May 23, 2018

ADDITIONAL INFORMATION PACKET

REGARDING SALE OF CHAMPAIGN COUNTY NURSING HOME

RESOLUTION NO. 2018-141

CHAMPAIGN COUNTY ADMINISTRATIVE SERVICES
1776 East Washington Street, Urbana, Illinois 61802-4581
ADMINISTRATIVE, BUDGETING, PURCHASING, & HUMAN RESOURCE MANAGEMENT SERVICES
Debra Busey, Interim County Administrator

TO: Members of the Champaign County Board

FROM: Debra Busey, Interim County Administrator
Van Anderson, Temporary Special Projects Administrator

DATE: Wednesday, May 23, 2018

RE: RFP 2018-001 – Additional Information

This memorandum is being sent to you to provide information pertinent to Resolution No. 2018-141 Authorizing the Sale of the Champaign County Nursing Home (CCNH) and to address additional questions raised and statements made concerning the CCNH sale. The information below is provided to address those questions and statements to ensure you have received the most complete and accurate information available to us as you make your final decision of the potential sale of CCNH.

Resolution 2018-141: Asset Purchase Agreement and Operations Transfer Agreement

The Asset Purchase Agreement (APA) and the Operations Transfer Agreement (OTA) set the terms and conditions for the sale of CCNH. The APA and OTA documents were included in your County Board Agenda Packet as attachments to Resolution No. 2018-141 Authorizing the Sale of the Champaign County Nursing Home. Attached please find the comments by our outside counsel, Polsinelli PC, regarding the final fully negotiated APA and OTA documents.

FY2019 PTELL and CCNH Levy Considerations

Previously, the administrative staff presented information to the County Board members regarding the impact of a potential sale of CCNH on the County's property tax levies including the resolution of the CCNH debt using the CCNH operating levy and the potential tax relief that would result from the sale. As previously disclosed, Champaign County will discontinue collecting the General Obligation Nursing Home Bond Levy which will provide $1.53 million in property tax relief in FY2019.

The State's Attorney has provided information regarding the future of the Nursing Home Operating Levy if CCNH is sold. Attached please find the State's Attorney's letter regarding this matter.

Due Diligence and the $11 Million Asking Price: The Brokers Response

To provide further, more in-depth information to the County concerning the valuation of CCNH, Institutional Property Advisors (IPA), a division of Marcus & Millichap (M&M), was asked to address the process they used for the valuation and marketing of CCNH. Matt Andriano, a member of the IPA's National Seniors Housing Team provided the following response:

Bullet Points to Support IPA/Marcus & Millichap's Process and Valuation for CCNH:

- The offering was sent out to the most qualified skilled nursing buyers across the country, which were compiled through 25+ years of networking, attending and speaking at conferences, facilitating thousands of previous/similar marketing processes, and closing over $4.6 billion of transactions in this space.
- 63 of these qualified buyers actually took the time to sign the Confidentiality Agreement and review the data vault, which included a marketing memorandum, financial and census data, and other pertinent property information.
- Our brokers (led by Josh Jandris and Matt Andriano) reached out personally via phone and email to each of the groups who signed CA's to discuss the deal in further detail, attempting to convince buyers to submit a bid.
- Much of the feedback from buyers stated that the price was too high for a nursing home in Central IL that is losing several million dollars annually ($2.3M at time of marketing). This combined with the fact that the County had not yet approved a sale caused several groups to lose interest. Keep in mind it takes weeks of time for a buyer to underwrite and model out these acquisitions. Therefore, if a buyer is not certain that a seller is committed to a sale, it is difficult to convince them to spend time on the opportunity.
- IPA/Marcus and Millichap's Seniors Housing team of 14 individuals has sold $4.6 billion in total transactions, with a total of 11,698 beds at a value of $450 million in the State of Illinois. This track record is unmatched in Illinois when compared to our peers.
- Additionally, the IPA team has successfully run the process and closed over 30 county owned nursing home transactions. This is by far the best track record in the country when compared to other Seniors Housing brokerage firms. Almost all of these county homes were losing money at the time of sale, so the IPA team has had to become experts on the valuation of these type of assets, with the goal always to achieve the highest possible price for our client (the seller).
- The process of valuation for a skilled nursing facility is complicated, and must be approached from several different angles. The first is to apply a capitalization rate (cap rate) to the Net Operating Income (NOI or EBITDAR, which stands for Earnings Before Interest Taxes Depreciation Amortization and Rent). This method was not applicable in the case of CCNH because the NOI or EBITDAR

