FOCUS ON NOM: BEST PRACTICES TO IMPROVE THE BOTTOM LINE

STRATEGIC IMPERATIVES: LEADING AND THRIVING IN 2016 & BEYOND
19TH ANNUAL SENIOR LIVING FINANCE + STRATEGY CONFERENCE | SEPTEMBER 21–23, 2016

B.C. Ziegler and Company | Member of SIPC & FINRA
PRESENTERS...

**DAN GRAY**  
President  
Continuum Development Services

**KEVIN McLEOD**  
President & CEO  
Carolina Meadows

FACILITATORS...

**MICHAEL KELLY**  
Managing Director  
Ziegler
OBJECTIVES

• To identify diagnostics to use, not only to avoid trouble, but to enhance operations.

• To learn from provider case studies about how to improve operating margin and avoid financial challenges.

• To identify what specific metrics are most important to track and focus on when looking to enhance the bottom line.
AGENDA

- TOPIC 1
  - INTRODUCTION

- TOPIC 2
  - OPTIMIZING OPERATIONS

- TOPIC 3
  - CAROLINA MEADOWS: 2016 OPERATIONS REVIEW

- QUESTIONS & ANSWERS
TOPIC 1: INTRODUCTION AND OVERVIEW

MICHAEL KELLY
Managing Director
Ziegler
OVERVIEW
SENIOR LIVING SUCCESS: KEY DRIVERS

Senior Living Financial Strength

- Baseline Operations
- Net Proceeds from Entrance Fees
- Contributions
- Capital Structure
- Treasury Management
BENEFITS OF USING BENCHMARKS

• Tell your story

• Identify strengths, weaknesses, opportunities and threats

• Provide high level direction for Management; identify small problems before they become big ones

• Enhance interim reporting; dashboard reports; trend analysis over multiple periods

• Create a culture of continuous quality improvement
CHALLENGES OF USING BENCHMARKS

• Comparisons among organizations may be distorted by unique attributes of each organization

• Access to quality published information

• Variances may be explained away too easily
  - There is a “story” behind every number

• Viewed as purely economic, rather than strategic, initiative
BENCHMARKS - WHERE ARE THEY?

- Your own historical operating data (including sister organizations for multi-sites)
- CARF-CCAC Financial Ratios & Trend Analysis
- Rating Agency Median Reports
- A2Z CCRC Platform
- LeadingAge - State Associations
- Proprietary benchmarks (accountants, actuaries, investment bankers, etc.)
2016 CARF PUBLICATION
FINANCIAL RATIOS & TREND ANALYSIS

- 2016 marks 24th publication
- Three types of ratios:
  - Profitability
  - Liquidity
  - Capital Structure
- Single-sites (136) & multi-sites (23)
- Predominantly non-profit (one for-profit)
- Partners in the publication with Ziegler
  - CARF, Baker Tilly

WHERE DO YOU FOCUS?
WHERE DO YOU FOCUS?

PROFITABILITY (OPERATING) RATIOS

Net Operating Margin Ratio - Core operations: resident revenue - resident expense. Excludes non-resident revenues and excludes interest/dividend income, interest expense, depreciation, taxes, amortization, contributions and entry fee amortization.

Net Operating Margin Ratio-Adjusted - Add net entry fees received.

Operating Ratio - Differs from NOM only in that it includes interest income, interest expense and net assets released for operations. Like NOM --- cash-based.

Operating Margin - Includes the impact of non-cash operating items such as earned entry fees and depreciation

Total Excess Margin - Builds on the Operating Margin Ratio but adds impact of realized investment gains or losses, contributions and other non-operating revenues/gains.
NET OPERATING MARGIN RATIO (NOM)

- In 2015, the median NOM increased for single-site providers to 5.44%, but dipped slightly to 5.93% for multi-site providers.

- Despite recent flattening/dip, long-term trend remains positive since the early 2000s.

