



HEALTHCARE MORTGAGEE ADVISORY COUNCIL

Financing Seniors Housing for America

# Playing the Master Lease Squeezebox

Expanding and Contracting HUD-  
insured Healthcare Portfolios





## Agenda

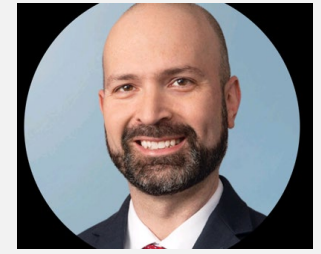
- Adding facilities to a master lease (underwriting, legal and asset management factors)
- Subtracting facilities from a master lease



**Moderator**  
**Jim Provenzale III**  
**Dinsmore & Shohl LLP –Legal Counsel**



James Provenzale III  
Legal Counsel  
Dinsmore & Shohl LLP  
5550 Wild Rose Lane, Suite 400  
West Des Moines, IA 50266  
317.860.5385



Sandra Rothe  
Director, Senior Healthcare  
Underwriter  
VIUM Capital  
205.542.4863



Jennifer Buhlman  
Credit Risk Officer/ Head of  
Program Integrity  
HUD Office of  
Healthcare Programs







## Master Lease Basics

- A “safety in numbers” approach to risk mitigation



## Facility A





## Facility B



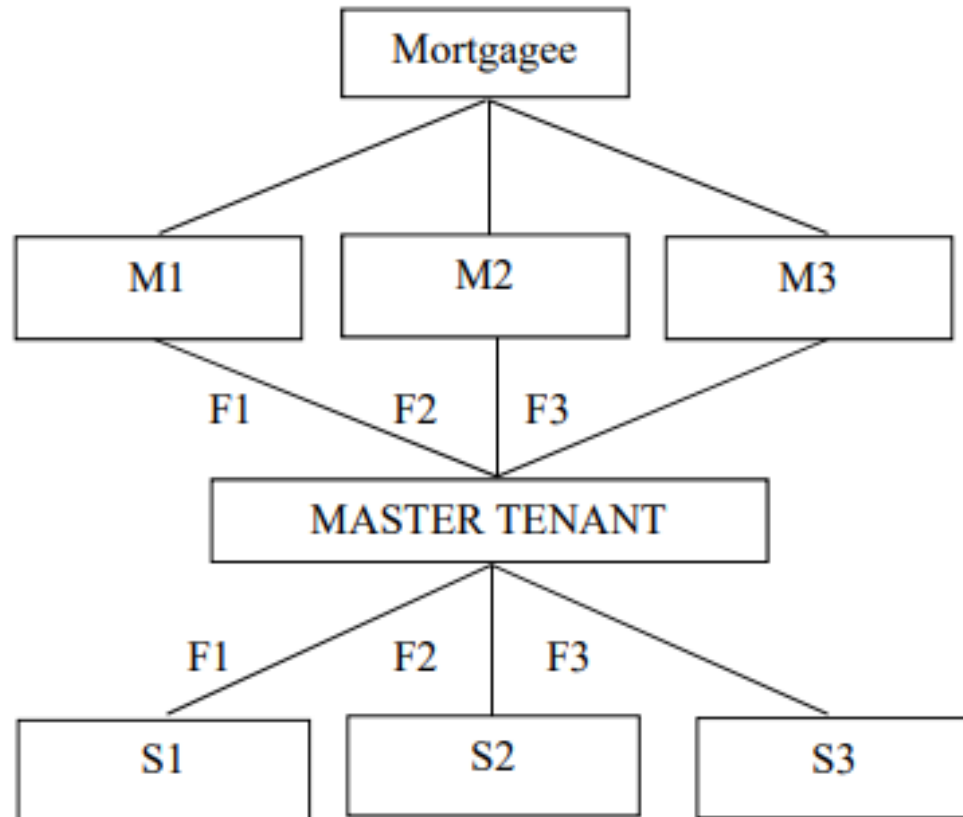
## Facility A



## Facility C



Master Lease Structural Map





**Schedule 2**

**LOANS**

*(Insert description of each Loan- for each Healthcare Facility: name of Healthcare Facility, name of Landlord, principal loan amount, Rent attributable to Healthcare Facility.)*

