

LeadingAge[®] PA

2023

FALL FINANCE CONFERENCE

IF YOU'RE NOT AT THE TABLE, YOU'RE PROBABLY ON THE MENU

Tuesday, October 31, 2023

PRESENTERS



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AGENDA

- Setting the Stage
- Current Reality & Strategic Considerations
- Case Studies
- Takeaways

 **2023**

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SETTING THE STAGE



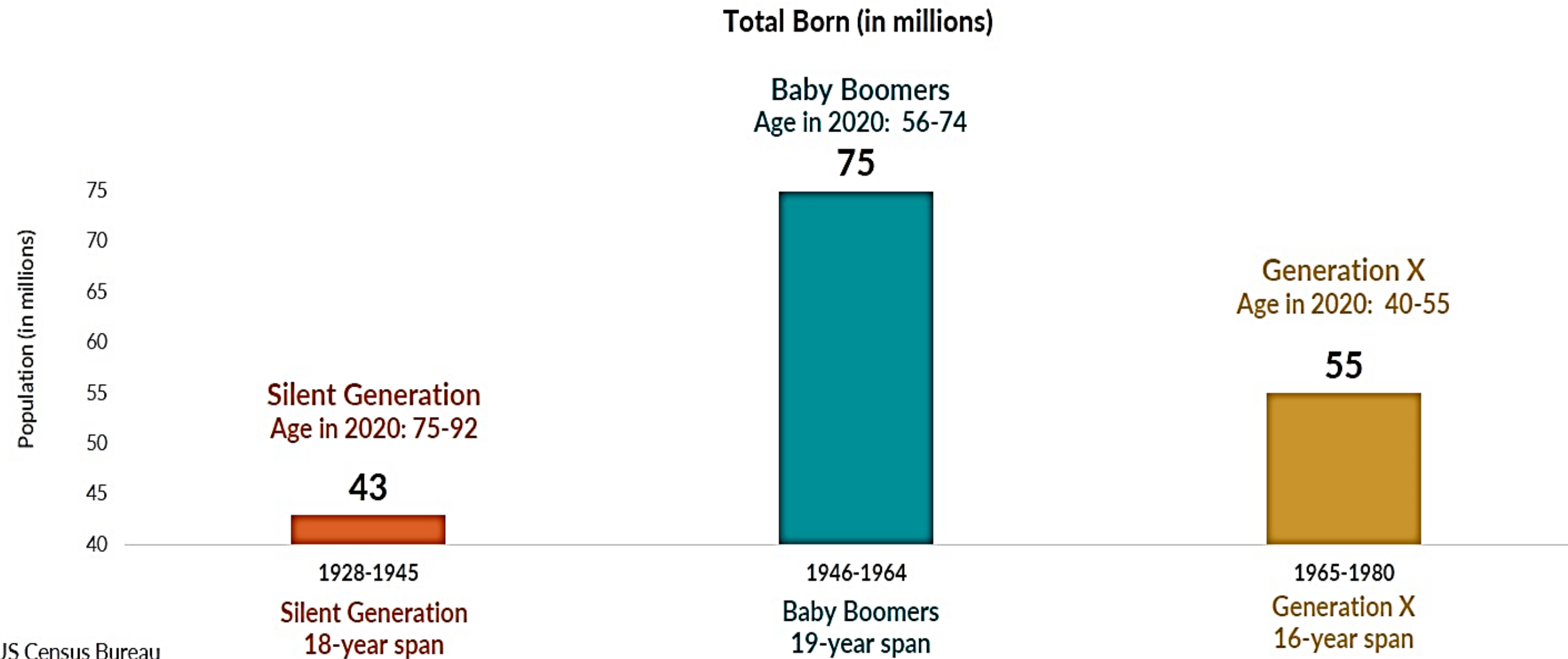
SENIOR LIVING TRENDS - CHALLENGES

- **Margin Compression**
 - Both Revenue & Expense pressures
- **Operating Complexities**
 - Residents, Staff, Regulation, Technology
- **Access & Cost of Capital**
 - Higher rates, restrictive terms and covenants
- **Leadership Turn-Over**
 - Aging C-suite and Limited Affordable Talent
- **Externalities**
 - COVID, Natural Disasters, Economic Cycle

