COVID-19 IMPACT ANALYSIS FOR NFP CCRCS

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EXECUTIVE SUMMARY

In our recent median report (dated November 15, 2021), we promised an in depth, COVID-related analysis of our ratio data. In this companion report, we attempt to examine the extent to which COVID-19 affected senior living providers, using our median ratio sample group as a proxy. We will focus on determining the financial impact on core operations, as well as sifting out the accounting impact of the various governmental aid programs.

As always, we encourage feedback regarding this report from the investing community. While we consider the raw data to be proprietary information, we can perform additional analysis/summarization upon request. Please contact the author with any comments or requests for additional information.

Summary of Pertinent Median Report Data

This report is a supplement to our FY 2020 CCRC Median Report, dated November 15, 2021. We highly recommend that the reader has that report, available on ZieglerCreditSurveillance.com, open as well for reference and context. To keep this report as concise as possible, we assume the reader has reviewed and generally understands the material in that report, possesses a baseline of knowledge regarding CCRCs and has actively monitored the impact of COVID-19 on the senior living industry since March 2020. We follow all conventions and definitions laid out in that report. We intend to release an update to this report next year along with our FY 2021 CCRC Median Report, as COVID-aid funding will continue to materially impact financial statements.

There are some statistics from the 2020 median report that we want to reiterate for the reader in the context of this report.

Sixty-six borrowers (57% of the 116 borrower sample group) received a PPP loan during their FYE 2020, with the median amount received equating to 32.5 DCOH. Twenty-three borrowers (20% of entire sample, 35% of those that received PPP) amortized at least a portion of their PPP loan during their FYE 2020, with the median amount amortized equating to 0.45 times coverage.

The following is the breakdown of FYE dates for borrowers in the 116 borrower sample group:

- **1/31 – 3/31:** 8 (7%); none received PPP before FYE, the program was not yet available.
- **4/30 – 6/30:** 27 (23%); 16 (59%) received PPP before FYE, 2/16 (12.5%) amortized.
- **7/31 – 9/30:** 19 (16%); 9 (47%) received PPP before FYE, 3/9 (33%) amortized.
- **10/31 – 12/31:** 62 (53%); 41 (66%) received PPP before FYE, 17/41 (42%) amortized.

Fifty borrowers in the sample did not apply for PPP before their FYE. On investigation into more recent data, we found 13 additional borrowers that applied post FYE. Of the 13, nine were part of a system or a subsidiary of a larger organization, and likely did not apply early on due to the original interpretation of the employee limit. Three had 3/31 FYEs, so would not have had a chance, leaving one borrower that applied very late for no immediately obvious reason. Based on our investigations, 31% (36/116) of the borrowers in the study did not apply for PPP at all. We could not find enough information on one borrower to confidently state whether they applied or not, and going forward we will treat that borrower as if they did not.

For our sample data, we did not investigate whether the SBA officially forgave the loan before amortization. We followed whatever accounting treatment the auditor proscribed.

Given that 79 borrowers in the sample eventually took PPP, FYE 2021 will have 57 of these borrowers amortizing PPP.

PPP Overview

In total, we could confirm that 79 out of the 116 borrower sample, or 68% received PPP eventually, even if post FYE.

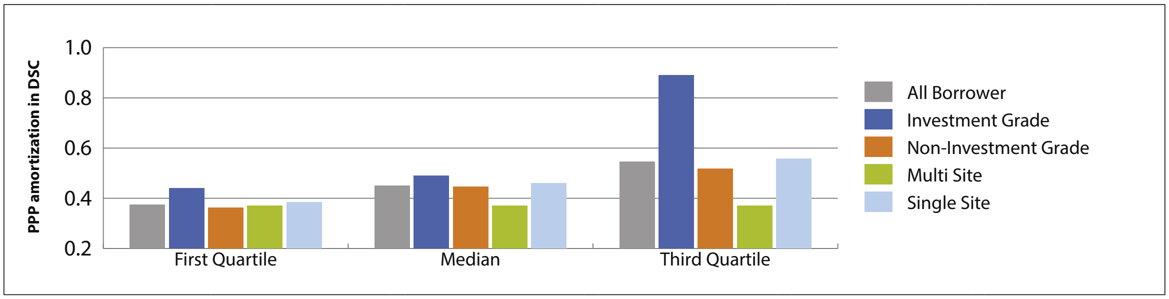
- 52 out of 77 (68%) of single-site borrowers received PPP during their FYE, with an additional seven applying afterwards for a total of 59 out of 77 (77%).
- 14 out of 39 (36%) of multi-site borrowers received PPP during their FYE, with an additional six applying afterwards for a total of 20 out of 39 (51%).
- 40 out of 64 (63%) of non-investment grade borrowers received PPP during their FYE, with an additional ten applying afterwards for a total of 50 out of 64 (78%).
- 26 out of 52 (56%) investment grade borrowers received PPP during their FYE, with an additional three applying afterwards for a total of 29 out of 52 (56%).