Name of Healthcare Facility	Name of Landlord	Principal Loan Amount	Rent Attributable to Healthcare Facility
Facility A Rehabilitation Center	123 S. Main Street	\$5,000,000	\$500,000 (annual)
Facility B Assisted Living Facility	800 E. Water Road	\$7,000,000	\$700,000 (annual)



**Schedule 2**

**LOANS**

*(Insert description of each Loan- for each Healthcare Facility: name of Healthcare Facility, name of Landlord, principal loan amount, Rent attributable to Healthcare Facility.)*

Name of Healthcare Facility	Name of Landlord	Principal Loan Amount	Rent Attributable to Healthcare Facility
Facility A Rehabilitation Center	123 S. Main Street	\$5,000,000	\$400,000 (annual)
Facility B Assisted Living Facility	800 E. Water Road	\$7,000,000	\$800,000 (annual)

# The Magic of Reallocation

# Adding to a Master Lease

- Each application under a master lease must stand on its own. It is not permissible for a master lease structure to be used to justify the approval of weak projects.
- Each project will have a separate note for each borrower which will be secured by its own security instrument.
- FHA does not cross-collateralize the real estate of projects included in a master lease structure. In other words, each HUD loan will be secured by exactly one facility.





# Adding to a Master Lease

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- When adding a project to a master lease, the following will need to be determined by the underwriter and/or legal counsel:
  1. Is there currently a master lease in place that is structured so that additional HUD-insured properties can be added?
  2. Are there any master leases with other lenders?
  3. Review the proposed organizational chart and organizational documents to determine if any of the following HUD guidelines apply:
    - A. **Portfolio:** Two or more borrower entities are under common ownership and/or common control.

# Adding to a Master Lease – HUD Guidelines

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- B. **Common Control:** Individual(s) or entity(ies) that controls the Borrower and/or Operator regardless of the percentage of ownership interest, so long as the individual (s) or entity(ies) comprise each Borrower and/or Operator. Affiliated residential care facilities and/or healthcare operating entities will be grouped into a portfolio if they share common control as defined here. The type of corporate credit review will depend in part on the size of the combined mortgage amount of the portfolio.
- C. **Single Asset Entity:** For each individual project, the mortgaged property must be the only asset of the Borrower and the Operator per Production, Chapter 2.5.B and 2.5.C for the single asset entity.
- D. **Affiliates/Affiliated:** Any person or business concern that directly or indirectly controls the policy of a principal or has the power to do so.



# Adding to a Master Lease - Criteria

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- Applications submitted within any rolling 18-month timeframe that begins when the first application creates an open window for a master lease. The window remains open for 18 months (until the new handbook is implemented in 2024) following the start of processing of the most recent application.
- At the direction of ORCF, the 18-month timeframe may be expanded.

# Adding to the Master Lease – Alternative Structures

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4. Are there any jurisdictional or State Laws that would prohibit the master lease? If so, HUD may compensate for the loss of protection by requiring one of the following alternatives:
  - a. Limited Guarantee Security Agreement (“LGSA”)
  - b. Increased debt service reserves
  - c. More stringent underwriting criteria for debt service coverage, LTV, and/or restrictions on surplus cash distributions
  - d. HUD may consider alternative structures that provide equivalent protection.



# Adding to the Master Lease – Operating Lease Calculation

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5. The debt service must meet ORCF requirements of 1.45 or better.
6. The underwriter will complete the lease calculation as reflected below:

a.	Annual principal and interest	\$1,100,193
b.	Annual mortgage insurance premium	168,914
c.	Annual replacement reserves	193,572
d.	Annual property insurance	72,000
e.	Annual real estate taxes	478,059
f.	Total debt service and impounds	\$2,012,738
<b>h.</b>	<b>Minimum annual lease payment</b>	<b>\$2,113,375</b>

# Master Lease/Addendum to Master Lease

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A master lease and/or addendum will be required when:

- A transaction includes 3 or more properties and/or an aggregate of \$15MM;
- Borrowers under the same ownership or a majority ownership individual or group with control of the properties;
- The operators of each property will be a lessee with the same ownership;
- Applications received within 18 months from the last project with the same ownership and operating structure as an existing FHA-insured portfolio with a master lease in place, the property must be added to the existing master lease. It is important to note that the 18-month lookback may change with the implementation of the new Handbook which is due out in 2024.



