

Advanced Ratios: Using Ratios to Measure Internal Operations Performance

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**Friendship
Village**

*The Bridge to
New Beginnings*

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Long Term Care Outlook

2001: expect weakening of most ratios

◆ Interim financials show stress

- Diminished profits

- Large unrealized losses

◆ Performance through remainder of year depends on external functions:

- Stock market (investment returns)

- Economy: unemployment rates (degree of “cooling”)

◆ Cyclical (except for shortage of nurses)

Long Term Care Outlook



- ◆ Demand remains strong
- ◆ Expect more defaults in the nursing home and assisted living sectors
- ◆ More concern for BBB credits, lower rated entities

Discussion of Medians: 'A' Credits

	2000	1999	1998
Days Cash on Hand	579.1	505.5	424.1
Cash to Debt	97.8	112.1	87.9
Excess Margin	10.5	9.0	8.4
Debt Service Coverage	2.7	3.6	2.9
Debt Service Coverage – Revenue Only	1.2	1.2	1.0

Discussion of Medians: 'BBB' Credits

	2000	1999	1998
Days Cash on Hand	252.3	307.8	305.2
Cash to Debt	61.6	59.4	55.3
Excess Margin	2.6	2.7	5.0
Debt Service Coverage	1.9	2.1	2.1
Debt Service Coverage – Revenue Only	0.8	1.3	1.3

What is Causing the BBB Declines?

- ◆ What's the difference between an A and a BBB credit?
 - **BBBs as a group have more nursing; as a group have more ILUs**
 - *A: 62% independent living, 527 average units
 - *BBB: 49% independent living, 315 average units
 - **BBB: More healthcare, therefore greater wage pressures**
 - **BBB: Smaller endowments, less investment returns**
 - **BBB: Collect less entrance fees**

Current Situation: External Pressures on Providers



Negative outlook in the short term because:

- ◆ Decreased investment returns and contributions
- ◆ Labor pressures
- ◆ Perpetual concerns mainly with nursing homes (AL somewhat)

Investment Returns

- ◆ A category – larger endowments
 - **More ILUs often mean more cash**
 - *All but 2 A credits collect entrance fees
- ◆ Greater investment income
 - **More reliance, but better performance**

Investment Returns

- ◆ Median A investment income: \$1.7 million (14% of total revenue)
- ◆ Median BBB investment income: \$489,000 (6% of total revenue)
 - **53% would lose money without investment income**
 - **Without contributions, donations and investment income, nearly all lose money**

CCRCs Investment Portfolios

	2000	1999	1997
% Return	5.2	7.6	9.3
% Equities	43	46	32
% Fixed Income	35	34	46
% Cash	23	20	22

Investment Returns and FYE 2000

- ◆ Mid-year end providers: (\$55,000), 5.7% return
- ◆ Calendar year end: (\$864,000), 4.0% return
- ◆ 2001 interims tell us it's getting worse
- ◆ Best and worst practices

Labor Pressures

Nursing homes labor pressures most acute, compounded by:

- **Increased liability insurance premiums (not just FL, now all over: IA, PA, etc.)**
- **Continued decline in occupancy**
- **Insufficient Medicaid**
- **Increased government scrutiny (Congressional Report)**
- **Favorite target of media, politicians, lawyers**

Ratios Used to Measure Labor Pressures

- ◆ Salaries, wages and benefits as a % of total revenue
 - A median: 48.14%
 - BBB median: 51.8%
- ◆ Agency expense as a % of total revenue
 - BBB median: 3.3%
 - One provider: 12%
 - Agency costs are 2 to 3 times the cost of a regular employee

Ratios Used to Measure Labor Pressures



- ◆ Nursing hours per patient day
- ◆ Total staffing hours per patient day
- ◆ Other

Cost Allocation



- ◆ Fully allocated profitability by service line/unit
- ◆ Contribution margin, operating margin
- ◆ Case study

FORECAST

- ◆ Negative outlook in short term due to expected:
 - **Reduced investment returns as a whole**
 - **Wage inflation**
- ◆ Demand will remain solid
- ◆ Stresses are mainly cyclical, except for nursing shortage

Friendship Village of Schaumburg (FV)

Organization Highlights:

