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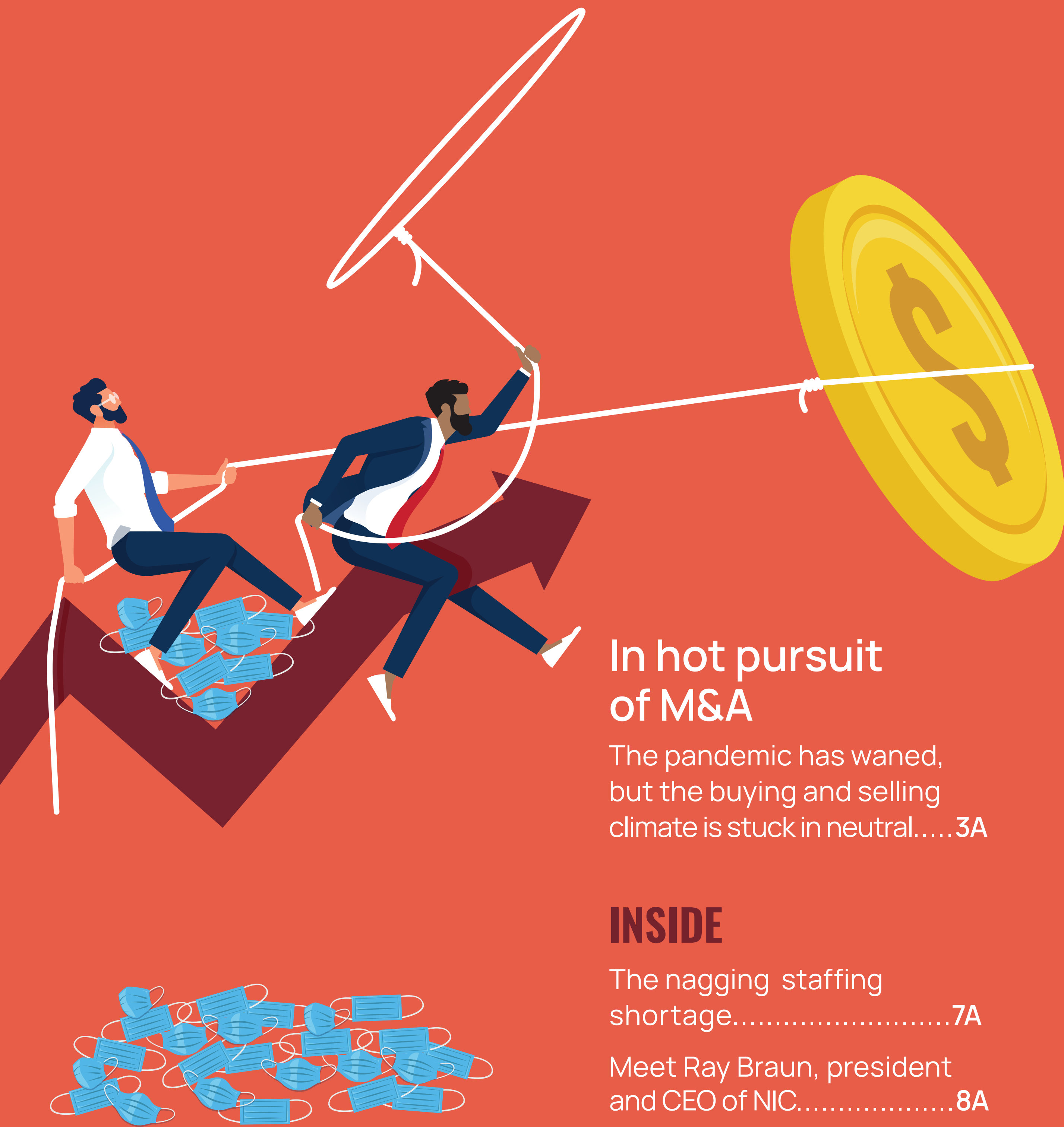

In hot pursuit of M&A

The pandemic has waned, but the buying and selling climate is stuck in neutral.....3A

INSIDE

A sluggish buying and selling climate?