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016
• Declining ratio is a favorable trend (cash expenses ÷ cash revenues)

• General improving trend for the past ten years

• Slight improvement in the median ratios for both single- and multi-site providers for 2015

• Medians have remained below the 100% break-even level since 2009 for multi-sites and since 2007 for single-sites.

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016
DEBT SERVICE COVERAGE RATIO
REVENUE ONLY

- Measures an organization’s ability to meet debt service obligations without net entrance fee turnover
- Results are substantially impacted by pricing policies and contract types
- Weakening for single- and multi-site organizations at all quartiles in FY 2015
- Top quartile is consistently well above 1.0x for both provider types

TRUISMS . . .

• Positive operating margin is essential for all organizations
  - “No margin, no mission”

• You manage what you measure
  - “What gets measured, gets improved”

• “Buy in” to the operations assessment process at all levels is essential
  - “A chain is only as strong as its weakest link”
JUST BECAUSE YOU’VE ALWAYS DONE IT THAT WAY DOESN’T MEAN IT’S THE BEST WAY.
TODAY’S FOCUS

• Hear what specific metrics are most important to track and focus on when looking to enhance the bottom line.

• Learn from a providers case study about how to improve operating margin and avoid financial challenges.
TOPIC 2: OPTIMIZING OPERATIONS

DAN GRAY
President
Continuum Development Services
REVIEW OPERATIONS ANNUALLY

• Objective—identify revenue/expense improvements that will:
  - Strengthen financial performance,
  - Improve debt service capacity,
  - Increase days cash on hand, and
  - Create additional opportunities for communities to act strategically in order to achieve mission.

- OR...
BE HAPPY, DON’T WORRY

“Our financial troubles are over, Edna. The fellas and I have formed a boy band.”
CCRCs need at least 10% to 15% net operating margin in order to act strategically.
CAUTION

• *DO NOT* focus on past or place blame

• *DO NOT* place too much emphasis on the numbers—the *INITIATIVES* are most important

• *TIME PROCESS*—allow adequate time for implementation of findings
TIPPING POINTS FOR FINANCIAL SUCCESS

• Maximizing Revenue
  - Occupancy
  - Premium pricing
  - Medicare/Managed Care
  - Home- and community-based services

• Optimize Value of Expenses
  - Organizational Structure
  - Staffing
  - Information
UNDERLYING SUCCESS FACTORS

- Organizations with:
  - Clear vision
  - Engaged staff
  - Satisfied customers
  - Great value

- Evidenced by:
  - Great teams—no silos
  - Low staff turnover
  - Broad referral base (e.g., residents, staff, and broader community)
UNDERLYING SUCCESS FACTORS

CHANGE MANAGEMENT

We're hiring a director of change management to help employees embrace strategic changes. Or we could come up with strategies that make sense, then employees would embrace change.

That sounds harder.
Maximize Revenue
DIAGNOSTIC

- Are units reoccupied within 60-90 days of acceptance?

- Are admissions to health care processed 24 hours per day, 7 days per week?

- Are more than 40% of new residents from current resident referrals?
DIAGNOSTICS

- Are service fees equal to or greater than competitors?

- Are services included in the monthly service fee used by the majority of residents? If not, are they charged additional fees at the market rate?

- Are your best programs charged at premium rates?
BEST PRACTICES

WE WILL BE ADOPTING THE BEST PRACTICES IN OUR INDUSTRY, JUST LIKE EVERYONE ELSE.

IF EVERYONE IS DOING IT, BEST PRACTICES IS THE SAME THING AS MEDIocre.

STOP MAKING MEDIOCRITY SOUND BAD!

