*Capital Markets, Mentorship & Senior Housing Trends with MidCap President Kevin McMeen*

Lucas: Welcome to Bridge the Gap Podcast with Josh and Lucas. We are continuing our interview series here at ASHA in California. The sun is out; it's been a great day and we've got a great guest on the show today- Kevin McMeen, the president at Midcap Financial. Welcome, Kevin.

Kevin: Thank you, great to be here.

Josh: Awesome to have you on the show.

Lucas: And Kevin, you live in Chicago where it's like -800?

Kevin: Yeah, maybe not 800 but it's darn cold.

Josh: I think I heard 20-year record, something like that.

Kevin: That could be. You know, they were talking about maybe breaking the record last night and I didn't follow up to find out for sure. But, it was going to be wind chills in -50 range. It's pretty cold.

Josh: Yeah, so California's been welcome for you, right?

Kevin: It's a nice break, but I will say my family was not very happy to hear that I was coming out here.

Josh: In the sun with pictures of the sun and the beach and stuff?

Kevin: Yeah, no pictures while playing golf yesterday, no pictures in the sunshine, in the ocean. Absolutely.

Josh: We're suffering working so hard.

Lucas: Yes.

Kevin: Absolutely.

Lucas: Kevin, you are a long standing figure in seniors housing and we'd love to get more of your background to see how you got to this point. I've been in the business since about 1998, I think it was, so about 21 years. I actually got into it because I was at a company called Heller Financial. The group that I was in was wound down and I had three opportunities that were available to me. Ray Lewis, who was the chief investment officer at Ventas (and) my boss, was starting a senior housing business within Heller at the time. It just sounded like such a great opportunity. Long-term I was like, yeah, I can do this, like start this business up within Heller. There's all kinds of other opportunities over the long haul.

So, I got started in it and stayed at Heller and then GE acquired us and (I) stayed there for awhile. Then, (I) went off to Maryland Capital where a bunch of our people went, was there for a few years and then back at soul, back to GE and started MidCap.

So, here I am, still doing senior housing and it's been absolutely fantastic.

Lucas: So, you've seen a lot of these cycles that go up and down and back and forth. You moderated a panel today of some great thought leaders talking about capital markets. Talk to us about some takeaways from the themes today.

Kevin: Well, I think a few different takeaways. So, first of all, it's- we're at a point where maybe there's- I wouldn't say an inflection point- (that) people are kind of staring at where there could be an inflection point with the economy and some of the fundamentals in the industry and that sort of thing. So, that's one and what the implications of that are.

Another is, you know, it's a complex business, right? It's operations, it's health care, it's hospitality, it's real estate- all these different things and that creates a lot of challenges for investors in the sector and lenders in the sector. So, capital providers in general.

So, those I think were probably the two most significant takeaways and just a lot of good dialogue around how do the different capital providers think about all these things that are scrolling around at this point in time. What's the outlook going forward? So, it was some great conversation for sure.

Josh: So, talk to me a little bit. Let's talk about, let's dive into at least- I know we don't have a lot of time- but let's dive into a couple of those themes and those takeaways. You know, we talked about maybe this inflection point in the industry, that complexity. You know, I think we could go a thousand different ways on this, but, you know, forecasts with the complexity and we're at this point where is this a pivotal point in the industry, are things radically about to change, are they not?

Who is gonna be positioned if you're trying to position yourself for what's next, what are the ingredients to make a winner for what's next that you see coming?

Kevin: So, first of all I'd say, obviously the future is unknown. Nobody knows what's going to happen and we're not in the situation where people have a lot of concern about what is, what's next. I think they're just more aware of it and more sensitive to it and thinking about it around how should I be positioned?

If you look at it from that standpoint, I think the people who will be best positioned for success are the folks that are well capitalized, that can deal with a downturn in the industry, whatever that may entail whether it's economically driven by the general economy, whether it's more development that takes place that pushes occupancies down, threatens the ability to, you know, generate the N.O.I that you need- all those kinds of things.

So, well capitalized and then you've got to be a really good operator to manage through because it's such a difficult environment not only with those occupancy challenges that everybody faces but also the challenges with wages, with regulatory issues. There's some states now that we think of as a lender, whether or not we really want to lend in those states because the regulators are really tough on some of these operators.

That's a challenge and you've got all these host of things that these operators have to figure out. So, if you've got a good operator with a great team, you know, that's a recipe for success going forward.

Lucas: Right, right. Well, that's a great transition into the operator topic. That was something that came up- the war for talent, the war for talented operators. It seems to be a big component of the success or fail.

