HAMLIN
CAPITAL MANAGEMENT, LLC

August 2020

Not All Bonds are Created Equal - Senior Living Credit in a COVID-19 World

Contact Information:
Mark Stitzer
640 Fifth Avenue 11th Floor
NY, NY 10019
Tel: 212.752.8777
Fax: 212.752.5698

Introduction

There has been no shortage of press on the prevalence of COVID-19 and associated fatalities at for-profit skilled nursing facilities. This is for good reason: of the ~140,500 fatalities in the United States linked to the virus, ~29% have taken place at nursing homes.[1] There are several reasons why seniors in Skilled Nursing facilities (both in the U.S. and around the globe) have borne the brunt of the COVID-19 crisis, including:

1) higher comorbidity rates of the senior population (they may already be suffering from heart disease, kidney failure, etc.)

2) the manner in which care is provided (the frailest cohorts of Senor Living populations, i.e. skilled nursing, requires extensive physical contact with multiple staff members as part of daily care), and

3) policy missteps at the local level and lack of protective equipment in the early stages of the outbreak when the virus was less understood.

However, not all Senior Living is created equal. Given the large portion of Hamlin's High Yield Municipal Bond Strategy that is invested in the Senior Living sector, we want to highlight the significant structural differences between for-profit Skilled Nursing facilities and the projects in the Hamlin Portfolio which are generally non-profit Independent/Assisted Living ("IL/AL") and Continuing Care Retirement Facilities ("CCRCs").

Senior Living – a 'Catchall'…Only on the Surface

There are broadly two types of Senior Living operators: (1) for-profit operators who are beholden to shareholders; and (2) non-profit operators who focus on reinvesting earnings to better the mission and residents they serve. Each type of operator offers a different level of care which influences the composition of resident populations at the facilities. The following bullet points provide a brief overview of the different types of facilities, the levels of care they offer, and the characteristics of the residents:

- Independent Living:
    - Independent living communities aim to make their residents' day-to-day lives a bit easier while still giving them the freedoms associated with living on their own. The services IL facilities provide are aimed at minimizing seniors' daily responsibilities, not assisting with activities of daily living ("ADLs"). Landscaping, laundry and housekeeping services, on-site dining facilities, security surveillance, and a variety of activities and social events are the typical offerings in IL settings. However, they do not have full-time staff dedicated to providing custodial or medical care. Monthly service fees can range from $2,000-$4,500, depending on the amenities provided. Residents pay for costs out of pocket, limiting the risk associated with government reimbursement.

[1] Based on data gathered from CMS (https://data.cms.gov/stories/s/COVID-19-Nursing-Home-Data/bkwz-xpvg/) and Bloomberg (accessed August 8, 2020) with available data through July 19, 2020.

- Assisted Living:
    - Assisted living is geared more towards helping aging adults who need some assistance with ADLs such as bathing, dressing, doing laundry, taking medications, and transportation. Staff members, including at least one medical professional (typically a nurse practitioner), are on call 24 hours a day in most AL residences. However, assisted living communities don't provide intensive hands-on or skilled nursing care for older adults with serious mental or physical ailments. Monthly service fees typically range from $4,500 - $6,000. AL is usually paid for out of pocket by the resident, although there is partial assistance available in Veterans Affairs pensions and Medicaid in some states.

- Skilled Nursing:
    - Skilled Nursing residents are the most frail and vulnerable across the continuum of care. These individuals require significant medical care such as a specialized line for IV medications, respiratory therapy, or a feeding tube. Essentially, any senior who needs medical treatment from a registered nurse 24/7 or daily therapy services will need a Skilled Nursing setting. A stay in a Skilled Nursing facility is akin to a hospital stay. It is often temporary, with the goal of rehabilitating and then returning a patient to AL or their home. A Skilled Nursing facility can also be a permanent placement for a patient with significant physical or medical needs, often until the end their lives. Cost of care is usually quoted as a per diem rate, ranging from $250-$450 ($7,500 - $13,500 per month). Skilled Nursing is often highly dependent on Medicare and Medicaid for reimbursement, although there are residents who pay for costs of service with long term care insurance or out of pocket.