As applications for PPP are currently closed, we can see that a significant portion of borrowers did not apply. We are not aware of any borrowers that applied and were rejected. We believe most management teams reviewed guidance and likely tended towards conservatism, so any that may have otherwise been rejected never applied. Some reasons for individual borrowers not applying were:

- Too many employees at a single facility disqualified them.
- Board/management felt that their financial position was strong enough that it would be unethical to apply or that the loan was not justifiable economically.
  - o This reason was more prevalent among high liquidity borrowers.
- Management did not want to be audited or have government involvement
  - o Initially there was uncertainty about the process and likelihood of loan forgiveness. By the time the SBA released more detailed guidance, some of the uncertainty regarding COVID was mitigated, which may have weakened the economic case for aid funding.

Debt Service Coverage

We have included the medians showing how much PPP each group amortized for FY 2020 in terms of DSC. The sample sizes for multi-site and investment grade borrowers are relatively small and not useful for analysis, but we have included them for reference.



	All Borrower (23)	Investment Grade (5)	Non-Investment Grade (18)	Multi Site (1)	Single Site (22)
First Quartile	0.375 times	0.44 times	0.363 times	0.37 times	0.385 times
Median	0.45 times	0.49 times	0.445 times	0.37 times	0.46 times
Third Quartile	0.545 times	0.89 times	0.518 times	0.37 times	0.558 times

We are aware of only three borrowers that did not amortize their entire PPP loan in the same FY, all three have 6/30 FYEs. Interestingly, one is splitting their amortization between FY 21 and 22, and did not amortize any amounts in FY 20. Auditor methodologies regarding timing of payment recognition are beyond the expertise of this writer.

A common question is whether borrowers strategically chose which year to amortize PPP, whether to avoid a DSC covenant violation this year or to bank that income to ensure compliance next year. While our coverage calculation does not necessarily line up with each individual borrower's requirements, we will use our DSC results as a proxy for covenant compliance.

Note that we were unable to calculate MADS coverage for one borrower that received PPP and one that did not, so the number of borrowers does not exactly match the totals referenced earlier.

Ten borrowers out of the 23 that amortized PPP went from an amount below/near 1.20 times to an amount above/near 1.20 times by our calculation. One that amortized was still well below the 1.20 times threshold. Twelve borrowers amortized but we believe were not at risk of covenant violation.

We also broke down our borrower group into segments based on their organic DSC- in other words, excluding PPP amortization.

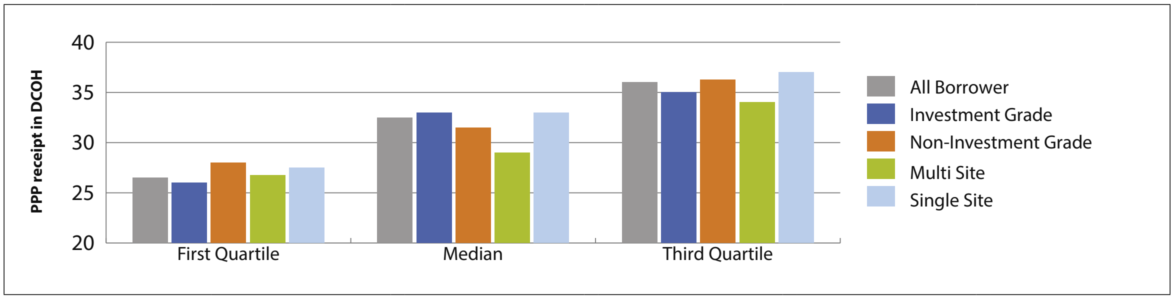
- Fourth quartile: 9 amortized out of 18 received, or 50%. The dividing mark in terms of DSC was approximately 1.15 times, borrowers had DSC below 1.15 times.
- Bottom half (inclusive of first quartile): 15 amortized out of 37 received, or 41%. The dividing mark was approximately 1.7 times, borrowers had DSC below 1.7 times.
- Top half (inclusive of fourth quartile): 8 amortized out of 29 received, or 28%. The dividing mark was approximately 1.7 times, borrowers had DSC over approximately 2.35 times
- First quartile: 4 amortized out of 13 received, or 31%. The dividing mark was approximately 2.35 times, borrowers had DSC over approximately 2.35 times

The data suggests that borrowers with DSC below 1.20 times were more likely to amortize PPP if they received it, and that if a borrower was over 1.20 times they were no more likely to amortize, regardless of how far over. While may be coincidental evidence on its own, the fact that the dividing point is around the 1.20 times we would expect lends some credibility to the analysis.