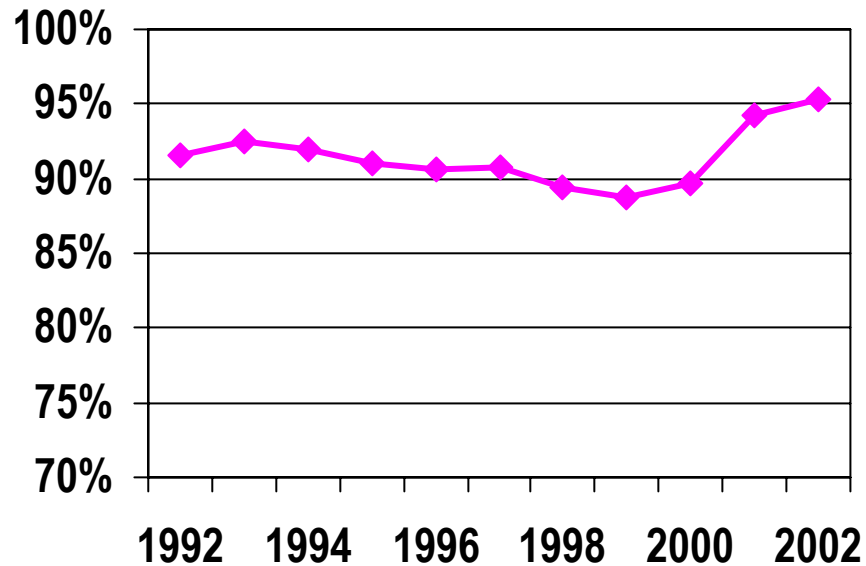
- ◆ Opened in January 1977 with the following unit mix:
 - **180 skilled nursing beds**
 - **600 independent units (50% of units are studio or alcove units)**

Changes to Unit Mix

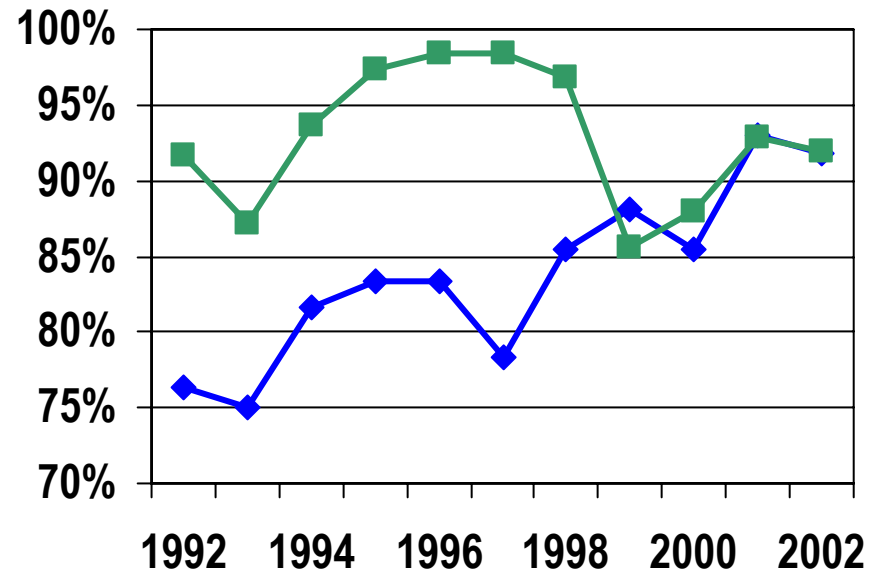
- ◆ 1987: Converted one floor of IL to assisted living (76 AL units)
- ◆ Periodically combine smaller units and use less desirable units for offices, storage, etc.
- ◆ 1994: Added 10 healthcare beds and converted 32 other beds to a 42 bed Special Care/Alzheimer's unit
- ◆ 1998: Added 60 healthcare beds

Friendship Village of Schaumburg Historical Occupancy Summary

Independent Living Average Occupancy



Assisted and Health Care Average Occupancy



◆ Assisted Living ■ Health Care

FV History of Financings

- ◆ 1977: Mortgage secured to develop campus
- ◆ 1987: First tax exempt financing to reduce interest rate from 9% to 6.5% plus additional cash to finance healthcare expansion
- ◆ 1994: Advance refunding of 1987 issue to further reduce interest cost
- ◆ 1997: \$30 million financing to renovate and expand existing campus

FV Organization Highlights



- ◆ BBB rated by Standard & Poors and Fitch
- ◆ CCAC accredited since 1987
- ◆ Strong strategic thinking board
- ◆ Integrated strategic, marketing and operational plans

FV Long-Term Financial Planning



Long-term financial planning is the driver in determining short-term objectives.

In other words, annual operating budgets are established that not only meet current operating needs, but help to achieve long-term financial goals.