SORRY.
BEST PRACTICES-REVENUE

- Embrace “aging in place” and create short-term stay capacity in skilled nursing
- Participate in bundles and ACOs in your market
- Achieve four or five star rating
- Have the lowest readmission rate and shortest length of stay in market
- Obtain RUGS near $500/day (most markets)
- Renegotiate managed care contracts annually
- Know your hospital’s challenges
- Know your MCO’s star rating
BEST PRACTICES-REVENUE

- Develop transitional care household with in-room dining and private rooms if possible
- Hire Medicare Community Liaison
- Design specialized customer service program
- Provide therapy seven days per week
- Track and market quality outcomes
BEST PRACTICES-REVENUE

- Concentrate on superb resident communications
  - Do your residents know the total costs of your operations?
  - Do they understand the value of your services compared to the market?
- Convert to declining balance dining plans
- Optimize level of care pricing in Assisted Living
BEST PRACTICES-REVENUE

• Transform your CCRC into a “Community Service Center” for your entire market, regardless of economic and functional status

• Develop low capital investment, high-margin programs, with appropriate development support (e.g., home health care Services, PACE, Continuing Care at Home)
Optimize Value of Expenses
BEST PRACTICES-EXPENSES

- Create a flat organizational structure
- Minimize administrative support
- Scrutinize indirect staff for value
- Utilize team leaders instead of supervisors where appropriate
- Use performance- not seniority-based compensation structure

CAUTION: be careful not to under power strategic changes
OVERALL STAFFING TARGETS

Target salaries and benefits to be <50% of net revenues
## FTES BY LEVEL OF SERVICE

<table>
<thead>
<tr>
<th>Unit Type</th>
<th>Occupied Units</th>
<th>FTEs/Occupied Unit</th>
<th>Total FTEs</th>
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<tr>
<td>ILU</td>
<td>300</td>
<td>.40</td>
<td>120</td>
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<tr>
<td>ALU/MC</td>
<td>40/20</td>
<td>.50/.70</td>
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<tr>
<td>NC</td>
<td>60</td>
<td>1.00</td>
<td>60</td>
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<tr>
<td>TOTAL</td>
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<td>214</td>
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BEST PRACTICES-EXPENSES

• Eliminate/reduce shift overlaps

• Use a patterned schedule that provides the appropriate staff at the right time

• Empower charge nurses to lead “care teams” to serve specific residents
BEST PRACTICES-EXPENSES

- Centralize facility operations (e.g., housekeeping, maintenance, laundry security)
- Create schedules with only housekeeper per unit cleaning units in the same area
- Schedule kitchen staff so that cooks open and close
- Regularly evaluate the use of contracted versus internalized services
BEST PRACTICES - EXPENSES

- Manage labor costs by providing payroll reports that compare to budget and set productivity targets
- Provide financial reporting that is concise and action-oriented
- Provide summary of financial performance using a “dashboard” approach
- Implement technology that reduces staffing requirements
BEST PRACTICES-EXPENSES

- Wireless call systems which signal a pager
- POS system integrated with receivables
- Electronic medical record combined with service tracking system, which helps maximize reimbursement under Medicare and case-mix Medicaid
- Eliminate time-consuming manual processes
Benchmarks for Reference
FACILITY OPERATIONS

- Target 50,000 square feet per maintenance FTE

- Target square feet per housekeeper
  - ILU = 30,000
  - Assisted living = 20,000
  - Health center = 8,000
  - Public Spaces = 20,000

- 60 pounds of laundry cleaned per productive hour
DINING SERVICES

• Target meals per labor hour
  - Health care = 4.0 to 4.5
  - Assisted living = 3.5 to 4.0
  - Independent Living = 2.0 to 3.0, depending on type of service

• 40% of labor should be part-time
### HOURS OF CARE/RESIDENT DAY

<table>
<thead>
<tr>
<th>Category</th>
<th>Hours</th>
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<tbody>
<tr>
<td>Direct Licensed</td>
<td>1.0-1.2</td>
</tr>
<tr>
<td>Direct Productive</td>
<td>3.6-3.9</td>
</tr>
<tr>
<td>All Hours</td>
<td>4.2-4.7</td>
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</tbody>
</table>
# ASSISTED LIVING

## HOURS OF CARE/RESIDENT DAY

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Assisted Living</td>
<td>1.7 to 2.2</td>
</tr>
<tr>
<td>Memory Care</td>
<td>2.2 to 2.6</td>
</tr>
</tbody>
</table>
TOPIC 3: CAROLINA MEADOWS 2016 OPERATIONS REVIEW