# Multiple Minority Owners

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While the master lease structure will be used for projects that have majority common owners but have a limited number of minority owners, minor modifications will be needed.

- Cash flows may be segmented so that minority partners do not need to share their minority profit with other projects where they do not have an ownership interest.
- Majority owners' profit will be pledged to all projects in the master lease.
- When there is more than one master lease, the majority owners will pledge their profit to support all master leases.

# Multiple Operators/Master Landlord

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- For projects that have multiple third-party operators, a master lease can be constructed for only those units that are leased to one operator. HUD recognizes that one operator should not be liable for the financial obligations of another unrelated third-party operator.
- It should also be noted that the owner is not excused from its obligation to provide financial support to all troubled projects.
- When there is more than one master lease for a common ownership group with different operators, the majority ownership will pledge their profit from all master leases to support all projects of the master leases.



# Multiple Lenders

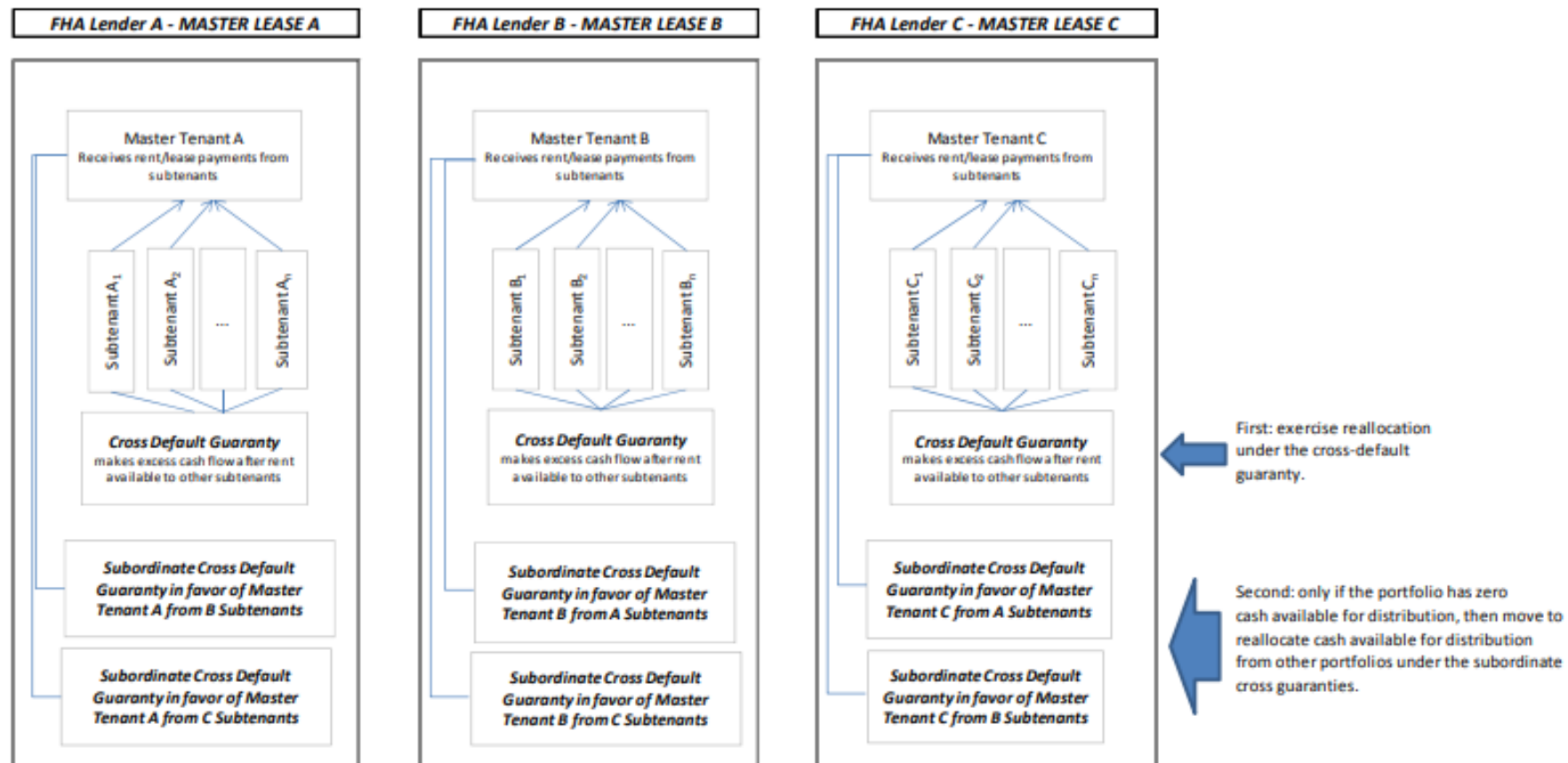
What happens when a borrower uses multiple lenders for financing HUD projects?

