise to understand Medicare or Medicaid. It was difficult to find lenders who were interested — they tended to look at credit history rather than the value of the property."

Estes has known Shine for more than two decades and says his company was one of Shine's first loan packages.

"He understood that if an operator gets into trouble, the underlying value of the property and license allowed a creditor to take over the property," Estes said. "That realization made lenders see the business as less risky and as a result made more capital available to fuel the growth of the regionals."

The U.S. Department of Housing and Urban Development guaranteed loans have been a consistent funding source over the years, Estes said, and even though "it's a very slow process" securing the loan, the 30-year financing option is often preferable to the typical 5- to 7-year terms banks offer. Real estate investment trusts (REITs) have also grown to become major financiers in long-term care.

Through the years, long-term care's financial cycles have gone up and down "like a roller coaster," observed John Cobb, managing director of GE Capital Healthcare's long-term care segment in Chicago.

"When I started in the mid-'90s, things were great: nursing homes were making money, new therapies were being developed and a lot of investors were in the market from equity and debt standpoints wanting to loan money," said Cobb, who at that time was an underwriter for long-term care properties at a south Florida bank.

"By the time of the Balanced Budget Act of 1997, there was a massive build-up of senior housing, with over 30,000 units being built. The nursing home industry went into a correction — revenues slipped dramatically and four of the top six operators went bankrupt. People were struggling."

Weeding out weaklings

The harsh climate that followed BBA '97 toughened a lot of operators and ultimately proved to be beneficial, said Mike Monticello, senior vice president with Chicago-based LaSalle Bank.

"Operators today are survivors, and as a result they are better than ever," he said. "Reimbursement has gotten more difficult, which has forced them to become smarter, swifter and more nimble. We see a lot of sophistication today," he said.

Cobb contends that the investment community has become more astute as well. His current method of evaluating prospective nursing home clients differs greatly from the early days, he said.

"At first it was all about the real estate — you wanted to understand the dimensions of the building, the assets, proximity to the hospital ... classic

READERS' CHOICE AWARDS

McKnight's
LONG-TERM CARE NEWS

25
TWENTY-FIFTH ANNIVERSARY

FINANCE

**GE Healthcare
Financial Services
GMAC Commercial
Mortgage**

As part of its special 25th year anniversary celebration, McKnight's asked its readers to vote for the products and services that have made the biggest impact on their work lives over the past 25 years. More than 1,400 votes were cast. No prompting or choices were offered — each voter wrote in his or her own answers in balloting conducted during late summer and fall 2005. More than one winner was declared in this category because the differences in top candidates' voting totals were not significant enough to separate them.

real estate analysis," he said. "Today, I can do a \$50 million loan and not even need to see the property. It's all about the operator now. I would much rather spend five days talking with the operator than spending time in the facility. It's a totally different way of doing business and our portfolios reflect that."

Monticello agrees that lenders are

instituting a much higher degree of due diligence when studying the marketplace and consequently "we have gotten much better at quantifying the risks" associated with the nursing home business, he said.

Going forward, many wonder about the future of the traditional nursing home in an increasingly diversified industry that now encompasses sever-

al different models, from assisted living to congregate care to continuing care retirement communities. Opinions vary about the nursing home operator's place in the spectrum and whether investors may take a dim view toward capitalizing these properties.

At the same time, a renewed emphasis on home- and community-based care is creeping in at both the state and

federal levels.

As policymakers continue to encourage the growth of these options, it remains unclear how nursing homes will be affected. Most experts agree that the shift will likely boost a trend that is already taking place: skilled nursing facilities ratcheting up high-end services to meet the needs of sicker and older residents.

Aging in place

One particular area of concern is wear and tear on buildings, many of which were constructed in the 1960s and 1970s.

"Infrastructure is definitely going to become a concern - there are over a million beds out there," Cobb said.

"Nursing homes now take care of a truly sick population."

**Bill Shine,
GMAC Commercial Mortgage**

Even so, a wave of new construction may not be a fiscally prudent solution, he said, because "a well-run cinder block building from the '70s can actually make more money than a brand new facility. Better to have an old building with good care than a nice new building with inadequate care."

As for the nursing home's viability in a market constantly becoming more congested and competitive, Shine believes it will always have a role, albeit somewhat different than it did back in 1980.

"Nursing homes now take care of a truly sick population," he said. "The acuity level has gradually and precipitously gone up and the business is far more operations intensive. How this has changed lenders' views is that there will no longer be any more net nursing home capacity. The number of beds will decline as old facilities are taken out of service and it is now a classic demand-driven product."

And contrary to what some may say, Shine asserts that nursing homes aren't really competing with other long-term and acute care organizations.

"Nursing homes are a companion, not a competitor to assisted living facilities and are critical short-term care solutions for hospitals," he said. "It's a nickel-and-dime business - the reimbursement rules are tough, but at least they are straightforward. It's a very clear niche in healthcare delivery for the aging population." ■

Congratulations, McKnight's, on your 25th anniversary!

Our EMR solution is clear...

when your organization is ready, we can help through education, installation & support.

INTERACTANT... The complete, secure solution featuring:

- Clinical Care Documentation
- Minimum Data Set
- Orders
- Pharmacy
- Billing & Financial Applications

HCS
Health Care Software, Inc.

www.hcsinteractant.com
800.524.1038

HCS INTERACTANT supports Skilled Nursing, Assisted Living, CCRCs & Rehabilitation Providers.