Mergers and acquisitions market remains primed but wary

Photos: Getty Images; photo illustration by *McKnight's*

BY RON RAJECKI

It has not exactly been smooth sailing in the long-term care mergers and acquisitions space in recent months. While the end of the COVID-19 pandemic has energized investors, other market factors have put a proverbial wrench in the sector's growth plans.

For example, there were 110 publicly announced merger and acquisition transactions in senior housing and care in the second quarter, LevinPro LTC reported. Although that is 11% more than the 99 transactions recorded in the first quarter, it is 25% fewer than the 147 deals in the second quarter of 2022.

The $1.29 billion spent on M&A transactions in the second quarter declined a whopping 63% from the $3.5 billion spent in the year-ago second quarter, based on disclosed prices.

Those numbers, according to the long-term care acquisitions intelligence company, reflect the effect of high interest rates on the M&A market.

Buyers, sellers both seek clarity

"It has been a pretty sluggish first half of the year," said Beth Mace, senior adviser, National Investment Center for Seniors Housing & Care. "That has largely been driven by capital market events started by the Federal Reserve when it increased interest rates in March 2022. Since then, we have seen a really fast and large increase in interest rates, and that has caused a lot of pause in the transaction markets. There's not much clarity in terms of pricing, and bid-ask spreads are still wide. Sellers don't want to put anything on the market, and buyers don't want to buy anything until there's a little bit more price transparency."

Mace noted that the increase in interest rates and resulting slowdown in the transaction markets is affecting all commercial real estate sectors, not just senior housing. She added that there's a great deal of "dry powder" on the sidelines in senior living.

"There's a lot of private equity money available, and the [real estate investment trusts] have been able to raise capital, so there's a large pool of investors out there," she said.

Bill Kauffman, senior principal, NIC, pointed out that although senior housing pricing overall has declined in line with other commercial real estate asset classes, skilled nursing pricing per bed has held steady and actually increased over the past year. One reason for this movement, he said, is that many states have increased their Medicaid pay rates.

"A lot of that was brought on by additional financial support from the federal government during COVID, which flowed into the state governments," Kauffman said. "Many states increased their Medicaid rates, which helped with cash flow in skilled nursing."

Although many buyers are looking to purchase skilled nursing properties, a couple of "wild cards" exist, he said: inflation and the newly proposed federal SNF staffing mandate.

"How does inflation play out for the rest of the year? And from an investor's perspective, how is it working out operationally in private-pay housing and skilled nursing in terms of expenses, occupancy growth and so on?" he said. "Another big open question is, what happens with the staffing mandate for skilled nursing? That's another thing investors are keeping an eye on right now."

As of this writing, the Centers for Medicare & Medicaid Services proposed a mandate that would require a minimum of 3.0 hours per patient day of direct care.

Record pace for not-for-profits

In the not-for-profit sector, senior living and care M&A activity continues at a record pace, according to the 2023 Mid-Year Not-For-Profit Senior Living M&A Update from specialty investment bank Ziegler.

Report author Lisa McCracken, NIC's new head of research and analytics, formerly of Ziegler, noted that many not-for-profit senior living and care organizations are devoted to growth, business development and M&A, and are proactive in scanning the market for potential like-minded partners.

Common drivers for discussions about the benefits of a potential affiliation with another not-for-profit include workforce challenges, the complexities of the healthcare (skilled nursing) marketplace, CEO turnover and, for some, significant expense pressures.

"[Mergers and acquisitions] is one of the more common growth strategies among today's not-for-profit providers, along with reinvestment and expansions of existing communities," McCracken wrote. "We will continue to see proactive not-for-profit organizations scan the market for potential partners whereby an affiliation can be a win-win for both."

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Occupancy trends receive scrutiny

Looking ahead to the second half of 2023, Ziegler Senior Director Dan Revie said that he thinks it will continue much like the first half of the year.

"I don't expect a big upswing or downswing," Revie said. "We're seeing very few cap rate deals with existing strong trailing cash flow right now, but we are seeing a lot of value-add opportunities in the market. Also, we're seeing a lot of smaller one-, two- or three-asset transactions rather than larger portfolios."

According to Revie, the debt environment and the lending environment currently are very challenged, making transactions that require a large amount of debt more difficult. That situation, however, may ease up during the remainder of the year now that interest rate rises have appeared to level off, he added.

