

China Senior Housing and Health Care

Newsletter
January 2017

*Happy
New Year*

News Update

State Council issued Several Opinions **on**

Opening the Elderly Care Service Market **and** Enhancing the Quality of Elderly Care Services

On 23 December 2016, the General Office of the State Council issued *the Several Opinions on Comprehensively Opening the Elderly Care Service Market and Enhancing the Quality of Elderly Care Services*, which set up a goal to comprehensively open up the elderly care service market by 2020. The Opinions touch upon a couple of encouraging policies, such as broaden the access of foreign investment and encourage foreign investors to establish non-profitable nursing homes. The Opinions urge to establish pricing mechanism for services in nursing homes through a market-leading approach; to speed up the reform of public elderly care institutions that have the capability to provide elderly care services to the public into enterprises or public-owned and private run; to enlarge the coverage of home-based care services and community nursing services within the communities and develop financial services catering to the elderly people.

As a mean to formulate and implement policies and tasks among various Departments, the Opinions set forth the following key tasks and implementation schedules, as a result of which, a series of new legislation and measures is expected to be implemented as of the beginning of 2017:

No.	Tasks	Responsible Departments	Schedule
1	Encourage foreign investors to establish non-profitable elderly care institutions	Ministry of Civil Affairs, Ministry of Public Security, National Development and Reform Commission, Ministry of Commerce, etc.	Complete by the end of December, 2016
2	Clean up completely and cancel all unreasonable pre-approvals for nursing homes, optimize approval procedures and simplify the approval process	Ministry of Civil Affairs, etc.	Complete by the end of December, 2016
3	In accordance with the Fire Protection Law and relevant laws, enact safe and convenient measures for the establishment of nursing homes and implement other ancillary administrative measures	Ministry of Civil Affairs, Ministry of Public Security, Ministry of Housing and Urban Construction, etc.	Complete by the end of June, 2017
4	Improve the price formation mechanism	National Development and Reform Commission, Ministry of Civil Affairs, etc.	Under continuous implementation

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5	Speed up the reform of public nursing homes	Ministry of Civil Affairs, Provincial People's Government	Under continuous implementation
6	Strengthen the construction of market credit	Ministry of Civil Affairs, National Development and Reform Commission, People's Bank of China, State Administration for Industry and Commerce, etc.	Complete by the end of June, 2017
7	Improve living standard and convenient environment for elderly	Ministry of Housing and Urban Construction, Ministry of Civil Affairs, National Development and Reform Commission, etc.	Under continuous implementation
8	Promote innovation of senior services with "Internet" themes	Ministry of Industry and Information Technology, Ministry of Science and Technology, Ministry of Civil Affairs, National Health and Family Planning Commission, National Development and Reform Commission, etc.	Under continuous implementation
9	Explore the establishment of Long-Term Care insurance system	Department of Human Resources and Social Security, National Health and Family Planning Commission, Finance Ministry, Ministry of Civil Affairs, National Development and Reform Commission, China Insurance Regulatory Commission, etc.	Complete by the end of December, 2016
10	Formulate related planning on senior services	Ministry of Civil Affairs, National Development and Reform Commission, etc.	Complete by the end of December, 2016
11	Perfect land supporting policies	Ministry of Land and Resources, Ministry of Housing and Urban Construction, National Development and Reform Commission, Finance Ministry, Ministry of Civil Affairs, etc.	Under continuous implementation
12	Improve professional skill level in tandem with the remuneration system of senior care service personnel	Department of Human Resources and Social Security, Ministry of Civil Affairs, etc.	Complete by the end of December, 2016
13	Explore feasible models of other asset-backed loans for nursing homes	The People's Bank, Ministry of Civil Affairs, etc.	Under continuous implementation
14	Strengthen the supervision of services	Ministry of Civil Affairs, The People's Bank, China Banking Regulatory Commission, Ministry of Land and Resources, Ministry of Housing and Urban Construction, The Ministry of Public Security, National Committee on Aging, etc.	Under continuous implementation
15	Improve the system for senior service standards	Ministry of Civil Affairs, General Administration of Quality Supervision, etc.	Under continuous implementation
16	Carry out comprehensive assessment and reporting system for nursing homes	Ministry of Civil Affairs, etc.	Under continuous implementation
17	Implement move-in assessment system for government-run nursing homes	Ministry of Civil Affairs, etc.	Complete by the end of December, 2016

Legal Insight

Basics *of* Senior Care Facility Management Agreement

Written By Michael Qu

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It has been over five years since we wrote the article “Enter into Senior Housing and Care Market in China”, at which time China had just introduced its 12th Five-Year Plan for the development of senior living industry. A lot of things—legislation, brands, product, supply and demand trend, among many others were unknowns to new entrants. Five years later, many operation brands, foreign and domestic, have emerged in the marketplace—some are doing pretty good and some are still struggling. Walking through the years, the market has evolved dramatically, and now it is a good time to have a recap.