- Continuing Care Retirement Communities:
    - While there is no formal definition of a CCRC, they can be broadly characterized as a senior living community that offers a broad spectrum of amenities, housing and healthcare—ranging from independent living to skilled nursing care—usually on one campus. Typical services offered to residents at a CCRC include meals/dining, activities, transportation, housekeeping/laundry, maintenance, utilities, telephone, wellness services, recreational facilities, and a full range of healthcare options. Virtually all CCRCs offer Skilled Nursing care and have AL units that provide care to residents who need help with one or more ADLs allowing residents to "age-in-place". Other healthcare services that may be offered include specialized dementia care, home healthcare, and adult day care. The biggest difference between CCRCs and the three levels of care when offered as stand-alone facilities is the fee structure - residents who enter a CCRC usually pay an entrance fee (these can range from $75,000 on the low-end to over $1,000,000 for luxury facilities), as well as an ongoing monthly fee. Monthly service fees are typically similar to the cost of care quoted above but vary depending on contract type. In addition, the entry fee may be also be refundable. Lastly, it is worth noting that ~79% of the almost 2,000 CCRCs in the U.S. are operated by non-profits.[2]

[2] LeadingAge - https://www.leadingage.org/sites/default/files/LALS20-0031_eBook_MarketSnapshot_LifePlan_Community_p3b.pdf

“Senior Living” is truly a catchall with vast differences in the resident served, price points, and services offered. The next section will delve into some of the reasons why the impact of COVID-19 has varied at different types of facilities.

Varied Impact of COVID-19

Based on a wide swath of publicly reported occupancy as well as conversations with borrowers and industry contacts, we believe that the virus is having a larger impact at stand-alone Skilled Nursing / Long Term Care (“LTC”) facilities as compared to broad spectrum CCRCs.

There are 2 main reasons why the COVID-19 epidemic likely poses an increased risk to Skilled Nursing residents vs. IL residents and CCRC residents:

1) The type of resident – Skilled Nursing residents are generally the oldest and frailest of any senior living cohort. They can be suffering from multiple other illnesses and often have very weak immune systems. Thus, even in a non-COVID world, the life expectancy of residents is limited. According to a large-scale study done on almost 2,000 seniors who died in nursing homes, the median length of stay (before passing) was 5 months.[3] Nursing homes are often providing end of life care. Sadly, it is not surprising residents of this age and nature fall sick in the face of this terrible virus.

2) The care provided – Given their higher acuity, Skilled Nursing residents require extensive physical contact with staff. Residents often require help with their medications, eating and drinking, using the facilities, bathing/cleaning etc. In the broader Senior Living world, it is often the staff that bring viruses into the facilities. They have constant touch points with many different residents and can spread viruses easily from resident to resident in a rapid manner.

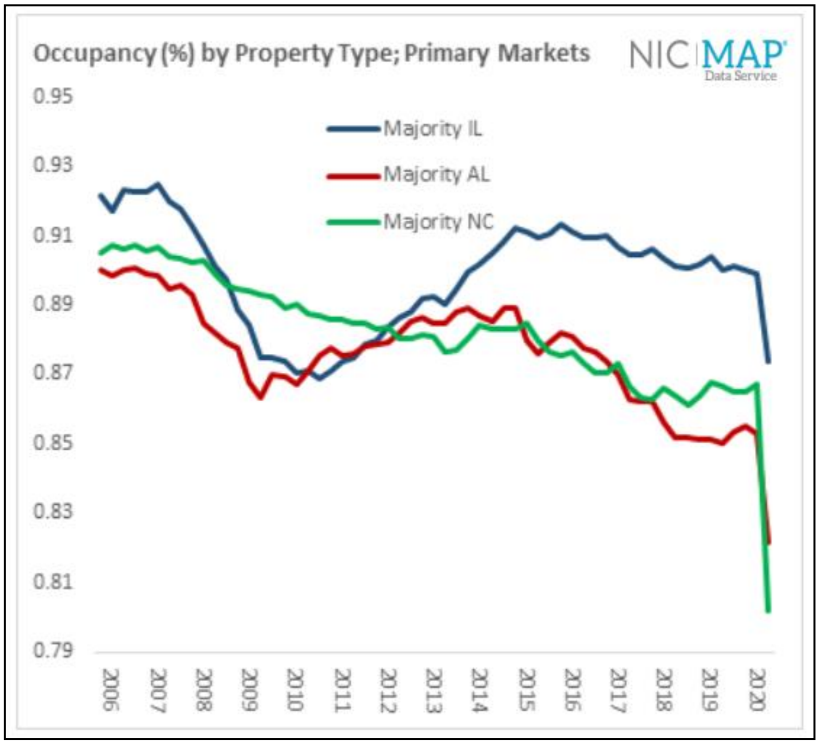
These two factors together create an unfortunate scenario where the frailest residents are least able to isolate/protect themselves from the virus.

