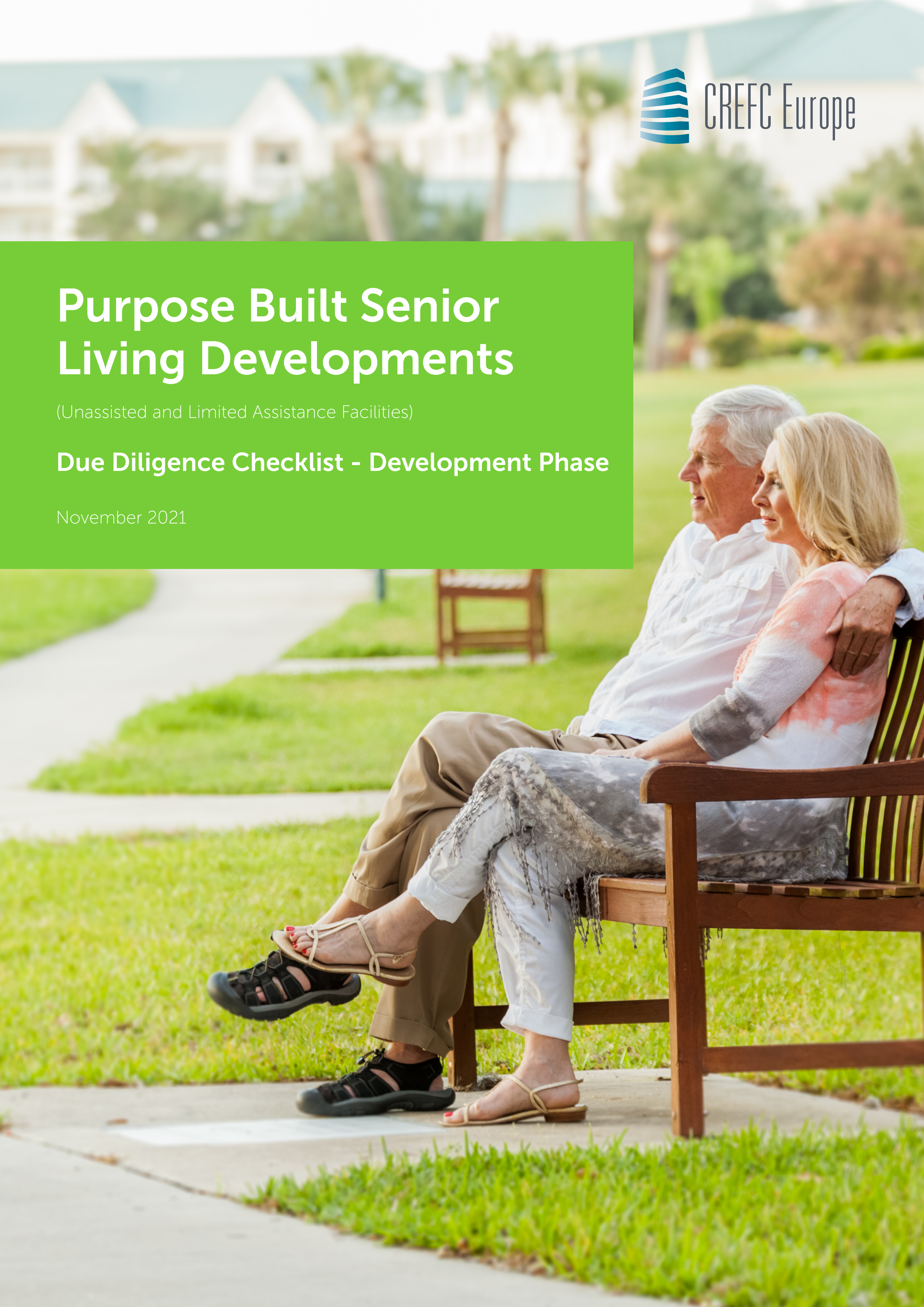
CREFC Europe

Purpose Built Senior Living Developments

(Unassisted and Limited Assistance Facilities)

Due Diligence Checklist - Development Phase

November 2021



Scope and Disclaimer

This Due Diligence Checklist is intended to function as a broad roadmap for market participants considering the advancement of debt for the development of senior living facilities. It is aimed at those with limited prior experience of the sector and seeks to provide a broad outline of relevant due diligence / issues to consider during the early phases of evaluation of a potential transaction.

