STRATEGIC IMPERATIVES: LEADING AND THRIVING IN 2016 & BEYOND

19TH ANNUAL SENIOR LIVING FINANCE + STRATEGY CONFERENCE | SEPTEMBER 21–23, 2016

FOCUS ON NOM: BEST PRACTICES TO IMPROVE THE BOTTOM LINE

Ziegler

CAPITAL | INVESTMENTS | ADVICE

PRESENTERS…

DAN GRAY
President
Continuum Development Services

Continuum Development Services

KEVIN MCLEOD
President & CEO
Carolina Meadows

CAROLINA MEADOWS

FACILITATORS…

MICHAEL KELLY
Managing Director
Ziegler

Ziegler

CAPITAL | INVESTMENTS | ADVICE

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.

3

Ziegler

AGENDA

TOPIC 1

- **INTRODUCTION**

TOPIC 2

- **TITLE**

TOPIC 3

- **CAROLINA MEADOWS: 2016 OPERATIONS REVIEW**

QUESTIONS & ANSWERS

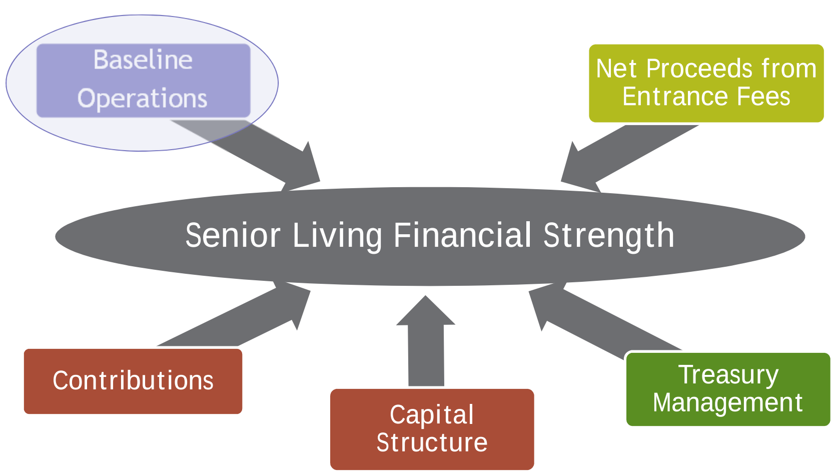
4

TOPIC 1:
INTRODUCTION

MICHAEL KELLY
Managing Director
Ziegler

Ziegler

OVERVIEW
SENIOR LIVING SUCCESS: KEY DRIVERS

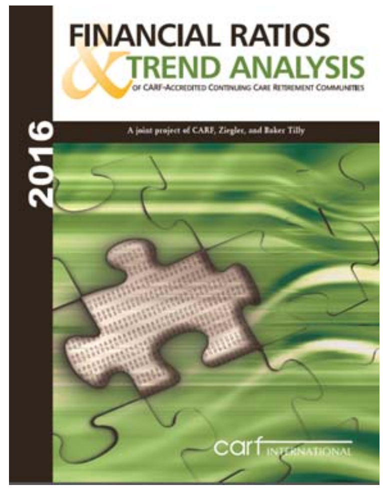


6

Ziegler

2016 CARF PUBLICATION
FINANCIAL RATIOS & TREND ANALYSIS

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



Source: Preliminary Financial Ratios & Trend Analysis of CARF-CCAC Accredited Organizations, 2015

Ziegler

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.

CORE SERVICES

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

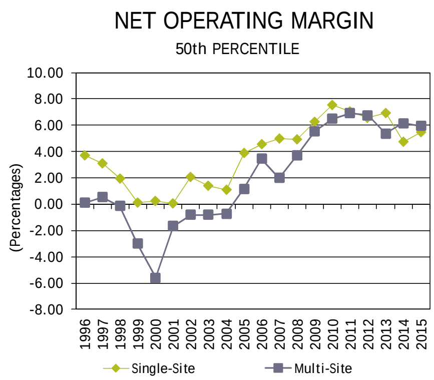
Operating Ratio – Differs from NOM only in that it includes interest income, interest expense and net assets released for operations. Like NOM --- cash-based.