KEVIN MCLEOD
President & CEO
Carolina Meadows
ORGANIZATIONAL PROFILE - CAROLINA MEADOWS

• Date opened: 1985              Location: Chapel Hill, NC
• Total # units/beds: 616
  - 447 ILUs (6 used for guest rooms)
  - 64 ALUs
  - 15 Memory Care Beds
  - 90 licensed skilled beds (86 in operation)
• # of Residents: 740             # of FTES: 340
• Total Acreage: 171              Available to build: 11
• Rating: NO
• CARF-CCAC Accredited
• Contract Type: Fee-for-service with shared appreciation
“Don't worry. I've been in touch with a consultant who has a get rich quick plan for our company.”
CATALYST BEHIND THE OPERATIONS REVIEW

- Completed a major expansion of 58 villas at the end of 2013 - all occupied

- Former CFO departed in Q4, 2014; New CFO on board in early 2015; Cost creep

- Began large scale dining and kitchen renovations in 2014 and completed the end of 2016; Cost creep

- Contractual concerns with Shared Appreciation and ease of refund
• COO retired in 2015 (New COO starts 9/26!!)

• Moved to a Balanced Scorecard approach in 2014 for monitoring and measuring but hasn’t been fully embraced by some key staff

• Proposed new health center construction in 2018 with capital needs...and additional debt service
slow down in residents moving through the continuum with declining census in nursing and AL beds - $1.5 million decline in operating revenues

• Implementing a new Early Advantage Program for Waiting and Ready List

• Went self-insured in 2014 for employee medical only to get nailed with a lasered claim - $870k first year, $470k second year; sicker employee population than ever before
CONTRACTUAL CONCERNS WITH FEE FOR SERVICE

• Basically a 100% refundable contract with no cash remaining with organization
• Monthly service fees not high enough to sustain ongoing cash flow needs given level of expenses
• Shared appreciation - expensed to the bottom line
• Not ready to embrace aging in place
• Health Care component financially dependent on moving through the continuum; loss of revenue ~$1.5 million
• Needed to evaluate overall entry fees and monthly service fees to optimize revenues and maintain market position
EARLY ADVANTAGE PROGRAM

- Available to future residents on our Ready List
- Requires an entry fee per person with a modest per person monthly fee
- Provides assurance that if a change in health status occurs, one cannot be denied entry into AL or Nursing
- Participants are still encouraged to move in IL first but for those waiting for specific homes/floor plans, it could mean up to 10 years in some cases
- Program is limited to 100 residents
- Care coordination key in assisting residents
- At capacity, expect ~ $750k additional revenue per year
“Pay closer attention to where our revenue goes.”
WHERE DID WE START?

- The trending behind the ratios - NOM
- How we stacked up against ourselves and other CCRCs (benchmarking)
- The “State of Seniors Housing 2015” from ASHA
- Trend Study between NC, PA, MD, TN, and FL published by CliftonLarsonAllen
- Accepting reality of declining financial strength... IF no changes are explored and implemented - can’t be status quo
HISTORICAL NET OPERATING MARGIN RATIO

Net Operating Margin Ratio - 2011 to 2016
HISTORICAL OPERATING RATIO

Operating Ratio - 2011 to 2016

- Q4, 2011: 93.60%
- Q2, 2012: 89.40%
- Q4, 2012: 92.30%
- Q2, 2013: 92.60%
- Q4, 2013: 94.70%
- Q2, 2014: 96.90%
- Q4, 2014: 99.60%
- Q2, 2015: 100.30%
- Q4, 2015: 102.70%
- Q1, 2016: 97.00%
Four perspectives govern the approach:
- Financial
- Customer/Resident
- Operating effectiveness
- Organizational capacity