SENIOR LIVING DEMOGRAPHICS - OPPORTUNITIES

Future Demographics: *The Boomers are Coming*

The Baby Boomers will be the Seniors Housing future occupants: First Baby Boomers will be 80 in 2026



Source: US Census Bureau

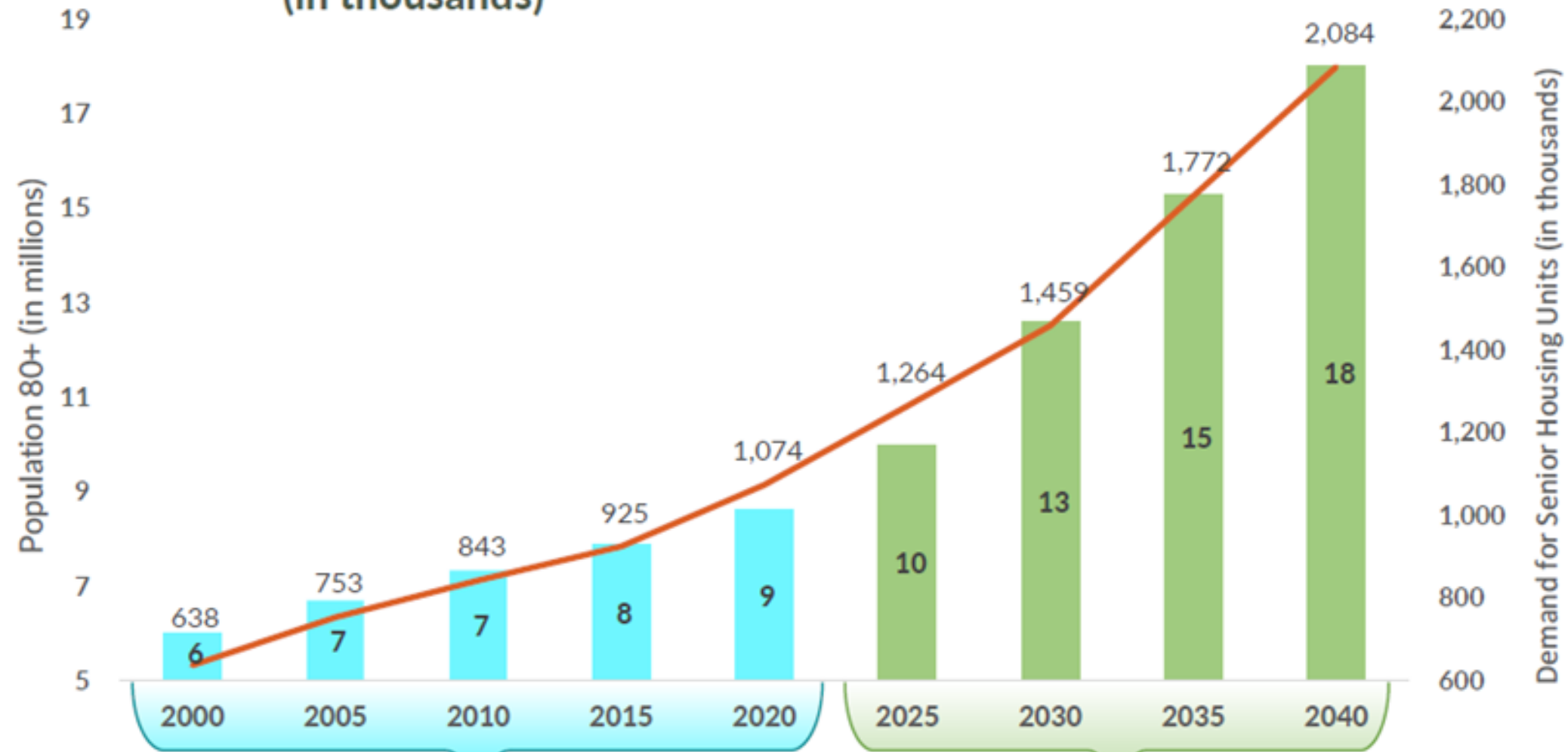
Source: Plante Moran

SENIOR LIVING DEMOGRAPHICS - OPPORTUNITIES

Future Demographics: *The Boomers are Coming*

Senior Housing Demand - Top 140 Markets (in thousands)

