

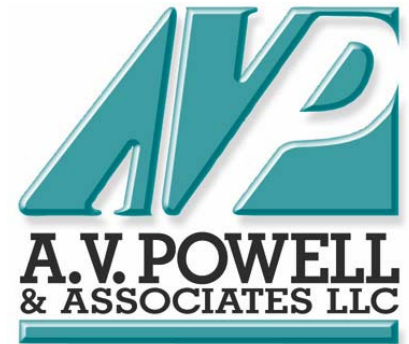
# Capital Repair & Replacement and Integrated Strategic Planning

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# Outlines of Consideration



- Developing budgets & financial plans
- Pitfalls of traditional financial plans
- Brief review of condition assessments
- Condition-based financial planning
  - **Thinking long-term**
  - **Developing opinions of cost**
  - **Extending service lives**
  - **The importance of maintenance**
  - **Computer aided planning tools**

# Developing Budgets & Financial Plans

- Do you prepare an annual budget?
- How far out do you look?
- How & when do you predict future costs?
- Do you find your predictions to be accurate?
- What tools do you use in your planning?
- Can you adequately justify your budgets?

# Challenges of Traditional Financial Planning

- Financial plans are not based upon condition assessment
- Have a tendency to look short-term
- Use previous budgets as basis
- Have difficulty justifying budgets
- Have difficulty predicting system failures
- Have difficulty prioritizing projects
- Have lack of resources for proper PM
- Accumulate deferred maintenance due to financial pressures

# Condition Based Financial Planning

What does this mean?

In short . . .

Basing financial planning efforts on the condition of the facility with the objective of maintaining, or improving, the overall condition of the facility in order to optimize performance, appearance, serviceability and life cycle costs.

# Life Cycle Costs

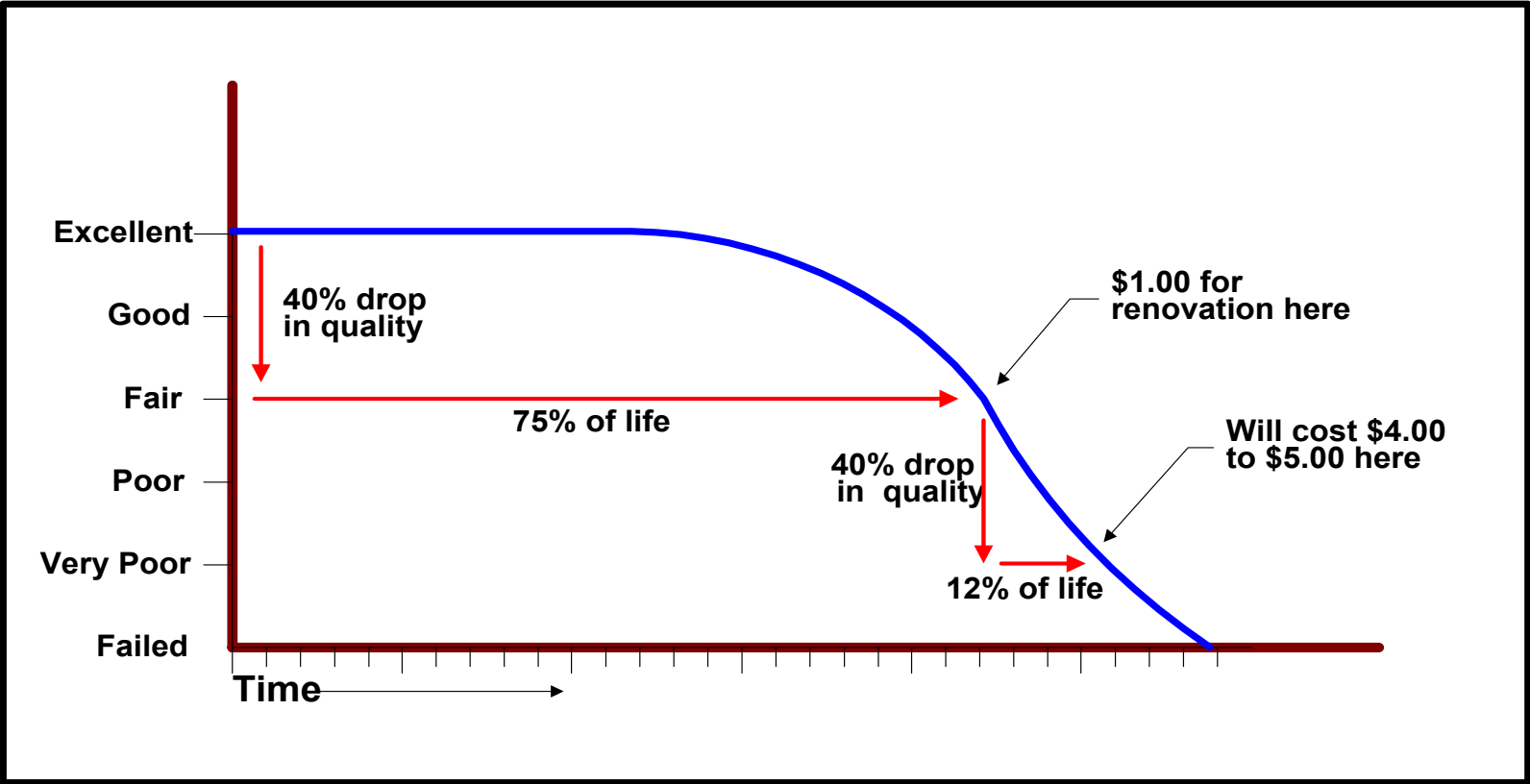


Figure 1 - Life Cycle Curve

# Where Does One Begin?



Do you assess your facility's condition?