Kevin: You know, it's interesting that that comes up on a capital markets panel. I mean, maybe we should be talking about interest rates and equity and returns and all that kind of stuff and the reality is that the sophisticated capital providers in the sector understand all of the operating nuances and the challenges that go with that. These are people who have a lot of experience in the marketplace. If you look at the group that was up there on the panel, they collectively probably had 80 years of experience. They've been through cycles. They recognize what it takes so an incredibly important aspect of what it takes to be successful is having really talented people and that's up and down the line

You're an operator, right? So, you know it's tough to keep people when they have a very demanding job of dealing with seniors who are frail and need a lot of care. It's emotionally demanding, it's physically demanding at different times and, you know, they don't get paid a lot. They're struggling to make ends meet so you've got to find a way to engage those employees. Make it more of, you know, a mission for them. Make it something that is more enjoyable for them and not something that they're just coming in and punching the clock for and thinking about, oh, where's the next dollar coming from.

Maybe go over to FedEx or the Amazon Fulfillment Center and get paid more there. Is that what I want to do or is being in senior housing more fulfilling? I've got a management company that treats me with respect, provides all these different things that help me make my life easier that, you know, that extra dollar doesn't make that much of a difference because of all these other things.

So, that's important at that lower level. And then, at the higher level, finding the right people that can actually run a business, right? I mean each of these buildings is a business and some of them are, you know, a meaningful business. I mean, you can have 5, 6, 7 million dollars of cash flow off of one building if it's a pretty good sized building. So, you've got to have a person who's really talented at running that from a marketing standpoint from staffing perspective, figuring out what's the right way to deal with all of the different financial aspects of the day to day operations, the procurement side of things.

For a capital markets panel to be talking about that stuff is reflective of how important that aspect of the business is to creating value and getting people comfortable that it's a good investment decision.

Josh: Yeah, so I totally agree and it was so interesting. Something else that was really interesting, Lucas, I walked in, didn't catch the beginning of the panel, but when you were guys were doing what I call basically a data dump, I mean, like revealing the capital markets and I remember walking in on the part where you guys were talking about the trends in occupancy and how that's trending down and putting pressures on revenues. Then you went and talked about expenses and how the labor, I think the unemployment- did I hear a 50 year low unemployment record? Is that what I heard?

Kevin: Close to a 50 year low, yeah. I think the last time it was this low as it is was 1968.

Josh: Yeah, so basically, you know, talking about how that's putting some pressure and some other things on the expense line and crutching the NOI and things like that and so it was kind of, I walked in, and I was kind of like, ooh, this is kinda heavy in here. I'm an operator; I need to walk back out of this room. But then, we also heard a conflicting kind of argument that some people were saying, hey, in spite of that data, some of these markets that we're hearing, oh don't go to this market or oh don't go to this market, they're experiencing, there's some operators that are experiencing some all-time highs on things.

What were some of the takeaways and do you have some insight on why are they winning in some of these tough markets when other people are really struggling and what are some of the secrets or takeaways in trends that we're seeing is differentiating those people from being successful and kind of beating these trending numbers?

Kevin: It's a great question. Obviously, I shouldn't say obviously, but the data we talked about was national in scope, right? So, if you look at the data down to the market, the submarket, there's a whole lot of variability there that is, you know, very different from what you see at the national level. So, you can go into a specific market and you can see that here's an asset that's really well located. There's great demographics all around. There's limited amount of competition and it's very difficult. So, you start with a great real estate asset and then you layer on top of that a great management company, management team not only in terms of the broader, here's a- Leisure Care for example. Judy Marczewski was on there. They're a great management company but not just that management company, but the people specifically at that property that can make or break, like we talked about that great executive director that's there.

So, you put those things together. They're going to be the outlier. They're going to be the ones that perform very well because of that asset quality and that location and the team that's there that's just performs at a notch above so many others.

And then when you get away from that, you've got somebody that maybe built an asset that you know that's not in a great location. It's tucked away, it's hard to find. Maybe it's designed in a way that's not ideal in terms of being able to deliver services. All those different kinds of factors and then if they're not as strong from an operating standpoint, those are the ones that really suffer and pull down those averages overall. So, you can find pockets of great performance within markets that look terrible on a broad perspective but really perform well when you nail it down or go down to a pinpoint level.

Josh: So, is one of the takeaways there that as the capital markets are looking, where they are going to invest. Is the indicator there that following and joining up and putting much more of a weighted weight on the operator than just the raw data from the market? Used to, if you had a good feasibility study from a reputable company, it's kind of like check that box, management company in place, let's rock and roll. How is that dynamic changing?