Population 80+ Demand for SH Units



Last 20 years:
Actual units increased 436k;
3.4% annual growth rate

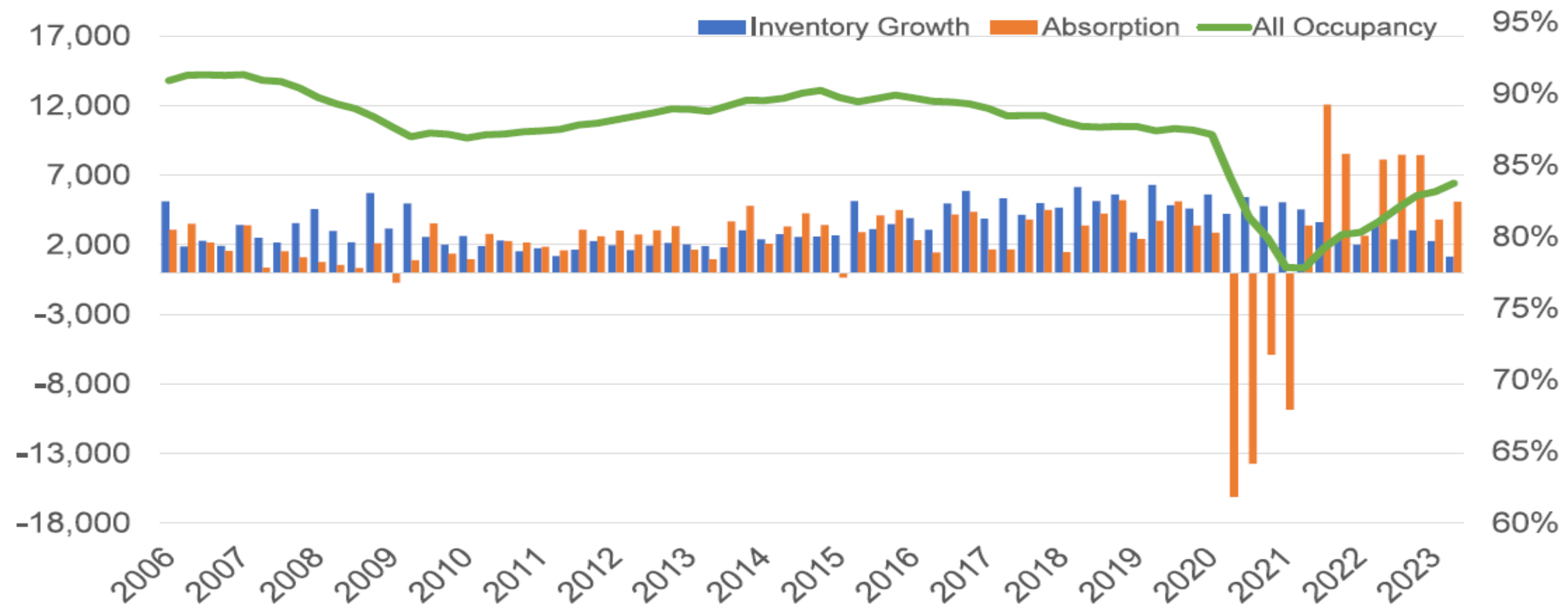
Next 20 years:
Projected units increase 1.01M;
4.7% annual growth rate

Source: US Census Bureau and ESRI; Top 140 markets are 65% of the total US population Historical units are based on NIC MAP® Data Service assumptions; 2025-2040 projected units are calculated as: (population 80+) x (11% penetration rate) / (95% occupancy)

