Evaluating CCRC Solvency

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Helping you solve your management challenges
Overview

◆ Defining solvency
◆ Methods of measuring solvency
◆ Case examples
◆ How do we use this information?
How Do You Determine Solvency?

◆ What is the definition of solvency?
◆ Stakeholders opinions
  ▪ Board and management
  ▪ Residents
  ▪ Regulators
  ▪ Financing institutions
General Definition of Solvency

Do the assets of your organization equal or exceed your liabilities?
Hierarchy of Solvency Criteria

◆ Level One (Residents)
  ■ Cash inflows projected to exceed cash outflows
  ■ No technical defaults of loan covenants

◆ Level Two (Regulators and Financing Institutions)
  ■ Projected accumulation of significant reserves
  ■ DSR and Cash-to-debt ratios exceed targets

◆ Level Three (Board and Management)
  ■ Meets criteria for satisfactory actuarial balance
Potential Measures of Solvency

- State CCRC statutes (regulation)
- Bond covenants
- A pre-defined set of ratio criteria (targets)
- Feasibility studies prepared in accordance with GAAP
Solvency Measures in Regulation

◆ No federal or national standards

◆ Four regulatory categories

  ■ Primarily disclosure or filing (19 states)
  ■ Minimum assets accruals (9 states)
  ■ Alternative reserve valuation (2 states)
  ■ Actuarial reserve valuation (5 states)
Distribution of Regulatory Categories
Solvency Measures in Bond Covenants

- Minimum debt service coverage requirements
- Possible cash-to-debt thresholds
- Concerned only with ability to repay bonds, not obligations to residents
Solvency Measures using Ratio Analysis

◆ Is there a “magic set” (high statistical correlation) of ratio that would indicate that a CCRC is solvent?

◆ If so, how does it vary and what are criteria for:
   ■ Mix of contract types
   ■ Age of facility
   ■ Unit configuration
Solvency Measures from Feasibility Study

◆ Five-year financial projection is too short to uncover long-term pricing problems
◆ Expectation that $0 GAAP future service obligation means that all liabilities are fully funded
◆ Which measure indicates net worth? FSO or Net Assets
ASOP No. 3 Conditions for Satisfactory Actuarial Balance

- Developed by American Academy of Actuaries Committee on CCRCs
- Adopted by Actuarial Standard Board, July 1994
- Defines three criteria to be tested by:
  - Condition 1—Actuarial balance sheet
  - Condition 2—Cohort pricing analysis
  - Condition 3—Cash flow projection
Condition 1: Funded Status @ 100%

- Are the resources available for current residents greater than or equal to the actuarial present value of the expected costs of meeting all remaining obligations to such residents under their contracts, with appropriate provision for surplus?

- Laymen’s terms—do the reserves held by the organization, which include liquid assets and PP&E, cover the shortfall between future costs and fees?
Condition 2: New Entrant Pricing Surplus @ 0%

Does the sum of entry fees paid plus the actuarial present value of monthly fees equal or exceed the actuarial present value at occupancy of the costs for meeting all obligations for a typical cohort of new entrants, with appropriate provision for surplus?

Laymen’s terms—will the combination of future monthly fees and entry fees cover the expected future costs of care and entry fee refunds for a group a new residents?
Condition 3: Projected Cash Balances @ $0

◆ Are positive cash balances projected with respect to current and future residents for a period of at least twenty years?

◆ Laymen’s terms—is the facility projected to generate sufficient cash to pay its expenses?
Why Use the Actuarial Conditions?

- Consistent
- Comprehensive
- Robust in handling facility uniqueness (variations)
- Procedural and applicable in real life
- 20 year history of meaningful use
How Do You Determine Your Actuarial Position?

