

Financing Assisted Living Facilities

Some Operational Dos and Don'ts to Ease the Process.

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- Introduction** Good Morning!! I'm Roger Frost. My main companies are Crown Commercial Realty LLC which specializes in commercial real estate, including assisted living facilities, in both North and South Carolina. A subsidiary of Crown Realty is Crown Capital LLC which is a commercial real estate mortgage brokerage. Over the last couple of years we've been instrumental in arranging finance for about 6 assisted living facilities in the Carolinas for a total of about \$15 million. This morning I would like to tell you some of the things I've learned about financing assisted livings so you may be better prepared for when you want to go back to the financial well.
- Overview** What I'm going to do is
- Ø Give you some idea of what lenders are currently looking for
 - Ø Give you some Don'ts that will make financing more difficult
 - Ø Some Dos to help you
 - Ø And then some ways to keep on top of understanding what's happening to your business
- Lenders** Lenders include banks, credit unions, insurance companies, private investors, hard money lenders etc. They all have their own criteria and what are called underwriting parameters. But one fundamental point to emphasize – **THEIR BUSINESS IS LENDING MONEY**. They are not lending you money as a favor – they're doing it because they have to, to be able to survive in business.
- Lenders wear underwear just like you** I grew up believing that to meet with your pastor and bank manager you should wear a suit. I suppose I still do. But underneath it all they're still real people who have the same likes and dislikes, strengths and weaknesses as you do. In other words they can be talked to as normal human beans. Or mostly so anyway.
- Lenders are open to negotiation** You can negotiate with your bank manager. There is some give and take in most situations. You can and should discuss their offers.

Lenders – what are they looking for?

- Lenders are looking
- Ø Firstly at the borrowers
 - Ø Secondly at the Business
 - Ø Thirdly at the property

The Borrowers

Borrowers are almost always people. Even if the name on the deed is some form of corporation, it's the people behind it that assure success or failure. Consequently, lenders will take a hard look at their financial condition and experience. If the building is under management, the management company will also go under scrutiny. A personal financial statement on each of the principals will be required plus (see attached) and also lenders will want to review the last 3 years personal federal tax returns on each.

What are they looking for?

- Ø Substantial net worth appropriate to the loan being sought.
- Ø Some degree of liquidity – if all assets are pretty non-liquid (real estate) not good.
- Ø Consistent earnings.

The business

Here's where my job often becomes difficult. I find myself all too frequently trying to generate reports for clients because they don't have them.

- Ø Lenders need to understand how the business is performing. And this boils down to financial performance. Getting good information on current financial performance is often like trying to get blood from a stone. Even quite large operators often have very rudimentary accounting systems which do not seem to be able to produce a snapshot on demand – or what is properly called a Year to Date (YTD) set of financials.
- Ø Financials – first, keep them current. Lenders want to know what's happening now, as well as a year ago. A year ago success may have been evident. Today the business may be tanking. Or almost more importantly, the opposite may be true – a year ago things were not good but hey guys, look how we've improved. Financial performance should be capable of being summarized on a monthly basis with year-to-date figures comparing the position with the same period last year.
- Ø Second, keep them clean. By this I mean only include in your business revenue and cost structures those items that are strictly relevant to business activity. So no putting the purchase of your Jaguar XKR through the books. This not only drains your cash but does not accurately reflect a business's health. And that means your bottom line is reduced and your debt capacity with it.

- Ø Third, it pays to be honest. The cash the business takes that doesn't get recorded is the cash which, if properly acknowledged will show the true value of the business for a sale, and the necessary cash flow for a financing transaction. Without it you are trying to sell a dog, or trying to finance a failure.
- Ø Fourth, resist the temptation to expense, at least in your operating (as opposed to your tax relevant) statements, as much of your purchases as possible. While this expensing may help your tax situation, it plays havoc with your bottom line. Remember we need to show the best possible bottom line for financing or sale purposes. Treating capital expenditures as such helps to keep the bottom line healthy.
- Ø And fifth, have a line item somewhere in your accounts called "Non-recurring Expenses." Sometimes your expenses can be inflated due to an emergency expenditure which is not likely to be repeated. Let's note that so we can add this item back into your bottom line as an anomaly. And if you have a Replacement and Reserves account be careful how you book any re-imbursements.

The property

The Lender, if he is relatively local will want to come and kick dirt. Even if he doesn't he will have someone do it for him. In fact there could be several "someones" visiting the property. Here's what will need to be done.