The data appears to show evidence that some borrowers may have strategically timed amortization. Note, that this can be weaker borrowers amortizing to meet DSC, and stronger borrowers deciding to push amortization to next FY in case next year's performance materially declines. We do not believe this is a nefarious or malicious trend, as borrowers and auditors were given fairly broad leeway as to the decision of when to amortize. Weaker borrowers may have been motivated to amortize more promptly for reasons unrelated to bond covenants. We do not believe there is any fraud or dishonesty in the timing decision, as most senior living providers were immediately and materially harmed by COVID-19. While investors are correct to be concerned about the impact on covenants and remedies, they should consider the amortization decision in the context of each borrower's situation.

Days Cash On Hand

We see that the type of borrower, as broken down below, did not make any appreciable impact on the amount of PPP received in FY 2020, in terms of DCOH.



	All Borrower (23)	Investment Grade (5)	Non-Investment Grade (18)	Multi Site (1)	Single Site (22)
First Quartile	**26.5 days**	**26.0 days**	**28.0 days**	**26.8 days**	**27.5 days**
Median	**32.5 days**	**33.0 days**	**31.5 days**	**29.0 days**	**33.0 days**
Third Quartile	**36.0 days**	**35.0 days**	**36.3 days**	**34.0 days**	**37.0 days**

When examining the amount, the following facts about the PPP loans will be helpful to the reader.

The loans were sized at 2.5 times monthly payroll expenses for employees. This includes salaries up to $100,000 per employee, but also includes other payroll costs such as retirement contributions and insurance. (https://www.sba.gov/sites/default/files/2021-03/HowtoCalculateFirstDrawLoanAmountsFAQs-3.12.21-508.pdf)

Given the sizing requirement, we would expect PPP loan amounts to equal at most 75 days of payroll/labor expenses, based on 2019 payroll. In other words, if we performed a DCOH calculation with only payroll/labor expenses in the denominator, and the PPP amount in the numerator, we would expect the result to be 75 DCOH. There would be some downward adjustment depending on how many employees earned over the $100,000 limit. C-suite and other management roles can generally earn over that amount. Depending on the local area labor market, some rank-and-file employees such as RNs could earn that amount, especially with overtime.

For detailed information on expense breakdowns, we used "The State of Seniors Housing 2019", published by the American Seniors Housing Association, specifically Table 9.7 regarding CCRC expense categories. After analysis and adjustment for treatment of debt service in expenses, we determined that 55.5% is an appropriate estimate of payroll expenses as a proportion of cash operating expenses for a CCRC. Multiplying the 55.5% of estimated cash operating expenses by the 75 days payroll that PPP would provide, we estimate that the average CCRC operator would be eligible for a PPP loan in an equivalent amount to 42 DCOH.

The highest DCOH equivalent of PPP applied for was 49 DCOH, with the lowest of 13 DCOH and median as 33 DCOH. Some potential reasons for the median being almost 10 DCOH lower than the 42 DCOH we would expect are:

- The removal of salary amounts over $100,000
- Management teams likely faced some uncertainty over including certain items in the computation. As most NFP management would be considered relatively risk-averse, we find it likely that those amounts would be excluded, rather than risk additional scrutiny and possible rejection of forgiveness.
- PPP amounts were computed based on 2019 payroll, and our DCOH figures were computed based on FYE 2020 expenses. Though the State of Seniors Housing publications show a decrease in expenses for their sample group year over year, there would be some variability among individual borrowers. This may have lowered or increased the median DCOH applied for.

We also examined whether a borrower's DCOH (excluding PPP) impacted whether they applied. The unsurprising answer is yes. As seen below, the very weakest were much more likely to apply, and the very strongest were much less likely. Somewhat surprisingly, a very wide swath in the middle had similar application rates, with the 4th quartile driven up by the inclusion of the bottom ten and the 1st quartile driven down by the inclusion of the top ten.