If yes ...

- What are you looking at?
- How often are you looking?
- Are you updating your findings?
- Are you using the information?
- How are you using the information?
- Is it an INTEGRAL part of your financial planning process?

# Assessing Condition



Condition assessment can include:

- Assessment of physical condition
- Review of maintenance procedures
- Review of repair and replacement trends
- Review of capital and operating budgets

# Managing the Data



- Read and understand your condition assessment
- Look at the condition assessment data for future repair and replacement forecasts; recognize the frequency of the repairs or replacements
- Use the data for your long-term financial planning

# Managing the Data (cont.)



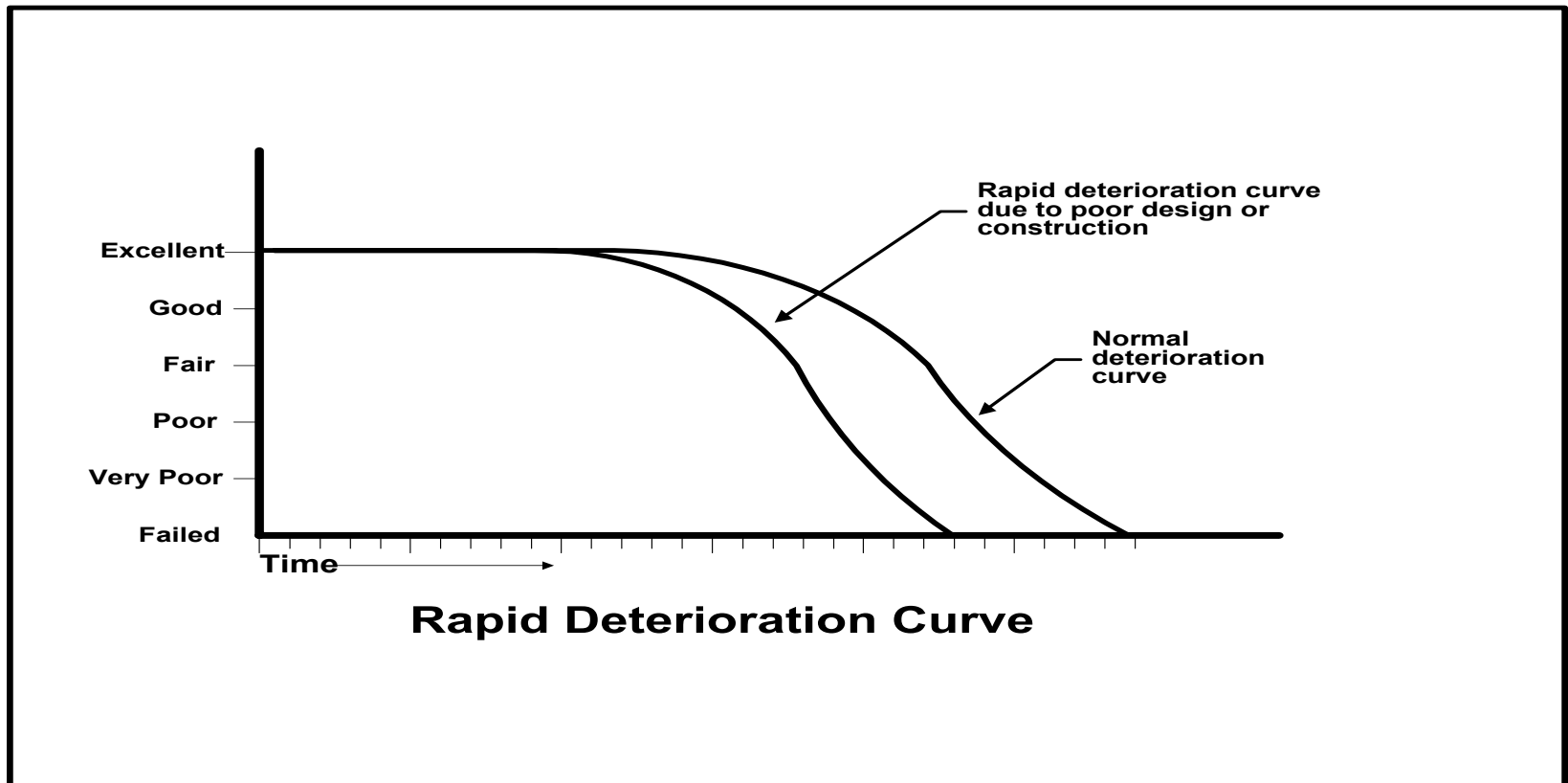
- Create or use available tools (database, spreadsheet, etc.) to manage the data and update it in the future
- Store and maintain the data so that personnel changes won't affect future planning efforts; don't let management changes render the data obsolete

