Alternative strategies considered for Ashbourne portfolio

By Paul Norman - Friday, June 03, 2016 13:30

Alternative strategies other than an outright sale of the Ashbourne portfolio – a legacy Southern Cross Healthcare portfolio originally owned by entities connected to London & Regional – continue to be evaluated by the Special Servicer including a break up for phased sale or a longer term hold in a bid to maximise the recovery for noteholders in two securitisations in a move that underlines the changing dynamics of the UK care home sector as an asset class.

In an Irish Stock Exchange announcement special servicer Capita, advised by financial advisors Brookland Partners, has made an update on progress on the proposed sale of a portfolio of UK healthcare assets valued in June 2013 at £153.47m, which is being marketed by EY.

As of November 2015, the portfolio had been whittled down from 90 to comprise 77 properties with 66 considered core and the remainder considered to be "non-core" to the majority of the business. The "non-core" are being marketed for sale on an individual property basis.

In the recent announcement Capita confirms it is considering other realisation strategies, in the event that the whole portfolio sale process is unable to maximise the recovery for noteholders in two securitisations backed by the portfolio - EQUINOX (ECLIPSE 2006-1) PLC and Hercules (ECLIPSE 2006-4).

This has involved discussions with three national business transfer agents with expertise in the care home sector. The strategies under consideration include a sale based on a phased disposal, either individual homes or in clusters, or a longer term period to stabilise the business. This would see a period of focused capital expenditure followed by re-marketing for sale, working closely with new operator HCMS.

The process is the latest chapter in a long-running process to secure the best result for noteholders in securitisations backed by a portfolio of care homes originally

operated by Southern Cross Healthcare, the business which collapsed in 2011 in one of the most high-profile failings during the recession.

In 2005, the £355m Ashbourne Portfolio Whole Loan was advanced by The Royal Bank of Scotland to London & Regional in relation to the financing of a portfolio of 91 care homes (including a day-care centre) trading from 89 properties located in the UK and let exclusively to a group of companies that became Southern Cross Healthcare Group.

In March 2006, Barclays Bank bought a super senior tranche of the Whole Loan for £159.895m creating the Priority A Whole Loan. RBS remains the facility agent for the Whole Loan.

Subsequently Barclays sold 50% of the Priority A Whole Loan to Equinox (ECLIPSE 2006-1) and 50% of the Priority A Whole Loan to Hercules (ECLIPSE 2006-4) in two separate securitisations.

In addition to the Priority A Whole Loan, the Whole Loan also comprises two further senior tranches being the Ashbourne Portfolio Priority B Loan and the Ashbourne Portfolio Skim Loan (which together with the Priority A Whole Loan forms the Ashbourne Portfolio Senior Loan), a mezzanine tranche (the Ashbourne Portfolio Mezzanine Loan) and a junior tranche (the Ashbourne Portfolio Junior Loan).

Southern Cross Healthcare experienced severe trading difficulties in 2011, resulting in a reduction in the rent paid which ultimately led to the surrender of its occupational leases and the operation of the care home businesses to the borrower.

The transaction moved from an "OpCo/PropCo" structure to effectively a whole business format, with the borrower appointing independent specialist elderly care providers Minster Care, Orchard Care and Care Circle under the new brand name Larchwood Care.

By the end of 2013 a restructure of the Whole Loan had been completed between the lenders of the Whole Loan, Ashbourne Portfolio Loan Hedge Counterparty and the borrower, which included an extension of the loan maturity date by three months to 15 January 2016.

At that time London & Regional Properties became asset manager agreeing an incentive and exit fee, payable only where all amounts outstanding in respect of the Ashbourne Portfolio Priority A Debt have been repaid in full.

In March 2015, the borrower brought to market the entire portfolio for sale on a consensual basis with EY then instructed to handle the sale.

More than 70 potential buyers were targeted, representing a mix of trade buyers, private equity buyers and other UK and international investors.

A total of seven first round bids were received in July to August 2015 but indicative bids were at levels that suggested that the Ashbourne Portfolio Priority A Debt would not be fully repaid from the sale proceeds.

Many of the interested bidders focused on the government's recent introduction of the National Living Wage and its impact on the trading performance of the homes, in a sector where wage costs represents the single biggest expense category. Some cited this as a basis for withdrawing their interest or reducing their bid. In total three second round bids were received, during the period January 2016 to March 2016. Evaluation of these bids is underway.

The Special Servicer reports the bids bring with them elements of conditionality, which vary from bid to bid, and include inter alia requirements for further due diligence, dependencies on debt packages as yet not fully committed/confirmed and thereby providing some uncertainty about ability to execute. The prospective offers are also insufficient to provide full recovery to the Ashbourne Portfolio Priority A Debt.

In the recent announcement the Special Servicer reports that since the sale was launched, market conditions for the care home sector have continued to deteriorate, with the introduction of the National Living Wage, which became effective from 1 April 2016, having a particularly negative impact on the outlook for profitability of the sector, impacting the availability and level of debt available and more generally creating negative investor sentiment.

Specific to the Portfolio, where circa 75% of revenues are derived from local authorities, this has created uncertainty as it is not known, the extent to which local

authorities are willing or able to increase fee rates to compensate for the increasing wage bills arising from the introduction of the National Living Wage.

The Special Servicer adds: “It is also widely reported that there is shortage of nurses, with many in the care home industry more reliant on agency staffing to meet their needs. Typically resourcing with agency staff comes at up to 50% added cost, but can be as high as 65% to 70% with the resultant impact on net trading receipts. In an industry where staff costs are the single biggest item of expenditure, these factors collectively have introduced greater levels of uncertainty and many bidders have raised such concerns during the Portfolio Sale process, citing these factors as a basis for withdrawing their Round 1 bids and (or) scaling back their Round 2 bids.”

In the midst of the portfolio sale process the existing operator Orchard Care decided not to renew its contract on 15 January and a new Operator HCMS was secured on a two year term, incorporating provisions for early termination in the event of a Portfolio Sale, flexibility to accommodate a Portfolio Breakup, incentivisation for HCMS linked to improvements in operating performance and also provides the Special Servicer closer insight of how the business is performing.

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