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Selecting a Master Tenant: To Be or Not to Be a Single-Asset Entity?

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Commercial real estate professionals live in a world where single-asset entities (SAEs) are ubiquitous. In this respect, the niche market of HUD-affiliated healthcare facilities follows suit. Skilled nursing or assisted living facility owners seeking HUD-insured financing and the operators overseeing day-to-day functions at those facilities generally need to be SAEs to participate in the HUD programs. But what about master tenants, those entities that serve as intermediaries between owners and operators in portfolio transactions? To be, or not to be [an SAE], that is the question!

I was on a conference call with a HUD-insured lender and borrower recently when this very question arose. As lender's counsel, I was introducing the borrower's representatives to HUD's master lease requirements, having established that the portfolio of facilities at issue would be subject to a master lease. The borrower's attorney suggested that a certain entity affiliated with both the owners and operators within the portfolio would be a natural candidate to serve as the master tenant.

Folks on the call were starting to warm up to the attorney's suggestion when someone asked, "But what about HUD's single-asset entity requirements?" After about 10 seconds of silence, the client asked, "Jim, would you like to address that question?" I said that my recollection, based on my years spent at HUD, was that master tenants, unlike the other players in these deals, need *not* be SAEs.

Not surprisingly, my answer was met with some skepticism. After all, the single-asset entity rule, while evolving over the years, has been a constant in FHA-insured finance for decades. Why would master tenants be allowed to deviate from the default rule?

As it turned out, my memory wasn't playing tricks on me. 24 CFR Section 232.1003 is the relevant regulation:

"Operator shall be a single asset entity. … A master tenant under a master lease … is not an Operator."

This doesn't explicitly say that master tenants can be multiple-asset entities, but the implication is hard to

miss. And if you read through the discussion of public comments in the Federal Register back when HUD introduced the final regulation in 2012, it becomes clear that HUD's intent was to carve master tenants out of the single-asset-entity requirement.

Of course, this is not to say that master tenants ***can't*** be SAEs. Borrowers and operators commonly agree to create a single-asset, single-purpose entity to fill the master-tenant slot. But they might just as easily agree that a parent company, existing holding company, or some other non-SAE is the ideal master tenant. HUD's regulation, unlike so many other HUD regulations, actually opens doors in this space, rather than closing them.

When selecting a master tenant, borrowers, operators and their attorneys will want to consider a host of factors. For example, which entity is best suited to assume the basket of duties in the Master Tenant Regulatory Agreement and Master Tenant Security Agreement? We may take a deeper dive into that host of factors in a future article. In the meantime, here's the key takeaway: When it comes to master tenants, HUD does not dictate the answer to Shakespeare's immortal question: to be, or not to be [an SAE]?

If you have any questions please contact Jim Provenzale or your Dinsmore attorney.