- Bottom ten: 9 out of 10 received (90%). The one that did not is part of a large multi-site organization, which did not apply as a corporate organization.
- 4th quartile: 22 out of 29 received (76%)
- 3rd quartile: 21 out of 29 received (72%)
- 2nd quartile: 20 out of 29 received (68%)
- 1st quartile: 16 out of 29 received (55%)
- Top ten: 5 out of 10 received (50%)

We also believe that borrowers in low cost of living areas were able to apply for higher loan amounts, in terms of DCOH, than their counterparts in high cost of living areas. Using data from Sperling's Best Places (bestplaces.net), we obtained a cost of living score for the top and bottom ten borrower locations, by loan amounts. For borrowers with multiple locations, we averaged the scores for each facility location into a composite. A score of 100 is the "average" US benchmark.

We found that the ten borrowers with the lowest DCOH equivalent amount had an average score of 143 with a median of 129, while the highest had an average score of 112 with a median of 113. For the low group, only one borrower was below the 100 benchmark, with another approximately equal to 100. For the high group, four were below the 100 benchmark. We believe these results are sufficient to support the theory.

PPP Forgiveness

We checked the ten borrowers with the highest PPP amounts in terms of DCOH for official SBA loan forgiveness. Of the ten, eight borrowers publicly announced final SBA forgiveness, two had last stated that they were waiting on final forgiveness, and we could not find definitive information on the status of the final one. Anecdotally, ZCS is not aware of any NFP CCRC borrower that did not receive effectively full forgiveness of their loan, assuming that they have received final notification from the SBA. We expect that the SBA will grant final forgiveness for most borrowers by the time 12/31/21 interim financials are posted in February. There is the possibility that some audits for high value loans and late applicants will be ongoing at that time.

While the majority of borrowers applied for a first round PPP, a second round was also available which required a 25% revenue reduction in 2020 vs 2019. ZCS is only aware of one NFP CCRC borrower that met the specific criteria to receive a second round. Anecdotally, multiple distressed borrowers reported that they could not apply for round two specifically because they did not meet the 25% reduction.

COVID Impact on Year-over-year Financial Results

The chart below shows the differences in median results between FYE 2019 and 2020, for the 53 borrowers that were included in both years' reports and have a 12/31 FYE. While focusing on borrowers with FYE 12/31 cut our sample by about half, we believe that this was the appropriate decision. These borrowers still had about 2-3 normal, non-COVID impacted months reflected in the financial statements. Including borrowers with earlier FYEs, especially 6/30 and earlier, would skew the impact results to look materially more favorable.

Same Borrower Comparison, 12/31 FYE only (53 borrowers)		
Ratio	2020 vs. 2019	Favorable/ Unfavorable
Net Operating Margin (NOM)	-4.2%	
Net Operating Margin – Adjusted (NOM-A)	-12.5%	
Operating Ratio (OR)	-1.5%	
Operating Margin (OM)	0.2%	
Total Excess Margin (TEM)	0.9%	
Change in Unrestricted Net Assets Margin (CUNAM)	-1.1%	
Days in Accounts Receivable (DAR)	-1 day	
Days Cash on Hand (DCOH)	12 days	
Days Cash on Hand (DCOH) *Excluding PPP*	0 days	
Cushion Ratio (CUSH)	0.43 times	
Debt Service Coverage – Revenue Basis (DSC-R)	0.01 times	
Debt Service Coverage – Revenue Basis (DSC-R) *Excluding PPP*	-0.18 times	
Debt Service Coverage (DSC)	-.50 times	
Debt Service Coverage (DSC) *Excluding PPP*	-0.63 times	
Maximum Annual Debt Service (MADS) as a Percentage of Total Operating Revenues and Net Non-operating Gains and (Losses) (DS-TR)	0.3%	
Unrestricted Cash and Investments to Long-Term Debt (CTD)	7.2%	
Reserve Ratio (RR)	3.9%	
Long-Term Debt as a Percentage of Total Capital (LTDC)	-2.8%	
Long-Term Debt as a Percentage of Total Capital – Adjusted (LTDC-A)	0.8%	
Long-Term Debt as a Percentage of Total Assets (LTD-TA)	-1.9%	
Average Age of Plant (AAP)	0.34 years	
Capital Expenditures as a Percentage of Depreciation Expense (CED)	-15.0%	

If the reader needs detailed definitions of each ratio, please refer to our main median report.