Long-Term Financial Modeling

- ◆ CCAC target ratios
- ◆ Operating performance
- ◆ Physical plant challenges
- ◆ Resident programming objectives
- ◆ Expansion and new services beyond the current campus
- ◆ Actuarial pricing and long-term viability

Annual Budget as Part of the Long Range Financial Plan - Assumptions

- ◆ Occupancy by level of care
- ◆ Resident turnover
- ◆ Payor mix
- ◆ Rate increases
- ◆ Expense increases
- ◆ Expansion
- ◆ Capital replacement
- ◆ Non-operating expenses
- ◆ Investment income

Variable Budgeting

- ◆ **Variable budgeting is used to determine what-if scenarios. Variable budgeting is particularly useful in testing:**
 - Different occupancy assumptions including differentiating by payor source
 - Per resident day costs that are directly affected by census...e.g., meal cost per resident day
- ◆ **Actual results can be calculated using per resident day cost and compared to that budgeted to better analyze budget variance.**

CCAC Ratios

- ◆ Targeted CCAC ratios are established as part of the long-range financial plan.
- ◆ FVS objectives:
 - **Show positive trends in these ratios**
 - **Make adjustments to operations, fees, etc. to ensure long-term financial viability**
- ◆ Annual budgets are established making sure projected CCAC ratios fit within long-term targets

Specified Ratios Targeted

Profitability

- Operating ratio
- Excess margin ratio
- Net operating margin
- Net operating margin ratio – adjusted

Liquidity

- Days cash on hand
- Cash to debt

Capitalization

- Debt service coverage
- Debt to total assets

Critical Success Factors in Meeting Annual Targets



- ◆ Net entrance fee receipts
- ◆ Positive operating performance
- ◆ Sustained occupancy levels
- ◆ Management of payor mix

Tools for Monitoring Routine Reporting

- ◆ Monthly financial statements, general ledgers, variance reports, census reports and capital spending to operating managers
- ◆ Budget Task Force
 - Guide new budget development
 - Monitor monthly actual results
 - Provide leadership in making mid-year corrections should results materially vary from budget

Board Involvement

- ◆ Monthly review of operations
- ◆ Monthly review of capital spending
- ◆ Monthly review of investment returns and review of investment mix every six months
- ◆ Review of long-range plans as updated, usually several times per year

Quarterly Reporting

- ◆ Quarterly reports are in same format as the annual audit to allow consistency in calculating ratios
- ◆ Quarterly reports are sent to:
 - **Investors, Bond Trustee, LOC Bank**
 - **Board including CCAC ratios**
- ◆ Quarterly town hall meetings are held with residents to discuss financial performance as well as other business issues affecting the organization

Compensation



The compensation policy was recently upgraded to be more performance-based.

This system is currently evolving as operating performance is stabilized.

Establishing Performance Targets

- ◆ Identify key statistics and ratios
- ◆ Not only financial measures, but also operational measures
- ◆ Leading indicators as well as lagging indicators

Key Statistics and Ratios

Revenue Items



- ◆ Occupancy
 - Turnover rate
 - Average unit downtime
 - Wait list readiness
- ◆ Fee Increases
- ◆ Investment Returns

Key Statistics and Ratios

Expense Items

- ◆ Cash operating expense increases, excluding interest
 - By level of care
 - By department
- ◆ Productivity measures
 - FTEs/resident
 - Nursing hours/resident day
 - Number of units cleaned/housekeeping FTE

Establishing Performance Targets

- ◆ Past performance and trends
- ◆ Industry performance and trends
- ◆ Projections of the future using reasonable assumptions
based on analysis of past and industry experience

Past Performance and Trends



- ◆ Financial ratios can vary significantly depending upon fee structure, contract provisions, age of facility, and type of financing
- ◆ Focus on items that are controllable; for which management can be held accountable

Industry Performance and Trends



Sources of data:

- ◆ Trade Associations
- ◆ Rating Agencies
- ◆ Investment Banking Firms
- ◆ Consulting Firms
- ◆ Governmental Agencies