SENIOR LIVING ABSORPTION TRENDS - OPPORTUNITIES

Senior Housing Fundamentals

Primary Markets | 1Q06-2Q23

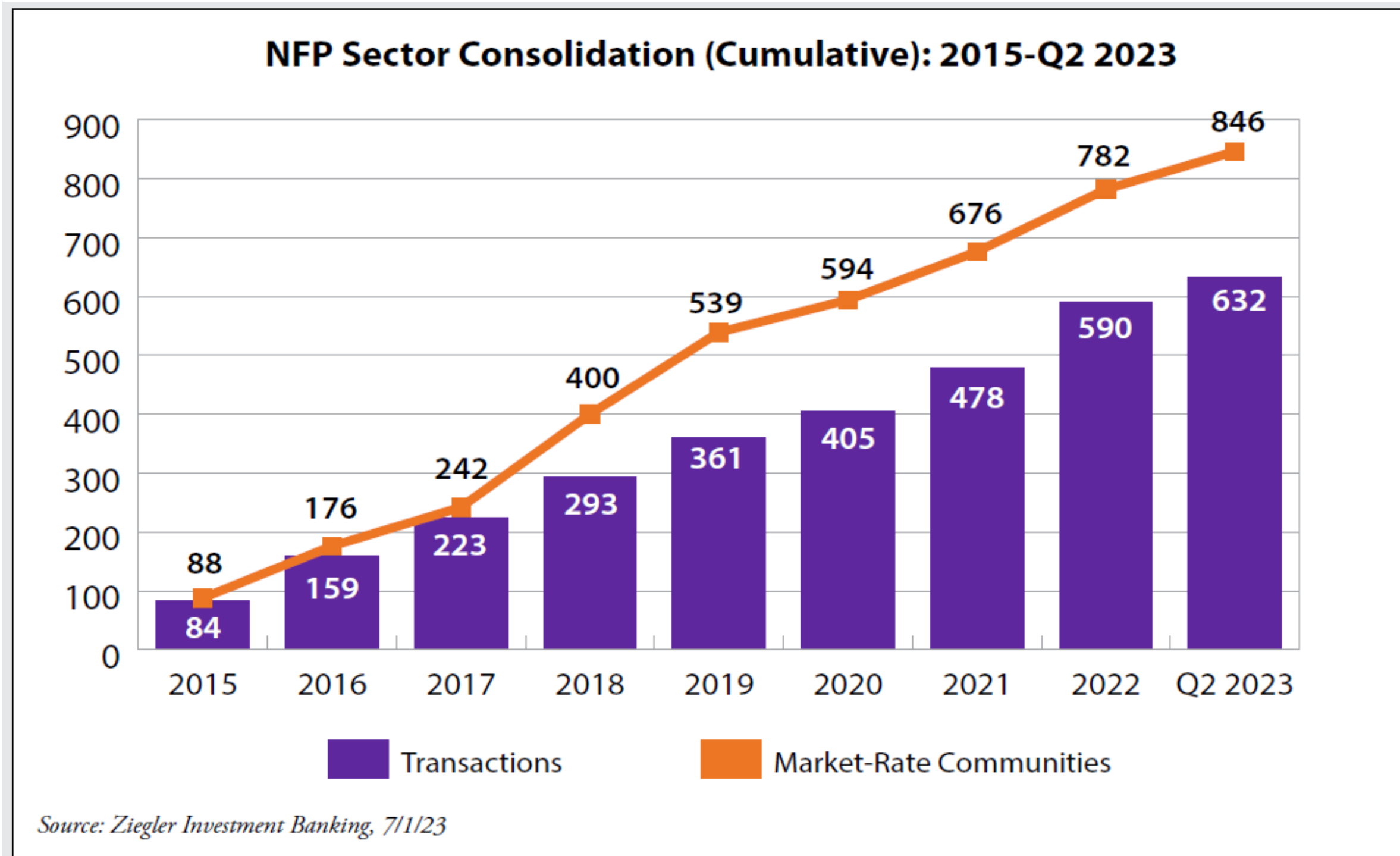


Source: NIC MAP® Data, powered by NIC MAP Vision

AFFILIATION/SPONSORSHIP TRENDS

- Continued increase in acquisitions, mergers, divestitures and sponsorship transitions
 - Accelerated by COVID and heightened by elevated inflation, higher interest rates and increased capital constraints
 - Reduced new construction activity and decreased asset sale prices
 - Less appetite for distressed situations by financing sources
 - Increase in *non-profit sales* of health care assets to *for-profits*
 - Increase in *non-profit acquisitions* of rental IL properties from *for-profits*

SECTOR CONSOLIDATION TRENDS (2015 – Q2 2023)



- Since 2015, approx. 46% of dispositions have been to for-profit sector. Most are freestanding nursing homes or severely financially distressed communities.
- Of all non-for-profit closures since 2010, approx. 70% have been nursing homes.