While deal activity in the senior living sector remains below projected levels, based on demographic trends and the significant interest expressed by various stakeholders in industry forums, demand for such facilities is expected to increase. This Checklist aims therefore to identify some commonly considered issues relating to the fundamentals of such facilities, for parties to bear in mind when structuring, or evaluating, a new transaction structure for which leverage will be sought (either at the onset or subsequently), or when considering the viability of refinancing an existing deal.

This Checklist is not however intended to be a primer for the level of diligence that would be required to support underwriting for the development of retirement living accommodation. A number of key considerations applicable to this sector are beyond the scope of this Checklist, for instance, retirement living facilities which offer personal care support, however limited, will require CQC registration (and its equivalent in any of Scotland, Wales and Northern Ireland, as relevant). This is a complex area of governmental oversight and regulation.

The content of this Checklist should also not be extrapolated for use as a basis for due diligence on operational facilities as a class. Facility-specific considerations will always apply.

For broader due diligence considerations, however, not specific to an asset class and which are therefore applicable more generally to investment and development financings secured on real estate assets in England and Wales, users should refer to *CREFC Europe's Due Diligence Guide for UK Investment and Development Finance* (most recently updated in 2019: click here).

Acknowledgements

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Dechert LLP

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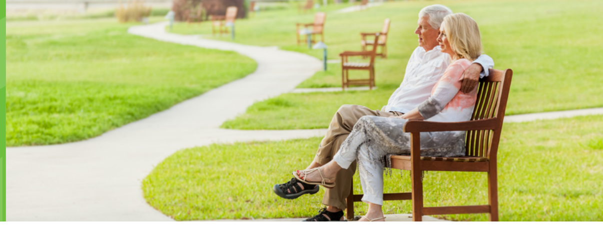


Key challenges of Senior Living schemes compared with other residential developments

Lack of profitability metrics

There are no visible profitability metrics available for operational Schemes. This is a function of the way in which returns are structured for such developments. This is in contrast with assessable metrics, such as Open Market Value (or 'OMV'), available for other classes of residential developments.

Relatively nascent sector

There remains limited empirical data corroborating statistical modelling on timing of Event Fees (also known as 'Exit Fees'; 'Contingency Fees'; 'Transfer Fees'; 'Deferred Management Fees' (or 'DMF'); or 'Selling Service Fees') with actual receipts.

Different project lifecycle

Development models, which currently contemplate high levels of sponsor "skin in the game" / future operator involvement, can operate as a brake on multiple developments moving forward on parallel tracks. Some articulated concerns:

- Capacity of management;
- Concentration of outsourced contractors being used;
- Covenant of operator / development partner.

Different phases to development

The "build" process is inverted to that for better understood residential assets. In senior living spaces, for example, common areas (with "no value") are built first, before the units for sale. This is in contrast with typical residential developments.

Age limitations

The sector is perceived to be "less liquid residential" because of age restrictions affecting who can purchase and occupy.

Terms

Pricing - a key challenge remains in linking de-risking construction with lower costs of financing. Loan-To-Cost remains conservative, at circa 45%, although higher blended LTC rates should be available for financing provided by debt funds. For discussion purposes, options include:

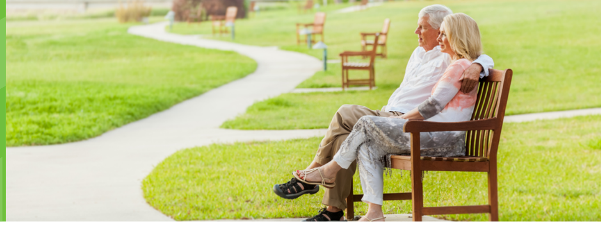
- Tranched / syndicated financing;
- Asset specific vs. pooled development facilities. This requires scale, but could be an option for established sponsors/lender relationships with some sponsor scale;
- "Flip" pricing facilities (development-to-investment pricing upon PC, pending disposals).

Differences in structuring

Structuring complexities (for multi-property retirement villages, in particular). E.g. opco-propco structures versus third party operators/management companies. Scale may lead however to competitive pricing.

Nature of sector – operating businesses with real estate

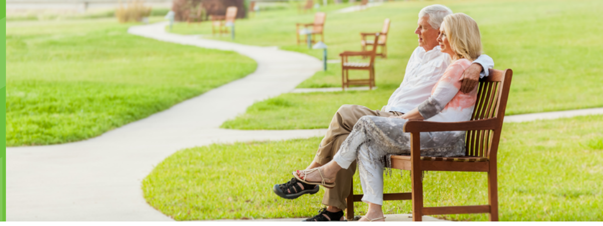
Credit approvals: accessing the right person within the lending institution can be difficult. (Ref. challenges of siloed teams – real estate backed secured lending vs. corporate finance / relationship lending).



