Senior Housing and Commercial Real Estate Capital: *Drinking from the Same Fountain… Blue Skies Ahead or a Storm Coming?*

2011 AHCA/NCAL Independent Owner Leadership Conference

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2011 AHCA/NCAL Independent Owner Leadership Conference

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CAMBRIDGE
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Cambridge Overview

- **Cambridge established in 1983, with Senior Housing emphasis beginning in 1988**
  - Consists of three firms – Cambridge Realty Capital, LLC – Origination, Underwriting, Conventional Mortgage Brokerage/Bridge Loans
  - Cambridge Realty Capital Ltd. of Illinois – HUD Lending
  - Cambridge Investment and Finance Company, LLC - Equity Investments, Sale/Leaseback and Joint Ventures
- **Cambridge's primary role in the industry**
  - Provide capital using HUD credit enhancement insurance
  - Facilitate conventional financing on an investment banking basis
  - Senior Housing acquisition, joint venture, debt acquisition or structuring operating leases for nursing home owner/operators.
- **Leading industry lender for the last 10 consecutive years for HUD 232 program**
- **$3.75 billion of Senior Housing/Healthcare financing completed for over 300 properties**
- **Extensive industry experience and relationships**

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Jeffrey A. Davis
President and Chief Executive Officer
Cambridge Realty Capital Companies

- Jeffrey A. Davis is Chairman and Chief Executive Officer for Cambridge Realty Capital Companies, one of the nation's leading senior housing / healthcare financiers, with more than 300 closed senior housing / healthcare debt and equity transactions totaling more than $2.75 billion since the 1990s.
- Mr. Davis is a graduate of the University of Illinois with a degree in finance. He earned a Masters degree in Real Estate Investment Analysis and Appraisal from the University of Wisconsin in 1976, and joined Baird & Warner Inc., a diversified Chicago-based real estate firm, the same year. In the commercial lending division, he swiftly moved up through the ranks to become the youngest Senior Vice President in the 150-year-old real estate company's history.
- Mr. Davis founded Cambridge Realty Capital in 1983 as a regional commercial real estate lender and merchant banking firm. In 1987, a decision to specialize in senior housing / healthcare financing was made, and the company began to expand nationally into new markets. Today, Cambridge has an affiliate office in Los Angeles, and correspondent relationships nationwide.
- The company has underwritten loans in 25 states and has emerged as one of the nation's leading HUD-232 FHA / Lean-approved lenders. Clients also are served by an integrated debt / equity financing strategy that includes direct property acquisitions and joint ventures, sale / leasebacks, conventional and mezzanine debt financing, and the acquisition of distressed debt. The company offers a wide array of conventional lending options, including permanent construction and interim loans on a floating or variable rate basis.
- Mr. Davis has been active in several professional organizations, including the Urban Land Institute, American Health Care Association, American Senior Housing Association, National Association for Senior Living Industry, and the Assisted Living Facility Association of America. He is a board member Emeritus for the Center for Enriched Living, an after-school activity center for mentally disadvantaged children, and a board member for Meals on Wheels Chicago, a not-for-profit organization providing meals to needy seniors, as well as the Holocaust Memorial Foundation of Illinois, a not-for-profit organization created to finance and build the world-class Illinois Holocaust Museum and Education Center which opened in 2009.
- Mr. Davis has been quoted in business and industry newspapers and magazines, including *National Real Estate Investor, Business Week, Chicago Tribune, Chicago Sun-Times, McKnight's Long-Term Care, Provider, Contemporary Long-Term Care, Commercial Property News, Dodge Construction News, Senior Housing Investor* and numerous other publications.