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.

ALL RESOURCES

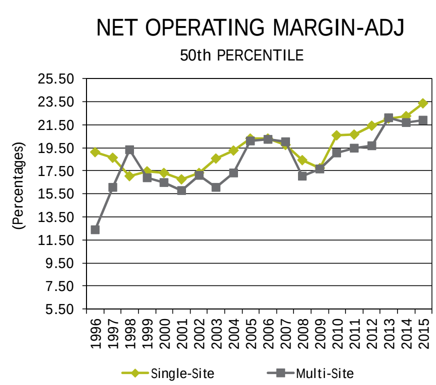
NET OPERATING MARGIN RATIO (NOM)



- In 2015, median increased for multi-site providers to 6.15%, but the single-site provider median decreased to 4.72%
- Decrease in NOM held across all quartiles for single-sites
- 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

NET OPERATING MARGIN-ADJ. RATIO (NOM-A)

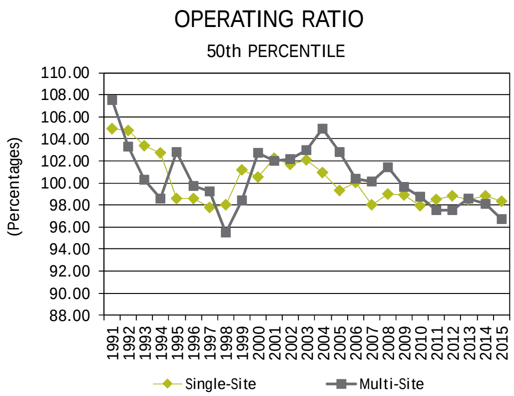


- NOM-A highlights importance of cash flow from entrance fees, compared to NOM, where net entrance fee receipts are excluded
- Creditors, regulators, rating agencies, etc. recognize importance of entrance fees in offsetting healthcare risk, operating costs
- NOM-A continues to improve for the 2014 fiscal year for single-sites; multi-site organizations decreased slightly
- Levels for both provider types at or near all-time highs

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

OPERATING RATIO

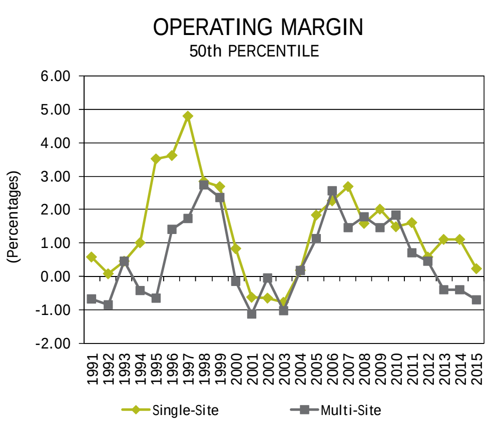


- Declining ratio is a favorable trend (cash expenses ÷ cash revenues)
- General improving trend for the past ten years
- Slight improvement for single-site providers weakening for multi-site providers
- Both medians remain below the 100% break-even level

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

OPERATING MARGIN

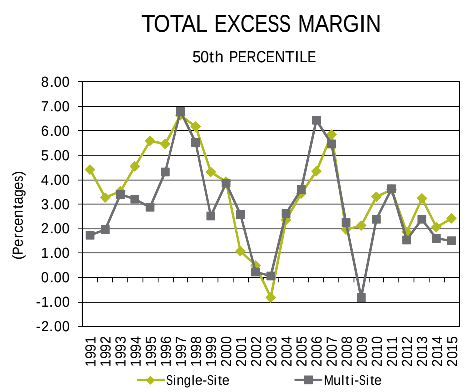


- Measures the portion of total operating revenues remaining after operating expenses are met
- Includes non-cash items such as amortization of entrance fees and depreciation
- Improvement in the single site median and a decline in the multi-site median

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

TOTAL EXCESS MARGIN (TEM)