- The borrower will be allowed to enter into a separate master lease with each lender.
- HUD does not support allowing one lender to interfere with another lender's master lease in a manner that could jeopardize the viability of another lender's projects. In these situations, a master lease for each lender with a subordinate cross default guarantee agreements will be required.
- The master leases from different lenders may contain a provision that a default under one master lease may constitute a default under all master leases if HUD, along with the lenders, determines that a cross default provision should be exercised.

# Alternative to Multiple Lender Master Lease

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The Subordinate Cross Default Guaranties are unsecured  
 With HUD Approval, a Master Tenant can make demands on any Subtenant under a Subordinate Cross-Guaranty to the extent of cash available for distributions under the applicable Operator Regulatory Agreement.

# Master lease additions: legal nuts and bolts

- Joinder to Master Lease
  - Add the incoming Borrower as a “Landlord”
  - Amend legal description of property being leased
  - Amend list of healthcare facilities
  - Amend schedule of loans and rent amounts



# Master lease additions: legal nuts and bolts

- What is a Cross-Default Guaranty of Subtenants?
  - The document that makes reallocation plans enforceable against operators

# Master lease additions: legal nuts and bolts

- Joinder to Cross-Default Guaranty of Subtenants
  - Amend the list of guarantors
  - Amend the list of landlords

# Master lease additions: legal nuts and bolts

- HUD has not standardized forms for the joinders
  - Lender's counsel may be able to provide templates
  - Borrower's counsel's responsibility to draft
  - Especially advantageous for Borrower's counsel to have 232 experience in this context



# Removing facilities from a master lease

- Why would anyone want to do this?
  - Sale of a facility (prepayment or assumption of loan)
  - Refinancing with a conventional loan
  - Change of Operator (CHOP)

# Removing facilities from a master lease

- Master Lease Subordination Agreement provides preconditions:
  - Lease Coverage Ratio for remaining facilities must be at least 1.45 to 1.00 (but HUD has right to reduce this)
  - New Landlord or new Operator obtains 2530 clearance (not applicable to prepayments)
  - HUD “reasonably approves” the purchaser or new operator based on “customary criteria” (not applicable to prepayments)

# Underwriter Perspective on Release of Master Leases

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Master lease releases are generally handled through Asset Management and not the underwriter. In a good scenario, all properties are performing well and meeting debt service so the release of one project from the master lease will not impact the portfolio. However from an underwriter's perspective, if the project with the strongest operations is being released, it can have a negative impact on the portfolio. The following will need to be considered and/or looked at.

- Once this project is released, does the portfolio still meet the 1.45x debt service?
- HUD would not prohibit a project from being released in connection with the sale of a facility.
- Alternate risk mitigation, such as a debt service reserve, will need to be looked at with Asset Management and ORCF should this situation occur.



# Removing facilities from a master lease – legal nuts and bolts

- Terminations
  - Memorandum of Master Lease
  - Master Tenant Security Agreement
  - Master Tenant Assignment of Leases and Rents
  - Master Lease SNDA
  - Master Tenant Regulatory Agreement
  - Master Tenant UCC Financing Statements

# Removing facilities from a master lease – legal nuts and bolts

- “Communal” Documents (Master Lease and Cross-Default Guaranty)
  - Need to be amended to release the relevant facility
  - Form HUD-92342-ORCF for master lease amendments

# Removing facilities from a master lease – legal nuts and bolts

- A/R Financing
  - Need to get written confirmation from A/R lender that the release will not be considered a default under the A/R loan documents



# Removing facilities from a master lease – legal nuts and bolts

- CHOP
  - If your Operator Security Agreement uses the pre-06/2019 HUD template, you'll have to amend it to remove references to the master lease and master tenant