- Ø Appraisal. The Lender or your Broker will order a commercial appraisal of the property. It should be an MAI appraisal done by a Member of the Appraisal Institute. These are not inexpensive, and needs to be done by an appraiser that is acceptable to the Lender. DO NOT order it yourself from Cousin Joe as the Lender will not be able to use it. It must be an arms Length appraisal. The values will include one based on the Real Estate alone, and a business value as a going concern. The latter will be the higher one and the hope is that the lender will lend on that one.
- Ø Property Condition Assessment (PCA). This is like a Home Inspection but more so. And, of course, it costs more too. It will also set out a list and estimated costs of necessary repairs needed now and some in the future.
- Ø Phase 1 Environmental. This is needed by the Lender to determine whether there is a problem with someone having dumped a whole bunch of polluting stuff on the property. Current owners (and future ones) are liable for the cleanup and the Lender, in the event of foreclosure, won't want that liability.

SO – How much can I borrow?

Apart from all the stuff above, we look at two main parameters.

1. Loan to Value – LTV. This tells what percentage of the value established by the appraisal will a Lender lend. Typically, we are seeing LTV ranges from 60% to 85%. We see higher LTVs from lenders lending on the real estate value and lower ones from those using the going concern value. However, in dollar terms the end result can be pretty much the same.
2. Debt Capacity. This takes the financials and tells you how much debt service (mortgage amount) your cash flow will support. We calculate how much cash the property throws off (we call it Earnings before Interest, Taxes, Depreciation, Amortization and/or Rent EBITDAR.) We then divide this by the Debt Service Coverage Ratio which is the amount of money in excess of debt service that a Lender will want. This can be as low as 1.1 and as high as 1.6. That means earnings must be 1.6 times the debt service. We then take that amount of cash available for debt service and figure out what the mortgage amount would be that would require that amount of debt service. See example below.

EBITDAR:	
NOI	71,000
Lease	420,000
EBITDAR	491,000
DSCR	1.20
Cash available for debt service	409,167
Interest	7.50%
Term	20
Debt Capacity:	4,232,561

How can I assure my bottom line is the best it can be?

Very simple really – maximize your revenue and control your costs.

Easier said than done I hear you say.

Some suggestions.

Revenue

1. Job number one is to keep the place full – have a good marketing effort. Referral sources are key. Newspaper advertising has its place, but referrals are key. Don't bother with radio.
2. Make sure you capture all revenue. If there are supplements in your State program for enhanced care needs, make sure everyone eligible is registered for that enhancement.
3. If you have private pay, see if there any opportunities for value pricing – e.g. better views, bigger rooms, nearer the dining area or whatever.

Costs

1. Know what your costs should be – have a budget
2. Know what your costs actually are, and as close to the event as possible. Ideally have a monthly budget and a monthly set of financials
3. Watch your food expenditures very carefully. Boxes of steaks can very easily walk out the kitchen door. You really don't want to be supporting that new restaurant down the road. How do you know what your food costs should be? Ask your wholesaler for his thoughts.
4. Are there any programs locally through your utility company for discounts for healthcare facilities?
5. See below for thoughts on staff costs
6. Watch your cost trends. How to do this? Use a regular cost per resident day analysis

Special note on controlling labor costs

Staff is probably your single largest expense item – 35-60% of total costs. Your staffing levels are set however, by weegy board, analysis of staffing requirements for a census level, whatever. But once set, you know by staffing category how many staffing hours per dept you have set. Now every two weeks or so you have a payroll, and on the payroll register are the number of hours by dept that you have paid for. Every two weeks therefore you can see very quickly if you have staffing creep or indeed whether you're understaffed. Don't be afraid to be tough on all cost areas but especially staff. It can kill you if you let it get out of control.

Cost per Resident Day analysis.

This is a very useful way to look at your finances. You divide all your line items by the number of actual census or resident days in the time period in question. The resulting numbers – revenues per resident day or costs per resident day – allows an apples to apples trending analysis and comparison between properties. The Chart below shows revenues and costs for a portfolio of three properties and allowed the owner to see where action was immediately necessary.

**Comments on
the Chart**

- ✓ Something weird is going on with Private Pay in Property 2. Could be a mistake in billing so that bills don't reflect true amount or could be a bad market or could be that PP rates have never been adjusted.
- ✓ Look at payroll. Property 1 is way out of line. A \$4 a day difference translates in this case to \$120,000 a year payroll expense. Now what is causing this could include overstaffing, different location different labor market, etc. But now you know and can work on it.