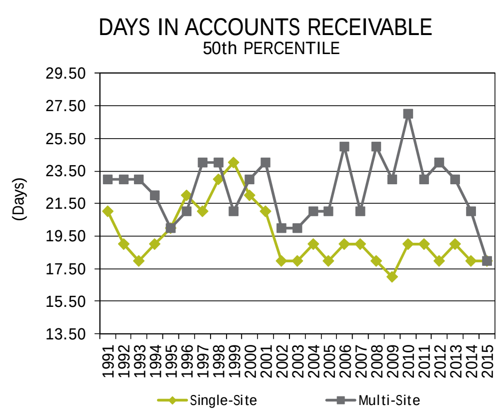


- TEM measures bottom line GAAP profitability
- Includes non-cash items such as amortization of entrance fees, depreciation and non-operating sources of revenues
- Multi-sites were down from last year (1.59% compared to 2.39%), and single sites down from 3.24% to 2.07%
- The timing of the adoption of Accounting Standards Update 2012-01 may be the contributing factor for the decreases

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

DAYS IN ACCOUNTS RECEIVABLE (DAR)

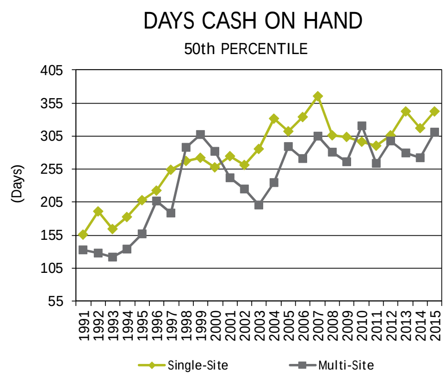


- DAR directly related to payor type
  - Independent living DAR may be as low as one to five days
  - Third-party payor DAR may be over 30 days
- Single-sites generally outperform multi-sites due to payor mix

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

DAYS CASH ON HAND (DCOH)

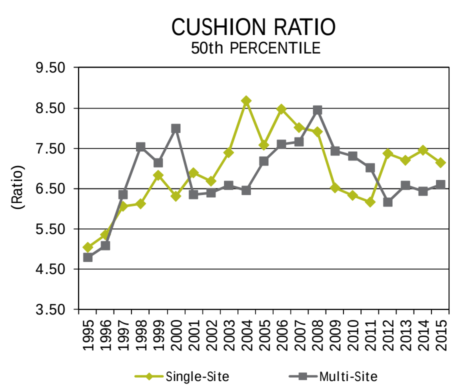


- DCOH is the chief measure of organizational liquidity
- The single-site DCOH median decreased to 317 days; the multi-site median dipped to 272 days
- The 25^{th} quartile was lower for both, while the 75^{th} quartiles improved
- The DCOH median remains in the +/- 300 day range of the past 10 years for both provider types

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

Ziegler

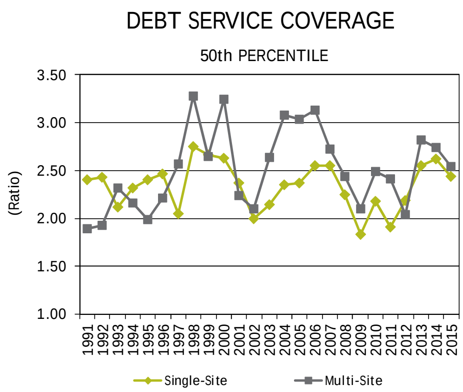
CUSHION RATIO



- Cushion Ratio (CUSH) measures a provider’s cash position in relation to its annual debt obligation
- For FY 2014, the median CUSH improved slightly for single-site providers, but showed a decrease at the 75^{th} percentile
- For multi-site providers, the FY 2014 CUSH showed a decrease at all levels

Source: Financial Ratios & Trend Analysis of CARF-Accredited Continuing Care Retirement Communities, 2016