was negative, or in other words the home was losing money ($2.3M at time of marketing). This would result in a negative value for the home, which we all understand is not realistic.

- The second method is to determine a price per licensed bed based upon comp data, or other nursing home transactions that have closed in the region. Based upon our research, and according to the sold comps shared with the county (source Irvin and Levin Associates), the average price per bed of sold comps in Central/Southern Illinois were: $39,660/bed over the last 5 years (only 8 total transactions), and $35,877/bed dating back to 2000 (32 total transactions). The fact that there were only 8 transactions in Central/Southern Illinois over the last 5 years shows how difficult it is to sell a skilled nursing facility in Illinois in the current marketplace. Even though CCNH was losing $2.3M of NOI annually at the time of our marketing process (and these numbers continue to decline as census dips), we were still able to achieve a price of $45,267 per licensed bed, well above the average comp price per bed over the last five years. There were three transactions of the eight that closed since 2013 that achieved a higher price per bed than CCNH. These were Helia Healthcare of Greenville, Coulterville Care Center, and a portfolio of 5 homes (in Harrisburg, Benton, Pinkneyville, DuQuoin, and Carrier Mills). All of these facilities had a positive NOI, so the capitalization method was applicable. Because these homes were performing with positive NOI makes them somewhat useless as comps for CCNH. The other five transactions that closed during the same time period traded for a price per bed of only $21,418.
- Additionally, IPA/Marcus & Millichap is currently involved in the sale of a large skilled nursing portfolio in Central/Southern Illinois that has positive NOI over $12.8 million. This portfolio, though we cannot disclose the buyer and seller at this time due to confidentiality, is currently under Letter of Intent at just over $43,000/licensed bed. This again shows that the price of $11 million or $45,267/licensed bed is an extremely aggressive price for CCNH given it's negative NOI of $2.3 million (and dropping).
- The last method IPA uses in its valuation process is for the underwriting team to build a "Pro-Forma" income statement, or a projection of what a subject property could look like if operated more efficiently. To do this, the team breaks down all of the financials by line item, and compares the subject property's performance to that of its peers in the region (expenses by department, Medicaid and Medicare rate and census, etc.). We then "rebuild" the income statement to show a potential buyer what the potential of a facility could be. In the case of CCNH, we had to drastically increase Medicare census to 21 (up more than double from current Medicare average census of 10), resulting in a $5M total revenue increase. This is NOT an easy task for the buyer to achieve in reality, but something the current buyer believes it can potentially achieve. After rebuilding the CCNH income statement into a "Pro-Forma", IPA believes the facility could

generate positive NOI of $1.7M. We then applied a 15.6% cap rate to the $1.7M of NOI to arrive on the $11 million ask price. Typically, nursing homes in Central/Southern Illinois will trade at a 14% cap rate, however it is always necessary to apply a more conservative cap rate to a "Pro-Forma" NOI because this performance is simply a projection, and obviously not occurring in reality.

IPA/Marcus & Millichap Seniors Housing Team believes that because of our experience in selling county owned facilities, our track record in the state of Illinois, and the valuation processes detailed above, that a price for CCNH of $11M is an excellent price that has been analyzed from several different angles by experts in this field. Not to mention, if the ask price was lower, we would certainly have had several bidders in the process. These buyers are very intelligent and the market is efficient. If there is an undervalued asset on the market, it gets gobbled up quickly.