PRD Analysis	PRD = Per Resident Day Dollars			NOTES
	Property 1	Property 2	Property 3	
REVENUES				
SPECIAL ASSISTANCE	9.36	11.15	8.80	
FAMILY ASSISTANCE	8.52	15.38		
SOCIAL SECURITY/SSI	10.99	14.89	8.84	
PRIVATE	23.80	15.19	29.06	Discrepancies with private revenues and rates.
MEICAIDE	7.92	2.12	15.13	
MISC	0.48	0.49	0.15	
TOTAL	61.08	59.21	61.99	Revenue capture reasonably consistent between properties
EXPENSES				
PAYROLL	25.54	22.91	21.95	Payroll significantly higher in P1. Higher wage rates locally not fully explain. Checking staffing levels
UTILITIES	2.48	2.09	1.69	Different and high cost utility company P1
RAW FOOD	4.95	4.37	4.32	Result of this analysis - changing menus to cheaper set in P1
FOOD SUPPLIES/CHEM	0.74	0.60	0.57	Researching
CLEANING SUPPLIES	0.47	0.24	0.41	Researching
CARPET CLEANING	0.40			
LINEN	0.03	1.60	0.08	P2 has contract linenes. Changing to own supply
TELEPHONE	0.34	0.09	0.12	P1 still using Ma Bell. Research cheaper operators and check usage. Anyone calling Mexico????
AUTO	0.16	0.06	0.06	
BUILD/EQUIP MAINTENANCE	1.38	1.35	0.92	
OFFICE SUPPLIES	0.16	0.14	0.08	
CRIMINAL BACKGROUND CHK	0.01	0.01	0.00	
POSTAGE	0.00	0.00	0.01	
ACTIVITIES	0.10	0.09	0.09	
MEDICAL SUPPLIES	0.46	0.36	0.71	
OSHA	0.02	0.00	0.02	
CONTINUING EDUCATION	0.00	0.00	0.01	
PUBLIC RELATIONS/ADVERTISING	0.24	0.06	0.10	Need to increase occupancy following a significant decline late 2006 early 2007
TRAVEL COST	0.01	0.00	0.00	
CONSULTING FEES	0.08		0.80	
OPERATING INTREST	0.44			
CASUAL LABOR	0.20			
EMPLOYEE BENEFITS	0.09		0.05	
MICS.	0.99	0.33	0.75	
TOTAL	39.29	34.44	32.71	
FIXED EXPENSES				
BUILDING LEASE	21.45	11.66	13.02	Reflects new and higher debt in Raeford.
CAMERA LEASE	0.25	0.21	0.12	
COPIER LEASE		0.07	0.03	
PAGER LEASE		0.05	0.05	
DISHWASHER LEASE		0.03	0.03	
DUMPSTER RENTAL	0.01	0.19	0.04	
LICENSES	0.00	0.01	0.00	
BIRDS-I-VIEW	0.16		0.14	
SANITARY/PEST CONTROL	0.23	0.43	0.30	
PETTY CASH	0.11	0.12	0.05	
CABLE TV	0.47	0.24	0.17	Different provider in Hoke county - would not do a bulk deal.
GENERAL/AUTO INSURANCE	2.05	0.59	0.05	Researching all insurance costs
WORKERS COMP	1.60	0.77	1.20	
ACCOUNTANT/LEGAL	0.77	0.14	0.14	Legal reflects an issue with problem resident - no longer in house.
CENTRAL OFFICE/MANAGEMENT FEE		2.37	2.48	
DUES AND SUBSCRIPTIONS	0.16	0.12	0.15	
PROJECT LIFESAVER	0.13	0.12	0.11	
BANK CHARGES	0.00	0.00	0.00	
BEAUTICIAN	0.33	0.14	0.23	
REFUNDS	0.30	1.02	0.45	
TOTAL FIXED EXPENSES	28.02	18.28	18.75	
TOTAL EXPENSES	67.31	52.72	51.46	Even without higher debt sevice, P1 has higher costs. Profit Improvement Plan being implemented.

**More
comments on
Chart**

- ✓ Food costs. One property stands out with higher food costs. Maybe looks minor – about 40cents a day. But again that translates into big bucks at the end of the day. Needs attention.

And so on. This analysis done on a regular frequent basis can be of enormous help. And if you've got a norm or benchmark to compare against even more valuable.

Benchmarks can be looking at your property over time or comparing against averages from various other properties.

Benchmarking

Crown Capital is looking to provide a benchmarking service. On a subscription basis we'll compile a data base of facilities and provide a report on a monthly, quarterly or some other basis with your PRD numbers compared with the average for that line item.

Please contact Crown Capital LLC for details. 919 249 6114.