As the country and the industry continue to emerge from the COVID-19 pandemic, occupancy trends are receiving increased attention, Revie pointed out.

"It's not so much about cash flow anymore, because the challenges in the labor market and inflation have created a bumpiness in cash flow, but occupancy trends are something that buyers are looking at more closely," he said. "Occupancy can bounce around a bit from month to month — that happens. But a consistent trend line over a six-month-plus period can be a good sign or a warning sign."

Ziegler Senior Director Steve Johnson added that M&A in rural areas continues to be more challenging than in urban areas.

"The urban centers tend to be moving more rapidly toward aggregation of assets and growing systems, and the challenge of finding affordable labor is really amplified in some rural communities," he said.

Historical activity and warning signs

Rick Matros, CEO, president and chairman of Irvine, CA-based Sabra Health Care REIT, said he expects M&A activity to continue to be light for the remainder of 2023. He anticipates increased activity in 2024, however, "as the skilled space continues to recover and private-equity buyers have reset seller expectations for seniors housing, given they have lost their spread with the shift in the debt markets."

Over time, Matros added, M&A activity in the various market sectors (skilled nursing, assisted living/memory care and continuing care retirement communities) will reflect historical activity.

Among the warning signs to watch for?

"Any further disruption to the rate of recovery generally and a draconian outcome on the SNF staffing mandate," Matros said.

Uncertain political climate

Is there anything else on the horizon that may have an effect on M&A in 2024? A certain presidential election perhaps?

Mace doubted that the election will be a big factor. But she pointed out that, in general, business does not like uncertainty.

"Businesses like for their crystal balls to be pretty clear," she explained, "and the environment in the political realm right now is certainly uncertain." ■

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Website:
www.guardianpharmacy.com

Phone:
(404) 810-0089

Email:
answers@guardianpharmacy.com

Address:
300 Galleria Parkway SE, Suite 800
Atlanta, GA 30339

Date Founded:
2004

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Guardian Pharmacy Services is based in Atlanta, Georgia, and currently has 43 pharmacy locations that serve nearly 157,000 patients across 33 states.

Staffing shortages put damper on senior living and care growth

CCRCs, in particular, are feeling the crunch in their skilled nursing divisions

BY KATHLEEN STEELE GAIVIN

While investment activity seems to have picked up in senior living and care, one problem is still casting a shadow on expansion: the staffing crisis.

"Increasing demand, combined with notable pandemic recovery, make memory care an attractive prospect for investors, but senior housing stakeholders looking to capitalize on the trend need to understand supply and demand trends, including workforce supply and availability," noted a National Investment Center for Seniors Housing & Care analysis published in June.

"I would say the investment environment seems to be very much focused on expanding independent living and/or reducing skilled nursing," Margaret Johnson, Fitch Ratings' head of analytics for US life plan communities, told *McKnight's*.

She noted that continuing care retirement/life plan communities are really feeling the staffing crunch in skilled nursing. To wit: Fitch Ratings revised its sector outlook for CCRCs to "deteriorating" in 2023 from "neutral/stable" the previous year due to continued labor challenges and a "softening broader economy."

"Nursing markets are particularly tight, given the demand for qualified staff, vaccine mandates and the willingness of hospitals and healthcare systems to offer higher compensation than [life plan communities]," a July report from Fitch Ratings said.

Attracting, retaining workers

Long-term care providers are not sitting idle. Since the pandemic started, Eskaton, which is based in Carmichael, CA, has been experimenting with many different strategies to attract and retain its workforce,

Photos: Getty Images; photo illustration by McKnight's

according to President Sheri Piefer. Whatever the company is doing seems to be working, she said.

"We do have incredible, loyal employees," she said. "Through navigating these difficult times, especially with inflation and the uncertainty of the environment and burnout from COVID, we've done a lot with reaching out to our employees with our wellness program, offering many different types of support from wellness exercise programs to meditation to financial planning.

"We also have focused on culture-building and taking care of one another," she added. "And that, I think, really helps the field because we, of course, are in a field that cares for other people. It's important to take those moments and care for one another and understand that if people need breaks, they can have the breaks and flexibility they need."

To fill open positions, Eskaton relies on some agency support for its communities. While some of them are 100% agency-free, Piefer said, some markets in the Bay Area are not.