Source: Ziegler, July 2023

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**CURRENT REALITY & STRATEGIC
CONSIDERATIONS**

LOOKING AHEAD





WHY CONSIDER AN AFFILIATION?

- Survival – typically one weaker organization
- Economies of scale and efficiencies
- Expand intellectual capital and people resources
- Spread risk – better safety net
- Growth – mission, programmatic, financial, or other reasons
- Enhance access to capital
- Diversify and/or solidify market base
- Name recognition/branding
- Liquidity "back-stop" / additional working capital



STRATEGIC CONSIDERATIONS

- Ask yourself the tough questions:
 - Where are we going as an organization?
 - How well positioned are we to continue our mission?...
in our current state?...or in partnership?
 - How do our values, sponsorship and mission influence who we seek as a partner?

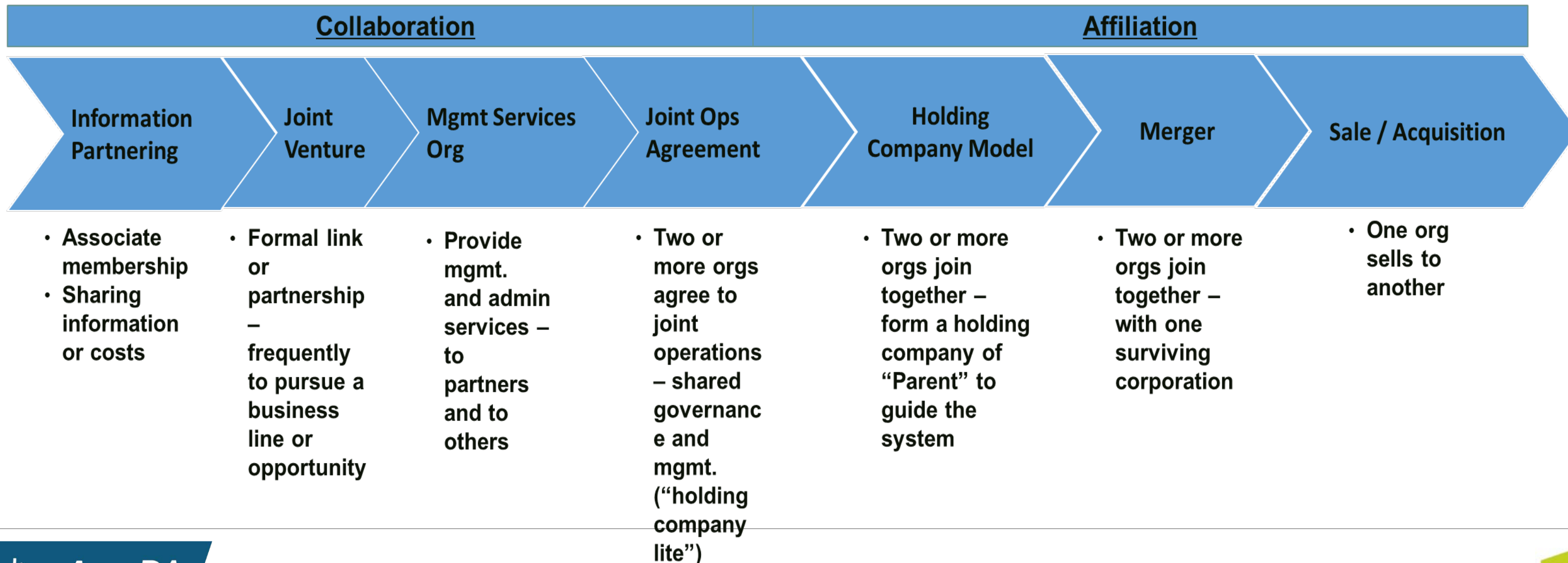
SELF ASSESSMENT

Desperate	Determined	Desirable
<p>In need of a cash infusion (which may range from imminent to expected need)</p> <p>And/or is unable to afford needed improvements to the campus.</p> <p>Both may be the result of unmarketable physical facilities – largely due to inattention or inability to address during the past 10+ years.</p>	<p>Have ‘determined’ to pursue an affiliation in order to achieve objectives that may include enhanced access to capital but also include other benefits, such as developing a safety net, providing additional expertise, branding/ identity, leadership or others. Are actively, though deliberately considering options.</p> <p>Might also be used to describe an organization ‘determined’ not to affiliate</p>	<p>Reasonably strong to strong financially, occupancy is good – is adept at considering how mission and vision might be advanced through an affiliation strategy</p> <p>Are aware of both the challenges and opportunities within the field, see affiliation as a potential strategy, but also see an independent course as having value. Decisions will depend on finding a compelling reason to affiliate and chemistry.</p>
<p>Few options, likely to cede control</p>	<p>Able to prioritize, balance advantages/disadvantages</p>	<p>Many options – able to walk away if objectives not met</p>

IMPORTANCE OF PARTNERSHIPS

Use of partnerships to enhance resident experience and organizational efficiencies:

- Allows organization to focus on its strengths
- Opportunities across all departments and functions



DEFINING AFFILIATION AND MEMBERSHIP SUBSTITUTION/ SPONSORSHIP TRANSITION

- **“Affiliation”** is a very broad term that includes a wide range of different business transactions, including the formation of new co-owned entities, mergers, asset or membership acquisitions, membership substitutions and similar arrangements
- **Membership Substitution or Sponsorship Transition:**