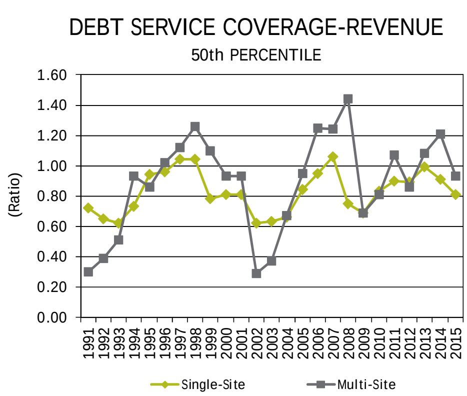
DEBT SERVICE COVERAGE RATIO (DSC)



- DSC ratio is generally considered to be the most important ratio for evaluating an organization's financial viability
- Reflects ability to fund debt service with cash flow from net cash revenues and net entrance fees
- DSC was down from last year for multi-sites (2.74x), while single-sites improved (2.62x)
- Average net entrance fees increased 12% - 15%

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

DEBT SERVICE COVERAGE RATIO REVENUE ONLY

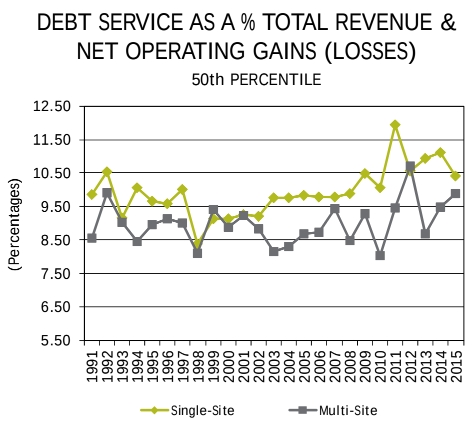


- Measures an organization's ability to meet debt service obligations without net entrance fee turnover
- Results are substantially impacted by pricing policies and contract types
- Improvement for single- and multi-site organizations at all quartiles in FY 2014
- Top quartile is consistently well above 1.0x for both provider types

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

Ziegler

DEBT SERVICE AS A % TOTAL OPERATING REVENUE & NET NON-OPERATING GAINS (LOSSES)



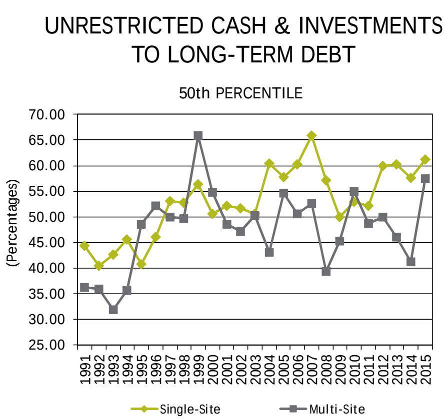
- This ratio indicates the percentage of all operating revenues and non-operating gains and losses used to meet annual debt service requirements
- A declining ratio is favorable
- The median ratio improved for single-site providers and weakened for multi-site providers in FY 2014

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

19

Ziegler

UNRESTRICTED CASH & INVESTMENTS TO LONG-TERM DEBT



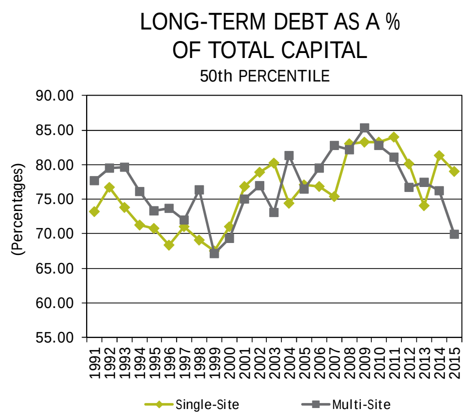
- Measures an organization's position in cash and marketable securities in relation to its long-term debt
- Average cash balances increased for fiscal year 2015
- Median Cash to Debt weakened for multi-site and single-site providers, most likely driven by increased debt

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

20

Ziegler

LONG-TERM DEBT AS A PERCENTAGE OF TOTAL CAPITAL (LTDC)

