Healthcare Real Estate Financing Market Insights

April 21, 2022

Debt economics by lender type

Healthcare real estate currently benefits from being a bank dependent market

Banks | 92% market share

- Spreads and other terms have remained largely unchanged since 2021, with leverage down slightly due to DSCR constraints
- Larger scale executions and portfolios ($50M+ loan size) receive premium economics
- Local banks offer forward rate locks & competitive fixed-rates on balance sheet
- JLL takeaway: Far and away the dominant lender type, bank appetite for healthcare real estate remains as strong as 2021, with premium terms offered for scale opportunities or repeat borrowers. Additionally, with the rise of hedge costs, local bank fixed rates are now competitive and come with the potential of forward rate locks.

JLL Quotes >$50M Loan

Terms	Current (4/21/22)	3 Mo. Ago	6 Mo. Ago	1 Yr. Ago
LTV	68%	>70%	>70%	65%
Spread	~170bps	~170 bps	~170 bps	~210 bps

Life Companies | 4% market share

- Pricing, which partially tracks corporate bond spreads, has gapped out 15 - 30 bps in 3 months
- While pricing for life company financing has gapped out, quoted long-term fixed rates are still at lower historical levels
- JLL takeaway: a significant player in other asset classes, life companies will play an increasing role in healthcare real estate in the long-term

US Corporate Bond Spread to Treasury

10-yr	Current (4/21/22)	1 Week Δ	1 Mo. Δ	3 Mo. Δ	6 Mo. Δ	1 Yr. Δ
A	114 bp	+1 bps	-5 bps	+22 bps	+40 bps	+34 bps
BBB	166 bp	+1 bps	-2 bps	+33 bps	+55 bps	+50 bps
5-yr	**Current (4/21/22)**	**1 Week Δ**	**1 Mo. Δ**	**3 Mo. Δ**	**6 Mo. Δ**	**1 Yr. Δ**
A	67 bp	-4 bps	-11 bps	+16 bps	+29 bps	+18 bps
BBB	114 bp	-3 bps	-9 bps	+27 bps	+46 bps	+35 bps

CMBS | 4% market share

- Both the 10-year CMBS swap index and CMBS spreads have gapped out in the last 30 days, with all-in rates up over 100 bps
- JLL takeaway: pure CMBS is a small share of the healthcare real estate market and will likely continue to be so for the foreseeable future
- Bonus takeaway: CMBS defeasance costs have reduced significantly thanks to the same mechanisms

CMBS Swaps

	Current (4/21/22)	1 Week Δ	1 Mo. Δ	3 Mo. Δ	6 Mo. Δ	1 Yr. Δ
7yr	2.950%	+10 bps	+56 bps	+121 bps	+142 bps	+172 bps
10yr	2.926%	+5 bps	+53bps	+111 bps	+121 bps	+138 bps

Sources: RCA for lender market share, Bloomberg for corporate spreads & yields

Debt impact on valuations

Underlying index movement driving potential valuation impacts

Illustrative LIRR-neutral impact of rising index rates on price since 4Q2021 base case

Time period & purchase price				Forward index average & returns			Impact on returns	
Time Period	**Date**	**Purchase Price**	**Cap Rate**	**1M SOFR (5yr Avg)**	**LCoC**	**LIRR**	**Value / % Δ**	**Cap Rate Δ**
6 Months Ago	10/18/2021	$40,000,000	5.55%	0.98%	8.98%	8.89%	n/a	n/a
3 Months Ago	1/18/2022	$39,445,682	5.63%	1.44%	8.74%	8.89%	($554,318) / (1.4%)	+8 bps
1 Month Ago	3/21/2022	$38,663,823	5.74%	2.08%	8.12%	8.89%	($1,336,177) / (3.3%)	+19 bps
Today	4/18/2022	$38,203,993	5.81%	2.52%	7.67%	8.89%	($1,796,007) / (4.5%)	+26 bps

Base Case

Takeaways

1. Keeping LIRR constant, from today to 6 months ago, the impact to cap rates based on the change in the SOFR forward curve is ~26 basis points
2. Given the amount of liquidity and demand for medical office, investors may be willing to accept a lower overall return, mitigating some of the potential cap rate movement

Assumptions

1. Deal represents a 100% leased, 2-property portfolio with 12+ years of WALT remaining
2. 5-year hold
3. Exit cap held at 5.75% in all scenarios
4. Debt terms: 65% LTV, 2-year I/O, 30-year amortization, 175 bps, 50 bps origination fee
5. Analysis floats off SOFR forward curve in existence at start date