Projections of Future Performance

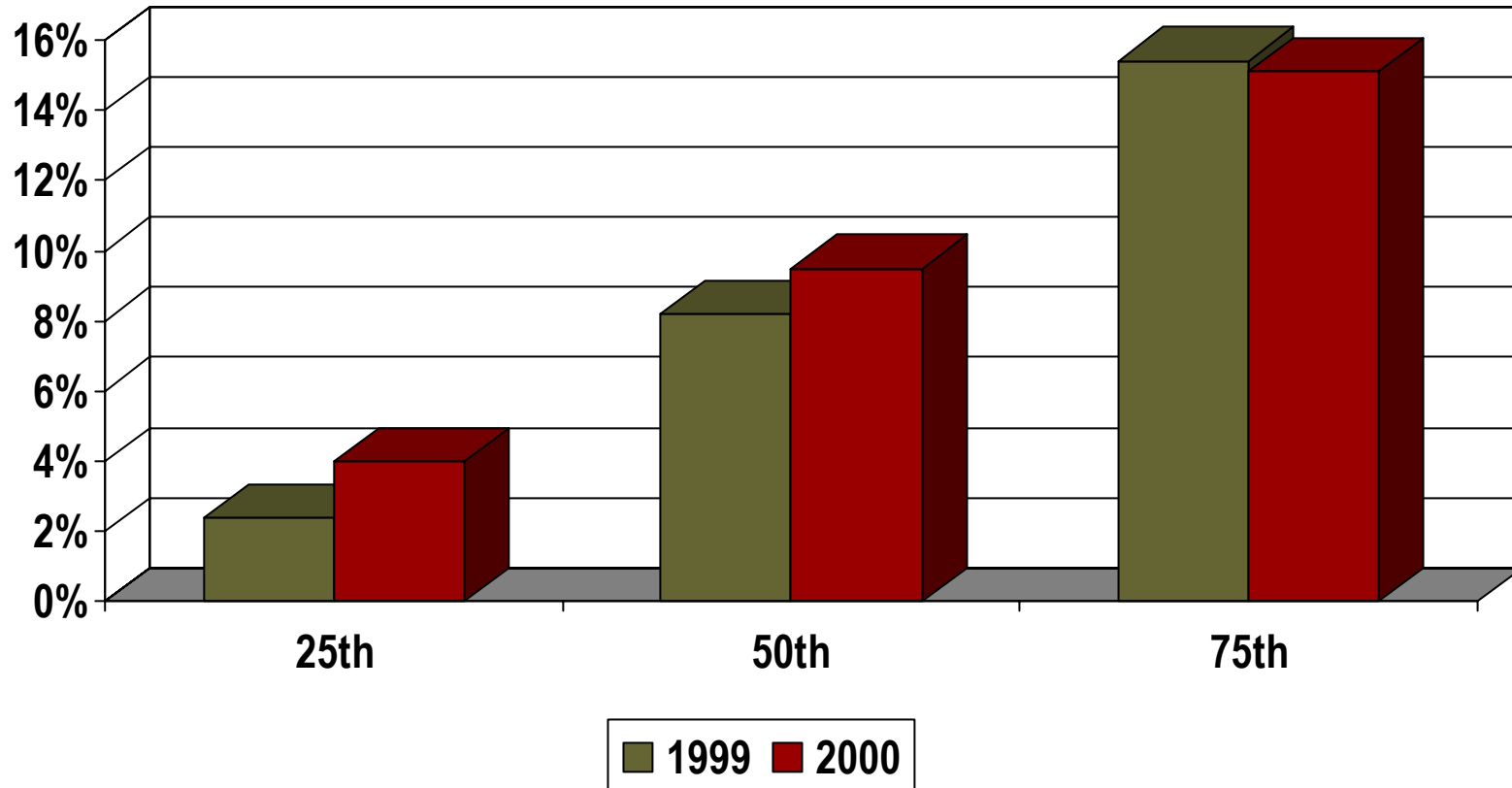
- ◆ Use financial models to project future under various scenarios
- ◆ Update when variances become known to assess impact and evaluate potential action plans
- ◆ Actuarial-based model incorporates long-term liabilities associated with CCRC contracts and provides customized targets for financial results

Actuarial Ratios

Profitability – New Entrant Pricing Surplus

- Provides revenue over expense margin for expected duration of new contracts
- Compares entry fee and monthly fees, less refund payment, to allocated share of operating and capital costs
- Based on actuarial projection of life expectancy and health care utilization