Kevin: Well, I think, you know, that the panel's a little skewed in the sense that the people who are up there have a lot of experience and have been through different cycles. They recognize the value of the operations. I think you heard from each of them that operations is the first thing that we look at in terms of the equity provider, the debt provider, that were up there. That's- there's a reason for that because they recognize that that's so important. So, they're very focused on that and I'm losing my train of thought in terms of what the original question was, so stop there and make sure that I'm on the right track.

Josh: You're on the right track because, I think you know, originally it seems like based on the complexity that we've talked about that no longer can you just really have a feasibility study that's based on big numbers. It seems like there's being more and more pressure put on the development team to be partnered with the right operator that understands that market, that can be that kind of ace in the hole, so to speak, that wild card. It seems like there's been a big shift in that.

Kevin: Yeah, I think, again to the point that the more sophisticated lenders, equity investors recognize the importance of that where you see the support for the more marginal operators, the sites that are not as good, that might be from capital providers that are either one: unexperienced or look at it and say, you know what, I'm lending or I'm investing in this asset at a level in terms of my dollar per unit that I'm not going to get hurt. For, by virtue of not having a great operator, but I can ultimately replace them and I am confident that I could sell this and sell the dream, so to speak, to somebody else who could bring in a new whole set of capital and operator and feel like, hey, I'm getting this at a good price and I can get out.

So, you've got two dynamics that support maybe some of those more marginal situations. It's the inexperienced capital providers and then it's maybe more experienced capital providers, but they're just in it at the right basis. So, where the break point is between I don't want to be in this because I'm really at risk of losing money and being at a level where I'm confident I'm not going to lose money or the likelihood is very low, maybe that's the better expression.

Lucas: Let's talk about 2019. Buyer's market or seller's market?

Kevin: Well, I think that if you, you know, listen to the providers, the view is that we're maybe at a point where we're going to transition from a seller's market to a buyer's market. I think there are some comments that you're starting to see a little bit more of a gap start to develop maybe not in every case, but certainly more frequent and I think that in light of some of the challenges around margin compression and the occupancy challenges and different markets that are helping drive that margin compression, you will start to see the investors and new capital providers coming and saying- and buyers I guess- saying, I'm willing to pay for your asset, but I'm only willing to pay this much and your expectation based on things that happened a year ago, or two years ago, aren't realistic in the environment that we're in with a more challenging operating environment, maybe a rising interest rate environment. So, all those things conspire to maybe drive us closer to a buyer's market than a seller's market.

Josh: Interesting. So, I'm not sure if you talked about this because I had to skip out right at the end. But one of the trends that I've been seeing that has drastically changed since I first got in the industry, but from a management company operating standpoint, almost every deal whether it's an acquisition of an existing asset or whether it's new development, there seems to be an expectation from the operator, from the management company to have skin in the game, whereas that used to not be a topic. You were hired, it was fee for service or you were just a seat at the table, help us with the proforma, you take care of ops in marketing, run the thing. Well, now, there's not a deal that comes to me as an experienced operator that I'm not expected to be part of that deal.

What's some of that dynamic that has caused that to happen? Please validate that- is that what you guys kind of have an expectation for generally?

Kevin: Yeah, it's a great point. I mean, the third party manager is tough from a capital providers perspective to get comfortable in different situations. I wouldn't say across the board that, you know, it's a bad situation. The more aligned you have, obviously the better, right? Because if you've got capital invested in a particular deal that you could stand to lose if you don't perform, your level of attention and focus is probably going to be higher there than another one where, hey, just get a fee. If it doesn't work out, it doesn't work out. I'm not losing any money. Maybe it hurts reputationally but your actions are a little bit different based on the impact on your pocket book versus your reputation because a lot of people feel like you can work around the reputational challenge, right. Well, it wasn't the right asset, I didn't get support from the owner, they weren't investing in the asset. You can make up a story around that.

So, I think from a lot of capital providers' perspectives, and I think this is probably in some respects maybe even more true on the debt side then on the equity side is that we love, and I'm a debt provider, we love having that alignment of interest. We want to know that that group is, it's operating and making those day to day decisions has got real skin in the game. Having said that, I know equity investors that they'll go either way. They're more than happy to have- and some of them prefer to have just a fee manager in there because if it doesn't work out, it's easier to unwind. It's easier to say, you know what, we've got a contract, there's a 60-day notice period or whatever it may be. I can do that versus I've got a management contract and they're equity investor, how do I deal with that?

It's a very-or JV structure, whatever it may be- it's a very different dynamic. There's no right or wrong but I think if you were to poll people in the industry on equity or debt side they would say, by far we want equity alignment so capital invested by that operator.