From top to bottom:

NOM and NOM-A were significantly negatively impacted. As a reminder, these two ratios did not include government aid of any kind. The corresponding increase in expenses, however, was included. The three COVID quarters were enough to decrease NOM by 4.2%. We can annualize that as an impact of about 5.25%, though as expenses and revenues were not affected proportionately we cannot use this for any rigorous analysis. We do not believe there is any valuable information gained by annualizing NOM-A, due to the highly variable nature of net entrance fees. We can see that over the three quarters, negative net entrance fees accounted for an additional 8.3% decline in NOM-A. We expect continued depressed results for these ratios for FY 2021. Occupancy improvement did not begin until the early part of calendar 2021, and occupancy has not returned to historical levels for most borrowers.

The other three operating focused ratios (OR, OM, TEM) include all Provider Relief Funds amortized, as well as PPP amortized. For this subgroup, 13 borrowers amortized their PPP. We can see that government aid actually improved the median results for these ratios, even with not all borrowers amortizing. We have no convenient way to remove the impact of PPP for those 13 borrowers to obtain a more pure comparison. Though a PRF will give these ratios less of a boost for FYE 2021, we expect a similar elevated result in these ratios due to many borrowers amortizing their PPP next year.

While CUNAM is slightly lower than last year, it is difficult to make any judgement on the cause due to the "kitchen sink" nature of the ratio. The variability in investment results alone, depending on mix of investment type, liquidity position, etc is enough to impede analysis.

DAR remained materially the same, suggesting that borrowers did not encounter any billing or collection issues due to COVID.

Liquidity ratios showed an interesting result. DCOH and CUSH, both including any PPP amounts received (33 borrowers received in this subgroup), improved somewhat. However, when PPP was adjusted out of DCOH, the difference in the year-over-year median was 0. Coupled with the positive operating differences, this suggests to ZCS that PRF funding alone was generally sufficient to cover the negative financial impact of COVID during the period.

Coverage ratios echo the results seen in the operating ratios above. Revenue-only coverage was neutral due to government aid inclusion. Backing out just PPP shows a material decline. Because DSC-R was neutral, we can see that the 0.5 times coverage decline is purely caused by negative net entrance fees. While we do not expect the existence of negative net entrance fees to surprise any investor who has been paying attention this past year, we believe the extent of the impact is interesting. Many CCRCs took advantage of favorable investment results to realize gains during FY 2020, which would have a somewhat mitigating impact on coverage ratios.

CTD and RR unsurprisingly show a similar trend to the operating liquidity ratios. Borrowers in this subgroup would not have issued any new long-term debt this year, and we removed PPP from long-term debt amounts reported by the borrower. Given the increase in liquidity (numerator) and, if anything, a slight decrease in bond debt outstanding due to regularly scheduled principal payments (denominator), we would expect to see improvement. The disparity between the increases in RR and CTD is most likely caused by some borrowers in the sample (7) not reporting their DSRF amount, so an RR is not computed.

We do not believe the capital structure ratios (LTDC, LTDC-A, LTD-TA) reveal any interesting nuance.

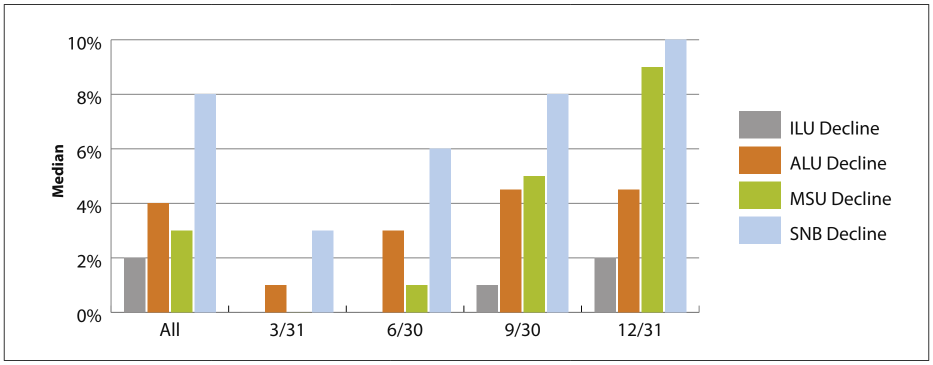
Unfavorable AAP and CED results show a lack in reinvestment in PP&E over the year, which will surprise no one. Reasonably, many borrowers decided to forgo routine capital expenditure. Some borrowers took the opportunity to undertake projects that would be easier during COVID, such as refurbishing common spaces. This would have impacted these two ratios favorably for those borrowers, though overall spending may still have declined from a normal year. The unfavorable results shown here would aid in the liquidity preservation/improvement discussed above.