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Andrew L. Erkes
Principal and Chief Operating Officer of Cambridge Realty Capital Ltd. of Illinois

- **Education**: Bachelor of Arts, Finance – University of Illinois, Champaign/Urbana, Illinois 1978.
  Masters of Business Administration, Finance – Loyola University of Chicago, 1983.
- **Professional**: **1985 through Present** - Cambridge Realty Capital Ltd. of Illinois, President & Principal
  FHA Mortgagee 12739 – GNMA Issuer No. 3733 Principal; responsible for all HUD-insured multifamily and healthcare loan underwriting, regulatory compliance, construction loan servicing administration, permanent loan servicing administration, investor relations and mortgage accounting, and supervision of FHA-approved Mortgagee and GNMA Seller/Servicer. Current Servicing Portfolio in excess of $700,000,000.
- **Past Accomplishments**: **1978 thru 1985** – Percy Wilson Mortgage and Finance Group,
  Loan Officer/Vice-President
  HUD-Insured – Multifamily Lending
- **Overview:** Mr. Erkes has spent his entire professional career of 31 years in the business of originating, processing, underwriting and servicing HUD-insured multifamily and healthcare loans pursuant to applicable sections of the National Housing Act. Mr. Erkes is a MAP Approved Underwriter, a MAP Approved Section 232 Healthcare Underwriter and a Section 232 LEAN Approved Underwriter.
- Mr. Erkes has acted as sole MAP Underwriter for 104 HUD MAP Loans closed since the MAP Program began in 2001. The 104 MAP Loans total approximately $815,000,000. Of these 104 MAP Loans, 94 of the loans have been for the refinance and purchase or sub-rehab or new construction of healthcare facilities pursuant to Section 232 of the National Housing Act, totaling $720,000,000 in aggregate MAP healthcare financings.
- In addition to these 104 MAP Loans, between 1979 and 2001 Mr. Erkes has processed and closed 78 loans pursuant to Section 232 of the National Housing Act. These 78 loans totaling approximately $575,000,000 in healthcare financing were HUD-Insured Loans utilizing Traditional Processing methods.
- Mr. Erkes has developed a renowned sub-specialty in the healthcare lending field. Cambridge and Mr. Erkes are recognized as nationwide experts in this field, and are often quoted in the country's leading healthcare journals, including *McKnight's Long-Term Care, Nursing Home Magazine, Contemporary Long-Term Care,* and *Provider* magazines. Mr. Erkes has spoken on the subject of Section 232 nursing home financing at national conferences, including the National Investment Conference and the Assisted Living Federation of America. Cambridge Realty Capital Ltd. of Illinois has continually been among the nation's annual leaders in HUD Section 232 loan originations.
- Mr. Erkes also participates on the LEAN Transition Committees for Asset Management, assisting HUD in the transition of the Section 232 Program from MAP to LEAN. He was among a select few participants chosen by senior HUD executives in creating the implementation elements to the LEAN transition and was instrumental in the design of the Asset Management procedures for HUD lenders in healthcare financing.

Senior Housing vs. Commercial Real Estate – Understanding The Similarities and Differences

- Right now, more than ever, it is important to understand how senior housing is perceived in capital markets.

- Age-old question for senior housing… *<u>Is senior housing a business or is it real estate?</u>*

- In boom times, all senior housing owners want capital markets to perceive senior housing as commercial real estate, and in times such as today, senior housing owners remind capital markets that senior housing is a need-based business, totally independent of the rest of the economy and recession-resistant.

- A few similarities and differences exist and are highlighted on the following slide.

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Senior Housing vs. Commercial Real Estate – Understanding The Similarities and Differences

- **<u>Senior Housing/Long-Term Care</u>**
  - Need and demand-based business
  - Serves an elderly population based on aging in place
  - Aging process is extremely disruptive to family dynamics
  - Dependant on private pay, Medicaid and Medicare
  - Heavily regulated
  - Very well thought of by everybody who's not in business; how many times have you heard how wonderful senior housing is?
  - Never overcapitalized. Up to 80% debt was maximum during Y2K + 10.
  - Capital markets always approached with hesitancy

- **<u>Commercial Real Estate</u>**
  - Always based on jobs and the economy
  - Everybody is always an expert
  - In all markets, both large program and national banks and smaller community banks became real estate lenders and grew by leaps and bounds making real estate loans
  - Banks totally abandoned C&I lending
  - Over-leverage became passé for banks
  - Many times, multiple capital layers
  - Financing up to 95% – 105% or greater