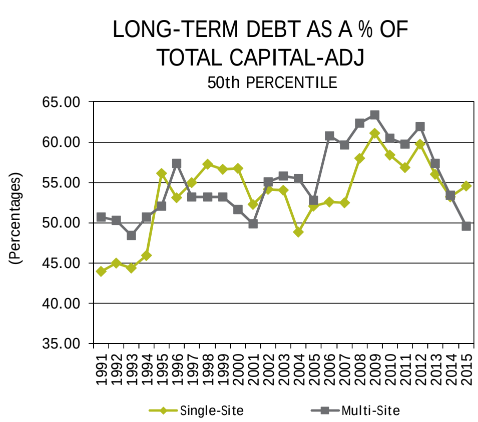


- LTDC is a measure of the extent to which a provider has relied on debt versus retained earnings and invested or donated capital
- For CCRCs, LTDC values in excess of 100 percent or negative values are not uncommon
  - Caused by net deficits due to reliance on cash from entrance fees (liability)
- General improving trend for both provider types over the past few years

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

Ziegler

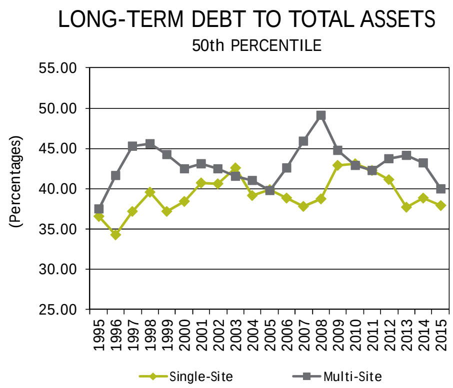
LONG-TERM DEBT AS A PERCENTAGE OF TOTAL CAPITAL-ADJUSTED



- Includes deferred revenue in its definition (denominator)
  - Adds deferred revenue from non-refundable entrance fees in recognition of its use for capital improvements or retention as cash reserves
  - "Quasi-equity"
- Declines at the median in FY 2014 for both single- and multi-site organizations.
- Impacted by the adoption of ASU 2012-01

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

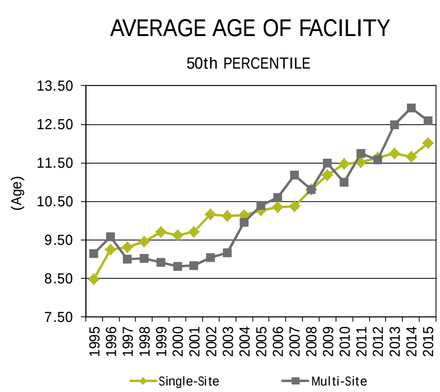
LONG-TERM DEBT TO TOTAL ASSETS



- This ratio (LTD-TA) compares an organization's indebtedness to its total assets
- The younger an organization the higher (weaker) their Long-term Debt to Total Assets
- Weakening for single-site providers; slight improvement for multi-site providers

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

AVERAGE AGE OF FACILITY RATIO (AGE)

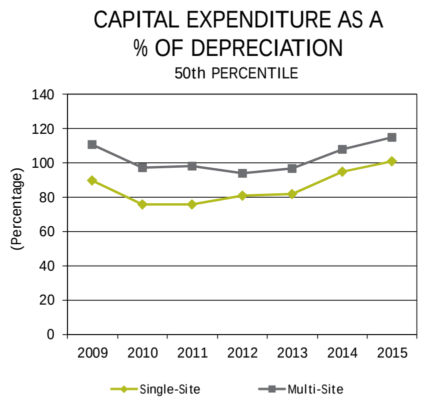


- AGE measures an organization's commitment to maintaining its physical plant
- AGE suggests the capital investment isn't sufficient to counter the aging of physical plants
- Many providers have embarked upon master planning, but there's a significant gap between project planning and opening

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

Ziegler

CAPITAL EXPENDITURE AS A PERCENTAGE OF DEPRECIATION



- Sixth year of data collection, trend is improving
- Both Multi-sites and single-sites improved from last year
- Important for organizations to show commitment to reinvest in physical plant at least to level of annual depreciation

Source: Preliminary Financial Ratios & Trend Analysis of CARF Accredited Organizations, 2016

Ziegler

TODAY'S FOCUS

- Learn from a providers case study about how to improve operating margin and avoid financial challenges.