In a typical marketing process, not dissimilar from selling your home, a buyer will submit a bid at or below the ask price. Then, if there are multiple bidders, additional rounds of bidding are conducted. In this case, the buyer was the only bidder, so we did not have the ability to push price in additional rounds. The only other offer received was at $7M, which did not qualify per the RFP.

There is no need to delay the vote, and the Board should feel comfortable that it has all necessary data to make a decision. In fact, if the vote is delayed, there is no guarantee that this buyer will still be willing to transact, and if so, what their new offer price would be.

Thank you,

Matthew Andriano
National Seniors Housing Team

Bottom Line: As previously stated, the County Board and administration have performed all due diligence activities required to date in support of the RFP process that led to a fair and accurate valuation of CCNH based on its operations at the time of valuation.

Information on Nursing Homes owned by William "Avi" Rothner

The following table was previously provided under the heading above:

Table 2. Nursing Home Three-Year Total Deficiencies and Average Deficiencies By Severity								
	ECC Homes Total		CCNH		Local Nursing Homes Within 25 Miles		Local Nursing Homes Within 40 Miles	
Deficiency Categories	#	%	#	%	#	%	#	%
Potential for Minimal Harm or Potential for Actual Harm (Categories 1 and 2)	448	97.82%	53	91.38%	292	96.69%	396	95.65%
Actual Harm or Immediate Jeapordy to Resident Health (Categories 3 and 4)	10	2.18%	5	8.62%	10	3.31%	18	4.35%

From Van: I apologize for inserting this table again but I saw where a single number in the table was incorrect. For the Local Nursing Homes Within 25 Miles of Champaign-Urbana, the number of Category 1 and 2 deficiencies was reported as 396 when it was 292. The rest of the data for those homes, including the percentages of Category 1 and 2 deficiencies and Category 3 and 4 deficiencies, were correct.

Relationship of William "Avi" Rothner to the Broker, Marcus and Millichap

Question or Comment (Special Board Meeting, May 9, 2018): Prior to the Special Board meeting, the question had been raised concerning a potential conflict of interest between the broker and the proposed buyers. It was rumored that Avi Rothner had a brother-in-law who worked for Marcus and Millichap. During the presentation/interview of the proposed buyers, a County Board member questioned the relationship between the buyers and the brokers. A portion of the exchange, viewable in the meeting video at 47 minutes 50 seconds into the meeting, went as follows:

> **County Board Member:** Can you describe your relationship with the broker?
>
> **Avi:** Yes. They're a broker, I'm a buyer.
>
> **County Board Member:** And that is the extent of your relationship with the broker?
>
> **Avi:** Actually, one of the brokers has his brother-in-law who works in the firm but neither of them are my family. If you want to ask them about their family connections you are more than welcome to call them.

Administrative staff followed up on this conflict of interest accusation and received the following response from Matt Andriano:

Josh Jandris of Marcus & Millichap is married to Melissa (Mruz) Jandris. Melissa's sister Angela (Mruz) Fleming is married to Ryan Fleming. Ryan Fleming is another broker on our Seniors Housing Team at Marcus & Millichap. Therefore, in his quote Avi was referring to Josh's brother-in-law, Ryan Fleming, because Josh and Ryan are married to sisters. Hopefully this clarifies for the Board Members that no one from our firm (or specifically on our Seniors Housing Team) are related in any way to Avi Rothner.

Bottom Line: There is no known conflict of interest due to familial ties between the proposed buyers and the broker.

Medicare.gov Star Ratings

During the May 9th presentation/interview the Medicare.gov star ratings became an issue as the buyers indicated they rely on other measures to assess the quality of care they provide. They indicated patient outcomes are of critical importance and patient care is of critical importance. Avi stated they objectively measure the quality of care through "all of the patients, all of the staff, all of the families, every interaction, every day, all the time." This includes the doctors and others providing services in the homes.