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Commercial Real Estate History, 1992 vs. 2010 – Similarities and Differences

Oversupply vs. Over-leverage: How 2010 is Different From 1992

- **Then: 1992**
  - **<u>In 1992, there was a commercial real estate "oversupply" problem.</u>** Banks and Savings & Loans created too much new real estate. Due to the loosening of regulations on Savings & Loans, many projects were financed on spec, and were built and never occupied. In short, commercial real estate was oversupplied.
  - In order to correct this problem, the Federal Government became a "real estate liquidator" and called itself the RTC (Resolution Trust Corporation).
- **Now: 2010**
  - **<u>In 2010, commercial real estate is over-leveraged, not oversupplied.</u>** Too many properties (while occupied) have debt that can no longer be paid current and the underlying loans cannot be repaid at maturity.
  - Assets today could have debt from one or more of the following sources:
    - Banks
    - CMBS (Commercial Mortgage Backed Securities)
    - Insurance companies
    - Private finance companies
    - CDO's (Collateralized Debt Obligations)

Commercial Real Estate History, 1992 vs. 2010 – Similarities and Differences

The Perfect Storm

- After 15 years of easy credit, commercial real estate is now saddled with record amounts of debt. Now the market has changed and four key factors will alter commercial real estate finance business for the foreseeable future:
  - The capital markets contracted: The majority of real estate capital has left the market. Now there is very little capital available, right at the time that the massive amounts of debt originated over the last 15 years are coming due.
  - Underwriting standards tightened: The debt that is available has much more stringent underwriting criteria.
  - The loans that will be approved in the future will have much lower loan amounts.
  - Fundamentals have declined: The economic downturn is affecting real estate fundamentals. Vacancy has increased, rents have decreased.

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Commercial Real Estate History, 1992 vs. 2010 – Similarities and Differences

<u>The Results of the Perfect Storm</u>

- This perfect storm will have a material impact on the commercial real estate business for years to come.
- **Maturity defaults:**
  - There is not enough capital in the system to refinance all of the debt coming due.
  - The debt that can be refinanced will require equity infusions to meet the new underwriting standards.
- **Term defaults:**
  - Some properties can no longer service their principal and interest payments due to over-leveraging and declining fundamentals.
- **Owner's liquidity crunch: Owners of real estate are feeling the pain from all sides:**
  - More equity to rebalance loans (paydowns)
  - More equity to cover interest shortfalls
  - More equity for property operating expenses, like tenant improvements and capital improvements

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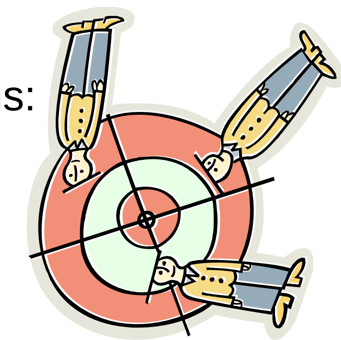
Commercial Real Estate History, 1992 vs. 2010 – Similarities and Differences

- **<u>Lenders: Few Good Options</u>**
  - Lenders have only a few options when dealing with these problems:
  - Foreclose and own the property
  - Sell the note at a deep discount
  - Extend the loan and hope that time cures the problem



- **<u>You Ain't Seen Nothin' Yet</u>**
  - There is a tsunami of commercial real estate debt coming due, with no place for it to go. This flood of maturities will only depress prices further, as there will be too many sellers/refinances and not enough capital.
- **<u>The Numbers: 2010-2013</u>**
  - The numbers on future maturities are staggering:
  - Total real estate maturing between 2010-2013: $1.415 trillion
  - Bank loans maturing between 2009-2013: $1.068 trillion
  - Toxic CMBS loans ('05-'07 vintage) maturing between 2009-2013: $112-187 billion
  - Life company loans maturing between 2009-2013: $100 billion

Understanding Senior Housing Lending by Understanding Commercial Real Estate Lending

- **Summary:**
  - Commercial real estate downturn relates to jobs, lending standards and the cash flow crisis plaguing virtually all businesses.
  - They are headed by the downturn in the overall economy, which drives up unemployment: some companies experienced layoffs and others have gone out of business completely.

