BB&T Capital Markets

A Case Study
Successful Execution of Strategic Plan: Being Adaptive is Key

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SUMMARY

As life plan communities continue to explore strategies to remain relevant, Aldersgate United Methodist Retirement Community, Inc. (Aldersgate) ***illustrates how proper organizational alignment, effective corporate governance and excellent executive leadership can create a successful outcome***. Aldersgate has transitioned from a challenged 453-unit community with declining occupancy and cash flow to a community with vastly improved operating and financial metrics. During this transition, Aldersgate is also building a new and larger health care center, expanding common areas and creating a newer and more diverse product. **The following story highlights how Aldersgate met its challenges by creating and executing a plan, while being adaptive along the way**.

ALDERSGATE

Founded in 1945, Aldersgate is a not-for-profit, mixed-model life plan community on a 231-acre site northeast of downtown Charlotte. In 2011, the community consisted of 256 independent living apartments and cottages, 47 assisted living units, 45 memory support units and a 105-bed health care center.

A CHALLENGING SITUATION

In 2011, after the abrupt departure of the CEO, the organization faced operational and financial challenges with low employee morale. Additionally, the campus was saddled with a 40-year-old health care center and aging amenities in a nonaffluent and challenging location. Although occupancy in assisted living and memory support units was at 98 percent, the independent living and health care units were struggling at 88 percent and 86 percent, respectively.

A key factor in Aldersgate's journey was having board members who were willing to step aside and be open to change. Suzanne Pugh, then COO under the previous CEO, was promoted to CEO. At that point, Pugh and her board began to embark on a very intentional strategic planning process that eventually led to a major repositioning of the campus, including:

- Obtaining CARF (Commission on Accreditation of Rehabilitation Facilities) accreditation, which benefited the organization as much by creating best practices and sophisticated systems (see related BB&TCM white paper) as the actual accreditation itself
- Revising the mission, vision and core values to guide all strategy
- Creating a more diverse and inclusive culture

THE TEAM: COLLABORATIVE PARTNERSHIPS FOCUSING ON SOLUTIONS

Essential to the process, a Strategy Task Force consisting of board members, consultants, residents and key staff was assembled to implement a comprehensive plan with multiple objectives. BB&T Capital Markets, led by John Franklin, and Brian Schiff and Associates, were hired to provide financial expertise and development leadership. The combined know-how of both internal and external resources set the stage for a successful outcome. Pugh and the board realized outside expertise aid the speed of execution without delays prompted by inexperience and overloading work for internal staff, who were already handling organizational and occupancy demands.

> *"Aldersgate's partnerships have been a key component in our strategic planning efforts that began nearly seven years ago. Through this multiyear strategy, Aldersgate has created a stronger capital structure that maximizes strategic flexibility while minimizing risk. We view the repositioning as integral to our ability to carry out our vision of creating the best day possible for all elders that we serve."*
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> – William Springs, former Chairman & Finance Committee Chairman

THE STRATEGIC PLAN

In 2011, in conjunction with strategic plan development, the Strategy Task Force created the following objectives, with buy-in from the board and residents:

- Determine tactics to attain and maintain campus at optimal occupancy
- Overhaul board governance from an operational and financial focus to a strategic/generative focus, reshaping most aspects of how the board was structured and functioned
- Re-examine operating expense structure, contracts and revenue sources
- Research opportunities to expand the delivery of home care services
- Complete evaluation of person-centered care, enabling the resident to direct his or her care
- Evaluate capital structure for current success and future flexibility
- Develop master site plan
- Establish plan for increasing philanthropy
- Expand and deepen relationships with the larger community to redevelop surrounding area

As a result of focusing on these areas, the following initiatives were realized between 2011 and 2013:

- Positive outcomes with the development of a licensed home care program
- Adoption of the person-centered care model in the health care areas
- Recognition of the evolution of reimbursement models, committing time, energy and resources to serving higher acuity patients and a robust short-term post-acute rehab practice
- Implementation of marketing tactics including (i) new sales and move-in tools to ensure expedition of occupancy; (ii) new pricing and refund structures; and (iii) a new Residency Agreement
- Development of a strong Outreach Committee to foster and deepen presence and relationship with community groups
- Development of an extensive master site plan of the campus and the larger community
- Decision to refinance existing debt structure to provide increased flexibility for possible funding of future strategic initiatives

THE FIRST FINANCING: LONG-TERM FOCUS, NEAR-TERM GAINS

Because plans included an expansion of independent living along with renovations/replacement of the health care community, a significant amount of debt would be incurred. To create strategic flexibility, Aldersgate's existing bank debt needed restructuring. However, financial improvements needed to occur first. Over the course of the next two years, management increased occupancy above 90 percent for independent living and health care and successfully lowered expenses, which required making some difficult but necessary decisions. These actions resulted in a 1.56x debt service coverage ratio in fiscal year 2012, compared to a 1.21x debt service coverage ratio for fiscal year 2011. Despite a challenging interest-rate environment in mid-2013, the existing bank debt was refinanced in October 2013 with nonrated, fixed rate bonds, creating a more stable and flexible capital structure.

NEXT STEPS AND FINANCINGS

Because of the complexity of the strategic plan, Aldersgate needed a way to spread the responsibility and create accountability. As a result, the Strategy Task Force focused on the initial review and approval of a Master Facilities Plan, which led to the official creation of the Gateway Project Development Task Force to implement the repositioning project. While dedicating resources resources to internal projects, the board also committed to being a strong partner in the East Charlotte community and created the Community Development Task Force that had a dual role of developing the long-term master site plan and improving the health of the surrounding community.