# ORCF HAPPENINGS

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# HUD EXPERIENCE REFLECTING INDUSTRY TRENDS

- M&A activity includes many existing HUD-insured facilities that are included in a master lease
- Release from master lease requires remaining facilities to have a minimum DSCR of 1.45



# HUD EXPERIENCE REFLECTING INDUSTRY TRENDS

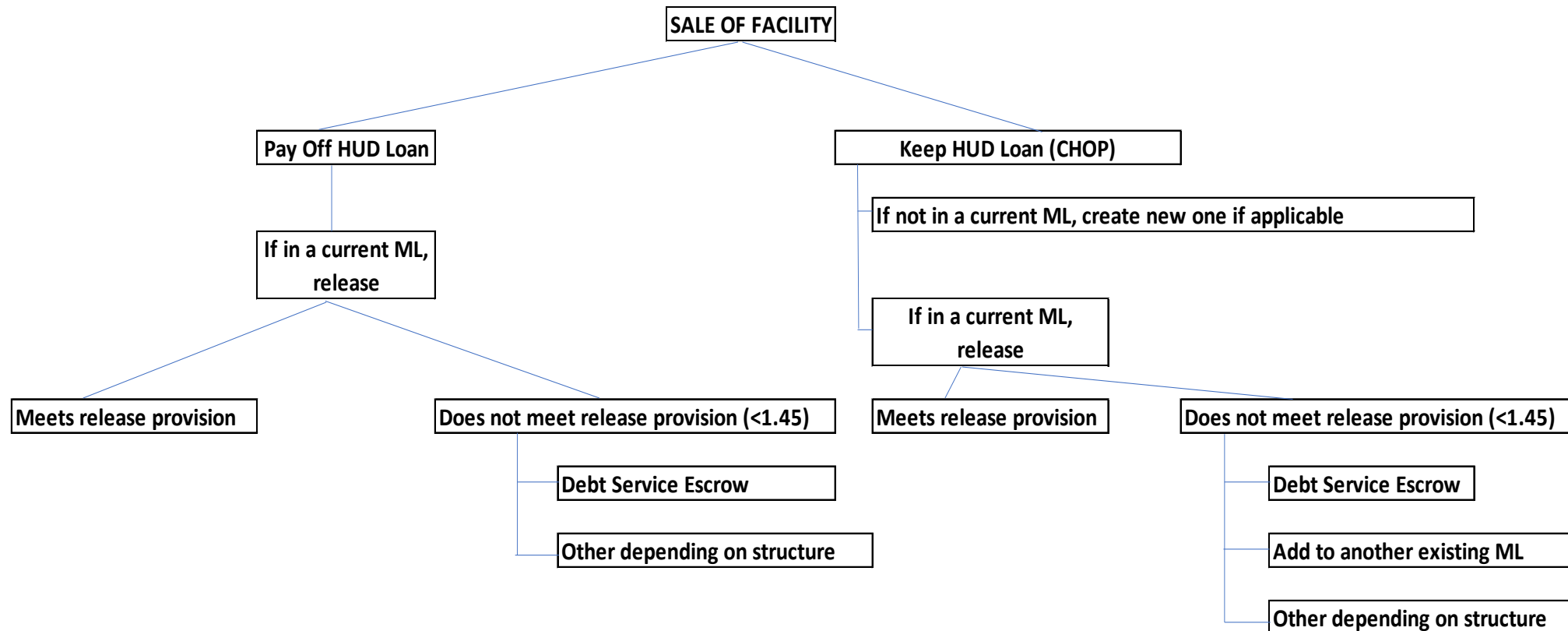
- If remaining facilities have below 1.45 DSCR, now what?
- Debt service escrow
- Who funds? Buyer? Seller?

# Changes to a Facility in a Master Lease

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## ASSET MANAGEMENT MASTER LEASE CHANGES



# HUD GUIDANCE ON MASTER LEASES

- PROPOSED DRAFTING TABLE VERSION
  - Removed 18-month window
  - Add ALL new related projects over any time period to an existing master lease

# HUD GUIDANCE ON MASTER LEASES

- PUBLIC FEEDBACK
  - Problematic because of HUD document versions that change over time
  - Legal document “nightmare”
  - Higher costs



# HUD GUIDANCE ON MASTER LEASES

- NEXT DRAFTING TABLE VERSION
  - Add back a window
  - Expand from 18-months to 36-months