Actuarial Ratios: Industry Performance New Entrant Pricing

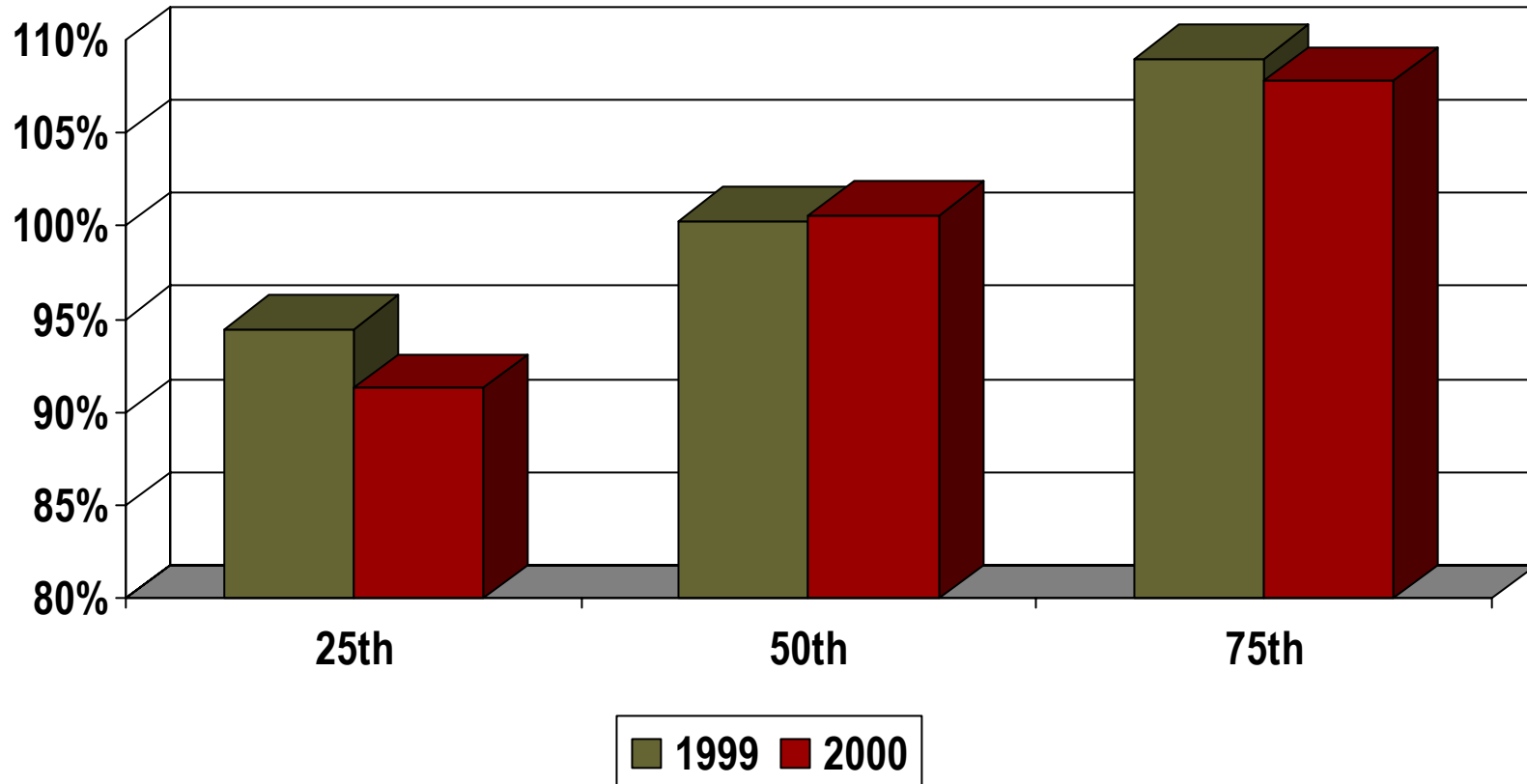


Actuarial Ratios

Liquidity (Solvency) – Funded Status

- Provides reserve adequacy ratio for expected duration of existing contracts
- Compares actuarial assets to actuarial liabilities to evaluate true “net worth” or economic value of CCRC
- Actuarial assets include investments in dollars and investments in fixed assets, net of debt
- Actuarial liabilities include allocated share of operating and capital costs, and refund costs