Income Statement reporting of both PPP amortization and CARES Act funding varied greatly among the sample group. The most common treatment of both was inclusion as an "other operating" line item — though recognition was often commingled with other items. If not included in an "other operating" item, there was little consistency of recognition and clarity — ranging from inclusion as a component of resident revenue all the way down to a below the line gain on debt forgiveness. In these cases, it was often necessary to refer to audit notes to determine an exact amount. Anecdotally, CARES Act funding was more likely to be higher up in the income statement as an operating item, and PPP forgiveness lower down as a non-operating item. Generally, auditors included both CARES Act funding and PPP forgiveness in calculations of debt covenant ratios, the auditor included a calculation. We believe this treatment is appropriate.

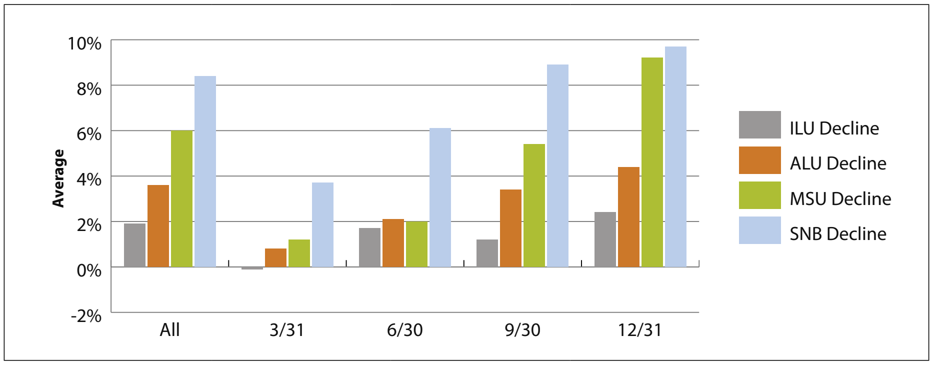
Occupancy

On the next page, we see a clear trend of worsening occupancy decline over calendar year 2020, especially in skilled nursing components and memory support. While there were few 3/31 and earlier borrowers, we included them to show the relative stability in occupancy between early 2019 and early 2020. We are cautious to rely on the SN decline shown for these early FYE borrowers due to the small sample. However, it would fit our expectations of early COVID impact.

FYE 2019 to 2020 Occupancy Declines (in Absolute Percentage)



	ILU Decline	ALU Decline	MSU Decline	SNB Decline
All	**2.0%**	**4.0%**	**3.0%**	**8.0%**
3/31	**0.0%**	**1.0%**	**0.0%**	**3.0%**
6/30	**0.0%**	**3.0%**	**1.0%**	**6.0%**
9/30	**1.0%**	**4.5%**	**5.0%**	**8.0%**
12/31	**2.0%**	**4.5%**	**9.0%**	**10.0%**



	ILU Decline	ALU Decline	MSU Decline	SNB Decline
All	**1.9%**	**3.6%**	**6.0%**	**8.4%**
3/31	**-0.1%**	**0.8%**	**1.2%**	**3.7%**
6/30	**1.7%**	**2.1%**	**2.0%**	**6.1%**
9/30	**1.2%**	**3.4%**	**5.4%**	**8.9%**
12/31	**2.4%**	**4.4%**	**9.2%**	**9.7%**

Skilled nursing is faster to adjust for many reasons. From a unit supply standpoint, many borrowers restricted entry to their SN facilities, especially early on. Mandatory quarantines, required COVID testing, COVID only wings, and operating fewer beds are all examples of borrower reactions that would reduce occupancy percentages. On the demand side, fewer elective surgeries and reluctance to stay in a facility due to fears of catching COVID would reduce occupancy percentages. Family members were also reticent, as visitation was heavily restricted. Due to the more transitory nature of SN stays, we would expect this component to be the first to show a decline compared to IL/AL/MS. While we do not have sufficient data to quantify the relationship, it is safe to assume that borrowers with a larger SN component proportional to their unit mix generally had a more severe financial impact. Other characteristics would factor in as well, such as margins on nursing services, state reimbursement levels, ability to right size expenses to utilization and contractual lifecare benefits provided to residents.

We will discuss ALU and MSU results together as they are closely related. A limitation of the data set is that many borrowers report ALU and MSU occupancy combined. Therefore, an unknown amount of the ALU decline should actually be attributed to MSU decline. As MSUs showed generally worse results than ALUs, we would expect the true ALU decline to be slightly better, though still material. Given this adjustment, we can see that the true ALU decline may have been closer to what was experienced in ILUs.