◆ Collect and analyze data
  ■ Resident demographics
  ■ Resident movements
  ■ Operating and capital budgets and history
◆ Project future population flows
◆ Generate financial projections
  Population flows ←→ Financial assumptions
How Do You Determine Your Actuarial Position? (continued)

◆ Evaluate financial projections
◆ Test sensitivity to alternative assumptions
  ■ Changes in economic assumptions
  ■ New entrant contract selection
  ■ Changes in health care utilization
◆ Discuss results and develop pricing policies
Empirical Data on Condition 1 Funded Status

- Median is fully funded
- Recommended surplus depends on age of facility, mix of continuing care contracts and their risks
- AVP standards are: 5 to 10% surplus

![Bar chart showing comparison between 1999 and 2000 Prelim funded status]
### Do Reserves and Fees for Current Residents Cover their Costs?

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Monthly Fees</td>
<td>$77.1 million</td>
</tr>
<tr>
<td>Actuarial Reserves</td>
<td>30.8 million</td>
</tr>
<tr>
<td>Ind. Living Costs</td>
<td>60.5 million</td>
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<tr>
<td>Assisted Living Costs</td>
<td>21.0 million</td>
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<tr>
<td>Nursing Costs</td>
<td>26.6 million</td>
</tr>
<tr>
<td>Refund Liabilities</td>
<td>0.6 million</td>
</tr>
<tr>
<td>Actuarial Deficit</td>
<td>($0.8 million)</td>
</tr>
</tbody>
</table>
Calculation of Funded Status?

100% +

Actuarial Deficit \( (\$ 0.8 \text{ million}) \)

Divided by

Total Actuarial Liabilities \( 108.1 \text{ million} \)

+ Refund Liability \( 0.7 \text{ million} \)

= Funded Status \( 99.3\% \)
Empirical Data on Condition 2
New Entrant Pricing Surplus

- Median is nearly 9%
- Recommended surplus depends on size of facility, type of continuing care contract and its risk
- AVP standards are: 10 to 15% surplus
Do Entry and Monthly Fees for New Entrants Cover their Costs?

Entry Fee $133,602
- Expected Refunds (3,699)
Future Monthly Fees 382,943
- Cohort Liabilities 505,590
Actuarial Surplus $7,256
Calculation of New Entrant Surplus (Deficit)?

Actuarial Surplus $7,256
Divided by
Total Cohort Liabilities 505,590
+ Refund Liability 3,699
= Actuarial Surplus 1.4%
Empirical Data on Condition 3
Projected Cash Balances

- Median is increasing cash balances
- Recommended position is for reserves to at least match increases in expenses since liabilities will approximately increase the same
- AVP standards are: 1.48 to 1.79 (10 year growth)
Calculation of 10-Year Projected Reserves

Projected Liquid Reserve Balance $31,472,000

Divided by

Initial Liquid Reserve Balance $14,050,000

= 10-Year Reserve Change Factor 2.24x
Issues that Relate to Actuarial Opinion

◆ Consultant must apply experience and judgment in reviewing results to formulate an opinion

◆ A CCRC can be considered in “satisfactory actuarial balance” even if one criteria isn’t met initially using baseline assumptions

◆ Many solutions may exist if a CCRC doesn’t meet one or more of the criteria
Sample Financial Assumptions

ILU Occupancy

<table>
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<tr>
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<th>GPR</th>
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<th>OHK</th>
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<td>95.2</td>
<td>95.6</td>
<td>94.7</td>
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</table>

ILU Per Capita Costs (2000$)

<table>
<thead>
<tr>
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<th>Median</th>
<th>GRP</th>
<th>INV</th>
<th>OHK</th>
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<td>$43.95</td>
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<td>$33.62</td>
<td>$36.94</td>
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</table>
Case Example A

- Funded status: 99.3%
- New entrant surplus: 1.4%
- Projected cash balances: 2.24x
- $32 million in debt with expansion financing
- Are they in “satisfactory actuarial balance”? YES, barely
Actuarial Study Trends