To underscore why the Medicare.gov star ratings should only be the starting point for an investigation into a nursing home, please see the attached article written by Paula Span of the New York Times. The article provides insights from researchers who "have discovered that even if the star ratings were accurate, they don't bear much relationship to how residents and families feel about these facilities."

As always, we are available to answer questions regarding the information presented above or other questions you may have regarding to the sale of the nursing home.

POLSINELLI

Memorandum

TO: Champaign County, Illinois

FROM: Polsinelli PC

SUBJECT: Comments regarding Asset Purchase Agreement and Operations Transfer Agreements

DATE: May 21, 2018

The purpose of this memorandum is to outline and provide recommendations regarding the final fully negotiated Asset Purchase Agreement and the Operations Transfer Agreement by and between Champaign County and Extended Care Clinical, LLC and Altitude Health Services, Inc.

Asset Purchase Agreement.

The final Asset Purchase Agreement modifications focused on form and process more than substance. Specifically, in Section 3, *Excluded Property*, Purchaser required that it have a clear understanding of what assets are being purchased by the inclusion of certain Schedules (property listings). In Section 4, *Closing Date*, Purchaser required a potential two-month extension to ensure Purchaser is able to review diligence and have a 30-day window for state reporting purposes. In Section 6, *Costs and Credits*, Purchaser required clarification to conform to local law for cost and credit responsibility (title and survey charges). In Sections 8 and 9, *Due Diligence* and *Title and Survey*, Purchaser required a 45-day window to conduct its due diligence and inserted a no-limit right during the due diligence period to withdraw from the transaction based on its review of the overall diligence, title, and survey. The foregoing requirements are not unusual requests, as a purchaser needs an opportunity to review and conduct its examination before committing to the purchase.

The additional requests are material but within the range of normalcy for a transaction of this size and scope. In Section 13 and 14 regarding the *Survival of the Representations and Warranties*, Purchaser required an 18-month period as opposed to the RFP's 12-month period. Considering the Purchaser demanded 3 years initially a compromise to 18-months is reasonable. In Section 15 regarding *License and Census*, Purchaser required that, at closing, the facility have at least 87.5% of its average census of the seven days immediately preceding the effective date. The census requirement is to ensure the facility does not have a significant downturn during the period between signing and closing. Using the census for a "Material Adverse Effect" type of pre-closing qualifier is typical in the skilled nursing home industry.

The last set of changes are very specific to the transaction. The Purchaser demanded changes to the resident transfer right to reflect certain business realities and such requests are appropriate. The Purchase also demanded a definitional change to the way in which the 50% Medicaid requirement is determined; basically, Purchaser requires that the beds are "primarily reserved" for Medicaid as opposed to "reserved", as to the extent there is an open bed, the Purchaser wants to make sure it will not be vacant. And, the Purchaser demanded a change in the liquidated damages amount from $1,000,000 to 5% of the Purchase Price (approximately $550,000). Please note that originally, Purchaser rejected the liquidated damages concept altogether, but the negotiations team held firm and Purchaser, ultimately, dropped such request.

Operations Transfer Agreement.

Similar to the final Asset Purchase Agreement modifications, the Operations Transfer Agreement modifications focused on form and process more than substance. Specifically, in Section 2, regarding *Open Survey Items*, and 3, *Excluded Property*, Purchaser required that, at closing, there are no open survey items, and, with respect to the assets, a specific asset listing for personal property. In Section 8, *Contracts*, and the related *Schedules*, Purchaser required that Purchaser have the opportunity to review the third-party contracts before accepting them (though Purchaser does agree to take the Union Contract). In Section 10, *Accounts Receivable*, Purchaser required a slight adjustment to the timetable regarding how payments are processed. In Section 11(b), *Employees*, Purchaser required a clarifying definition. In Section 16, *Indemnification*, Purchaser required that Patient Trust Fund damages be excluded from the Cap and Basket, which request is not unusual. These requests are typical in this type of transaction.