The market status for foreign operators

There was a time foreign brands are struggling with whether or not they shall have Chinese partners to work with. To answer that really requires leveraging the mixture of various factors—specialty, team, capital, commitment to the local market etc., which usually will be putting together as a company’s business strategy of moving to the China market. However, many actually are more opportunistic. Partners being chosen to work with, locations being selected, or even core team members on board are not happening in a strategic way. Often times, it is just opportunities haven’t been emerged in other possible ways.

Over the times, the route into China has become clearer, thanks to a couple of pioneers from the U.S, Europe, Australia and Japan. Here is a summary of their attitudes towards a partnership. First, they are open for various types of cooperation with Chinese partners. Even for those who do insist on the WFOE (Wholly Foreign-owned Enterprises) investment form (or going solo putting in another term) are not resistant to have a Chinese partner to help them get access to real assets, capital, government relationship and other resources. Second, the market has been developing rapidly, in particular in the merger and acquisition spectrum. Nowadays, you can find a number of deals where Chinese companies buy equity or assets of overseas senior care communities, large companies buyout startup business, and big brands merge, just to name a few. Today’s solo could be tomorrow’s cooperation. Third, as is played in every business, joint venture is still a prevalent approach to pursue when a foreign investor enters into a nascent market. Admittedly, in many industries, JV could be fragile where the parties fail to find mutual ground to accommodate diversified views and accomplish different goals. But for now it could be more risky and costly haven’t a Chinese partner working together and navigating a lot of uncertainties at the first place.

In this context, the most frequent way operators adopted to expand their landscape has to be the execution of “Facility/Community Management Agreement” with Chinese owner, a business model that U.S. operators are very familiar with and feel comfortable to start with in the Chinese market. It is neither new things for other operators, foreign or domestics, as during the years it has become one of the highly welcomed cooperative models for many real estate developers and insurance companies in China.



Provided by Nathaniel FAROUZ

Pictured in December 2016—Orpea Xianlin
International Care Center, Nanjing, China

Definition of Facility Management Agreement

The common definition of operation management is that manager is granted with full authority by owner and holds responsibilities and complete and full control and discretion in the operation, direction, management and supervision of a senior housing project. Operation management contract may vary in different context and forms due to particularity of different projects. It is particularly important to note for seasoned operators that typical Western-style contract terms in the Management Agreement have been developed in China to the extent that we cannot take it for granted that some well-accepted commercial terms in the U.S. context will also be working on the negotiation table with a Chinese partner.

Negotiating a management contract satisfactory to both the owner and manager is a work of art that requires patience and effort for all stakeholders. Closing a management deal is also a self-reflection journey to find out an operator’s bandwidth as well as reach a balance between the owner and itself. In a typical 30 to 40 pages’ management contract, there are lines both parties care about the most, failure to achieve mutual agreement of which may cause a negotiation broken.

Ten Basics for a Senior Care Community Management Agreement

Q1: Is due diligence necessary?

Many think it does not worth the time and cost to conduct a due diligence but actually it does. Simply because the negotiation of a Management Agreement is a time and money cost process for many foreign operators, it is extremely important to conduct a preliminary legal and commercial due diligence to exclude opportunities that don't fit for the parties at the first place. When negotiation goes on, further due diligence regarding project information and owner's track record on selected items recommended by an experienced counsel is necessary, as the result of which might affect major commercial terms in the Management Agreement.

Q2: What are signing parties of a Management Agreement?

A foreign operator can choose to set up a Wholly Foreign-owned Enterprise ("WFOE") or Joint Venture ("JV") to conduct business in China as a manager. Whether a Chinese partner holds stake in the management company could make a lot of difference for a manager in the bargaining power of such agreement.

Company incorporation procedure for foreign investor has been simplified in China in recent years, and usually there is no restriction to establish a senior care management, consulting or service company to sign and execute a Management Agreement. However, it is advisable to carefully choose business scope of the management company as that will have significant impact on a foreign investor's capacity to conduct business in China.