Both ALU and MSU demand were hampered for similar reasons to SN, though to a lesser extent. An additional factor for these level was that more adult family members were temporarily unemployed or working from home. Many of those cases chose to care for their elderly relatives at home instead of moving them into a facility. The status of work from home for the general economy is still uncertain, but that may be a long term damper on occupancy for AL/MS. MSUs had one additional complication that we believe was the main driver of the difference between the ALU and MSU decline. It was very difficult for caretakers to ensure dementia patients were following COVID guidelines. As a result, there were a disproportionately large number of outbreaks in MSUs across the country. This had the dual occupancy impact of materially increased fatalities and families of residents rightly keeping elderly relatives out of facilities until vaccines were available. Different borrowers and state regulators have different acuity levels of AL and MS. We would expect that higher acuity AL/MS would experience lower occupancy similar to SN, and that lower acuity AL/MS would be less impacted, similar to IL.

IL showed the least occupancy decline of the four levels of care, but it is financially significant due to the entrance fee model used by all the borrowers in this sample. Even a slight decrease in IL occupancy can have a material impact on entrance fee collection. Lower collections are not enough to explain the significant DSC decline observed year-over-year. Entrance fee refunds also increased by a material amount. In addition to refunds due to residents leaving their ILUs, refunds are often paid to residents who have transitioned through the continuum when they leave the other levels of care. We see above that those other levels of care showed much higher occupancy declines. The extent to which refunds impacted net entrance fees would depend on the residency contracts for each borrower, most importantly the contract type (A, B or C), state regulations on refund timing (ie, within number of days vs upon unit reoccupancy), and dollar amount of the entrance fees.

Mitigating lower move ins, many borrowers reported that current residents were hesitant to move through the continuum of care, effectively shoring up occupancy in IL while reducing occupancy in the other levels. While we believe most of those people will eventually move through, that will have the impact of reducing IL occupancy while straining capacity in the other levels of care, which tend to be significantly smaller and more labor intensive.

Note that the percentages given are in terms of absolute, not relative, decline. A positive number indicates decline and a negative number indicates improvement. For example, a borrower whose IL occupancy declined from 95% to 90% would show as 5.0. We included both the median and average so the reader can determine if the medians were skewed, but will rely on the median for analysis. In most cases, median and average are similar.

The number of data points for each category are listed below. Some borrowers do not report occupancy in a useable way, or had data points deleted from the sample as discussed next.

- **All:** ILU 98; ALU 96; MSU 39; SNB 91
- **3/31 and earlier:** ILU 7; ALU 6; MSU 5; SNB 7
- **4/30 – 6/30:** ILU 19; ALU 19; MSU 8; SNB 18
- **7/31 – 9/30:** ILU 18; ALU 18; MSU 8; SNB 18
- **10/31 – 12/31:** ILU 53; ALU 52; MSU 18; SNB 47

We routinely collect this data for our own individual credit monitoring, not with the intention to analyze as a whole. Therefore, our data collection methodology is not as stringent as it would have been if we started the collection process knowing we would use the data in this way. Some notes on the data collected to generate this report:

- Most borrowers report occupancy as of the FYE date, and if available, that is what we record. In some cases, we used average for the shortest timeframe reported that included the FYE date. We do not know how many data points were reported under which method.
- We rounded to the nearest percentage point for occupancy. Some nuance is lost in the aggregate analysis.
- While these borrowers were included because they did not have any material ongoing expansion projects in either year, some may have had a small number of units in fill up mode during the studied timeframe. If we determined that was the case, we removed the data point for that level of care.

- We reviewed the data for outliers and operational situations that may have impacted occupancy in specific levels of care that were non-COVID related. We removed any data points that would have been materially impacted for non-COVID reasons. For example, a pre-planned unit mix adjustment would change occupancy percentages, so we removed the impacted levels of care from the data. Five borrowers had their data adjusted in this way.
- If a borrower took units offline specifically due to COVID, we based occupancy on the full unit count.

Conclusions and Challenges for FY 21/22

Borrowers received comparatively small amounts of Provider Relief funding in 2021. We do not expect any more material funding after PRF 4. Most PRF dollars were received before 12/31/21. As borrowers generally received PRF 4 in December 2021, amortization of those funds may be split between calendar year 2021 and 2022. Some individual borrowers have grant applications outstanding with organizations like USDA and FEMA, but we do not believe these programs will materially impact the industry as a whole.

Many borrowers will still be amortizing PPP in FY 21 and a handful into FY 22. ZCS will continue to include sensitivity analysis in reporting of those ratios as long as there is a material impact.