 - This model poses less legal, regulatory, tax and financial issues than other affiliation alternatives
 - Typically, no financial consideration flows from the “acquiring” company to the members of the “acquired” company
 - The acquired corporation changes its legal governing documents, as applicable, to reflect the acquiring corporation as its (new) “sole member”

DEFINING AFFILIATION AND MEMBERSHIP SUBSTITUTION/ SPONSORSHIP TRANSITION

- As the sole and controlling Member, the acquiring corporation has the right to elect the directors of the acquired corporation
 - Results in a relationship normally described as a “parent-subsidary” relationship in the for-profit context. While that term is often used in the NFP context, technically it’s a “controlling member – controlled affiliate” relationship.
- The relative power and authority of the governing bodies of the two entities, as well as financial and other terms of the affiliation, can vary as mutually agreed upon and delineated in the Affiliation/Member Substitution Agreement.
 - May prescribe changes to the composition of the controlling entity’s Board of Directors to reflect Board representation from the acquired corporation
 - Typically sets-out provisions relating to financial commitments/obligations including the incurrence of additional debt or transfer of assets
 - Also typically outlines any agreed-upon post-transaction investments and operational considerations



COMMON ISSUES/CONCERNS

- Control
 - Board appointment / removal authority
 - Leadership and management
- Identity
 - Branding / name
 - Mission – maintaining legacy / history
- Finances
 - Commitment of capital/credit support for additional debt
 - Obligation for outstanding debt
 - Management Fee (paid to the Controlling Member/Parent)



COMMON ISSUES/CONCERNS

- Loss of identity, mission, culture, and control depends on type of affiliation
 - Myth: affiliation means complete loss of control and culture
 - Realty:
 - Retaining full autonomy is unlikely; however, amount of control granted/shared is negotiable

SELL SIDE AND BUY SIDE PROCESSES

Simultaneous Internal and External Processes

Internal:

Which Providers Do We Want Consider as Partners?

- Faith-based or not (and which)
- For-Profit/Non-Profit
- Local/Regional/National

Profile Prospective Partners

External:

Prepare Opportunity Memorandum/Value Proposition

- History, Mission
- Operations
- Financials

Non-Disclosure Agreement



HJ SIMS COMPARATIVE EVALUATION MATRIX

- What does our “ideal” affiliation or acquisition target look like?
 - What factors do we use to describe that situation?
 - Location
 - Levels of Care
 - What other factors should we consider?
- Define what is “ideal” vs. “less preferable” for each factor
- Relativity – which areas are more important than others?

