



Special Considerations for Long-term Care Transactions

08.23.2016

"This article was first published in [Opening Statement](#), Vol. 4, No. 3 (VBA Young Lawyers Division 2016).

Assisted living facilities, continuing care retirement communities, and skilled nursing facilities are all types of long-term care facilities. In 2015, we experienced a record-breaking year for long-term care mergers and acquisitions, which often entail a change in the owner and/or the operator of a long-term care facility. In the first quarter of 2016, deal volume in the long-term care industry has continued to increase. While seemingly similar to other transactions, such as the sale of a retail business, long-term care deals offer special challenges to both buyers and sellers. Any party that is about to enter into a long-term care facility transaction, or any counsel whose client may be a part of such a transaction, should consider the following key topics:

Resident Census: The ability to demonstrate that a facility remains nearly full is a necessary condition for a seller wishing to receive maximum value for a facility. However, having a historically high resident census is just the starting point. Often, buyers will demand that the census remain at historic or near-historic levels at least through the due diligence and possibly through the closing. From a buyer's perspective, the buyer does not want to take over a facility with a declining resident population, as a low or declining census could signal a host of other hidden issues. Buyers and sellers can think of a facility's census as one litmus for the operational health of the entity. Maintaining a consistent resident population is critical throughout the transaction.

Payor Mix: In the due diligence stage, if not before, a buyer will ask for a facility's payor mix. For skilled nursing facilities, this is often a question of Medicaid versus private pay as much as it is a question of long-term care versus rehabilitative care. The payor mix is a telltale sign of how efficiently and effectively the facility has been managed. For example, if a skilled nursing facility has a strikingly low number of rehabilitation patients, this may signal poor relationships with local referring physicians, or it may indicate a marketing issue.

State Approval: In certain states, if a facility has non-profit status and is sold to a for-profit buyer, the seller will have to obtain the approval of an administrative or executive agency. In Virginia, before a non-profit entity can be sold to a for-profit company, the seller must receive approval from the state's Attorney General. This approval process includes public notifications (which affect the timing of resident notifications), public community meetings, and a comprehensive review by the Attorney General. In Virginia, the seller must notify the Attorney General at least 60 days in advance of the effective date of the proposed transaction.

Notification to Residents/Staff: In any transaction there is always the question of when to notify the

employees impacted by the transaction. Sellers often have a natural proclivity to want to notify those employees whose lives will be impacted as soon as possible. While the seller may desire to make early disclosures, it may be prohibited from doing so because of confidentiality provisions in the contract or concern that an early announcement will evoke a mass exodus. It is no secret that directors of nursing (DONs) and building executives often make or break facilities. When and how to disclose the news to these key staff members is a major strategic decision and should not be taken lightly. The notification of residents directly impacts the staff notification timeframe. In many cases, state statutes require residents to be notified within a certain number of days in advance of closing the transaction. In Virginia, the Virginia Administrative Code requires the current licensee of an assisted living facility to notify residents, legal representatives, and designated contact persons of the intended sale no less than 60 days prior to the closing date.¹

Assignment and Assumption of Contracts: In most transactions the buyer will have to decide which vendor contracts it wants to assume from the seller. In long-term care transactions, the assignments and assumptions are often handled as a schedule to Operations Transfer Agreement (“OTA”). In standard transactions, if the buyer does not make the appropriate assumptions or otherwise arrange for the provision of certain services, there may be a relatively small disruption on the first day or two after the new operator assumes operations. If this happens in the long-term care arena, where federal payors are paying for certain key services, the new buyer could be violating the law. Even for the simplest of services (e.g., cable television, linens, etc.), a one-day glitch could have massive implications for residents. If secondary provider services are not arranged, such as with contracted physical therapists, patients could go without key services. All parties should be aware that issues involving the assignment and assumption of contracts are often exacerbated by fluctuation in closing dates.

Licensure: In long-term care facility transactions, the buyer almost always will require the seller to represent that it has all required licenses, permits, approvals and certifications that are required to operate the facility. Several states have licensure laws that require the new operator to be licensed at the time of the transfer. In many states, the licensure process can be cumbersome and difficult to manage. For example, state agencies may require a host of documentation unfamiliar to the buyer, and some states require additional inspections or site visits. Some states even mandate the date by which the office of licensure be informed about the transaction. In Virginia, if an assisted living facility is to be closed or sold, the current licensee must notify the regional licensure office no less than 60 days prior to the closing date.² Licensure issues are best handled by the seller assisting the buyer with the licensure process.

Structure: It is becoming increasingly rare for a facility’s real estate to be owned by the same entity that operates the facility. However, there are certain small facilities that still operate under this model. Larger sophisticated buyers will often include multiple entities (e.g., a real estate entity, an operations entity, and a parent that may serve as guarantor). Transactions in which one side has a basic structure and the other has a complex structure present natural allocation and transfer questions. In the long-term care realm, both sides want to be diligent to ensure that the correct buyer entity is taking on the appropriate responsibilities (e.g., licensure, inspections, etc.).

Closing Pro Rations: Pro rations deal with how income and expenses are split between the buyer and the seller. Fortunately, most pro ration issues can be handled with clear provisions in either the transaction document or the OTA. In many cases, the buyer and seller agree that the buyer will receive all revenues from the facility arising from operations prior to the closing. The seller will want to ensure that the buyer submits applicable cost reports as soon as possible following the closing date.

Medicare/Medicaid Reimbursements: In any long-term care transaction there are always numerous reimbursement issues. In many states, managed care is changing Medicaid reimbursements, and bundled payments are impacting Medicare reimbursements. In any size transaction, buyers should confirm their Medicaid reimbursement assumptions with a reimbursement expert to ensure that their post-closing reimbursements are what they anticipate. They should establish an indemnification escrow

against Medicare and Medicaid overpayment liability, which the buyer will assume with other liabilities. Buyers should also prepare to manage reimbursements under the seller's Medicare and Medicaid status while they await approval of their own Medicare and Medicaid status.

CHOWs: For skilled nursing facilities, Change of Ownership ("CHOW") documents must be filed with the facility's Medicare Administrative Contractor ("MAC"). In addition to other MAC-specific documents, the Center for Medicare and Medicaid Services ("CMS") requires all CHOW applicants to complete the CMS-855A form. The CMS-855A is a 54-page application completed in part by the buyer and in part by the seller.

COPN: Of the 36 states that still have Certificate of Public Need ("COPN") laws, several, including Virginia, still have laws that pertain to long-term care facilities. For many states, a COPN transfer is not an additional burden in the transaction, but consideration of a state's COPN laws should not be overlooked. These are but a few of the special issues that emerge in long-term care transactions. Each type of transaction presents its own unique burdens, and those associated with long-term care transactions, including the foregoing, require proper diligence and care.

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