Q3: What is common Fee Structure for the manager?

Management services are usually defined at different stages of project development: pre-opening consulting and technical support, operation management as of facility opening, support on the property sales (often seen in multi-stage and mixed-used developments), and other services such as day care and home care services (optional). Accordingly, fees can be charged in forms of consultancy fee, base fees, incentive fees, brand use fees, etc. There are benchmarks from the Western market we can refer to as to how much those fees can be charged. For example, base fees usually vary from 3 to 6 percent of gross revenue, and incentive fees can be determined by earning result of the community. However, when the facility management model is transformed and evolved in China, those references from other countries have become less reliable for operators as market performance is hard to project but operation cost in a new market is usually higher than that in developed markets—therefore, it is also common to agree on a minimum monthly fee in case the calculated base fees result in short of its expenses.

Accounting rules specific to gross revenue, net income and cash flow is also important to be clearly defined if any of the fees are calculated based on these factors.

Q4: Is the royalty fee for using the operator's brand common to charge?

It is not common in Facility Management Agreement because a manager's reputation and expertise have been reflected in the fee structure at above point 3. However, in a multi-stage development project, the owner/developer will be willing to discuss a brand use fee if part of the project is for sale and the

operator's brand and participation in the sales and marketing activities (usually together with manager's service available to the homeowners) is expected to make a great contribution to the project value. In those cases, brand use fees generally represent a fixed percentage of the sales price of real property, mostly like what branded residence under hotel groups will charge but usually lower than the benchmark in a hotel business.

Q5: Manager's autonomy vs. owner's appropriate supervision in daily operations

In the fight of decision making of daily operation issues, manager definitely seeks complete and full control and discretion over the operation without intervention of the owner; however, the owner wants to make sure it will not assume the operational risks as a result of manager's wrongdoing, and the manager will make proper and good use of its money.

A lot of practices in the hospitality industry can be transformed in this respect as fights alike have been taking place and addressed in China for over a decade. Participation of an owner's representative in daily operation can be carefully designed. It can be very useful to coordinate tons of matters in day-to-day operations. It is also common for a manager to hold firm position to make decisions on expenditure within approved budget, prepare and execute marketing and sales plans, recruit and train employees, draft and implement residency policy and documentations, etc.

In a multi-stage project development, a manager may only participate in a portion of community management job. In that case, other consultants, service providers or stakeholders may be involved. It is of great importance for the manager to define clearly of its duty and authority of management in order to avoid intervention by third parties, or in some instances being blamed for the failure of a project not attribute to it.

Q6: What performance test clause usually provides?

Performance text clause usually entitles an owner a right to elect an early termination in the event the community is under-performed. This requires a lot of elaboration as the pricing model, market projection, project cost has a lot to do with the metrics of performance. With less confidence and experience in the Chinese local market than in their home countries, managers are very cautious in choosing earning-based or expense-based tests formula. More often, performance test is as easy as simply based upon the occupancy rate.

Q7: Who will recruit and employ operation team?

While in the hotel industry it has been well accepted that an owner's entity which operate a hotel will employ all operational staffs but the senior ones (e.g. hotel General Manager) usually report to the manager, practice in the senior care industry is a bit different that many of the senior level employees are employed by the manager, and owner may only reimburse part of the HR cost.

From the manager's perspective, it is a highly professional business that senior operation and marketing people need to be retained by themselves to protect their knowhow and avoid the risk of losing control over project. Burden to have more HR cost will usually reflect on the fee arrangement so eventually it aims to be shared by the owner.

Q8: Typical terms of a Management Agreement and where early termination can apply

It is typically between 10 to 20 years. Sometime in an agreement with a relatively short term, a manager will have a renewal right if certain conditions are met. Early termination usually applies when managers fail to pass the performance tests during a certain period of time. Occasionally, manager will ask for a right to cure a failure by paying remedies to the owner in order to continue with the facility management.

Q9: How operational risks are allocated between the owner and manager?

A manager has a duty of care to fulfill its diligence in day-to-day operations. However, while operational risk in the senior care business is high, a manager usually will only agree to hold the liabilities arising from its misconduct or wrongdoing under server circumstances, and a manager's liability to reimburse the owner is only on top of what the premium owner can firstly acquire from a liability insurance policy. Apart from these, ordinary risks arise in the course of daily operations are usually born by owner.

Q10: Is exclusivity clause common for a manager to agree?