Meanwhile, PruittHealth has gone to a strictly nonagency staff policy. The organization put the rule in place early in the pandemic. It meant closing parts of buildings or putting a "cap and hold" on admissions when staffing levels at given buildings fell below internal thresholds.

Pre-pandemic, the company had close to 16,000 employees, PruittHealth Chairman and CEO Neil Pruitt told *McKnight's*. Today, the employee count is around 13,700, with approximately 4,213 openings in the firm's skilled nursing facilities and 4,893 openings companywide.

Initially during the pandemic, PruittHealth tried the agency route. But Pruitt said, it was "quite frankly, a disaster. It was very expensive. The agency staff, contract staff, did not know [our] patients, and we decided early on that we were going to limit our census to get rid of agency."

Instead, PruittHealth beefed up its talent acquisition management team. Additionally, he said, the company has taken to hiring foreign nurses to help offset shortages.

"We have 200 currently working with us, and we have about 800 more that are in the pipeline that are scheduled to come on board," Pruitt said. "The foreign route has been very good for us, and that's something to explore. But we started this process two years ago. It takes at least two years by the time you sign a contract to get a nurse on board, so it's a longer process." ■

NIC chief Ray Braun reflects on market turbulence, five-year strategic plan

Photo: Tori Soper

BY JOHN HALL

Since joining the National Investment Center for Seniors Housing & Care in the fall of 2022 as president and CEO, Ray Braun has worked to implement NIC's new five-year strategic plan. At the same time, he has helped guide the industry through challenging times and "lead the evolution of the senior housing and care business."

Now embarking on his second year at NIC, he finds himself in the middle of a roller coaster ride that is sure to test his mettle. While the long-term care sector is rebounding from the pandemic, it is still facing occupancy struggles, a workforce in crisis, ongoing reimbursement uncertainties and a proposed nurse staffing mandate.

"Let's hope COVID-19 is in the rearview mirror, or at least the worst of it," Braun told *McKnight's*, likening the 2019 pandemic to "an earthquake that has had many aftershocks."

Those included supply chain bottlenecks that led to a 40-year high in inflation and a Consumer Price Index peaking at 9% in June. By the time the Fed's 11th interest rate hike hit 5.25% in July 2023, capital markets had shrunk and transactions slowed. "The buying and selling climate is not robust at this time," Braun said.

Upbeat outlook

Still, he is bullish on the next two years.

"I think market fundamentals in senior housing will continue to improve and the overall occupancy rate for senior housing will move back to its pre-pandemic levels," Braun said. And in spite of anticipated near-term "choppy" capital and sluggish transactions markets, he said he is optimistic about the senior housing industry and its growth opportunities.

"Demand is strong, especially for higher-acuity assisted living," he added. "In fact, the occupied unit count is currently the highest on record." He also believes demographic patterns increasingly favor senior housing demand overall.

Braun is understandably energized about the upcoming 2023 NIC Fall Conference as an essential effort to accelerate business and change for an industry "at an inflection point." The conference promises to be essential for accelerating business and change for the industry. It will include a great deal of content around workforce challenges and turbulence in the capital markets. In addition, four experts will give TED-style talks on cutting-edge ideas that will affect the senior housing and care industry, Braun said.

The work of NIC ahead

Braun's vision is to finish a five-year strategic plan that includes the industry's first Data & Analytics Conference "through which data professionals gained best practices, shared knowledge, and applied data sets and tools to make better decisions in the investment analysis process."

Other long-term projects include a number of high-level research projects on aging, healthcare access and outcomes, and a Fundamentals of Underwriting Senior Housing and Care certificate program as part of the NIC Academy, culminating in a Certified Senior Housing Investment Professional (CHIP) designation.

Simply put, the work of NIC can be boiled down to four areas, he explained.

"We're leveraging next-generation leadership, with new board members, officers, and dynamic and diverse volunteers," Braun said. "We're providing valuable, actionable insights with first-of-its-kind research and analytics. We're showcasing emerging opportunities for the industry. And — as always — we're fostering relationships and helping industry stakeholders make needed connections so the sector can thrive, and older adults can enjoy greater access and choice in their housing and care." ■