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THE BOND BUYER

NOT-FOR-PROFIT HEALTHCARE

# California senior living bond deal benefits from new legislation

By Keeley Webster

Two public finance professionals helped craft legislation that added whole categories of residential care facilities to the list of borrowers eligible to issue debt through the California Health Facilities Financing Authority.

Assembly Bill 839, authored by Assemblymember Dawn Addis, D-Morro Bay, and signed by Gov. Gavin Newsom in October, allows nonprofits that operate independent living, assisted living, continuing care retirement communities and memory care units for seniors 60 and over, to access CHFFA financing. Prior to the change, only senior facilities that offered skilled nursing could issue debt through the conduit, a unit of the State Treasurer's Office.

**Courtyard at MonteCedro senior housing development in Altadena, California, which will expand with help from tax-exempt bonds facilitated by a new state law.**

*Episcopal Communities & Services*

Episcopal Communities & Services for Seniors, an Altadena-based senior living facility operator that runs three campuses in southern California, was the first to make use of the law, which took effect Jan. 1. ECS, a 501(c)(3) nonprofit founded in 1923, operates three retirement communities in southern California that provide a continuum of care including residential, assisted living and memory care facilities.

Lead underwriter Katherine Kirchhoff, a managing director with Cain Brothers, a division of KeyBanc Capital Markets, the sole bank on the deal, priced $107.7 million for ESC on Wednesday. Orrick was bond counsel.

Fitch Ratings rated the deal A-minus, with a stable outlook, and affirmed its A-minus issuer default rating.

The change in the law is meaningful partly because the sector has seen a trend toward delicensing skilled nursing facilities in favor of offering a continuum of care that includes assisted living, Kirchhoff said.

Kirchhoff and Jenna Magan, co-head of Orrick's Public Finance Group and a partner in the Sacramento office, were the pair that initially saw the need for such facilities to have access to a broader array of financing, and sought out LeadingAge California, a trade organization for the industry, to sponsor the bill.

"We met with LeadingAge and asked if they would be interested, since they represent lifeplan nonprofits," Kirchhoff said. "We helped them with gathering the facts and the data and explaining how the industry has shifted. How consumers don't want to be in skilled nursing. And how most skilled nursing beds are now filled by outside temporary admissions."

"It's driven by what our clients want," Charlie Rahilly, executive vice president and chief financial officer, said of the movement away from skilled nursing facilities.

The change will also help a market sector that is growing as the state's population ages.

The state's over-60 population is projected to outpace any other age group, and by 2030, 10.8 million Californians will be in that age group, comprising one-quarter of the state's population, according to the California Master Plan for Aging cited in the Assembly staff analysis of the bill.

The state has 7,469 residential care facilities, 239 of which are nonprofits that could benefit from the provisions of the bill, according to Department of Social Services figures included in the Assembly analysis.

Being able to issue through CHFFA makes it easier for a senior living operator that has facilities in different counties, because if a conduit issuer isn't statewide, it is required to hold Tax Equity and Fiscal Responsibility Act hearings in each county, Kirchhoff said. The Internal Revenue Service requires the so-called TEFRA community hearings before private activity bonds are issued to give the public the opportunity to weigh in.

The debt ECS priced Wednesday finances the $150 million expansion at its MonteCedro main campus and renovations at two other campuses, the 126-unit Canterbury in Rancho Palos Verdes and The Covingon in Aliso Viejo that has more than 200 units comprised of independent living, assisted living and memory care. Changes to the latter two involve shifting units that provided skilled nursing to other uses, such as memory care and assisted living, and other improvements to amenities.

The pricing included $30 million in fixed rate, initial entrance fees bonds with a four-year final maturity.

**"We had really strong response from investors. We had $1.3 billion in orders. It was oversubscribed on all the different tranches," said Katherine Kirchhoff, a managing director with Cain Brothers, a division of KeyBanc Capital Markets.**

*Cain Brothers*

The bond structure involves semi-annual payments beginning May 15, and a bullet maturity in 2027. The bonds require the initial entrance fees for 40 new independent living units at the MonteCedro campus in Altadena to be deposited into a redemption fund with a quarterly sweep to pay off principal as entrance fees are received and a 90-day rescission period ends.