Sources: Kensington Capital Advisors, Bloomberg

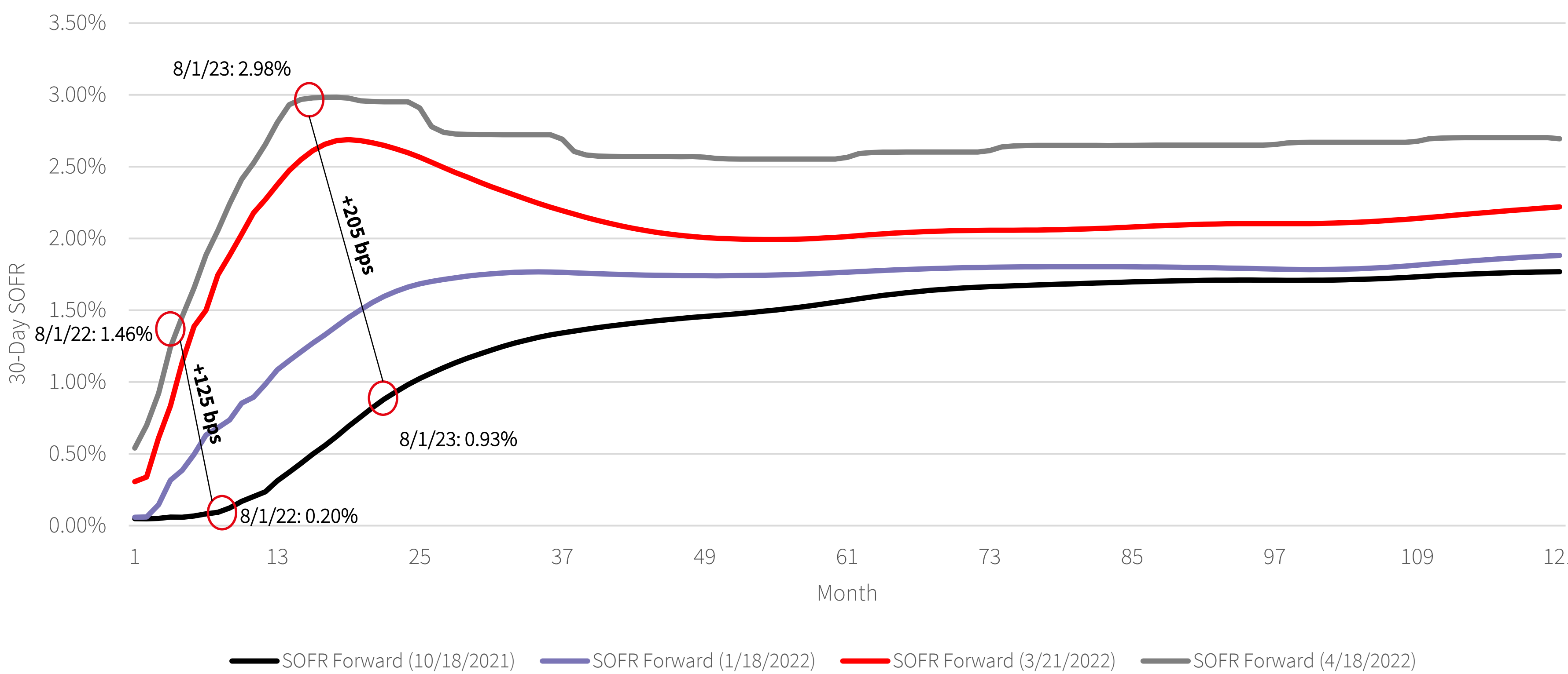
The new reality of index rates and hedge costs

From “transitory” to “persistent”, inflation data has accelerated Feds rate hike guidance

- 12-month forward curve is nearly **5x steeper** than the same period was projected 6 months ago, reflecting the Feds hawkish pivot to combat inflation which was initially considered transitory
- Fed minutes released April 6th reaffirmed hawkish stance on rate hikes, signaling the potential for **two 50 bps hikes by July 2022**
- Based on the current Fed position, the market expects floating rates to increase **70 bps** by July 1st, **187 bps** by January 1st, and **remain above 250 bps**; debt driven valuations won’t improve for the foreseeable future

	Current (4/21/22)	1 Month Δ	3 Months Δ	6 Months Δ	1 Year Δ
Term SOFR – 1 Month	0.6236%	+31.8 bps	+56.2bps	+58.1bps	+60.2 bps
5yr SWAP (SOFR)	2.706%	+58 bps	+130 bps	+162 bps	+204bps
SOFR Cap[1]	322 bps	0.6x	2.7x	4.7x	8.2x

[1] 3yr cap, 2.0% strike, $20M notional



Sources: Kensington Capital Advisors, Chatman Financial Services

Key takeaways for healthcare real estate owners

Lender terms are unimpaired and creative opportunities exist with rising index rates

1 Rates are still historically low

- Float-to-fixed bank financing and life company rates are still in the low-to-mid 4's

2 Spreads are as competitive as 2021; the most accretive terms available are for <u>scale</u>, <u>long WALT</u>, and <u>investment grade tenancy</u>

- Take advantage of low breakage & defeasance costs associated in a rising rate environment to refinance individual loans into a large portfolio level facility
- Converting scale economics to small deals via a subscription or credit facility

3 Exploit the local bank market to rate lock on-balance sheet in the teeth of a steep forward curve

- With swap rates up >100 bps since 2021, balance sheet fixed rates offered by local & regional banks are competitive with money center bank float-to-fixed terms
- With deposit rates unchanged, local & regional banks are taking advantage of the moment, with some offering rate locks for 45 days+
- JLL's national network can connect borrowers with local banks in each market to capitalize on this dynamic

4 Orphaned interest rate caps may have <u>significant</u> economic value

- Interest rate caps orphaned by the payoff of their underlying loan instrument are still legitimate contracts until they expire
- Given the ~3x increase in cap costs since 2021 and >7x increase in 6 months, historic caps have significant economic value to their owners
- These caps can be traded for a profit, or transferred to a new loan (for whole or partial notional amount)
- Kensington Capital Advisors, JLL's preferred expert in interest rate derivatives, can assist in any such transactions

5 Mixed hedge strategies allow borrowers to reap the benefit of a steeper forward curve

- Springing caps allow borrowers to float until the floating rate reaches the springing level which requires a cap purchase – no escrow required
- Springing caps can provide borrower the benefit of a flatter forward curve and improve IRR by avoiding upfront payment, although could result in higher costs in an increasing interest rate environment
- JLL can negotiate partial hedge requirements with lenders to permit creative hedge strategies or can discuss hedge vehicles like swaptions that allow borrowers to hedge against rising rates between term sheet execution and close

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