- Funded Status:
  - 1997: 97%
  - 1998: 99%
  - 1999: 101%
  - 2000: 103%

- New Entrant Pricing:
  - 1997: 5%
  - 1998: 4%
  - 1999: 3%
  - 2000: 2%
Actuarial Study Trends

Liquid Reserve Ratio

1997 1998 1999 2000

1.5 1.7 1.9 2.1 2.3 2.5

10-Year Cash Growth

1997 1998 1999 2000
## Actuarial Report Card

<table>
<thead>
<tr>
<th>Measure</th>
<th>Result</th>
<th>Quartile</th>
<th>Grade</th>
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<tbody>
<tr>
<td>Actuarial Funded Status</td>
<td>99.3%</td>
<td>Second</td>
<td>B+</td>
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<tr>
<td>New Entrant Pricing</td>
<td>1.4%</td>
<td>First</td>
<td>B</td>
</tr>
<tr>
<td>Projected Cash Accumulation</td>
<td>2.44x</td>
<td>Third</td>
<td>A</td>
</tr>
<tr>
<td>Health Care Capacity</td>
<td>Sufficient for Expected Utilization</td>
<td></td>
<td>A-</td>
</tr>
</tbody>
</table>

Remember: Future fee increases must cover internal expense inflation or funded status may decline.
Other Case Examples

Site A
Site B
Site C
Site D

Funded Status
NE Surplus
Cash Growth

CCRC Solvency – 33
Case Example B

◆ Funded status: 103.6%
◆ New entrant surplus: 20.1%
◆ Projected cash balances: 2.83
◆ $26 million in debt
◆ Are they in “satisfactory actuarial balance”? YES
◆ Have capability for lower rates of future fee increases or expansion in non-revenue generating areas
Case Example C

- Funded status: 95.9%
- New entrant surplus: (0.6%)
- Projected cash balances: 2.36x
- $20 million in debt
- Are they in “satisfactory actuarial balance”? NO
- Increase monthly fees by 6.5% immediately, or by 1.3% over internal inflation for remaining lifetimes
Case Example D

- Funded status: 71.9%
- New entrant surplus: 30.6% ($84,000 per 28 annual turnover)
- Projected cash balances: 1.97x
- Are they in “satisfactory actuarial balance”? MAYBE
- New entrants generate $2.4 million surplus annually; project that they will show fully funded in 12 years
How Does Management Implement a Plan for Maintaining Actuarial Balance?

◆ Board should adopt policies on ranges in acceptable actuarial results from year-to-year
◆ For a 100% lifecare facility, set target:
  ■ Funded status of 103 to 105 percent
  ■ New entrant cohort surplus of 8 to 12 percent
  ■ 10-year cash projection increase of 1.70
◆ Targets will vary according to many factors
◆ Adjust fees at budget time to maintain these targets
Summary

◆ Estimating the GAAP FSO is of minimal use
◆ Trending GAAP FSO has marginal value
◆ There is no known set of ratio criteria that ensures and validates solvency
◆ Methods to achieve satisfactory actuarial balance have become the de facto standard for prudent stewardship
OVERVIEW

◆ Description and purpose of database
◆ Definition of actuarial report card
◆ 1999 and preliminary 2000 statistics
Objective was to share the distribution of results from clients that we review regularly.

It’s our opinion that these clients represent the best of CCRCs, in terms of financial condition.

Annual updates for limited number of statistics:
- 76 sites in 1999 results
- 61 sites (# of responses vary) in preliminary 2000* results
Development of Actuarial Report Card

◆ The actuarial report card has been used in to summarize the results of the actuarial study
  ■ Actuarial valuation
  ■ New entrant pricing analysis
  ■ Projected cash flows
  ■ Adequacy of health care beds

◆ Use of comparative results database allows us to more objectively assign grades
Comparative Database Grading System: Satisfactory Actuarial Balance

Based on where a client’s results falls in data, a consistent grade would be assigned
- First quartile (0 to 25th percentile)—up to B
- Second quartile (25th to 50th percentile)—B to A-
- Third quartile (50th to 75th percentile)—A- to A
- Fourth quartile (75th to 100th percentile)—A to A+