We believe that the cohort of borrowers that will show the greatest degree of financial/accounting impact from COVID in FY 21 are those with FYE 3/31 – 6/30 due to timing. There will be no pre-COVID results mitigating losses. Occupancy recovery only started after vaccines became widely available in January of 2021, so these borrowers will only show the early months of recovery.

Government entities permitted borrowers to defer some payroll related expenses. Presumably, these still flowed through the income statement as expenses and through operating ratios, net available for debt service, and the DCOH denominator. Amounts deferred will have to be repaid with cash in future periods. In addition, deferred capital expenditures supporting ongoing operations may need a catch-up period of additional spending as well to ensure continued capital adequacy. We do not have the data to analyze the potential impact on any of these items, though we believe they will cause a decrease in liquidity if not mitigated by other factors.

Strong investment gains aided many borrowers in 2020 and 2021. While we will not speculate as to when that will end, we can confidently state that strong investment gains will not persist indefinitely.

During 2021, many borrowers were able to partially mitigate lost occupancy related revenue by controlling expenses — reduced staffing levels (even if just less overtime). Scarcity of personal protective equipment (PPE, not to be confused with PP&E) was a concern early on, and continues to be an ongoing expense. We do not believe increased PPE related expenses had a material impact on financial ratios. Many borrowers also realized expense savings on ancillary services that were not permitted/safe while COVID was rampant, such as full service dining and group activities. Anecdotally, many borrowers received funding for required COVID testing of staff and residents.

Going forward, with occupancy starting to revert back towards normal levels and restrictions generally easing, these expense reductions will no longer be possible. In fact, we expect expenses in general, and especially wage rates, to increase significantly going forward. While many borrowers have instituted rate hikes, we believe that, as a group, borrowers do not have the pricing power required to increase rates to cover the entire cost of increased staffing in the near term. Pricing power will depend on the individual borrower, the demographic they serve, and the economics of their PMA. We also believe that borrowers will see continued and increasing wage pressure, especially on entry-level/non-specialized labor. Borrowers compete for labor in these positions with non-senior living entities, many of which will have more flexibility to increase wages to attract workers away from the industry.

We conclude our report with our opinion on a matter of paramount importance to bond investors — payment defaults. Based on global metrics and individual credit analysis, we do not believe there will be a material increase in payment defaults over the next year. We believe that the increase in CCRC defaults seen in 2020 and 2021 can be attributed to borrowers with pre-existing weaknesses that made them particularly vulnerable. We believe an increase in technical defaults, such as coverage or occupancy covenant violations, is likely as borrowers adjust to a potentially more challenging operational environment ahead, without the crutch of government aid funding. Nursing heavy CCRCs will be particularly vulnerable. We note that the retirement sector as a whole has reported a material increase in defaults. On inspection, a relatively low proportion are not for profit CCRCs, with the majority represented by borrowers that issued debt under 142(d) restrictions. Further information on CCRC defaults will be provided in our updated CCRC default study, which we expect to publish in March.

ZIEGLER CREDIT SURVEILLANCE AND ANALYTICS

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Mike Vitiello joined the surveillance team at Ziegler in April of 2013. He is primarily responsible for monitoring a portfolio of Ziegler and non-Ziegler underwritten senior living, healthcare and education credits. Mike is responsible for authoring borrower-specific credit research reports, commenting on each borrower's financial condition and highlighting any significant changes for the benefit of investors and Ziegler's internal business groups. His responsibilities also include the ZCS annual CCRC Financial Ratio Median Analysis and the Default Study, as well as maintaining certain aspects of the Continuing Disclosure Call Program. Mike received a B.S.B.A. from Boston University in 2009, an M.B.A. from Pace University in 2018, holds Series 7 and 52 licenses from FINRA, is a CFA charter candidate, and belongs to several healthcare and municipal bond-related organizations.

ANALYSTS CERTIFICATION

I, Mike Vitiello, hereby certify that the views expressed in this research report accurately refl ect my personal views about the subject securities, issuers and borrowers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specifi c recommendation or view expressed in this research report. The opinions expressed here refl ect my judgment and are subject to change. This is not a complete analysis of every material fact regarding any company, industry or security. Information has been obtained from sources considered reliable, but Ziegler cannot guarantee the accuracy. Additional information is available upon request. Other departments of Ziegler may have information, which is not available to Ziegler Credit Surveillance and Analytics, about companies mentioned in the report. Ziegler may execute transactions in the securities mentioned in the report, which may not be consistent with the report conclusions. Past performance should not be taken as an indication or guarantee of future performance. Ziegler may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this report. This document may not be reprinted without permission.

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