Healthy Prices Keep Finance Players Busy

Demand for properties remains high, while providers keep an eye on Congress.

PATRICK CONNOLE

When assessing the current state of the capital and finance markets for the long term and post-acute care (LT/PAC) sector, leading players in the space continue to see solid returns for well-performing operators selling their businesses and ready access to loans for those owners looking to expand or remodel their existing physical plant.

If anyone needed evidence of the demand for properties, witness what happened in early July, when Kindred Healthcare announced that it had sold its entire skilled nursing facility (SNF) business for $910 million to BM Eagle Holdings, a joint venture led by affiliates of BlueMountain Capital Management.

Erik Howard, managing director, real estate finance, for Capital Funding Group (CFG) in Baltimore, said the consolidation trend in the LT/PAC sector is definitely a feature of the current marketplace, which may not be at a plateau yet given the concerns about the future reimbursement streams in the Medicaid and Medicare programs.

"Obviously, one of the main headlines that has dominated our space and the national news is the proposed changes to the Affordable Care Act and the implications for our sector," he says.

"We suspect that type of uncertainty will continue to weigh on folks that don't have a tremendous amount of diversification. To the extent you own one or two or three buildings in one state in particular, this could deter folks from continuing in the business."

ECONOMIES OF SCALE PERVADE

This is because a small operator—versus a diversified company with revenue streams from more than a SNF business—

Howard

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can be at the mercy of how Medicaid funding plays out in any given state, Howard says. If policies shift, there are going to be "winners and losers" among the states.

To buffer against this possibility, it pays to have economies of scale, and this leads to the consolidation trend being so popular.

"Given all the uncertainty on which direction this all goes, we continue to see smaller operators selling to medium-sized operators and large public REITS [real estate investment trusts]," he says. "I think the market is clearly nervous, and it is looking to understand any level of any potential cuts to Medicare and Medicaid. But, while the market looks for certainty, having certainty in the wrong direction would not be good for the industry either."

How much longer this consolidation trend lasts is also, of course, up for debate, with Howard pointing out that this is already the third or fourth year of consolidation being so prevalent in the profession.

However, even if demand ebbs, operators doing well in a clinical sense with good patient outcomes and short stays for rehabilitation purposes with good referral networks, will remain attractive buys, he says.

Howard also says it's not just Wall Street and REITs on the prowl for SNFs and other seniors housing, with

Chinese-based investments and some other foreign interest being in evidence in recent months.

ACTIVITY LEVEL RUNS HIGH

Tracy Maziek, managing director, Oxford Finance, agrees that consolidation is on the lips of many in his business. "We are not seeing a shortage of activity," he says. And the pace of deals is not just small guys looking to exit, but as in the case of Kindred and others, large players seeking to sell, with buyers lining up to take advantage.

"One man's junk is another man's treasure," Maziek says, noting the cliché is facile but points to the fact the bigger companies looking to sell may have realized running a national platform in the SNF space is not an easy thing to do.

Maziek

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"Ultimately, service is still delivered on a local level, and some of the larger guys have struggled to deliver," he says. Some of the challenges they face include not knowing the local demographics as well as a smaller or medium-sized operator.

"This is needs-based care, not want-based care, and so ultimately you have to know what is going on in that particular locality or at the very macro level what is going on in that region," Maziek says. "There are also local referral dynamics, local payer dynamics and the local state of health care and regulations and reimbursement. Some state surveyors, for instance, are tougher than others."

When deals are being made, the prices are healthy, he adds, pointing to the overall strength of the SNF industry as the longer-term outlook remains focused on the aging U.S. population and the needs of the elderly and people with disabilities moving forward. "I think buyers are paying $80,000 a bed without even blinking," Maziek says.

The resident mix can move that price level as well, according to Jason Stroiman, founder and president of Evans Senior Investments in Chicago. His company does two things: One is to value and provide benchmarking services to owners of skilled nursing and seniors housing and secondly, at the appropriate time, represent these owners and sell their businesses for them.

"We looked at $8 billion worth of skilled nursing and seniors housing businesses in the last 12 months, involving around 40,000 skilled nursing beds," he says.

PRICES REMAIN HEALTHY

The business right now has a lot of moving parts, and is generating a buzz among the REITs and Wall Street in

Stroiman

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general, Stroiman says. "It is an interesting time. To some of the smaller guys, the sky is falling in, but to the guys that are growing, they are paying crazy prices and trying to get more and more economies of scale," he says.

"The bigger operators have so many ancillary businesses. They are making money so many different ways. They are in for the long haul. We are at a crossroads, I think, where you get out or get big and hunker down."

He says the prices paid for SNFs come down to cash flow. Ten years back, SNFs sold for around $40,000 to $60,000 a bed, but now that is more like $100,000 a bed. "That is like the new norm. And, for higher-end post-acute care, the transitions model with Medicare pay, that can go up to $200,000 to $250,000 a bed," Stroiman says.

While some states like Texas appear to be in an overbuild status for SNFs and seniors housing in general, states with certificate-of-needs regulations are seeing strong occupancy levels.

HOW LONG CAN IT LAST?

Stroiman says all economic cycles come to an end, and what may hasten this trend's end is what banks do, because in the end to do a deal or rebuild a property the bank remains king, with commercial banks or the Department of Housing and Urban Development (HUD) front and center.

"And, that is directly tied to interest rates and as the Fed [Federal Reserve] raises rates, then it will affect the business. Capital market rates are at an all-time low, and no one knows when it will end. It is as easy as it has ever been to get a loan, for good operators," Stroiman says.

Howard concurs on the health of the capital markets and loan financing. For example, some of CFG's recent deals include bridge-to-HUD acquisition financing of $10 million for a skilled nursing facility in Maryland, the arrangement of nine HUD loans worth close to $72 million, and the HUD refinancing of a Washington SNF for just under $10 million.

FOR MORE INFORMATION

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CLINICAL PERFORMANCE VITAL

Beyond dollars and cents, capital market experts say potential buyers are looking to see that SNF acquisition targets are on the right track with rehospitalizations and that operators are efficient in managing their buildings with cost-effective care to go with their quality scores and Centers for Medicare & Medicaid Services Five-Star Quality ratings.

Overall, the metrics used to measure the health of a SNF, or for that matter that of an assisted living building or other seniors housing, usually include revenue generated, occupancy rates, and resident satisfaction. Other factors are the success of the sales and marketing team, staffing, and clinical care of residents.

Howard says it is more important than ever, given the shift to value-based care, that SNFs have their care management in order and perform at the industry standard or well above. ■