CCRCs should target grades of A or higher in all three conditions for satisfactory actuarial balance
Comparative Database Grading System: Evaluating Health Care Adequacy

◆ Appropriate to consider total combined health care needs as opposed to assisted living or nursing or dementia separately due to modeling credibility

◆ Compare capacity to expected utilization and potential variation in annual needs; grading criteria
  ■ Capacity<Expected—up to B
  ■ Expected<Capacity<90th percentile—B to A-
  ■ Expected<90th percentile<Capacity — A- to A+
Comparative Statistics from the AVP Database

- Actuarial
- Demographic
- Financial
Actuarial Statistics

- Funded Status
- New Entrant Pricing
- 10-Year Reserve Increase Factor
- Liquid Reserve Ratio
- Actuarial Ratio
- Actuarial Return on Fixed Assets
Funded Status (Table 4.1)

Measures extent to which future costs associated with current residents are met by current reserves and future revenues.

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
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</thead>
<tbody>
<tr>
<td>1999</td>
<td>94.5</td>
<td>100.3</td>
<td>102.2</td>
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<td>2000*</td>
<td>96.8</td>
<td>101.5</td>
<td>104.7</td>
<td>109.0</td>
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Percentages
Single New Entrant Pricing (Table 5.1)

Measures the degree to which fees charged to new entrants are expected to cover the cost of contractual obligations.

<table>
<thead>
<tr>
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<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>1.5</td>
<td>8.4</td>
<td>9.7</td>
<td>17.8</td>
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<tr>
<td>2000*</td>
<td>1.6</td>
<td>8.0</td>
<td>9.2</td>
<td>16.7</td>
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</tbody>
</table>
Couple New Entrant Pricing (Table 5.1)

Measures the degree to which fees charged to new entrants are expected to cover the cost of contractual obligations.

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<td>3.4</td>
<td>10.2</td>
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<td>11.4</td>
<td>10.9</td>
<td>16.7</td>
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</table>
Typical New Entrant Pricing (Table 5.1)

Measures the degree to which fees charged to new entrants are expected to cover the cost of contractual obligations.

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<td>2.4</td>
<td>8.2</td>
<td>9.6</td>
<td>15.4</td>
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<td>2000*</td>
<td>3.8</td>
<td>8.8</td>
<td>9.5</td>
<td>14.3</td>
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</table>
### 10-Year Reserve Increase Factor

Represents the expected growth in liquid reserves.

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<th>Average</th>
<th>75th</th>
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<tbody>
<tr>
<td><strong>1999</strong></td>
<td>1.14</td>
<td>1.72</td>
<td>2.24</td>
<td>2.55</td>
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<tr>
<td><strong>2000</strong></td>
<td>1.52</td>
<td>2.09</td>
<td>N/A</td>
<td>2.85</td>
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</table>
Liquid Reserve Ratio

Measures the degree to which actuarial liabilities are met by liquid assets.

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<td>1999</td>
<td>27.1</td>
<td>52.4</td>
<td>51.5</td>
<td>68.9</td>
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<tr>
<td>2000*</td>
<td>27.4</td>
<td>53.0</td>
<td>62.6</td>
<td>76.8</td>
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</tbody>
</table>

Percentages
Actuarial Ratio

Represents the portion of future expenses covered by revenues that can be adjusted in the future.

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<td>62.7</td>
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<td>2000*</td>
<td>63.9</td>
<td>69.8</td>
<td>70.3</td>
<td>76.3</td>
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</table>

Percentages
Actuarial Return on Fixed Assets

A measure of the internal rate of return on investment in fixed assets.