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Understanding Senior Housing Lending by Understanding Commercial Real Estate Lending

- The banks continue to be scared of most lending opportunities after several years of fearing nothing.
- As a result, they have not only tightened standards in reasonable ways, but also have driven even good, long-standing clients out of the market.
- Whole storefronts are vacant, and large property management conglomerates are struggling to stay afloat.
- With CMBS slowly getting back up to speed and with consistent underwriting-associated lending completely shut down, income property borrowers must continue to focus on the life insurance, bank, credit union and private capital lender sectors for any financing needs for the foreseeable future.

Understanding Senior Housing Lending by Understanding Commercial Real Estate Lending

- Due to the current (and potentially ongoing) dramatic imbalance between capital demand (existing and projected loan maturities) and capital supply (lenders/capital in the market), underwriting standards are and will continue to be very conservative.
- Maximum LTV's (for the very best properties) top out at 70% of current value, with minimum debt-service-coverage hovering in the 1.30 or greater range.
- In the multifamily property sector, Fannie Mae and Freddie Mac continue to be the lender bright spots, though underwriting parameters have tightened recently.
- Banks continue to be under increasing regulatory pressure. In 2007, a total of 7 banks were taken over by the FDIC. This number increased to 25 in 2008, 140 in 2009, and 157 in 2010.

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Profile of Commercial Real Estate Lenders Today

- The CMBS (conduit) lending window continues to be completely closed.
  - In 2007, $237 billion in loans were funded to income property borrowers and then securitized through the Commercial Mortgage Backed Securities (CMBS) window. In 2008 this dropped to only $12.2 billion, to $3.0 billion in 2009, and to $11.9 billion in 2010.
  - The closing of this “window” has resulted in a huge “hole” in the commercial real estate capital markets and the results have been predictable.

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Profile of Commercial Real Estate Lenders Today

- **<u>Life Insurance Companies</u>**
  - LTV's continue to top out at 70% of current value (for the very best properties & borrowers).
  - But life companies are really looking for loans in the 55% - 65% range. 5,7 and 10-year terms are available, with 30-year amortizations acceptable for lower LTV requests.
  - How insurance companies compete for business:
    - Interest Rate
    - Term
    - Amortization
    - Proceeds
    - Prepayment penalty
    - Escrows

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Profile of Commercial Real Estate Lenders Today

- **Banks / Credit Unions**
  - The banking industry continues to be under significant regulatory pressure as the FDIC pays more and more attention to medium and small bank balance sheets. In fact, FDIC is staffing up significantly in 2011 and anticipating more and more similar bank transactions.
  - With the stabilization of the top 20 banks (who hold 65% of all deposits!) near completion, the FDIC now can focus on the remaining 8400 banks in the US, if the Top 20 fall in the category of "Too Big To Fail".
  - Needless to say, this results in a very conservative atmosphere in the lending departments of banks across the country.

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Profile of Commercial Real Estate Lenders Today

- **Fannie Mae / Freddie Mac**
  - The brightest spots in the income property lending industry continue to be Fannie Mae and Freddie Mac for multifamily properties. Will be discussed for Senior Housing later.
  - All-in pricing for new loans is in the 5.75% - 6.25% range depending on loan term and requested LTV.
  - Besides lending on multifamily properties, both agencies have programs for affordable housing projects, mobile home parks and senior housing.
  - Not surprisingly, due to this debt capital availability, values of multifamily properties have held up best out of all income property types during the last year.

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Profile of Commercial Real Estate Lenders Today

- **<u>Private Capital</u>**
  - Private debt providers continue to grow.
  - Pricing is steep - 10% or greater - and collateral requirements expansive, but these lenders can provide borrowers who are faced with a significant & immediate financing need, a welcome alternative to a more traditional lender.