# Long-term Planning

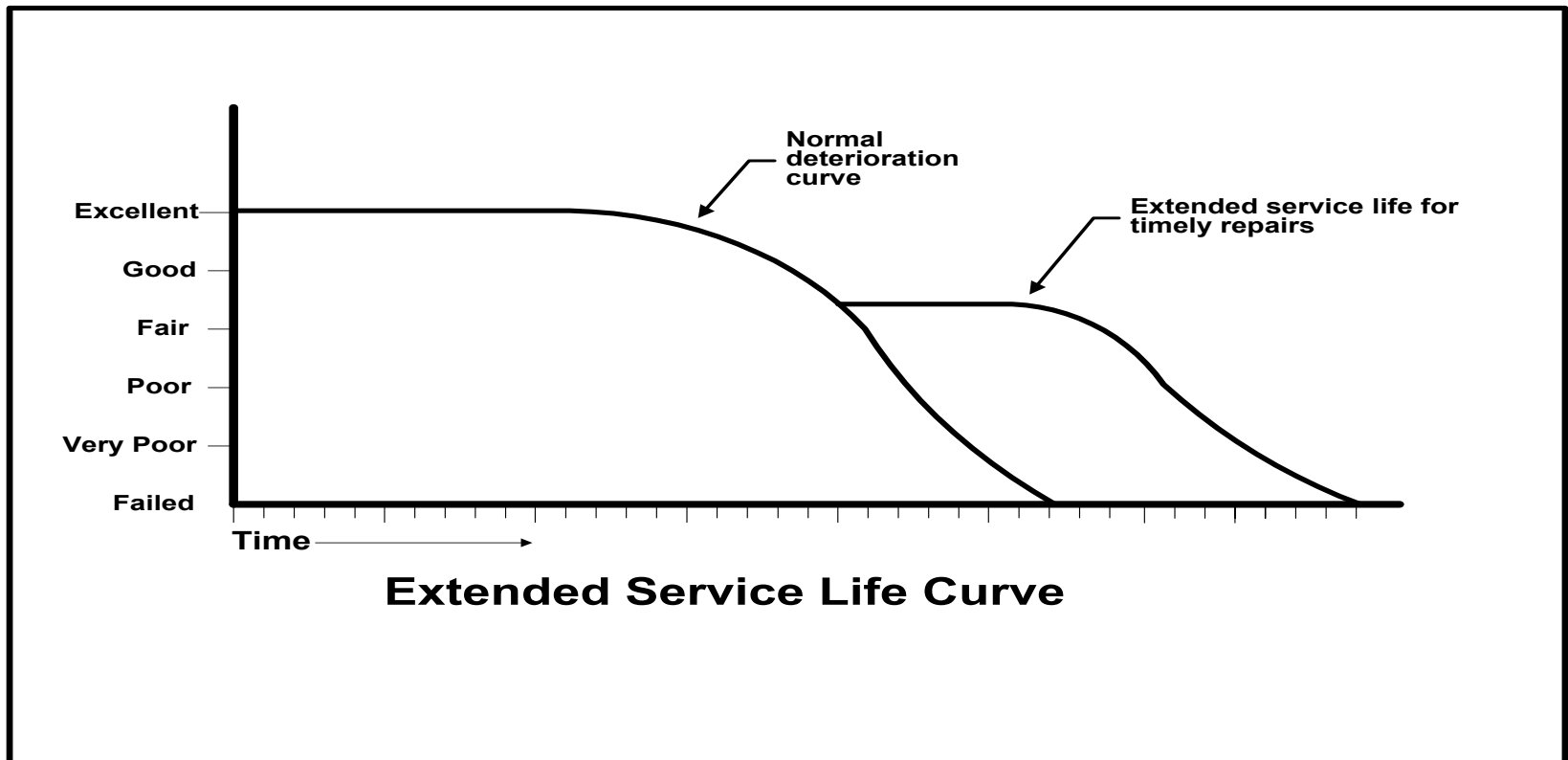


- Most financial plans are not looking beyond the first few years
- Most budgets do not consider the long-term effects of the current maintenance program

# Long-term Planning - System Deterioration



# Long-term Planning - System Deterioration



# Measuring your Facility's Health

- Make sure you know what condition your facility is in
- Determine what it will take to get your facility healthy ... physically and financially
- Use a method of measuring your facilities condition that can be used now and in the future

# Understanding your Costs

What does it cost to run your Facility?

## ■ Capital Costs

- Building system repair/replacement costs
- Damages due to system failures
- Code/Regulatory Agency upgrades
- Improvements, expansions, etc.

# Understanding your Costs (cont.)

- Operating costs
  - In-house maintenance costs
  - Outsourced maintenance contracts
  - Utility costs
  - Tenant-related costs
  - Taxes, insurance, salaries, etc.