The second series of bonds is $77.74 million in fixed rate bonds with a 35-year final maturity, a 10-year par call and level debt service.

Several years ago, ECS sold debt with Los Angeles County as a conduit. Even though ECS has an investment grade rating, the county required it to buy bond insurance or obtain a letter of credit, which Kirchhoff said isn't really economic on smaller deals.

"We knew when we refinanced the outstanding debt we would need to find another conduit issuer," Kirchhoff said.

The statewide issuers including the treasurer's conduit don't require the same credit enhancements for an investment grade borrower.

With Cain Brothers as underwriter, ECS made the decision to refinance existing debt in a $90.25 million private placement in 2021, avoiding the issue.

That deal had two forward closing dates. The transaction was priced, executed and committed on July 2021. The first tranche was set to refinance in May 2022, and the second tranche closed in November 2022, she said.

They also restructured the organization, which once had the Covington and Canterbury properties in the obligating group but not MonteCedro, so all three properties were under the same organization, Rahilly said. They were able to do that once the 2014 debt was restructured, she said.

But this time when ECS needed to issue debt to support its expansion and renovation projects, thanks to the new law, it could issue debt through CHFFA.

California Advocates for Nursing Home Reform had opposed the bill saying extending its financing to continuing care retirement communities subverts the mission of CHFFA to support health care.

"While CCRCs include some licensed skilled nursing beds on the premises, the overwhelming majority of CCRC residents are in independent living units," CANHR said, according to a Senate staff analysis of the legislation. The bill "will expand the profits of these already profitable companies, regardless of for-profit or nonprofit status."

Most CCRCs do not accept Medi-Cal, the state's Medicaid program, even in their skilled nursing units, CANHR told lawmakers.

AB839 passed both houses unanimously.

The bond proceeds from Wednesday's pricing will partially fund the expansion at the MonteCedro campus consisting of four three-story mission style villas with 40 new independent living apartments, a new restaurant, dog park and other amenities.

The proceeds will also fund renovations at the other two facilities, reimburse prior capital expenditures, fund a capitalized interest account for 30 months and pay issuance costs. ECS will be using $51.5 million of equity to fund the projects listed above, according to an online investor presentation.

"We had really strong response from investors," Kirchhoff said. "We had $1.3 billion in orders. It was oversubscribed on all the different tranches."

The 35-year yield was 120 basis points over the Municipal Market Data yield curve, she said.

"It was a really good showing for an A-minus borrower in today's market," Kirchhoff said.

They also repriced in all of the maturities to achieve a "meaningful improvement in spreads," she said. On the 35-year maturity, they repriced by 14 basis points, she said.

"With the rates where they were, there wasn't as much interest at the 10-years as there was for the 25-year, 30-year and 35-year maturities. Even on the short end, we had movement on a number of tranches of four to five basis points," she said.

The $30 million 2024A entrance fee bonds came down a full 15 basis points during the order period, she said.

"I don't think having CHFFA by itself as the conduit drives better rates, but the process is more efficient," she said. "Just having all the eyes you have on the deal by working with the State Treasurer's Office ... you have a lot of people who are in the market on a daily basis, involved."

The finance and management team fielded a bevy of questions from investors, Kirchhoff said, which isn't surprising given the senior living sector has had its share of bond defaults over the past few years.

In a survey conducted by HilltopSecurities around expectations for high yield debt in 2024, senior living was among the top three sectors in which industry participants said they expect to see defaults.

"There have been a number of articles written about concerns in the senior living sector," Kirchhoff said. "When you go to market, it's incumbent on the deal team to present a comprehensive picture. We had a lot of questions from investors wanting to understand the details."

Questions were coming about refundability, about the entrance fee contracts, about the governance structure and about the vision of the board, she said.

"The board is committed to retaining its investment grade rating," Rahilly said. "The company is 100 years old. It has a strong balance sheet and liquidity."

ESC has already sold 38 of the 40 units planned on the eight-acre MonteCedro campus, adding to the existing 183 independent living units and 20 memory care units, he said.

"We are very, very pleased with the pricing," Rahilly said. "We are very grateful for Kathy's leadership."

He added the new debt not only fits in well with the existing capital stack, but they were able to finance the renovations at a cost of capital below 4%.

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