Key to benchmarking and overall organizational metrics to monitor; Ops review provides some industry best practice staffing benchmarks for comparison purposes; gets to the heart of the operational considerations.
BENCHMARKS - HOW WE LOOKED AT THEM

- Macro view first, then by department, then by line item/category

- Looked for the obvious variances compared to the benchmarks

- Did not look good - results were usually less than the 50th percentile. Needed objective third party view to slice the operations

- CDS to the rescue!
MACRO BENCHMARK VIEW - DESIRE 75TH QUARTILE

- **Net Resident Revenue**
  - Total Operating Expenses as a % of Net Resident Revenue (<25th quartile)

- **Health Care Revenues**
  - Total health care expense as a % of Health Care Revenue (50th quartile)

- **Total Units/Beds**
  - Total Operating Expenses per total occupied units/beds (<50th quartile)
MICRO BENCHMARK VIEW - FLASHLIGHT

Departmental expenses
- Per occupied bed
- Per resident days
- Per square foot

Salaries by department
- Per occupied bed
- Per total resident days
- Per total FTEs

Labor and non-labor related expenses
- Per occupied bed
- Per resident days
CDS OPERATIONS REVIEW RESULTS

- Broken down into Strategic Recommendations and Departmental Recommendations

- Asked for any and all items; received detailed recommendations

- Thirty items for consideration totaling approximately $4.4 million in possible expense reduction items; another $400k in potential revenues from a change in utilization of AL beds and programmatic suggestions
“This device can burn money in thirteen exciting new ways.”
• Give up two guest rooms that currently use ILU units - $72k annually

• Shorten renovations/refurbishment process - $317k annually (hold residents to time limits)

• Renegotiate the therapy service contract with a revenue sharing option and/or up the cost of leased space - $100k annually

• Limit donations to other organizations to charitable contributions received - $200k annually
• Reorganize Resident Services and eliminate overlapping functions with other departments (social services, activities, etc.) - $138k annually

• Change the scheduling of housekeeping staff and reduce # of staff - $110k annually

• Reduced laundry staffing - $33k annually

• Reduce grounds department staffing - $84k annually

• BIGGY - consider reduction of dining staff in all 7 venues - $200k for 2017, $600k for 2018
SAMPLE OF CDS SUMMARY RECOMMENDATIONS

- Reorganize Clinic operations with reduction of nurse practitioner and licensed nurse staffing - $200k annually
- Adjust productivity and billing targets for nurse practitioners - $170k annually
- Reorganize staffing in assisted living - $330k annually - expect staff pushback on this
- Reorganize health center staffing to a resident centered staffing approach - $850k annual potential - expect staff pushback on this
Most recommendations deal with staffing cuts - hard to implement quickly but some can be done right away - need to avoid the “shock value”

Will take the approach of ranking recommendations as:
- Achievable as recommended
- Achievable with modifications
- Not achievable due to political or resident concerns
- “Low hanging fruit” - to be immediately implemented (within 6 months)
“Say! Look at this typo!
You put zero for my department's budget. Ha ha!”
“So what if I underestimated costs and overestimated revenues? It all averages out in the end.”
SOME OBVIOUS “TRUTHS” FROM OUR REVIEW

• If it is not included in the ops review, it will likely not be improved

• We cannot improve what we do not consider

• If we do what we’ve always done, we will always get the same results

• It’s okay to benchmark against yourself - as long as you are willing to challenge the results

“Fool you are...to say you learn by your experience...I prefer to profit by others’ mistakes, and avoid the price of my own.”
Prince Otto Von Bismarck
SOME OBVIOUS “TRUTHS” FROM OUR REVIEW

• Financial results are more than just past performance indicators - they should be a guide to improvements

• Prioritizing leads to improving

• Ratios and trends analysis can only change the future, not the past

• We have a call to action with the report

“Keep on the lookout for novel and interesting ideas that others have used successfully. Your idea has to be original only in its adaptation to the problem you’re currently working on.” Thomas Edison
Chase the elephants, don’t milk the mice!
QUESTIONS & ANSWERS

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