Also, please note that Purchaser originally demanded that the Basket be reduced to $5,000 from $50,000 and that the Cap be increased to $11,000,000 from $1,000,000. The negotiations team held firm against the significant material change request and the Purchaser dropped such request.

The lasted set of changes mirror the Asset Purchase Agreement requirements regarding (i) a slight increase to the length of the representations and warranties period (18-months), (ii) transfer restrictions of certain residents, and (iii) the 50% Medicaid requirement.

In summary, the Asset Purchase Agreement and Operations Transfer Agreement are similar in form and substance to what we see in these types of transactions with skill nursing facilities.

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Office of
State's Attorney
Champaign County, Illinois

May 22, 2018
[Via Email Only]

Debra Busey, Interim Champaign County Administrator
Champaign County Board Members

Re: FY2019 PTELL & CCNH Levy Considerations

Dear Ms. Busey and Members of the Board:

You have requested that our office provide information necessary to describe the impact of a potential sale of the Champaign County Nursing Home ("CCNH" or "NH") on the County's property tax levies. There is some suggestion that if the NH levy goes away, the County will not be able to levy for potentially remaining outstanding obligations relating to the NH in any other manner – that is not accurate – and we hope that this memo can describe in the simplest way possible how that complicated analysis can occur.

Any discussion of property tax levies must include analysis of the Property Tax Extension Limitation Law (PTELL)'s influence on Champaign County budget and levy considerations. Under PTELL, the County's *aggregate extension* is the total of the County's property tax rates for all funds subject to PTELL. PTELL limits the aggregate extension to an annual increase of the lessor of 5% or CPI (as applied through a detailed, highly algebraic, PTELL "limiting rate" formula). The CCNH levy is currently at the rate of .0317 which is included in the aggregate extension. This means that the amount that the County property tax rates for any fund included in the aggregate extension has always been limited by the amount associated with the CCNH operating levy, which has been about three cents for quite a long time.

The specific county nursing home finance authority is found in the Counties Code: "to make appropriations from the county treasury for the purchase of land and the erection of buildings for the home, and to defray the expenses necessary for the care and maintenance of the home and for providing maintenance, personal care and nursing services to the patients therein, and to cause an amount sufficient for those purposes to be levied upon the taxable property of the counties and collected as other taxes . . . " 55 ILCS 5/5-21001. The County generally refers to this authority and the budget and levy associated with this authority as the NH "operating levy".

If the County no longer budgets and levies for the NH operating levy, there will be PTELL implications because the funds included in the aggregate extension will not be limited by the NH operating levy in FY2019 and beyond. As you may know, certain funds do not have statutory rate limits. For example, the general fund, social security fund, and IMRF fund do not have rate caps, even though they are still included in the PTELL aggregate extension and therefore subject to the limiting rate. PTELL can be considered (at least in part) as a response to the fact that some funds do not have rate limits, since it can prevent increased tax rates even where specific funds have no statutory limit. These funds or any other fund that is not currently levying at a statutory rate limit will experience an ability to increase levies in FY2019 if a sale occurs because the NH operating levy will no longer be included in the aggregate extension.

As a County that has had to consider PTELL for over two decades now, many of our governing officials understand how each year impacts every subsequent year in the PTELL analysis. Officials have seen how PTELL's limiting rate has impacted all the funds in the aggregate extension since PTELL was approved in 1996. The County is financially prudent to fully consider how any elimination of the NH operating levy should be captured by other funds to at least maintain the current property tax aggregate extension, or to allow the aggregate extension to grow the maximum amount in FY 2019 under the PTELL limiting rate. Nothing in PTELL prevents the County from appropriating from the general fund or other funds at a higher rate in FY2019 to assure that the County's limiting rate at least stays the same for purposes of PTELL in FY2019. The only other way to impact the limiting rate is through referendum action, which involves mandatory PTELL language that is complicated and no doubt confusing to anyone who hasn't had to analyze or think often about PTELL.