Actuarial Ratios: Industry Performance Funded Status



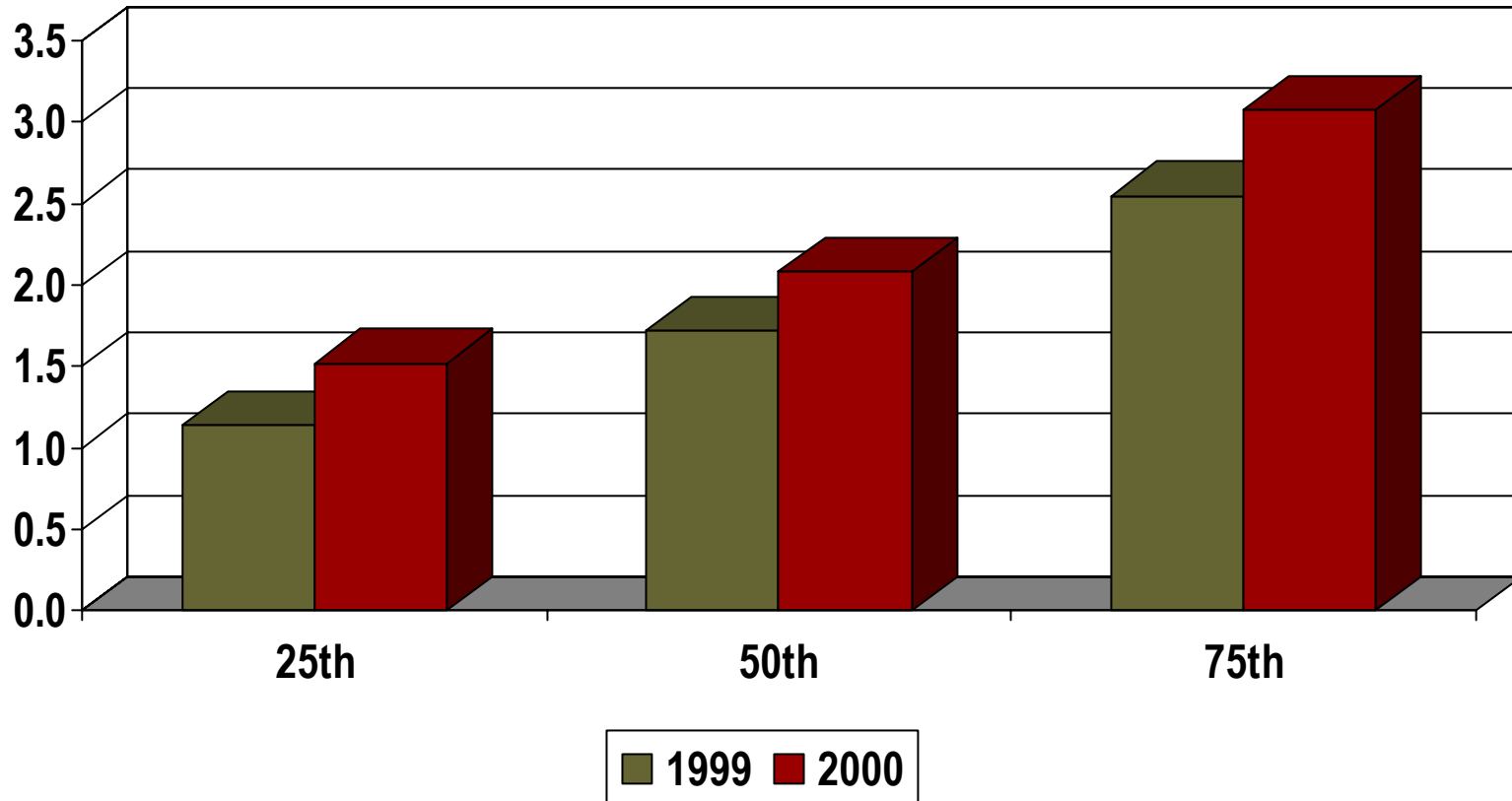
Actuarial Ratios

Capital Structure – Cash Flow

- **Actuarial-based 20-year projection of cash sources and uses**
- **Reflects contract provisions and assumptions related to revenue and expense items and future capital expenditures**
- **Basis for financial ratios**