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Profile of Commercial Real Estate Lenders Today

- **Bottom Line**
  - If you are going to have a financing or refinancing need in the next 18 months, start the process now. Given the environment, everything is taking longer than has been the case for the past 20 years.
  - There are lenders lending money and environment much improved from 2008 and early 2009. The underwriting is tighter…the price is higher…the terms are tougher…but there ***are*** lenders lending.
  - If you are a buyer or owner of multifamily, it is a great time to be a borrower.
  - If you have a problem with an existing property you own due to the property's debt, do not hesitate to call in outside, expert help.

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- Overview:
  - Senior housing capital, similar to commercial real estate, was constrained beginning in 2008/2009 and throughout 2010, and this will most certainly continue in 2011. Activity will revolve around bridge and term lending with commercial banks, Fannie Mae and Freddie Mac government agency lending on independent living and assisted living buildings, and HUD Lean lending on nursing homes and assisted living facilities.

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- <u>Bridge Lending and Term Lending with Commercial Banks</u>
  - Continue to be constrained.
  - In some banks, these loans fall under commercial real estate and in other banks, they fall under senior housing.
  - Will be primarily for existing customers, not new customers.
  - Heavily dependent on relationships in place either directly with borrower or through intermediary representing clients.
  - Will be considerably less aggressive and much less user-friendly than in times past.

Senior Housing Major Capital Funding Options – 2011 and Beyond
Bridge Lending and Term Lending with Commercial Banks

CONVENTIONAL BRIDGE LOAN FINANCING

ACQUISITION / REFINANCE OF CONGREGATE APARTMENTS, INDEPENDENT LIVING ASSISTED LIVING AND NURSING HOMES

LOAN AMOUNT:	$5,000,000 or greater
PROPERTY TYPES:	Long Term Care & Senior Housing Facilities · Nursing Homes · Assisted Living Facilities / Board and Care Facilities · Independent Living Facilities · Congregate Retirement Apartments
GEOGRAPHIC PREFERENCES:	Nationwide
CURRENT RATES:	Contact Cambridge for Current Rates
LOAN FEES:	Negotiated
LOAN TO COST / VALUE:	70% to 75% loan to value / cost advance. Higher ratios will be considered on a case-by-case basis.
LOAN TERM:	24 to 60 months with extension option
TYPES OF LOANS:	· Refinance / acquisition of stabilized properties · Refinance of construction / interim loans
SECURITY:	First mortgage on fee simple real estate and assignment of LLC or partnership interests. Personal recourse preferred. (Non-recourse loans will be available depending on the transaction.) Second mortgage will be considered subject to higher interest rates and other terms and conditions.
SECONDARY FINANCING:	Permitted subject to approval of lender.
HIGHLIGHTS AND APPLICATIONS:	Ideal for: Acquisitions and Refinance Consolidate debt Lower interest rate HUD 232 / 223(f) take outs The borrower should have senior housing / healthcare experience

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Senior Housing Major Capital Funding Options – 2011 and Beyond
Sale Leaseback Financing

- Separates real estate from operations.
- Allows operator to acquire more buildings with limited capital.
- Has historically been an excellent vehicle to separate real estate and operations.
- Allows operator to focus on higher margin component of senior housing: operations.

Senior Housing Major Capital Funding Options – 2011 and Beyond
Sale Leaseback Financing

Senior Housing / Healthcare Acquisitions Sale/Leaseback
Operating Leases to Qualified Operators

PURCHASE AMOUNT: $2,500,000 or Greater

PROPERTY TYPES:
- Nursing Homes — Skilled and Intermediate
- Assisted Living Facilities
- Board and Care Facilities
- Congregate Apartments

GEOGRAPHIC PREFERENCE: Nationwide

HIGHLIGHTS:
- CAMBRIDGE will purchase facility and lease directly to operator.
- Ideal for operators looking to maximize working capital.
- Net Operating Lease provided to qualified providers.

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- <u>Government Agency Lending, a brief primer</u>
  - Government agency lending is one of the primary driving forces in senior housing and healthcare finance today.