IL/AL facilities and CCRCs have been impacted to a much lesser degree because residents are generally younger and more robust than their counterparts in Skilled Nursing. Almost as importantly, many of the residents take care of themselves. This decreases the need for interaction with employees who have spent their non-working hours in the outside world. Many lower acuity projects are essentially age-restricted apartment/townhouse living with various amenities (dining, gyms, pools, etc.) available to the residents. Early on in this pandemic, most facilities closed the common amenity areas and the residents have been quarantining in their units – much like the rest of us. This proactive management coupled with a healthier resident population is why we have not seen a significant decrease in occupancy or deaths at IL or CCRC facilities. The lesser impact of COVID-19 on IL residents is also evident in the smaller percentage of residents who contracted COVID-19 as compared to higher acuity care settings. A survey conducted by the National Investment Center for Senior Housing & Care showed that the average infection rate for IL residents across 52 multi-site Senior Housing and Skilled Nursing operators was only 0.4% versus 2.9% in AL

[3] https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1532-5415.2010.03005.x

and 3.9% in Memory Care.[4] Furthermore, based on current national case count information from the CDC[5], the Independent Living Senior Housing infection rate in this study is below the current national infection rate.

Regardless of the type of facility, there is no question that the COVID-19 epidemic has had a negative impact on the operations of Senior Living facilities. This is due to the combination of fatalities decreasing occupancy, increased costs associated with personal protective equipment and other precautions, shutting down of in-person marketing efforts, negative press, and the economic damage caused by state shutdowns. Unsurprisingly, occupancy has suffered during the COVID-19 pandemic although the decrease in occupancy has been far more acute at majority Skilled Nursing facilities vs. Majority IL/AL facilities[6]:



[4] https://blog.nic.org/executive-survey-insights-covid-19-week-2 - as of 7/23/2020

[5] https://www.cdc.gov/coronavirus/2019-ncov/cases-updates/cases-in-us.html - as of 8/4/2020

[6] *National Investment Center for Senior Housing and Care* - https://info.nic.org/hubfs/2Q20_Market%20Fundamentals%20PDF.pdf?hsCtaTracking=e0b3e245-670c-4aa4-b29d-ec3a04ab68d8%7Cdaaffebc-90bd-42ba-83a9-f24f77fdf1a4)

What this means for Hamlin Investors

Hamlin's Senior Living borrowers are not immune to the impacts of the epidemic. As a result, our team has been in frequent communication with borrowers to ensure that proper precautions are being taken to protect residents. After 4 months of observing our borrowers handle the COVID crisis, we are confident in their ability to weather the storm.

Adding to our confidence are the crucial differences between Hamlin Senior Living projects and other long-term care senior living projects in the general High Yield market:

- Often the project has significant liquidity on hand or is backed by an entity that provides additional financial support. This liquidity comes in many forms – from large obligated group balance sheets to supporting charitable foundations. Having these sources of liquidity provides a crucial margin of safety and is key to weathering any temporary occupancy and cost issues arising from COVID-19. We evaluate forward operations on existing (and potentially reduced) occupancies to ensure properties continue to operate successfully for years.
- We have been very careful in project selection. We have not put thinly capitalized deals that lack cash equity into the portfolio. Our projects generally have equity, liquidity support agreements, and real teeth in the documents that allow us to affect change if and when something goes wrong.
- We generally work with 501(c)(3) non-profit borrowers which have a very different time horizon than for-profit companies and work to serve a mission rather than a bottom line.

These requirements all speak to the long-term Hamlin model of generally owning a high percentage of bonds for projects with non-profit borrowers that we know and trust. We also believe these requirements and safeguards enhance our project's ability to continue to make their bond payments in a timely manner.

As a result, we have not seen a rash of deaths in our facilities and we do not expect a rash of defaults. Our projects are generally well operated and well capitalized. While it is unavoidable that we have had COVID-19 at various facilities, it has generally been an operational problem rather than an existential problem for our borrowers. This is a time to be thankful for the due diligence and deal sourcing that is a key part of the Hamlin investment model.

Despite these mitigating factors, we are not underestimating the epidemic. Our investors can rest assured that we are remaining vigilant in monitoring the impacts of COVID-19 on our portfolio and doing everything in our power to manage the associated risks.

PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS. Investing involves the risk of a loss of principal. Any projections, targets, or estimates in this report are forward looking statements and are based on Hamlin Capital Management, LLC ("HCM")'s research, analysis, and incorporate assumptions made by HCM. All expressions of opinion are subject to change without notice and HCM undertakes no obligation to update the statements presented herein. While HCM believes that the sources of all data provided in this presentation are reliable, HCM does not guarantee accuracy, reliability or completeness. Data is presented as of the date indicated and HCM does undertake any duty to update the information presented here.

This document is provided for information purposes only and is not an offer or solicitation to buy or sell any security, product or service. Due to rapidly changing market conditions and the complexity of investment decisions, supplemental information and other sources may be required to make informed investment decisions based on your individual investment objectives and suitability specifications. Clients should seek financial advice regarding the appropriateness of investing in any security or investment strategy discussed or recommended in this report.