

10 Common Mistakes of Senior Care Providers

“For three or four years, we’ve had the cheapest cost of capital in 45 years,” notes Amy Hayman, Managing Director at **Cain Brothers** in Chicago. “Today, we’re experiencing the most expensive capital market.” The result is that a project that works at a five percent cost of debt may not work at a seven percent cost of debt, so value engineering — improving both the financial and the non-financial metrics — becomes all the more critical for senior living providers, particularly those carrying any variable-rate debt. During her 20 years in the business, Hayman has worked with a lot of restructurings. And in her experience, these organizations have almost always made at least seven of the following 10 common mistakes:

1. Underfunding Capital Replacement

Many organizations that opened in the 1950s, ‘60s, or ‘70s mistakenly relied on high occupancy rates and ignored or deferred upgrading the plant. They also didn’t systematically raise their fees to fund capital replacement accounts. The challenge then becomes “catch-up” financing. Yet not enough new revenue units are built to carry the new debt, and insufficient new funds are available to upgrade existing units. And it’s difficult to pass along double-digit fee increases to the residents. Set up a capital replacement account and fund it annually through current pricing. Explain to residents the need to keep the plant current and that depreciation is a real cost.

2. Underestimating the Importance of Skilled Nursing and Assisted Living Operations

In a CCRC model, assisted living and skilled nursing operations represent a very high percentage of the overall budget. And compared to general inflation, those costs have gone up much more quickly. Many challenged organizations assumed that independent living fees would subsidize health care. Moreover, they did not adequately measure their performance at each level of care and, as a result, could not identify the actual and relative amounts that each operation was earning (or losing). Create separate cost centers for each level of care. Then benchmark that data against local or regional standards to help get costs under control. Consider turnaround strategies to reach break-even such as reducing health care units/beds to actuarial minimums, taking outside admits for Medicare and private pay patients, and outsourcing skilled nursing, rehab management, and billing.

3. Not Benchmarking Operational Performance

Benchmarks are standards used to compare one facility to another. **CARF-CCAC** provides financial benchmarks to accredited organizations and is an excellent resource for non-accredited organizations to track where they stand financially compared to accredited organizations. It’s also useful for organizations to gather information and measure non-financial indicators — staff turnover per unit, cost of food per plate, the number of FTEs per occupied bed by level of care, and similar items — to quickly identify and address problems before they become financial problems. Staff should develop and “own” benchmarks, while the board should follow key indicators.

4. Lacking Objective Fee Setting

It often makes sense for an organization's marketing staff to set fees. But basing salaries on occupancy levels rather than on financial performance provides a built-in incentive to keep fees below market value so occupancy will remain high. That results in pricing power being constrained and common extras ignored. Set revenues to provide a cushion over expenses. Complete an annual, independent, fee comparison study to measure profit or loss in each department and to determine the ability to increase fees.

5. Allowing Services Creep

Aging residents need increased care and daily living assistance, but fees often stay the same. Organizations with one or two pricing tiers, particularly assisted living facilities, should have three or four tiers based on the level of care required. Install basic departmental accounting, benchmarking, and clear policies on fees for each level of care. Complete regular resident functionality assessments and adjust fees accordingly.

6. Aggressively Pricing Fees Based On Home Prices

Entrance fees for many startups are priced at 100% to 120% of the area's median home value. The dramatic softening of the real estate market over the last 18 months has affected new projects and expansions in terms of presales, as well as existing projects with available units that are overpriced. Carefully gauge the price points for new senior living projects. Balance services and amenities, and emphasize refundability of entrance fees. Make the units affordable to as large a group as possible by maintaining tight controls over development costs to keep monthly fees down and entrance fees at 60% to 80% of the area's median home value.

7. Ignoring the Community Base

A strong community base is critical for securing favorable land use and zoning approvals, developing active marketing and fundraising programs, diversifying in-home and community services, and justifying real estate tax reductions. View the community as an important stakeholder. Get to know city officials. Strengthen ties with sponsoring groups. Undertake mission-focused activities.

8. Complacency/Lack of Strategic Focus

Organizations may do an integrated strategic plan, but then it sits on the shelf. Being complacent about new products coming on the market and not looking strategically into the future can result in the organization losing its competitive edge. Know your niche. Continuously reevaluate the market for new products that seniors need and want. Seek diversified growth strategies customized to the area. And always strive for economies of scale.

9. Failing to Manage Assets and Liabilities

A common misconception is that an organization can minimize risk by investing in short-term assets and borrowing at long-term fixed rates. This strategy actually creates risk and volatility. Integrated variable-rate investment/variable-rate debt strategies have outperformed variable-rate investment/fixed-rate debt strategies in all but one of the last 18 years. An organization should always at least match what it's earning on investments against what it's paying on debt.

10. Providing Too Generous Health and Other Employee Benefits

For-profit organizations often pay higher hourly wages but less generous employee benefits than not-for-profits. Personnel costs that are way above the industry average may lead to a technical default. Review staff turnover rates and benchmark your personnel costs, including both salary and benefits.

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