RHarper Consulting Update

Sale-Leaseback – Can it Save Challenged CCRCs?

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It is no secret that many bond financed continuing care retirement community (CCRC) transactions are currently facing difficulties in meeting the debt service coverage and working capital requirements of their bond issues. Many transactions over the past decade have been highly leveraged and as admissions have slowed during the past two years, operating reserves have dropped below minimum requirements and placed many CCRCs in technical default. Some have been forced to seek the protection of an acquisition or even bankruptcy.

While tax-exempt transactions have presented tremendous rate advantages to borrowers, the covenants and liquidity terms are conservative and generally lack the flexibility to address the challenges of today's market conditions. In the event of technical default, most covenants require evaluation by an outside consultant to assess operations and marketing in the CCRC and make recommendations. While there is always room for improvement in these areas, today our markets are so impacted by the slow real estate market that the opportunity for rapid and significant revenue improvement is practically non-existent.

In many cases the CCRC has collateral that is restricted from being used for additional borrowings due to restrictive covenants. This collateral, if available, would be sufficient to provide additional borrowing to bridge the working capital shortfall, but the covenants won't allow the additional debt. The real estate itself may have appreciated and have sufficient equity, that if accessible, would be sufficient to solve the crisis.

One solution emerging solution is a sale-leaseback transaction. In this type transaction, an institution or a real estate investment trust (REIT) purchases the real estate, paying off the outstanding bonds, then leases the facility back to the operator. This transaction taps the equity in the real estate and allows the operator to make lease payments from operations.

A sale-leaseback will not require the reserves and issuance costs present in tax-exempt transactions thus reducing the total debt outstanding on the facility. While there is a rate disadvantage between the sale-leaseback and a tax exempt transaction, the difference is offset by the reduced amount of outstanding debt and the lease payment is generally comparable to the debt service on the bond issue.

The lease term is generally between seven to twenty years. Further, the sale-leaseback transaction provides greater flexibility relative to future borrowings. If significant capital improvements or facilities expansions are desired and can be supported by underwriting, the funds can be advanced and the lease expanded. Tax-exempt transactions requirements are much more difficult and costly to achieve the same results.

Generally, the purchasers in a sale-leaseback transaction are looking for facilities that will remain viable over the term of the lease and demonstrate the ability to generate sufficient cash flow to adequately cover the lease payments. Further, the purchaser looks closely at the quality of the operator as well as their creditworthiness.

The sale-leaseback transaction can be a useful tool for CCRC and other long term care facilities who may be seeking access to capital. Clearly, if the current operations are performing well, the terms may be easier to negotiate and more flexible. The challenges many CCRCs are facing today require creative solutions and out-of-the-box thinking; sale-leaseback may be one of those solutions.

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RHarper Consulting Group provides development consulting, program management, and owner representation services focused on the senior living and mixed use sectors. In addition, Mr. Harper is also a listed mediator and arbitrator providing dispute resolution services for the construction and real estate industries.

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