Josh: Makes total sense. That's been a big change. So, one last thing and then I know we've got to wrap up here. So, there was- and there is no way I can even probably explain this but you'll know what I'm talking about because you led the panel- but there was news that the trajectory of your conversation changed a little bit because of some fed news yesterday I believe. Was that correct? Explain that to those that maybe aren't up on the markets as much as you guys are and the potential ramifications of that.

Kevin: Right, so the announcement yesterday from the fed that they were taking a more dovish approach to interest rates, so not going and saying we're going to continually raise interest rates because of concerns about the economy, getting too hot, maybe inflation, that sort of thing.

So, pulling back a little bit and that has people looking at interest rates maybe a little bit differently. So, an interest rates, long term interest rates are in generally correlated with cap rates. So, as interest rates go up on a long term basis, cap rates go up. Cap rates are the way you value an asset. So, the higher the cap rate, the lower the value, right. As interest rates go down, cap rates compress with that and typically your values go up.

The fact that the fed is saying, we're not going to be as aggressive in raising interest rates, people are like, okay, different ballgame now. So, maybe that changes my outlook in what I'm willing to pay because I know I can get debt that's long term that's priced off of a ten year treasury that's a little bit cheaper than I might have otherwise thought I would get when I closed the transaction in whatever 3, 6 months.

So, that's what people were talking about. That was Beth Mace that brought that up.

Josh: Woah, that was great timing for your panel to be here to address that. So, fascinating.

Lucas: Well, I actually have one more thing. I'm not letting you go just yet. There's a phrase that you said and I'm going to spin it a little bit but you said the long term is filled with a bunch of short terms. I see you, many people do, you're a servant leader in the business and you actually mentor people in the business and so where you may have meant that for a more market, we have a lot of listeners that are getting in the business. There's entrepreneurs, there's front line workers, there's partners to the industry that are building businesses through technology or through whatever else and they're getting in.

Since you are involving yourself with younger people coming up in the business, I'd love to know your motivation behind that and then maybe some advice to some people that see senior living as a really great opportunity to build that career.

Kevin: Yeah, so, you know, I think that if you look at the industry, there's a little bit of a gap between people who started it and the people who are just getting into it. I think, one of the things that I had always talked about earlier in my career was, you know, you want to know that there's bench strength, right, so if something happens to the guy who started the business, do they have a strong enough management team overall to really support it and drive the culture and do the right things to make sure that they can continue to operate and perform well?

And the way to do that is to have people who are well trained, understand the business, and you're bringing in newer people into the industry and, you know, the education of those people and the ability for them to network with one another and create relationships that can turn into different business opportunities going forward, I think is great, and it adds some fresh blood, some fresh perspective that, you know, might not otherwise be there.

I could develop some kind of game changing type of ideas that would be very beneficial for the industry. So, for me, it's important to do that. It's important to give back in a lot of ways just because, you know, I've been very fortunate to get into the industry not in the beginning by any means in 1998 - it'd been around for well over 10, 15, 20 years whatever it was- but, you know, relatively early in this asset class' development and I've been able to be a great beneficiary of that which is terrific.

I think it's important to give back, whether it's people at my company and having the right sort of training and benefits that they can get to learn and expand and grow to people throughout the industry and some of the stuff that ASHA is doing, that NIC is doing for networking opportunities and development opportunities and tapping all the creativity of some of these really vibrant, really smart younger people, that's a great thing for the industry.

So, I'm a huge supporter of it.

Lucas: I think it's great. The university outreach topic is definitely something our listeners are going to be hearing a lot more about this year and this is- when we say it's a complex industry- we mean that we need all people with all types of skills. So, if you're going to school and you're getting an MBA in finance or whatever you are, senior living should be on your list of industries to look into.

Kevin: Right, no doubt. I mean, if you look at the industry, I mean, the amount of potential growth is staggering with the demographics. If you understand that and can step back and either see it or have somebody explain it to you, the potential with that means being with an operator, being with a capital provider that's focused in the sector- the opportunities are huge.

So, it's very important that this be on the radar for the people in business, architecture, hospitality, health care- there's a whole universe of people out there that can really come in and add a lot to this sector and I think that the opportunities for them will be tremendous.

Lucas: Josh, this has been a great conversation. I feel energized just talking about this. Great panel. Kevin, thank you for your time. If there's people out there that are listening to this (and) they say, wow, how do I get connected to MidCap or how do I get in contact with Kevin? This might be something that I want to get involved in. What would you say?

Kevin: You can go on our website. We've got our contact information there. Give me a buzz, shoot me an email. I'm happy to chat with people.

Lucas: Excellent.

Josh: We'll obviously provide all that in our show notes as our audience is connecting with us.

Lucas: That sounds great. This has been another great episode of Bridge the Gap.

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