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- HUD Lean
  - Finances nursing homes
  - Provides rehabilitation and new construction loans
  - Does not finance independent living or independent senior housing

- Fannie Mae/Freddie Mac
  - Do not finance nursing homes
  - Do not provide rehabilitation and new construction loans
  - Provide financing for independent living or independent senior housing

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- Government Agency Lending, A Brief Primer

Skilled Nursing Facilities (SNF), Assisted Living Facilities (ALF) Independent Living Facilities (IL)

	Refinance	**New Construction**	**Sub Rehab**	**Term**	**LTV**	**Facility Type**
HUD Lean	X	X	X	Fully Amortizing 35 Years	Up to 80% Refi.	SNF/ALF/MC
Fannie Mae/Freddie Mac	X			10 Year/25 Year Amortization	Up to 75%	IL/ALF/MC

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Senior Housing Major Capital Funding Options – 2011 and Beyond

- **Fannie Mae and Freddie Mac**
  - Fannie Mae and Freddie Mac have almost identical programs which focus on the existing refinance of independent living, assisted living and memory care nursing facilities. Each lender can finance multi-use properties including a very small component of skilled nursing beds, but each lender is extremely hesitant to fund any facility with Medicaid-provided nursing home beds.
  - Each of these lenders is active and a major capital source for senior housing today, and have helped keep the housing market stabilized for owner / operators and indirectly, senior housing residents who require these types of facilities to satisfy and address their needs.
  - The basic loan programs revolve around the following:

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Senior Housing Major Capital Funding Options – 2011 and Beyond

Fannie Mae and Freddie Mac	
Loan Terms:	Range from 5-25 years
Eligible Borrowers:	Experienced owner / operators of independent living, assisted living, and memory care facilities
Financing Options:	Fixed rate, variable rate, bond credit enhancement, and multiple structures
Maximum Loan to Value:	75%
Maximum Loan to Cost:	80%
Amortization:	Typically 25 years
Debt Service Coverage:	From 1.35 to 1.75%
Replacement Reserve:	Yes
Tax and Insurance Escrow:	Yes
Personal Recourse:	No
Supplemental Financing:	Yes

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Introduction: Issues for Owners to consider when going on Capital Pursuit**
  - Underwriting issues
  - Documents to have available
  - How to present to lenders and equity investors
  - Decision/deal points
  - Key factors that determine financial success
  - Summary and conclusion

How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Key Underwriting Issues Facing Lenders And Investors**
  - Loan-to-value ratio
  - Debt service coverage ratios
  - Feasibility / need analysis
  - Equity requirements
  - Deal structure
  - Collateral / security
  - Operator track records
  - Timing requirements
  - Exit strategy for lender & borrower
  - Credit analysis

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Documents Needed For Financing**
  - Business plan
  - Market feasibility study
  - Financial forecasts / financials
  - Qualifications of principals
  - Sources & uses of funds
  - Title report
  - Exit strategy

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Presentation To Lenders**
  – Be prepared
  – Know your audience
  – Respond quickly to lenders' documentation requests – provide information & documentation in timely fashion
  – Get your third-party studies done by accepted & approved consultants
  – Understand their type of financing & their hot buttons
  – Understand the lender's background & be prepared to educate when necessary
  – Know your project
  – Get representation if needed
  – Insurance

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Financing Decision Points**
  - Timing
  - Recourse or Non-Recourse
  - Leverage
  - Structure
  - Time horizon / exit strategy
  - Covenants & reporting requirements
  - Rate / pricing

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Factors Determining Financing Success**
  - **Market**
    - Demographics
    - Upcoming projects
    - Competition
    - Regulatory environment
    - Project positioning
  - **Management**
    - Direct industry experience
    - Depth & reputation
    - Adaptability
    - Historic operating performance

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- **Factors Determining Financing Success**
  - **Collateral**
    - Physical plant
    - Marketability
    - Location
    - External forces
  - **Structure**
    - Financing requirements
    - Liquidity & default risk
    - Recourse or Non-Recourse
    - Upfront and long-term costs

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How To Look At Loan And Equity Opportunities As A Capital Provider, Not An Owner / Operator

- Summary and Conclusion

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