KEY CONSIDERATIONS

Funding

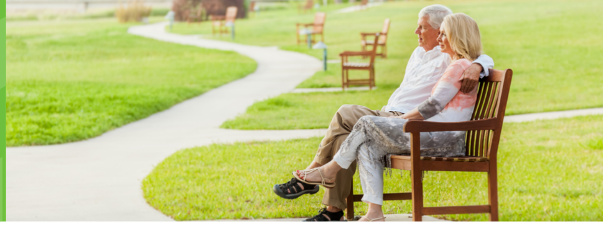
Debt vs. Equity ratio: [per Development]	Cost of capital for lenders	☐
	Impact of zero / limited pre-sales? Viability of cash control structures to mitigate risk	☐
	High entry costs? Viability of establishing a joint venture with an established market participant	☐
	Feasibility of sale and leaseback structures	☐
Joint Ventures ('JV'): [Covenants]	Considerations for facility / security documentation – ensuring bankability	☐
Debt vs. Cost of Development (LTC ratio): [per Development]	Post- Practical Completion projected volume and rates of sales of Units in Valuation	☐
	Proceeds from sale of Units (mid-term / end of term of financing?). Investment costs / development costs	☐
	Receipt of cash flows from Event Fees. Event Fees from year 7 versus debt funding with a 3 to 5 year initial term	☐
	Interplay between projected cash flows from operating activities (e.g. service charges) versus level of Event Fees (i.e. higher cash flows from operating activities / lower Event Fee and vice versa) in Valuation	☐
Tax:	Structure-specific considerations	☐
Repayment: [per Development / Pooled]	Business Plan	☐
	Forward Funding Structure	☐
	During Sales phase *Nb. Diligence leases and operating model to ensure the viability of refinancing will be available if the Disposals Plan is compromised*	☐
	Gross Development Value ('GDV') versus Development Costs calculation for sales of Units and retained common parts	☐
	Exit Value	☐
	Sales of Units	☐
	If value placed on Freehold, sale of Freehold	☐



Repayment (cont'd):	Competence / track record of Operator	☐
	Calculation of Event Fees. Correlation with Service Charges / Deferred Service Charges	☐
	Evaluation of risk profile; impact of phasing of Development	☐
Risk appetite of potential lenders:	*[Nb. Consider if institutionally more conservative approach than "normal" development finance for residential sector]*	☐

CONSTRUCTION & DEVELOPMENT

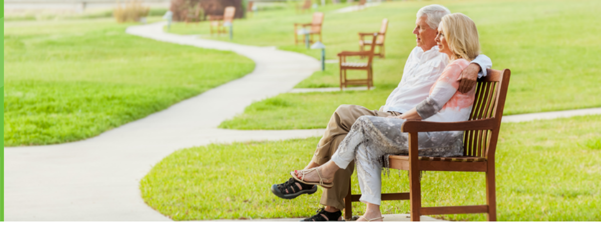
Procurement route: [per Development / Pooled]	Traditional	☐
	Design-and-Build ('D&B')	☐
	Construction Management	☐
Modular Construction:	Front loaded design	☐
	Front loaded cost	☐
	Quality controls	☐
	Title / insurance / timing interface issues	☐
	Track record (insolvency risk)	☐
Developer:	Track record	☐
	Covenant	☐
	Professional team	☐
	Programme *[Nb. Model time lag between first utilisation and repayment of part of loan on sale of first unit]*	☐
	Phasing of Development (e.g. Are common areas built first? Is financing secured against a particular phase of development; if yes, timing to come online)	☐
	Effect of COVID-19 on design of building (variations for future proofing)	☐



Key Contractors:	Track record	☐
	Covenant	☐
	Professional team	☐
Other Construction Costs:	Party wall award[s]	☐
	Building control	☐
	Construction, Design and Management ('CDM') Regulations	☐
	Building warranty for residential new build	☐
	Energy Performance Certificates ('EPC')	☐
Collateral Warranties:	*[Nb. Full suite required for optimal financing options. Build delivery upfront into contractual arrangements]*	☐
Funding Security: Options	Performance Bond	☐
	Parent Company Guarantee ('PCG')	☐
	[Others]	☐