CAROLINA MEADOWS

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

Continuum Development Services

TOPIC 2:
OPTIMIZING OPERATIONS

DAN GRAY
President
Continuum Development Services

Ziegler

REVIEW OPERATIONS ANNUALLY[DG1]

- 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...

Slide 28

DG1 We have been challenged to pretty up/funny up these slides
Daniel Gray, 9/9/2016

Ziegler

BE HAPPY DON’T WORRY

"Our financial troubles are over, Edna. The fellas and I have formed a boy band."

29

Ziegler

OPERATING MARGIN

CCRCs need at least 10% to 15% net operating margin in order to act strategically

30

Ziegler

CAUTION

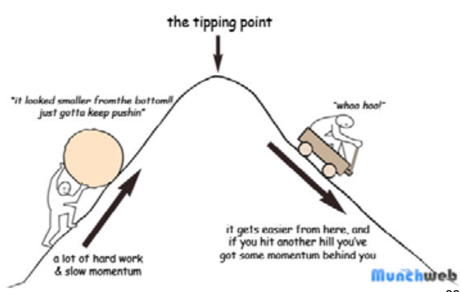
- *DO NOT* focus on past or place blame
- *DO NOT* place too much emphasis on the numbers—the *INITIATIVES* are most important
- *TIME PROCESS*—allow adequate time for implementation of findings

31

Ziegler

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



32

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)

33

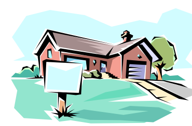
UNDERLYING SUCCESS FACTORS

CHANGE MANAGEMENT

34

Ziegler

Maximize Revenue



Ziegler

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 include 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

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

39

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

40

Ziegler

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

41

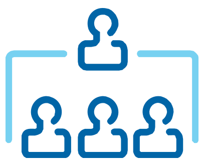
Ziegler

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)

42

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

Unit Type	Occupied Units	FTEs/ Occupied Unit	Total FTEs
ILU	300	.40	120
ALU/MC	40/20	.50/.70	34
NC	60	1.00	60
TOTAL	420		214

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

47

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

48

Ziegler

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

49

Ziegler

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

50

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

53

NURSING

Hours of Care per Resident Day

Direct Licensed	1.0-1.2
Direct Productive	3.6-3.9
All Hours	4.2-4.7

54

ASSISTED LIVING

Hours of Care per Resident Day

Assisted Living	1.7 to 2.2
Memory Care	2.2 to 2.6

55

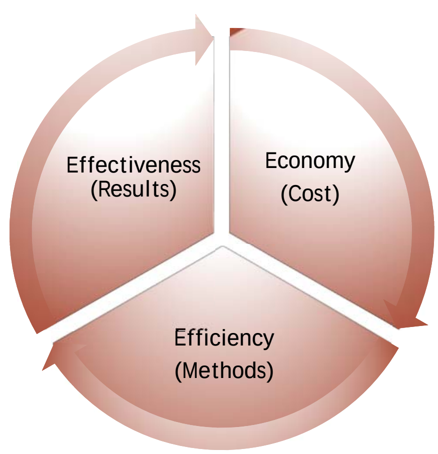
CAROLINA MEADOWS
2016 OPERATIONS REVIEW

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
- Contract Type: Fee-for-service with shared appreciation

THE THREE "E'S" OF OPERATIONS



From ***Improving the Economy, Efficiency and Effectiveness of Not-for-Profits – Conducting Operational Reviews*** by Rob Reider

CATALYST BEHIND THE OPERATIONS REVIEW

- Completed a major expansion of 58 villas at the end of 2013
- Former CFO departed in Q4, 2014
- New CFO named in early 2015
- 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 with capital needs…and additional debt service

CATALYST BEHIND THE OPERATIONS REVIEW

- Slow down in residents moving through the continuum with declining census in nursing and AL beds - $1.5 million decline in operating revenues
- Named a new investment advisory firm at the end of 2014 due to lackluster results from former advisors
- 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