HJ SIMS MATRIX CATEGORIES AND WEIGHTING - EXAMPLE

- Levels of Care
- Proximity of Location
- Facility Location
- Financial Strength
- Quality of Care
- Occupancy
- Their Board Willingness
- Timing (Fit w/Current Situation)
- Capital Outlay Required
- Facility Condition
- Facility Layout
- Staff
- Current Ownership
- Faith/Sponsorship
- Ease to Close

Matrix to Quantify Interest in Opportunities

	Weight	3 Ideal	2 Acceptable	1 or 0 Luke-warm	Score
Level(s) of Care <i>Score</i>	3x	Levels currently identified need to “fill out” in our current offering	Levels currently identified need to “fill out” in our current offering plus other levels	Levels not needed (ie SNF?)	
Proximity of Location <i>Score</i>	2x	Within the same county	Within 90 minute drive	Further than 90 minute drive away	
Facility location <i>Score</i>	1x	1 st Ring Suburban	Urban	Rural	

MATRIX EXAMPLE - SCORING

- Each factor is weighted
- Determine Minimum and Maximum total points available

	Top Third	Middle Third	Bottom Third	
Totals	53-78 points	27-52 points	0-26 points	78 possible points

- Run a couple dummy-scenarios through matrix to double-check weighting
- Prevent second guessing when it goes live

Factors, preferences, and weighting can be completely customized

CRITICAL PATH & TIMELINE

- Determine conditions and criteria to pursue affiliation and finalize target list
- Draft Confidential Information Memorandum (“CIM”)/Establish data room
- Approach targets/Execute NDAs/Circulate CIM
- Receive Letters of Interest
- Deeper conversations/Tours with interested parties
- Receive Letters of Intent/Determine exclusivity
- Due Diligence/Execute Memorandum of Understanding
- Document and close affiliation/partnership/sale

Time frame is dependent on the structure, licensing and state requirements, State Dept of Health Approval, Attorney General review, discussion with existing lenders, etc.

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CASE STUDIES

AFFILIATIONS



Background

- 2 campus provider in Western Michigan heavily weighted towards AL
- Goal was to change their product mix to be more Independent Living focus
- With recent project (52 bed IL apartments) financed in 2019 and opening in 2021, limited debt capacity to do more growth in near-term future
- Survey of the Board and Senior Management ensured aligned goals and helped focus the search towards prospects that would meet the priorities of the Board set forth
- After intensive process and search, affiliated with BHI to assist in longer-term growth goals

Partnership Outcomes

- Affiliation accomplished via a membership substitution. Both the Clark and BHI Obligated Groups remain separate financially
- Clark is projected to meet their financial covenants when they are tested (starting in 2024)– BHI parent has the resources to assist if/when needed
- Clark has 2 board seats at BHI to have representation of the Michigan operations at the parent level
- BHI and Clark will work together at continuing to look at repositioning opportunities on both of Clark's campuses and beyond, something Clark couldn't afford to do on their own prior to the affiliation

AFFILIATIONS



SENIOR LIVING
Integrity. Experience. Commitment.

Background

- 2 campus provider in Cincinnati area
- In 2019, began work with Management and Board to discuss potential affiliation process to address unforeseen challenges over next 5-years
- Did not anticipate Pandemic which accelerated need to affiliate, but also slowed process
- Guided organization through evaluating interest from multiple affiliation partners - aligned best with BHI

Partnership Outcomes

- 12-month "Dating Period" to confirm desire to affiliate with BHI
- Remained outside of BHI's core obligated group
- Parent entity entered into a management agreement with Maple Knoll
- Board Representation:
- Maple Knoll Board remains in place
- Parent Board will include 2 members from Maple Knoll's Board
- BHI provided funds for the foundation
- BHI agreed to ensure Maple Knoll met all debt related financial covenants
- Kept "Maple Knoll" brand

AFFILIATIONS

KENDAL[®] at Granville
Together, transforming the experience of aging[®]



