PENUMBRA

2021
MAY-JUNE

FOR SELLERS AND BUYERS OF SMALL ADULT CARE FACILITIES, HOME CARE AGENCIES, AND MEDICAL PRACTICES

Market Watch

Timing is everything. Buyers need to act now.

There are not many times when the perfect storm comes for business buyers. Due in part to the Covid-19 pandemic, the recession, and government stimulus, now is the time for buyers to act. In December 2007, the Great Recession started. Baby boomers who were looking to retire had to wait at least 19 months for this recession ended. As the recovery emerged in the following decade, some did not cash out. Then, the 2020 Pandemic hit and the economy sank. Now, those who waited have perhaps this last chance to cash out. With the CARES Act and $1.9 trillion stimulus package enacted by Congress, many owners are headed for the exit. *(cont'd)*

Education

Wet beds. Why ALF price per bed metrics don't fairly represent MPSP

Some economic analysts track over time assisted living facility (ALF) price per bed (PPB). For large ALFs, these metrics can give investors a sense of how the aggregate market value of industry inventory compares to other asset classes. Variability in this metric could indicate industry risk which, in turn, could affect capitalization rates and valuations. These macroeconomic metrics do little to accurately determine the most probable selling price (MPSP) of an individual ALF, especially small ALFs. *(cont'd)*

Financing

SBA 7a or 504, which is better?

Many small adult care facilities and healthcare practice buyers can benefit from using SBA's programs. But what program is best for you? It depends. SBA offers a 504 program for real estate based transactions and a 7a program for real estate and non-real estate transactions. For transactions between ½ to 2 million dollars, what SBA program is best? Adult care and family care transactions usually involve the purchase of real estate. For deals under $2 million, the 7a program probably has lower total costs over the life of the loan.
(cont'd)

Regulatory Watch

IRS treats personal PPE as medical expenses

The IRS recently ruled that amounts taxpayers paid for personal protective equipment, such as masks, hand sanitizer and sanitizing wipes, for the primary purpose of preventing the spread of the Coronavirus Disease 2019 can be treated as amounts paid for medical care. Under Section 213(d) of the Internal Revenue Code, these expenditures for use by the taxpayer, the taxpayer's spouse, or the taxpayer's dependents that are not compensated by one's insurance or other means qualify as deducible under *(cont'd)*

et cetera

- NC DHHS announces new phone service helpline (844-728-0191) for family caregivers of Alzheimer's or dementia persons.
- As of March 31, nearly 50% of seniors in the US are fully vaccinated, CDC data shows.
- CDC extends eviction moratorium until June 30.
- IRS confirms that SBA 7(a) payments are no longer taxable income.

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Education cont'd

There are three reasaons why using multiples of enterprise discretionary earning or revenue are better measures of MPSP than PPB.

Buyers want cash flow and revenue not perceived asset value. Buyers of small ALFs need to make a living, generate income, and earn a good return on their invested capital. Enterprise discretionary earnings measures the cash flow from operations that is available to the owner. PPB is a perceived value of a hypothetical transaction.

Census mix can drive revenue per bed and operational cash flow. PPB does not consider census. ALFs with a higher percentage of census as private pay earn more revenue per bed than ALFs with more Medicaid census. Similarly, facilities with special care units earn more per bed that standard care beds. PPB is an aggregate average of market census which is not useful in evaluating individual ALF transactions.

PPB ignores an individual facility's operational efficiency. When operators manage costs, they are rewarded with higher profit and discretionary earnings. Cost efficiencies translate into better selling price multiples.

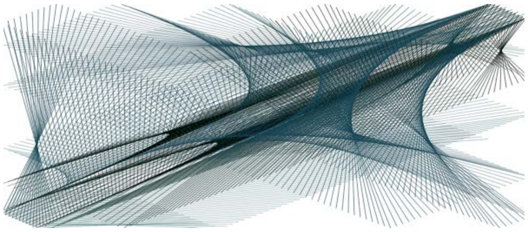
Buyers reward ALF operators for generating sustainable cash flow. By focusing on operational excellence rather than macroeconomic asset values, seller get a clearer view of what the MPSP can be.

Regulatory Watch (cont'd)

Section 213(d), *provided however*, that the taxpayer's total medical expenses exceed 7.5% of adjusted gross income. Be sure to check with your tax advisor. Alternatively, the medical expenditures can be paid or reimbursed under health flexible spending arrangements, Archer medical savings accounts, health reimbursement arrangements, or health savings accounts. Of course, if one of the above options is used, the medical expenses cannot be deducted under Section 213(d). For more information on this announcement, click here.

Market Watch cont'd

Under the CARES Act, the SBA waived the upfront guarantee fee it charges on 7a loans. It will also covers principal and interest payments (up to $9,000 per month) for new SBA borrowers through September 2021. The American Rescue Plan Act provides an additional $7.25 billion for the Paycheck Protection Plan, $15 billion additional for Targeted Economic Injury Disaster Loan Advance, and $28.6 billion targeted for restaurant revitalization fund. While no money down deals are unrealistic, these initiatives for reducing the transaction costs of buying a business are a real benefit.



Financing cont'd (i)

Under 504, the borrower has two loans – one 25-year bank loan and a second 20-year debenture from the Community Development Corporation (CDC). Current rates are quite attractive at 3.04% for bank loan and 3.00% for the debenture. There are upfront fees and ongoing CDC service fees. On a $2 million 504 loan ($1 million from your bank and $1 million from the CDC), upfront fees would be about $23,000 plus closing costs.

The CDC service fee is up to 2% per year of the outstanding CDC loan. The total CDC servicing fee paid over the 20 year term is about $200,000. This makes the total cost $223,000. The 504 loan also has prepayment penalties.

Under 7a, the borrower has one loan from the bank and pays a guarantee fee to SBA (once). The bank pays an ongoing guarantee fee to the SBA but cannot

Financing cont'd (ii)

charge that fee back to the borrower. The SBA guarantee fee ranges from 2% to 3.75% depending on the amount of the guarantee. On a $2 million loan, the SBA would guarantee $1 ½ million with an estimated total cost about $53,000 plus closing costs. 7a interest rates are usually a variable rate of 2.5 to 3.5% plus the Prime rate (currently 3.25%). For non-real estate transaction like the purchase of a home care agency, dental practice, or medical practice, the 7a program is available. Visit SBA for more information about these programs.