PTELL's implication on the actual levy for any particular fund in FY2019 will necessarily involve calculations of the PTELL limiting rate formula described generally above in conjunction with the specific details of the budgeting process as directed by the Board at several stages throughout the budget process and then crafted by County Administration & Finance while working with all the county offices and departments. The annual analysis always includes discussion of the authority of specific budget appropriations which must be tied to the levy for any particular fund. County Administration & Finance consult regularly with the County Clerk's Office and our office throughout the budget process to fully consider PTELL implications in the context of the specific details. County Administration & Finance have already considered some specific ways to budget and levy in FY2019 that consider potential NH obligations to the County general fund that may not be fully recovered through sale proceeds or ongoing accounts receivable. These options appropriately reallocate portions of the PTELL aggregate extension that would no longer be associated with the NH operating levy to appropriations in other funds that can address the obligations.

PTELL is a highly technical statute and analysis of PTELL implications necessarily involves numerous experts and officials. However, we hope that this analysis can clarify and address the concerns relating to the NH operating levy if there is a sale of the CCNH.

If there are questions which remain, please direct those to Ms. Busey so that we may assist in any way possible.

Sincerely,

Donna M. Davis

Herald-Tribune

Entertainment & Life

Don't judge nursing homes by 'likes' or stars alone

By Paula Span / The New York Times

Posted May 22, 2018 at 2:01 AM

Can you really select a quality nursing home by reading Yelp reviews?

Gerontologists at the University of Southern California think they make a useful addition to the homework any prospective resident or family member needs to undertake.

It's not that reviews posted on Yelp and other online platforms (Google, Facebook, Caring.com) are such reliable guides to nursing home quality, said Anna Rahman, senior author of a recent article in The Gerontologist. It's that the supposed gold standard, the five-star ratings on the federal government's own Nursing Home Compare website, remains so faulty.

"We had a growing sense of how disappointing those measures have been," Rahman said of Nursing Home Compare. "After 20 years and all the money spent to create it, it's become a marketing tool. But most people don't realize how little it measures. It's garbage in and garbage out."

Nursing Home Compare made its online debut in 1998 and added the starred ranking system in 2009, after a senator complained at a congressional hearing that it was easier to shop for a washing machine than a nursing home. This year, the federal Centers for Medicare and Medicaid Services anticipates that the tool will be used 2.4 million times.

Critics have charged for years that the metrics are untrustworthy and prone to manipulation.

"I would never use it for quality measures because I don't believe it," said John Schnelle, director of the Center for Quality Aging at Vanderbilt University Medical Center. "I think they're distorted."

Researchers also have discovered that even if the star ratings were accurate, they don't bear much relationship to how residents and families feel about these facilities.

In Ohio, which conducts its own statewide nursing home surveys, "plenty of times residents really liked a facility with a low star rating, and vice versa," said Robert Applebaum, a gerontologist at Miami University in Ohio.

He has found that families' and residents' satisfaction varied significantly at the poles — they did prefer five-star to one-star homes — but the differences between one- and two-star homes, or those with four versus five stars, were negligible.

Enter Yelp, where the first nursing home review appeared a decade ago. Rahman and colleagues at the University of Southern California, looking at 51 Yelp-rated nursing homes in the state, found that most reviewers commented on intangibles like staff attitude, caring and responsiveness; they rarely mentioned health care quality or safety concerns.

You wouldn't want to rely too much on Yelp and other online platforms. The great majority are polarized — either five-star reviews or one star.

"Nursing homes inspire a lot of emotion," Rahman said.

The bottom line is that all these sources have dismaying limitations. Online placement services like A Place for Mom get paid by the nursing homes they refer people to.

So experts advise starting your investigation online. Then, inescapably, you've got to show up at the nursing home, walk around, talk to residents and family and staff, ask a zillion questions.

Then, go back and do it again.