The Gateway Project Development Task Force created a repositioning plan to be completed in four phases:

- Phase 1 – Memory support expansion and renovation (approximately $5.5 million in debt).
- Phase 2 – Skilled nursing facility replacement and expansion (approximately $49 million in debt), which also included shelled-in space for potential partnerships in Hospice and dialysis care.
- Phase 3 – Three independent living buildings consisting of 62 units (approximately $35 million in debt), which would help create a new entrance as a front door to the community.

> *"'We began pursuing a refinancing at a time of significant transition in governance and leadership at our organization. The timing was also proved to be a challenging market environment in the larger economy. Our board and leadership believed in the process but asked tough questions, positioning Aldersgate for implementation of future key strategic initiatives."*
>
> – Suzanne Hodge Pugh, President and CEO

ANOTHER CASE STUDY – WCR

In 2001, Westminster Canterbury of Richmond, Va., (WCR) had a critical decision: whether to move its campus or reinvest in its existing campus. WCR decided to borrow more than $120 million to reposition its existing campus. As a result, WCR's bonds were downgraded from A- to non investment grade (BB+) because of the execution risk associated with the plan. Even though S&P downgraded the credit by five notches, which was unprecedented, S&P remarked WCR was pursuing a sound strategy. Today, WCR has a BBB+ rating and remains a leader in its market. The takeaway from the WCR story is that even strong organizations cannot remain complacent and should remain proactive and look for opportunities.

- Phase 4 – New commons area (approximately $16 million in debt), which would help occupancy for both existing and new independent living units and create a more unified core for the campus.

It was very important to the board that the first two phases be viable financially without the need to add additional independent living units to help cover the associated debt. To manage risk and hold the development team accountable, the Gateway Project Development Task Force created a financial metric dashboard that made it easy to monitor whether the project should continue. In the end, Phases 1 and 2 actually enhanced the existing operations of Aldersgate from both a market and financially accretive perspective. The new health care center ensured a sustainable market position as a preferred provider of post-acute rehab and long-term care services with the local health systems. It also made the community more appealing for potential independent living residents. The establishment of partnerships for leases in the health center with a for-profit dialysis provider and a nonprofit Hospice partner also allowed the health center to provide necessary services to the larger community.

A key takeaway was Aldersgate's ability to improve underlying operations while proceeding with the repositioning. The continued improvement in occupancy and financial metrics created debt service coverage of 1.5x in 2014 and more than 2.0x for 2015.

Aldersgate dual-tracked bank financing and bond financing for the first two phases. Dual-tracking enabled Aldersgate to adhere to the project schedule and ensure timely construction. After analyses of bank feedback, Aldersgate and BB&T Capital Markets decided to move forward with a tax-exempt, fixed rate bond financing. The $49 million fixed bond financing, which was completed in November 2015, was well received in the market due to a sound strategy and excellent operating trends.

THE FINAL COMPONENT AND FINANCING: A COMMITTED TEAM FOCUSED ON CLIENTS FIRST

After issuance of the Series 2015 bonds, the same client-driven financing team worked in 2016 to develop a plan to finance the last phase of the strategic plan that began in 2011. This phase included renovation of the existing community center and 62 new independent living units.

It became very apparent to the task force the new commons area needed to be financed and started before the new independent living units were financed. First, it would improve occupancy of existing inventory and, second, it would accelerate pre-sales of the new units. The willingness of the board to adjust the order of the master facilities plan and capital formation strategy was a key to a successful final outcome.

A taxable bank loan was obtained in mid-2016 to finance the renovation and expansion of the community center and assist with marketing the new independent living units. The taxable bank loan also lowered costs during construction due to its "drawdown" feature. When the new independent living units were ultimately financed, fixed rate, tax-exempt bonds were issued to refinance the existing taxable bank loan, and $35 million in new tax-exempt and taxable bank financing was used to finance the independent

"'As we continue to implement this phase of our strategic journey, we are thrilled with this most recent transaction. We have always felt our business partners truly have the best interest of the mission and vision of Aldersgate in the forefront of their minds as they counsel and shepherd our organization. Having demonstrated an ability to intentionally assess and manage risk and move our organization forward, our board is now better prepared to take advantage of future opportunities."

– Suzanne Hodge Pugh, President and CEO

living units. This financing structure allows the community to avoid significant negative arbitrage. Both transactions closed in May 2017 ***with the $20 million bond transaction incorporating the lowest 30-yea, fixed interest rate to that date in 2017 for a non rated life plan community, highlighting the confidence the investor community has in the plan and its execution***.

IN SUMMARY AND LESSONS LEARNED

Over a five-year period, Aldersgate executed on more than $104 million in debt to complete a repositioning strategy that began in 2011. With a redeveloped campus and excellent financial metrics, Aldersgate has positioned itself to thrive in a competitive and fast-changing market.

Lessons learned during the process include:

- Create a board culture that focuses on growth and opportunities instead of risks
- Educate the board continuously; education should be included in most board meetings
- Use task forces to get work done
- Develop metric dashboards to create accountability while allowing task force autonomy
- Use outside consultants; they bring expertise, insights and fresh perspectives
- Use CARF accreditation to create best practices and sophisticated systems
- Recognize organizations can improve operations and pursue major projects at the same time
- Hire and keep good staff; this may mean existing staff members no longer have the skill set required
- Do not underestimate what is possible
- Be adaptive; things do change even with the best strategic plans

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