PLANNING CONSIDERATIONS

C3 (residential institutions) or C2 (dwelling house):	C3 traditionally contains affordable housing element (i.e. potentially less viable scheme)	☐
	C2 designation typically preferred. *[Nb. Recent case law (Rectory Homes, 31 July 2020) - C2 should also have affordable housing element.]*	☐
[Should this type of development have its own use class? Watch this space for developments – not addressed in changes to use classes which came into force in September 2020]	Section 106 agreements and CIL (potential costs to be reflected in Valuation)	☐
Planning Costs:	Section 278 [Highways Act 1980]	☐
	Section 38 [Highways Act 1980]	☐

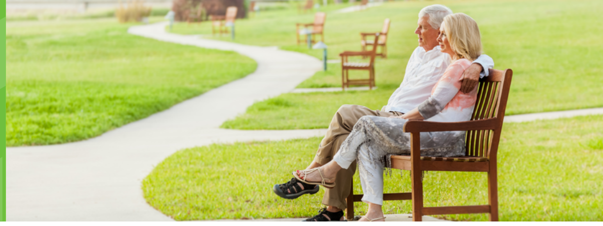


Planning Costs: (cont'd)	Section 184 [Town and Country Planning Act 1990]	
	Section 104 [Water Industry Act 1991]	
	Community Infrastructure Levy ('CIL')	

INSURANCE REQUIREMENTS

Nb. Requirements will differ depending on whether the borrower is also the operator, or if operations are outsourced to a third party.

Buildings and Contents:	[Y] / [N] If Y, Key Terms should cover inflation, professional fees, debris removal	
Business Interruption:	[Y] / [N]	
Terrorism:	[Y] / [N]	
Employer's Liability:	[Y] / [N]	
Public and Products Liability:	[Y] / [N]	
Professional Liability (including medical malpractice):	[Y] / [N]	
Cyber Liability:	[Y] / [N]	
Nb. Where there is development, the following are also key requirements:		
Construction All Risks ('CAR'):	[Y] / [N] If Y, Key Terms should cover full value of development, including debris removal, shoring and propping up, inflation and professional fees	
Delay in Start Up ('DSU'):	[Y] / [N] If Y, Key Terms: [•]	
Public Liability:	[Y] / [N] If Y, Key Terms: [•]	
Non-negligent Liability:	[Y] / [N] If Y, Key Terms: [•]	
Terrorism:	[Y] / [N]	



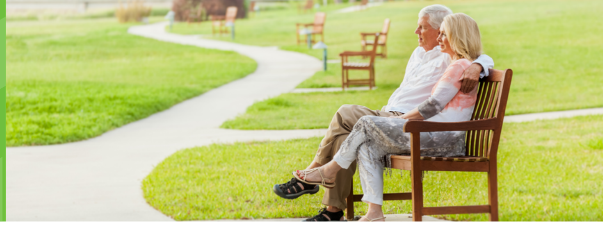
Professional Indemnity:	[Y] / [N] If Y, Key Terms: [•] Professionals: [•] Design Team: [•]	
Latent Defects:	[Y] / [N] If Y, Key Terms: [•]	
Environmental Risk:	[Y] / [N] If Y, Key Terms: [•]	
Nb. • Consider "No Diligence" Title Insurance for portfolios of properties. • Consider employing an insurance broker at the outset to produce a report on the business and title insurances.		

TITLE ISSUES

Development Constraints Audit:	[Y] / [N] If Y, Key Terms: [•]	
Certificate of Title:	[Y] / [N] If Y, Key Terms: [•]	

MACRO-ECONOMIC FACTORS

Real Estate:	Location	
	Demographics. Flexibility to flex e.g. "accessible and adaptable" quotient	
	Staffing	
	House prices (i.e. fluctuation in value of family home to be sold to finance unit purchase).	
Build Value:	[•]	
Proposed Government Reforms:	Ongoing review	



VALUATION

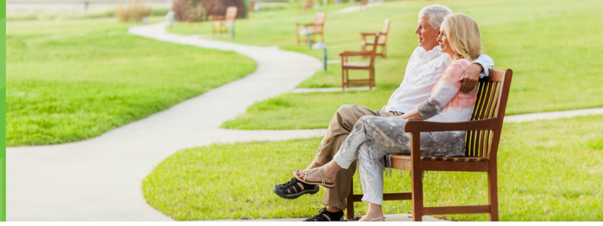
Land:	Compliance with sustainability / environmental laws	☐
	Reflect future Deferred Management Fees ('DMF'), discounted and deferred	☐
Operational asset:	Valued on the basis of compliance with RICS methodology for land	☐
	Trading Valuations to include Event Fees	☐