Background

- Small single site provider based in Columbus, Ohio suburb
- Occupancy challenges drained liquidity over time and caused EOD
- Need to identify affiliation partner to ensure long-term financial stability including campus reinvestment and targeted growth
- After due diligence period, mutually agreed to sever ties with initial affiliation partner; Otterbein emerged as ideal affiliation partner
- Sims led affiliation process while partnering with independent financial advisor who led bond restructuring process
- Also needed to negotiate with Denison University to acquire land that was under ground lease

Partnership Outcomes

- Added to Otterbein's obligated group
- Otterbein used "A" S&P Global Rating to refinance Kendal at Granville's high interest rate debt at a low cost of capital.
- Turned community around in short amount of time, did not charge management fee in first year, with Kendal at Granville now a leading community in Otterbein portfolio.
- Otterbein confirms Kendal at Granville's Board
- President/CEO, CFO, and COO of Otterbein are ex officio directors
- Includes at least one resident Board member
- Kendal at Granville's Board is self-governing, but Otterbein has the ability to veto major decisions
- Key alignment attributes included Otterbein's market presence, proven management systems and balance sheet strength and credit profile. Kendal at Granville brought strong presence in attractive market including expansion opportunities (now being planned).

ACQUISITIONS (BUYSIDE)



- 2 campus provider in Maryland
- In 2023, Sims was engaged to assist LSMMD in exploring an acquisition opportunity presented to the organization.
- The acquisition target was a Life Plan Community with 321 units across all levels of care.
- Sims provided strategic consulting, and valuation services to help LSMMD explore the viability of the acquisition. Ultimately, the purchase was not pursued beyond LOIs due to target's weak operating cash flow combined with limited prospects for improvement and need for significant capital reinvestment.

The logo for ECUMEN consists of the word "ECUMEN" in a bold, blue, sans-serif font, with a registered trademark symbol (®) to its upper right. The logo is centered within a rounded yellow rectangular border.

- Large multi-site provider headquartered out of Minnesota, including over 20 senior-living facilities as well as affordable housing products
- Sims was engaged, after the client executed a LOI, as a buy-side consultant to assist the organization through the purchase. Sims was also engaged to model the operations of the facilities being sold.
- The portfolio being purchased includes 10 facilities and over 660 units/beds
- This affiliation enables Ecumen to bring-in stabilized facilities into the broader corporation, facilitating, amongst other things, the ability to further spread overhead costs.

DIVESTITURES

Confidential (Mid-Atlantic)

- Sims was consulted by a not-for-profit multi-site organization regarding an expansion that was being contemplated and required additional equity
- Sims provided strategic planning advice and a preliminary valuation of two other campuses the organization owns. The valuation paired with management/board education prompted the organization to explore the sale of two campuses encompassing three facilities (SN/AL/MC)
- The operations at the two campuses, poised to be sold, were not proximate to the main campus of the organization and the organization wanted to consolidate its exposure to skilled nursing
- Sims is currently soliciting the opportunities to various buyers. The sale proceeds will be used to fund an independent living expansion, at the organization's mainstay campus

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TAKEAWAYS

WHAT ARE THE SUCCESS TRIGGERS IN AN AFFILIATION

- Having the same Target
 - LOI outlines the Path
 - Aiming for the Target
 - Not always a straight path to get there
- Understand each others' Drivers, Motives and Constraints
 - Why is this important to accomplish
 - What does this do for the overall organization
 - Where is this in our list of priorities
 - What is the Board's commitment/engagement?
 - Constraints:
 - Limited resources
 - Capital Access, Debt Capacity, Management Depth
 - Debt covenants
- Culture/Risk Tolerance



CLOSING THOUGHTS FOR MANAGEMENT & BOARD

It's likely that your organization is on the affiliation "radar screen" of other organizations.

- What is your response?
- Who is on your radar screen?



If you and your board haven't considered what partnerships or affiliations may look like, now's the time.

Board education and engagement are crucial for an informed organizational assessment and thoughtful approach to affiliation opportunities, whether proactive or reactive.



DISCLAIMER

Additionally, Information and opinions are current up to October 12, 2023, and are subject to change without notice. The opinions expressed by Jim Bodine and Siamac Afshar are strictly their own and do not necessarily reflect those of HJ Sims or its affiliates. HJ Sims is not providing any financial, economic, legal, accounting, or tax advice or recommendations.



THANK YOU!