# Developing an Opinion of Cost



- Your own cost records
- Bids from contractors or vendors
- Professional estimating service
- Engineer / architect opinion of cost
- Printed cost estimating guides
- Cost estimating software

# Developing an Opinion of Cost

What to consider with repair & remodel cost estimating

- Every project is different
- “As-built” drawings are not always available, or accurate
- Requires more time on site to accomplish similar tasks in new construction
- Must consider restrictions of existing structures

# Developing an Opinion of Cost (cont.)

- Matching existing materials may be difficult or impossible
- Complete plans and specifications for the work are not always available
- There are always possibilities of “hidden conditions”
- Must consider disruption and inconvenience to building occupants

# Developing an Opinion of Cost (cont.)

- May be required to upgrade to existing facilities to comply with current codes if scope of work requires it
- Must deal with challenges of demolition and disposal of existing materials and construction
- Must identify and possibly abate hazardous materials in the existing building

# Developing Budgets

## Typical budget components

- Capital budget
  - Items budgeted to occur at some time over the budget period that are not considered part of the normal operating, maintenance, and/or repair of the facility
- Operating budget
  - Items that are considered part of normal operating, maintenance and/or repair of the facility

# Developing Budgets



## Budget Gray Area

- Where budgets overlap ...
  - General maintenance & repair that is overlooked ... becomes DM
  - Preventive maintenance that is overlooked ... becomes DM

# Developing Budgets

- Where budgets overlap (cont.)
  - Legal, professional & administrative fees involved in capital repair or replacement projects, which can often contribute a significant percentage to the overall capital repair or replacement project budget

# Developing Budgets



Typical capital budget includes:

- Repairs or replacements based on EUL and RUL criteria
- Repairs or replacements due to premature failure (lack of PM)
- Accumulated Deferred Maintenance (DM)
- Code or regulatory agency upgrades
- Other projects identified by condition assessment

# Integration of Capital Plan with Strategic Plan

## CCAC Standards:

- Strategic plan integrates with financial, **physical plant** and marketing plans
- Five-year capital repair and replacement plan
- Financial projections must reflect capital replacements

# Planning for Capital Needs



- Identify capital expenditures
- Assess financial projections over next five years (or longer)
- Assess pricing and funding adequacy over long-term

# Identify Capital Expenditures



## **Comprehensive Approach:**

- Capital repair and replacement plan (CRR)