Ziegler

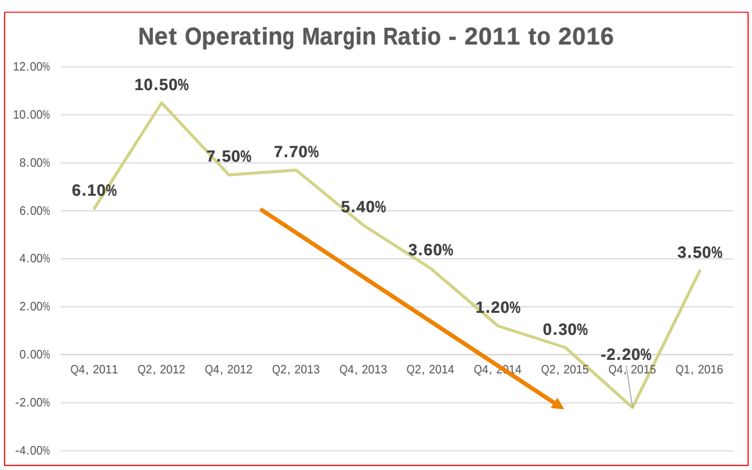
WHERE DID WE START?

- 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

61

Ziegler

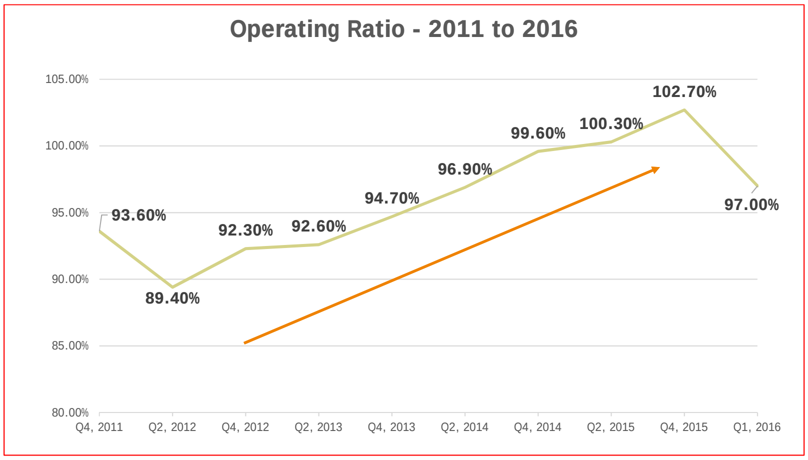
HISTORICAL NET OPERATING MARGIN RATIO



62

Ziegler

HISTORICAL OPERATING RATIO



63

Ziegler

OPERATIONS REVIEW AND BALANCED SCORECARD

- 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

64

BENCHMARKS – HOW I 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!

65

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)

66

Ziegler

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

Ziegler

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

SAMPLE OF CDS SUMMARY RECOMMENDATIONS

- 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

69

SAMPLE OF CDS SUMMARY RECOMMENDATIONS

- 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

70

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

71

OPERATIONS REVIEW RESULTS

- 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)

72

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

73

SOME OBVIOUS “TRUTHS” FROM OUR REVIEW

- Financial results are more than just past performance indicators – they should be a guide to improvements
- Prioritizing results in improving
- Ratios and trends analysis can only change the future, not the past
- We have a call to action with the report

74

Ziegler

QUOTES – VICARIOUS LEARNING

"If you know your enemy and know yourself, you need not fear the result of a thousand battles." Sun Tzu, *The Art of War*

"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

"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

Ziegler

QUESTIONS & ANSWERS

ABOUT US

- Ziegler is a privately-held investment bank, capital markets, wealth management and alternative investments firm.
- A registered broker dealer with SIPC & FINRA
- Ziegler provides its clients with capital raising, strategic advisory services, equity & fixed-income trading, wealth management and research
- Founded in 1902, Ziegler specializes in the healthcare, senior living, educational and religious sectors as well as general municipal finance

*Investment banking services offered through B.C. Ziegler and Company. FHA mortgage banking services are provided through Ziegler Financing Corporation which is not a registered broker/dealer. Ziegler Financing Corporation and B.C. Ziegler and Company are affiliated and referral fees may be paid by either entity for services provided.