<table>
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<tr>
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<th>50th</th>
<th>Average</th>
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<td><strong>2000</strong></td>
<td>7.70</td>
<td>9.38</td>
<td>10.01</td>
<td>12.53</td>
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Demographic Statistics

- Average Age at Entry
- Average Attained Age
- Life Expectancy
- Health Care Ratio
Average Entry Age

Female

<table>
<thead>
<tr>
<th>25th</th>
<th>50th</th>
<th>Average</th>
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</thead>
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<td>78.6</td>
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<tr>
<td>2000*</td>
<td>78.6</td>
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<td>79.9</td>
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Male

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<tr>
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<tr>
<td>2000*</td>
<td>79.1</td>
<td>80.8</td>
<td>80.6</td>
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CCRC Solvency – 56
Average Attained Age

Female

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<td>2000*</td>
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Male

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<td>82.2</td>
<td>83.9</td>
<td>83.8</td>
<td>85.3</td>
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</table>
Age-80 Life Expectancy

Total remaining life expectancy for an 80-year-old resident.

<table>
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<tr>
<td>1999</td>
<td>7.8</td>
<td>8.3</td>
<td>8.2</td>
<td>8.6</td>
</tr>
<tr>
<td>2000*</td>
<td>7.7</td>
<td>8.3</td>
<td>8.1</td>
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</table>
Number of ALU Residents per 100 ILU Residents

Measures assisted living utilization by contractholders.

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<td>6.20</td>
<td>10.32</td>
<td>17.15</td>
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</table>
Number of NUR Residents per 100 ILU Residents

Measures nursing care utilization by contractholders.

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<tr>
<td>2000*</td>
<td>9.31</td>
<td>13.98</td>
<td>20.46</td>
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CCRC Solvency – 60
Number of Health Care Residents per 100 ILU Residents

Measures health care utilization by contractholders.

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
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</thead>
</table>
Financial Statistics

◆ Average Occupancy
◆ Per Capita Expense Per Day
Average ILU Occupancy

<table>
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<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
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<tbody>
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<td>1999</td>
<td>NA</td>
<td>95.6</td>
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<td>NA</td>
</tr>
<tr>
<td>2000*</td>
<td>89.5</td>
<td>94.9</td>
<td>92.4</td>
<td>97.8</td>
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Percentages
Average ALU Occupancy

<table>
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<th>Average</th>
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<td>91.7</td>
<td>87.7</td>
<td>NA</td>
</tr>
<tr>
<td>2000*</td>
<td>88.5</td>
<td>93.0</td>
<td>90.3</td>
<td>96.2</td>
</tr>
</tbody>
</table>
Average NUR Occupancy

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>NA</td>
<td>93.9</td>
<td>92.1</td>
<td>NA</td>
</tr>
<tr>
<td>2000*</td>
<td>85.3</td>
<td>91.4</td>
<td>87.9</td>
<td>95.0</td>
</tr>
</tbody>
</table>
Per Capita ILU Expense Per Day

Reflects gross operating expenses per day by level of care.

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$32.98</td>
<td>$40.80</td>
<td>$44.95</td>
<td>$55.93</td>
</tr>
<tr>
<td>2000*</td>
<td>$37.37</td>
<td>$43.17</td>
<td>$48.09</td>
<td>$58.88</td>
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</tbody>
</table>
Per Capita ALU Expense Per Day

Reflects gross operating expenses per day by level of care.

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$73.50</td>
<td>$87.55</td>
<td>$87.70</td>
<td>$102.58</td>
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<tr>
<td>2000*</td>
<td>$73.42</td>
<td>$92.67</td>
<td>$91.34</td>
<td>$106.43</td>
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</tbody>
</table>
Per Capita NUR Expense Per Day

Reflects gross operating expenses per day by level of care.

<table>
<thead>
<tr>
<th></th>
<th>25th</th>
<th>50th</th>
<th>Average</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$122.64</td>
<td>$142.85</td>
<td>$146.02</td>
<td>$168.36</td>
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<tr>
<td>2000*</td>
<td>$125.65</td>
<td>$147.16</td>
<td>$149.92</td>
<td>$175.92</td>
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</table>