OPERATIONS

Management:	Reputation and Experience	☐
Capacity of Management:	Platform of Operator	☐
Concentration of outsourced contractors:	Impact on variable overheads	☐
Modular Construction:	Transit risk and insurance	☐
Costs:	Business Plan and ongoing Capex requirements	☐
	Set-off / coverage from Deferred Service Charges for episodic overheads	☐
CQC:	Rating of Operator at other sites	☐

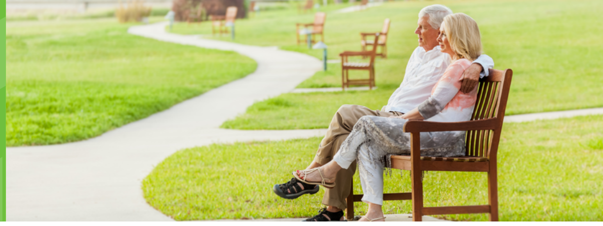
INTELLECTUAL PROPERTY

Branding:	Single site versus Multi-site	☐
Technology:	Any "in-house" apps and "hidden tech" solutions	☐
	Third party technology developer? Terms of contract and ownership of IP rights	☐
	Cost of upgrade of technology over time	☐



DATA PRIVACY

Data Management:	Policy details	☐
	Enhanced security for "special category" data	☐



Appendix I

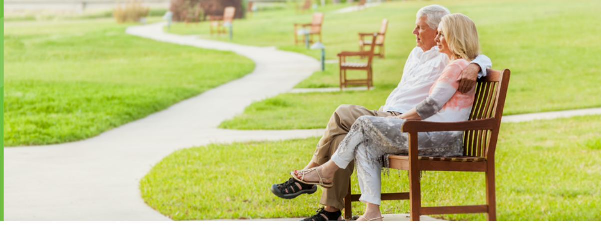
Definitions of Senior Living Provision

Living Options for Older People

ARCO | Setting Standards for Retirement Communities

Retirement Housing Also known as sheltered housing or retirement flats	**Retirement Communities** Also known as extra care, retirement villages, housing-with-care, assisted living or independent living	**Care Homes** Also known as Nursing Homes, Residential Homes, Old People's Home
Self-contained homes for sale, shared-ownership or rent	Self-contained homes for sale, shared-ownership or rent	Communal residential living with residents occupying individual rooms, often with an en suite bathroom
Part-time warden and emergency call systems	24-hour onsite staff with optional care and domestic services available	24-hour care and support (including meals)
Usually have a lounge, laundry facilities, gardens and a guest room	Range of facilities including a restaurant or café usually alongside leisure and wellness facilities such as gyms, hairdressers, activity rooms, residents' lounges and gardens	Range of facilities and activities, including gardens, lounges and dining rooms
Typically 40 - 60 units	Typically 60 - 250 units	Sizes vary considerably

Source: ARCO



Appendix II

Glossary of Key Terms

Term	Definition
Consumer	Anyone with an interest in, or comes into contact with, a retirement community. This includes both "customers" and "residents".
Customer	Prospective occupiers; i.e. prospective purchasers, renters, or other tenants, from the point when they first make an enquiry about any retirement community up to when they sign a reservation or tenancy agreement for a property in a retirement community.
Event Fee / Deferred Management Fee	This applies when a leaseholder has to pay an amount (or forego a financial benefit) on an event such as the sale of a property or lease, subletting, or certain changes in occupancy. The fee is fixed or calculated in accordance with a formula. Event fees may also be referred to as "**exit**", "**transfer**", "**deferred management**", "**contingency**", or "**selling service**" fees.
Ground Rent	A sum payable, usually annually, to the landlord in respect of a leasehold property. The amount may be fixed or change according to a formula.
Resident	Current occupiers, namely any property owner, renter, or other tenant living in a retirement community. A customer who has signed a reservation or tenancy agreement but has not yet moved in is also considered a resident (sometimes termed an "incoming resident").
Service or Management Charge – Fixed	A service charge that changes in accordance with a fixed formula. In some cases this will be a charge that remains fixed for the entire duration of a resident's stay.
Service or Management Charge – Variable	A service charge that changes according to actual costs only.
Sinking Fund	A fund established by setting aside revenue over time to fund a future capital expense. A sinking fund may also be referred to as a "reserve" or "contingency" fund.

Source: ARCO

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