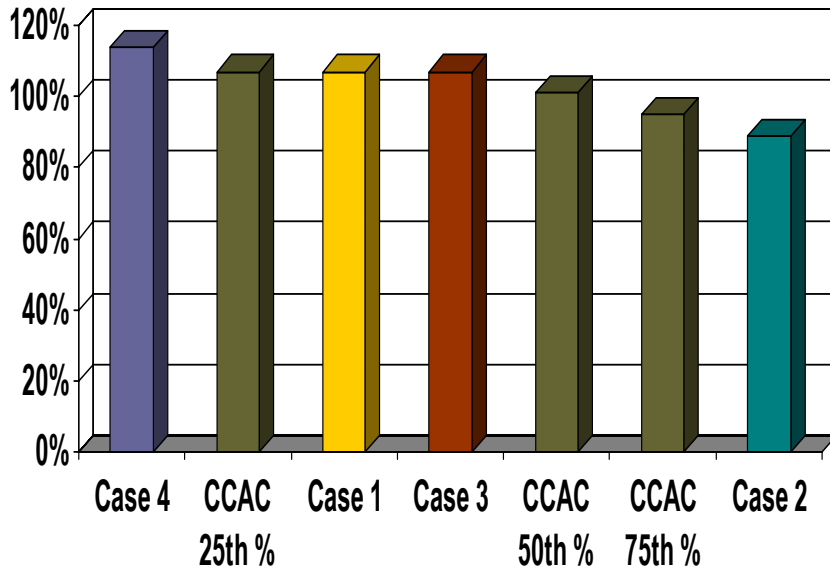
Actuarial Ratios: Industry Performance

10-Year Reserve Increase Factor

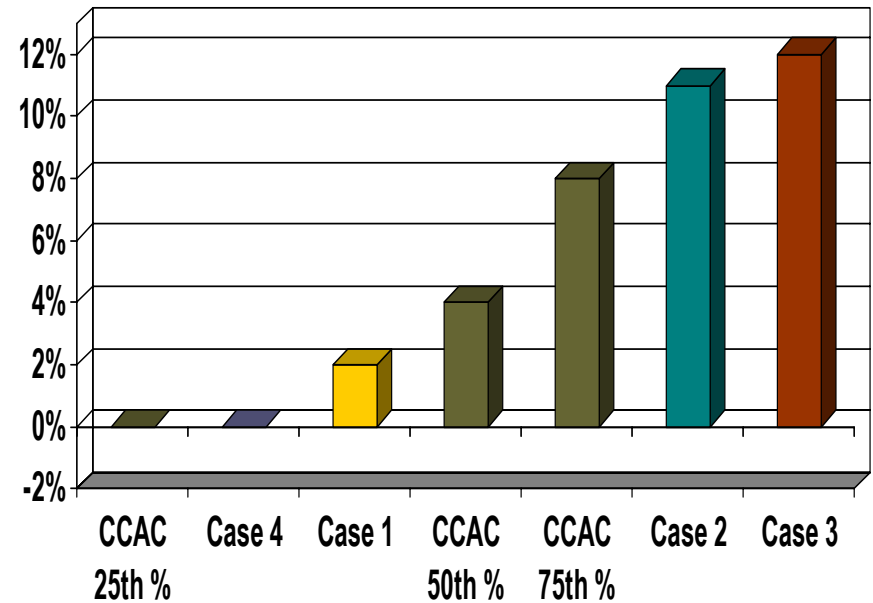


Comparison of Four CCRCs with 100% Funded Status

Operating Ratio

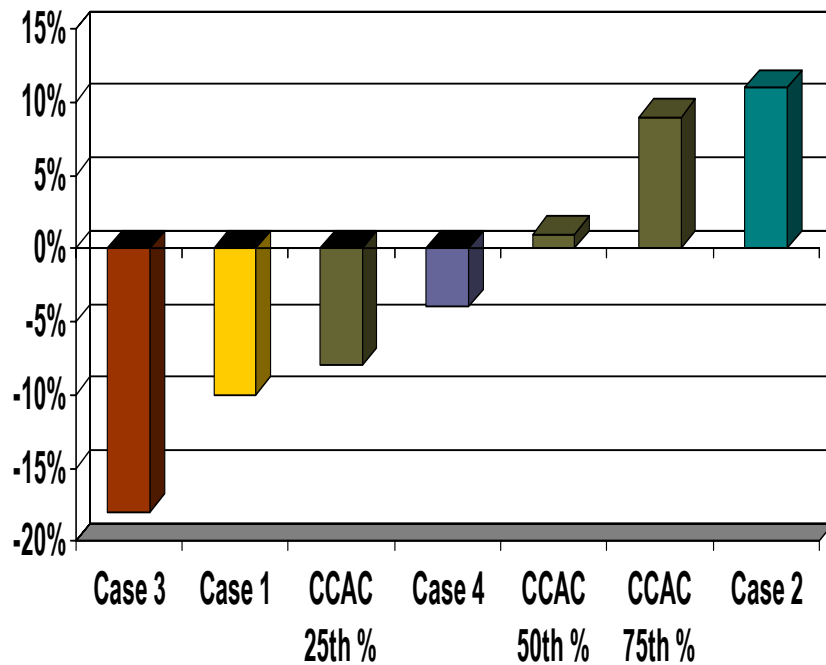


Excess Margin Ratio

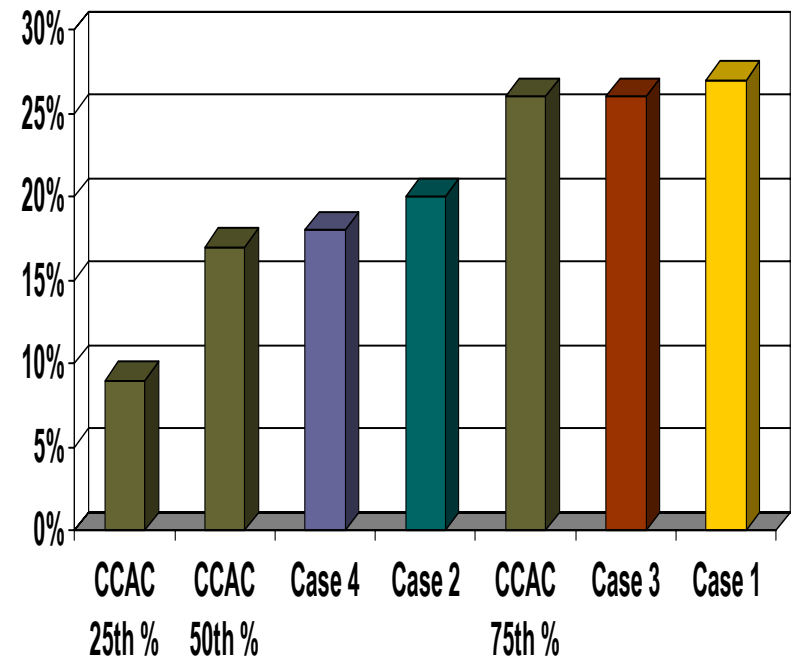


Comparison of Four CCRCs with 100% Funded Status

Net Operating Margin Ratio

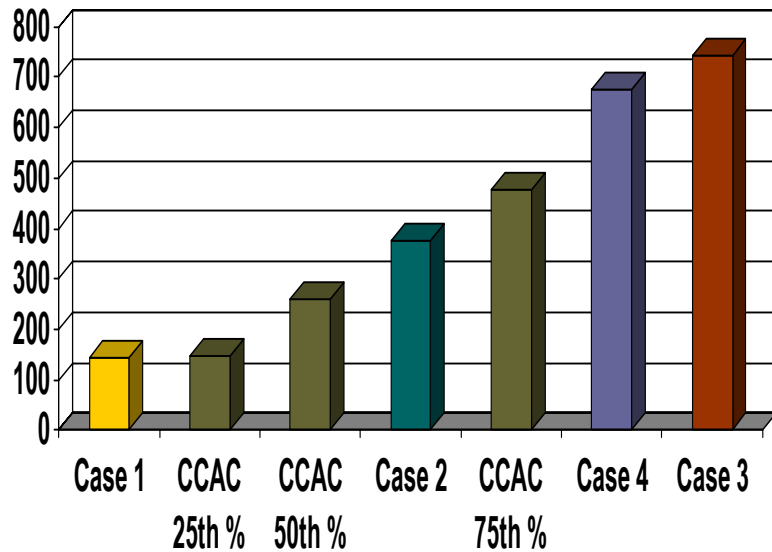


Net Operating Margin Ratio - Adjusted

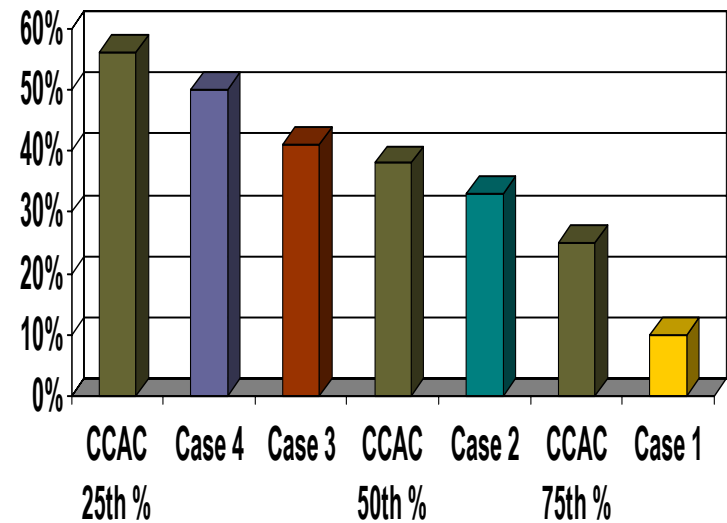


Comparison of Four CCRCs with 100% Funded Status

Days Cash on Hand



Debt to Total Assets



Summary of Four CCRCs with 100% Funded Status

	Quartile Rankings *			
	Case 1	Case 2	Case 3	Case 4
Operating Ratio	3	1	3	4
Excess Margin Ratio	3	1	1	3
Net Operating Margin	4	1	4	3
Net Oper. Margin – Adj.	1	2	1	2
Days Cash on Hand	4	2	1	1
Debt: to Total Assets	1	2	3	3
* 1=above 75 th %; 2=75 th -50 th %; 3=50 th -25 th %; 4=below 25 th %				

Summary



- ◆ Financial ratio targets must be specific to individual community
- ◆ Customized targets can be developed from actuarial-based financial projections
- ◆ Ratios and statistics selected as key performance measures must be monitored at least quarterly by board and management