## **Alternative Methods:**

- One year budget (BUD), inflated
- GAAP useful life (GUL) replacement

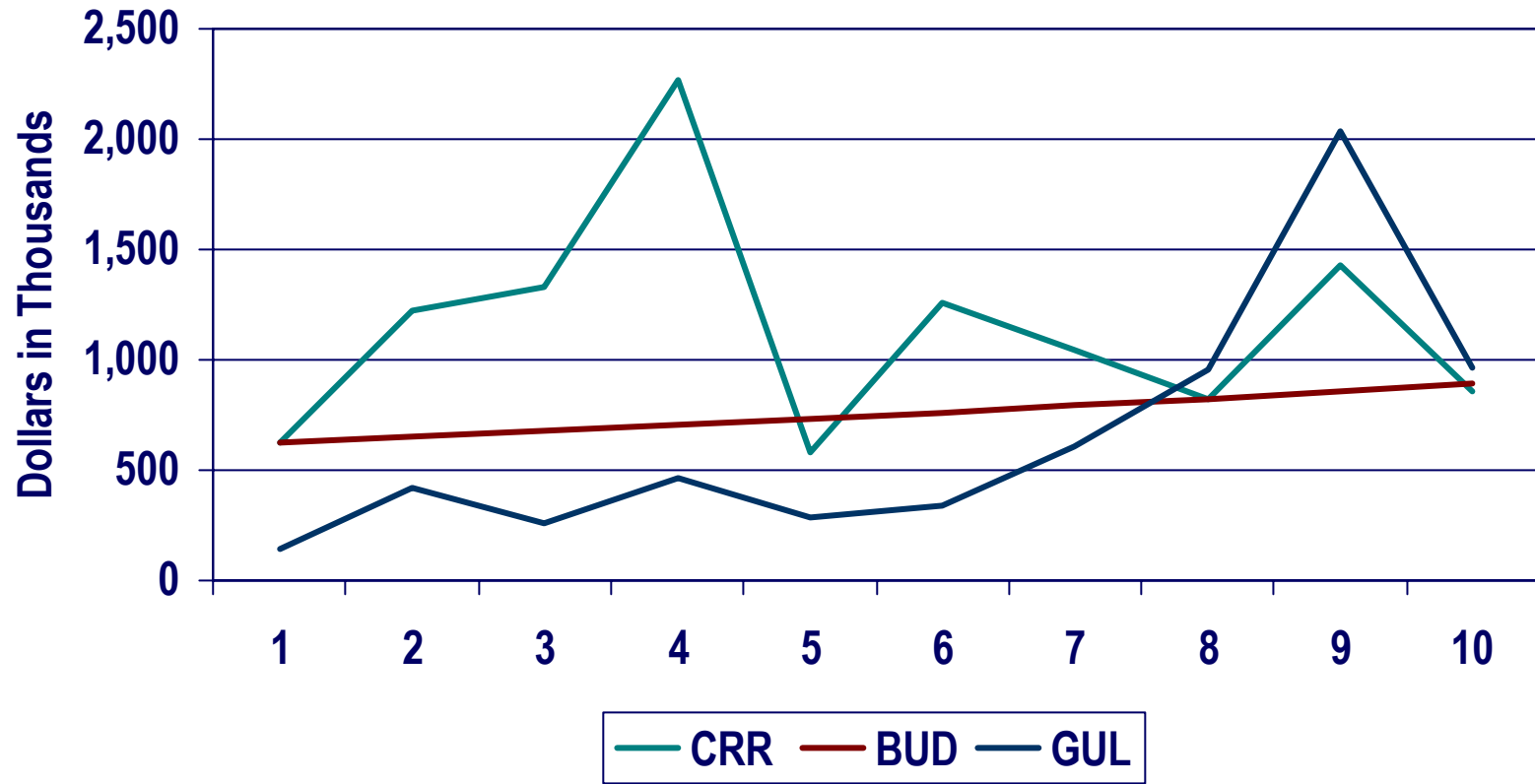
# Case Study

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## CCRC built in 1998

- ◆ 250 ILU
- ◆ 60 ALU
- ◆ 60 NC

# Capital Expenditure Scenarios

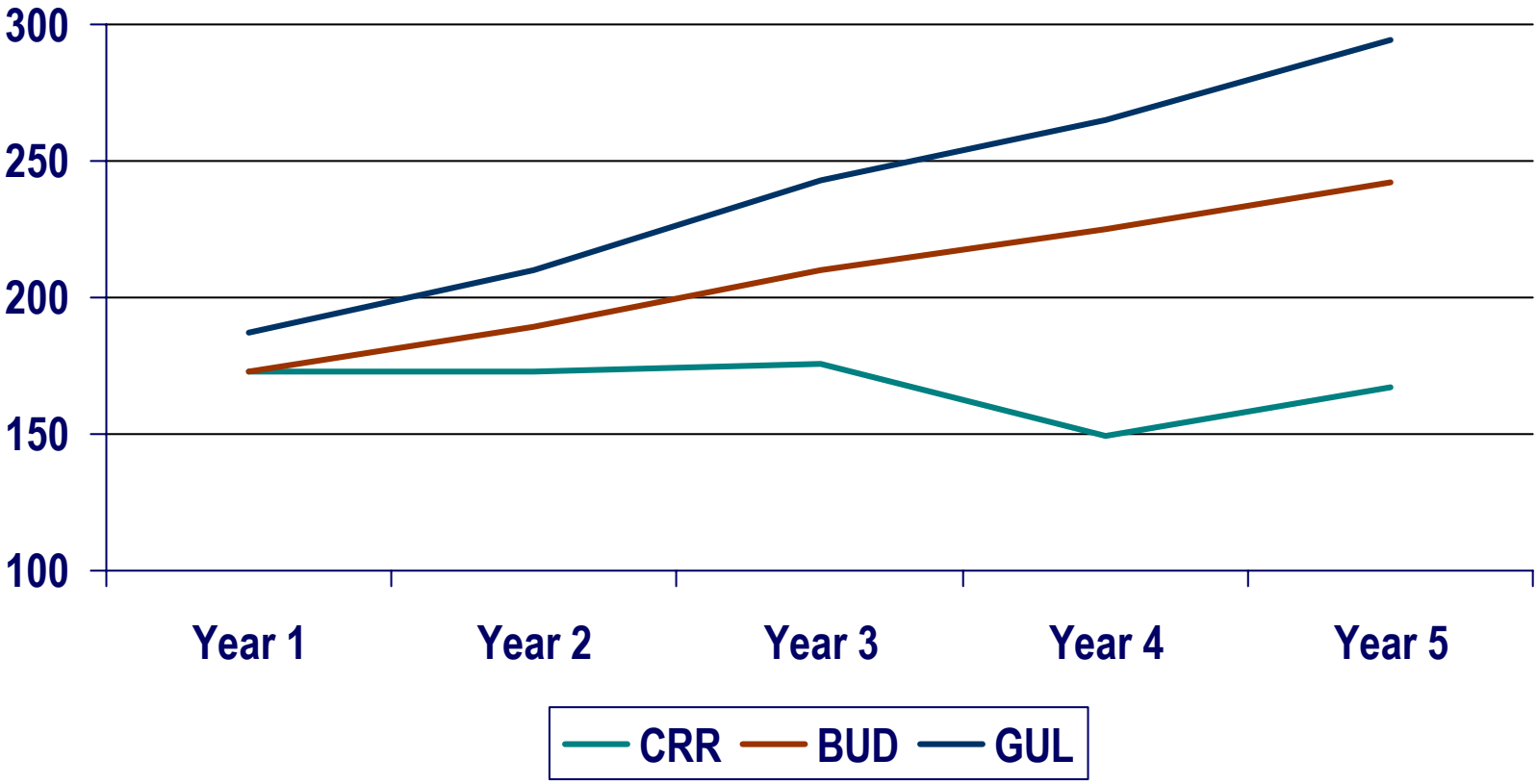


# Assess Financial Projections

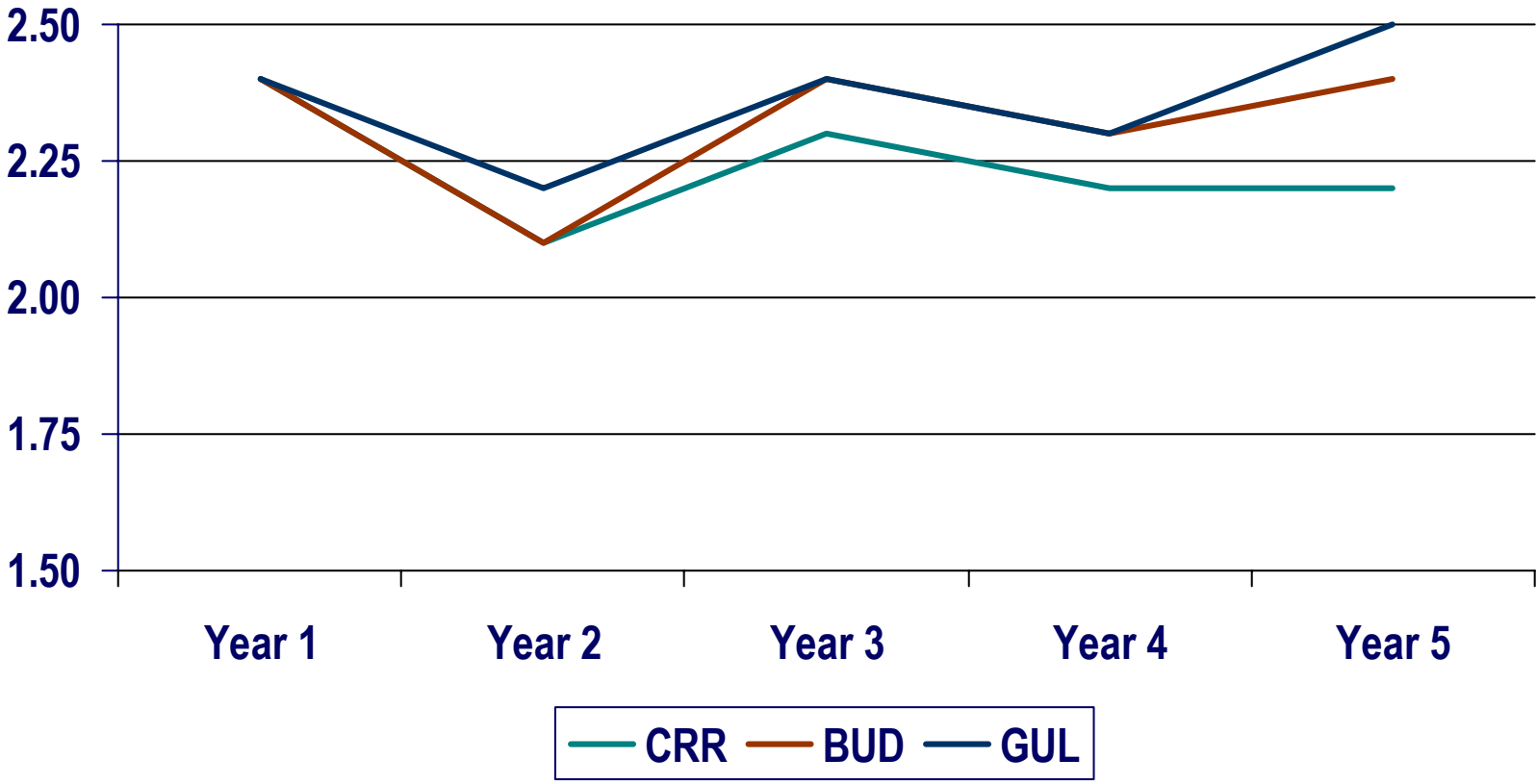


- Prepare five-year projected financial statements to determine whether cash will be available to fund capital needs
- Analyze key financial ratios over projection period

# Financial Ratios - Days Cash



# Financial Ratios - Debt Service Coverage



# Financial Ratios - Summary



Capital budgets based on one-year estimate or GAAP useful life can:

- result in overstatement of financial ratios
- lead to bad management decisions

# Assess Pricing and Funding Adequacy

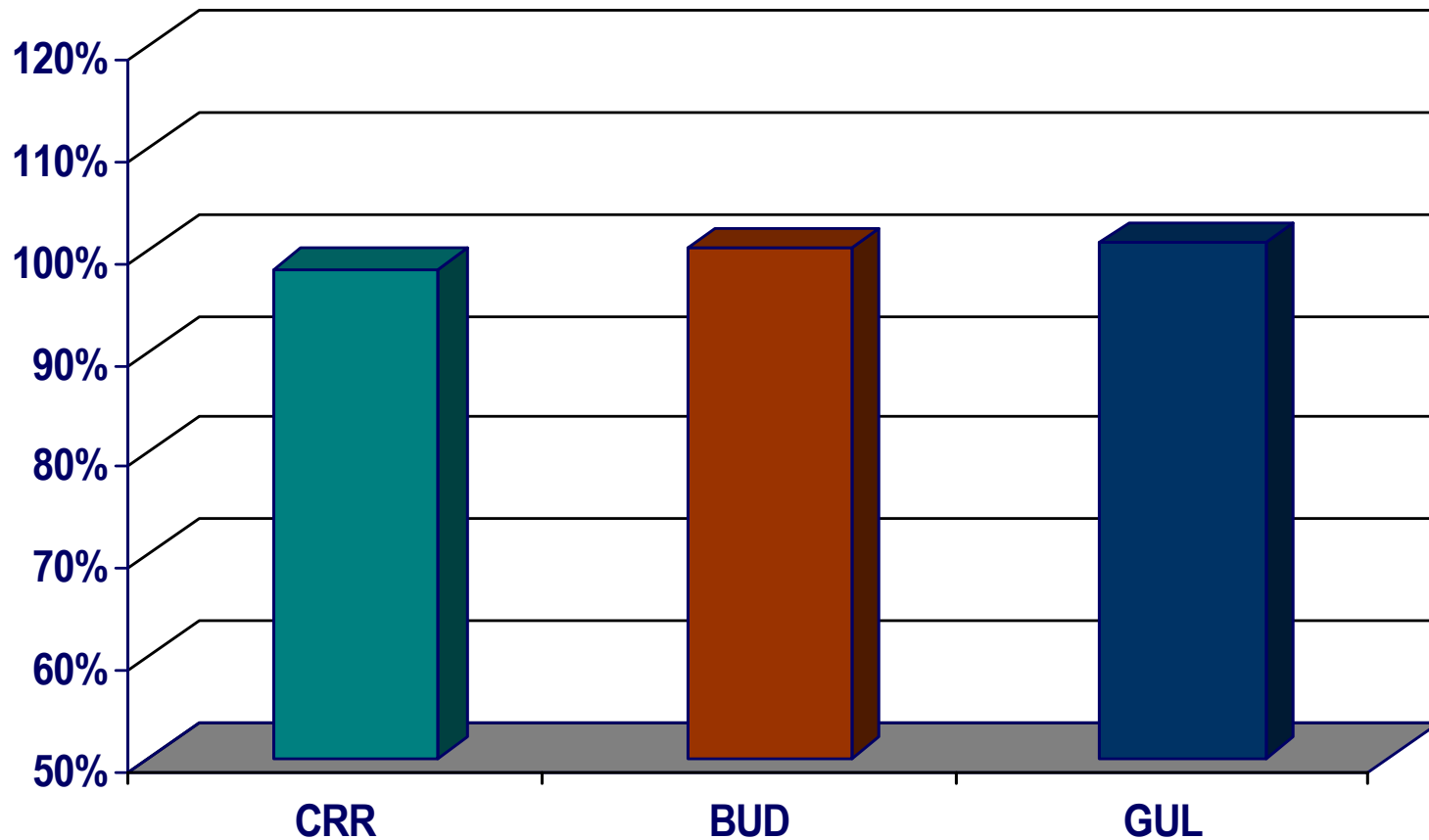


Future capital expenditures are a key assumption in actuarial studies, because a share of capital is allocated to each generation of residents to reflect usage of facility

# Funding Adequacy

- Actuarial valuation shows reserves required to fund future costs not covered by monthly fees
- Actuarial reserves consist of:
  - cash and investments
  - fixed assets (investment to provide housing component of contract)

# Actuarial Valuation - Funded Status



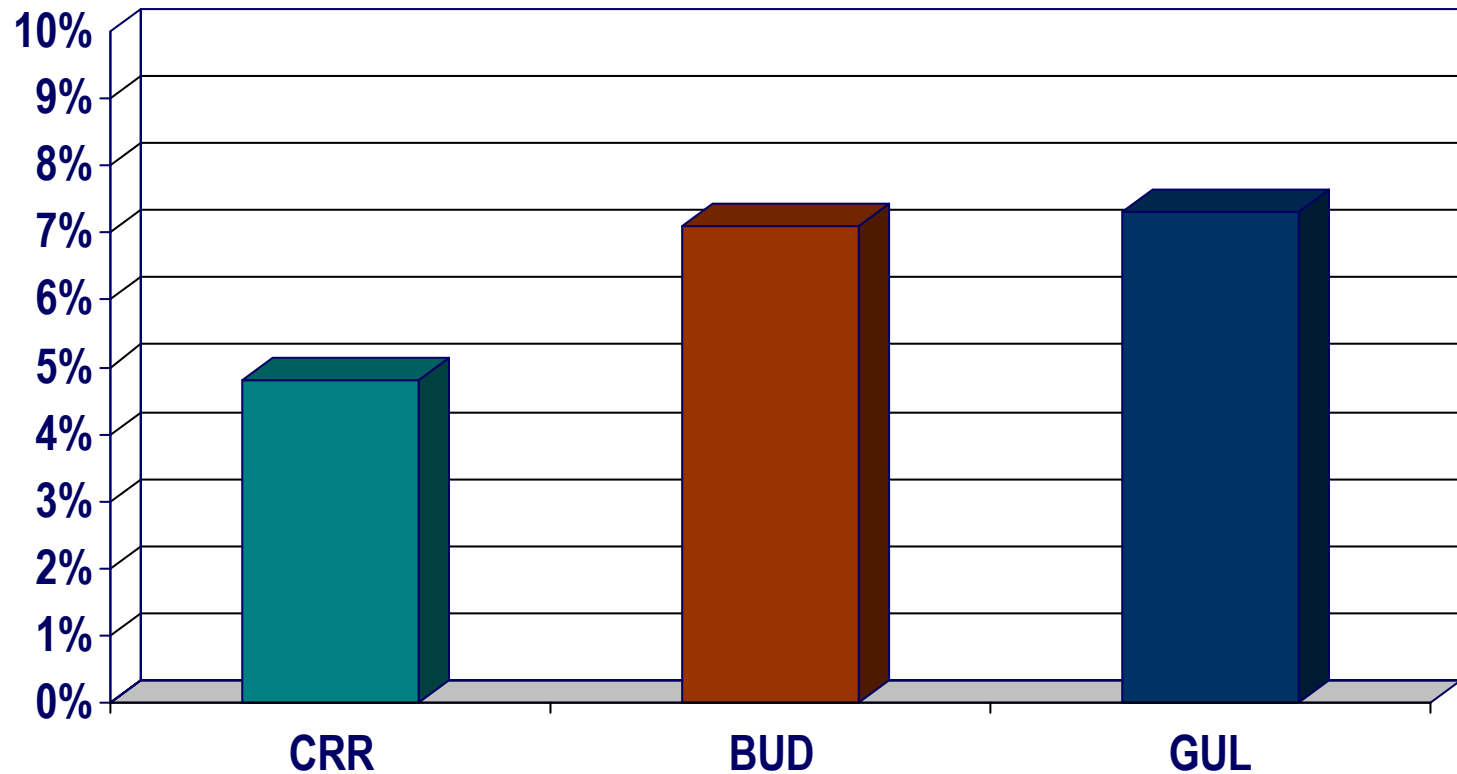
# Pricing Adequacy



Actuarial pricing shows whether entrance fees and monthly fees are adequate to cover contractual costs over a resident's lifetime:

- share of operating costs
- share of capital expenditures

# Actuarial Pricing - New Entrant Surplus



# Capital Spending Sensitivity

To attain BUD/GUL pricing results (7% surplus) with CRR capital spending:

- Increase monthly fees 5%

or

- Increase entrance fees 7%

# Funding Future Capital Needs



Present value of expenditures  
equals  
Present value of reserves  
plus future contributions

# Comparison of Funding Approaches

- Present value of 20 year CRR capital plan  
= \$ 13.5 million
- Some alternative funding streams
  - \$ 675,000/year level
  - \$480,000/year inflated
  - \$500,000/year 1st 10 years;  
\$1 million/year next 10 years
- Look at annual cash flows

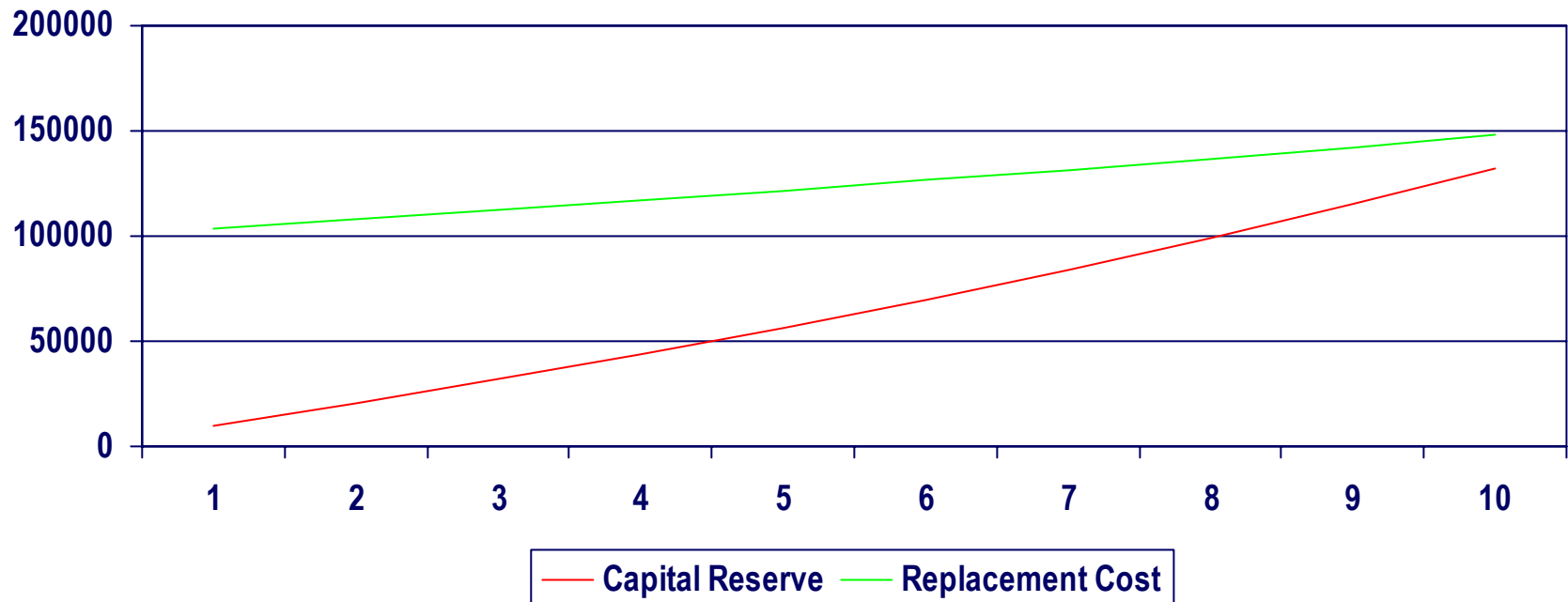
# Funding Depreciation

- Depreciation is an accounting expense that reflects the consumption of a fixed asset over its expected useful lifetime
- Funding the annual depreciation expense may not be adequate to meet future capital needs
  - Fixed assets may need repair or replacement before the end of their assumed useful life
  - Community may have new growth plans
  - Replacement costs in an inflationary environment may be higher than depreciation contributions plus accumulated interest

# Funded Depreciation Test

■ \$100,000 Asset, 10 year life

■ 4% inflation, 6% interest earnings



# Funding Future Capital Needs



- Funding is implicit in actuarial approach if valuation shows adequate reserves and pricing shows surplus
- Many CCRCs do not have designated capital replacement reserves

# Summary



- Quantify future capital needs over a long period of time
- Regularly monitor financial and actuarial ratios to determine if funding is adequate