Exclusivity is not common in a pure management agreement. But in some circumstances, owner might request an exclusive cooperation in specific region (territorial or radius restrictions) while the owner has a pipeline to develop multiple senior care communities in targeted region and seek cooperation with the same manager. Situation may be different if the owner has an equity interest in the manager's corporation, as in those cases need to restrict competition becomes mutual interest for both to consider. Having that said, it is not common for the manager to charge an exclusive fee. ■

About us:

Law View Partners is a boutique law firm in China that specializes in providing services to foreign investors and companies in high-growth sectors. The firm's resources and services span foreign investment and trade, M&A and finance, construction and real estate, corporate compliance, as well as market-leading experience advising clients in corporate transactional advice, intellectual property and commercial litigation.

We understand that clients are looking for value beyond legal expertise. For years, our team has been focusing on advising foreign investors, emerging companies and investment funds, on, capital investment, mergers and acquisitions, business strategy and operation, etc. We focus on business—not just paperwork. We have a proven track record of unparalleled performance, working together with our clients to achieve business goals with our in-depth understanding of their industries, and have built a client roster that includes many of the world's most recognized and respected brands.

The Firm's strengths are in the fields of senior housing and healthcare; hospitality and retail real estate; foreign investment; advertising, technology and media (“ATM”); corporate compliance; and merger and acquisition (M&A).

Our Clients:

Real estate developer
Private equity investor
Operator
Banker and insurer
Architecture and design companies
Government agencies
Retail pharmacies and wholesale distributors
Medical device manufacturer and supplier

We represent providers across the continuum of senior living and care, including retirement living communities, assisted living and skilled nursing facilities, community centers and nursing station, home health, rehabilitation and specialty hospital.

Our services include:

- Advice on project regulatory feasibility and structuring of business models;
- Business incorporation and licensing, and negotiation with joint venture partners;
- Development and operation management contract;
- Draft and standardize documents for operation: resident contract, policies and procedures for residency, vendor contract, etc.;
- Senior housing assets development, acquisitions and dispositions;
- Advice on Public-Private-Partnership (PPP) structuring and documentation;
- Regulatory Compliance;
- Advice on finance and tax;
- Deal with issues involving intellectual property, liabilities and employment;
- Litigation and arbitration.

Our strengths:

--**Most renowned global team.** As early entrants as legal professionals in this industry, we understand the way the senior housing and healthcare industries works. We are trusted key advisors, with the experience and reach to advise at all stage of this business.

--**Outstanding track record.** Having represented international companies, from developers and aged care/hospital operators to institutional investors, in their entry into the Chinese market, we benefit our clients with our deep industry knowledge and experience, and with our creative, solution-oriented and responsive approach.

--**Industrial networking platform.** We are the chief editor of China Senior Housing and Health Care Newsletter. Our partners have participated in many senior care conferences in Asia, as chairperson, speaker and/or panelist, and have authored several articles and reports. Clients benefit from our industrial network in a wide variety of business.

--**Service covering the full life cycle of senior care project.** Providing sound service on the full spectrum of issues in project development which can arising during the site selecting, acquisition, feasibility studying, construction, financing, pre-opening preparation, post-opening operation and disposal of senior care or hospital facilities.

Speeches and publications:

Our partners have participated in several senior care conferences in Asia, as chairperson, speaker and/or panelist, and have authored several articles and industry report, including:

- American Chamber of Commerce, Hong Kong, September 2011.
- Retirement Communities World Asia, Hong Kong, October 2011 & 2012.
- Retirement Living World China, Shanghai, May 2012 & October 2013.
- Care Show China, Shanghai, August 2013. A half-day workshop on doing senior care business in China.
- International Association for Housing and Services for the Ageing (IAHSA), Shanghai, November 2013. A half-day workshop on doing business in China, with a focus on senior housing.
- The 4th Summit Retirement Living World China and the first Aged Care Service International Seminar 2014.
- ULI Mainland China Winter Meeting 2014, speech on the topic of “Hospital and Senior Care Facilities Development and Investment”.
- China Senior Living & Healthcare Design Debate 2015. Panel discussion on the topic of “Optimizing Design for better operational risk management”.
- Care Expo China, Shanghai, 2014 to 2016.
- Columbia-Fudan Global Summit on Aging and Health, Shanghai, October 2016. Panel discussion on the topic of “Public-Private Partnerships in the Elderly Care Industry”.
- Co-author with Rubicon a China Senior Care Report which includes in-depth analysis on new regulations specific to both senior housing and home healthcare.