WHITE PAPER

Here Today, Here Tomorrow: Building Financial Fitness to Meet the Coming Changes in the Senior Living Industry

Senior living providers face many challenges. One of the toughest, looking ahead, is that the services expected by baby boomers are going to be different from those that most providers typically offer today. Creating a realistic vision for this future — and a healthy financial plan and structure to support it — is vital to every provider's success.

Every day in America, 10,000 people turn 65. Yet the prospects for the nation's senior living industry — including skilled and long-term-care providers, assisted living organizations, retirement communities, community health organizations, and other senior living healthcare and housing operators — face significant challenges despite a rapidly growing market.

Straight ahead: A new kind of future

In addition to the economic and political uncertainties confronting healthcare organizations of all kinds, senior living providers find themselves dealing with additional challenges specific to their sector. These include providing stable, high-quality direct care staff (e.g., RNs, LPNs, and CNAs), rapidly rising costs, the complexity of federal and state regulation and oversight, and the changing needs and demands of baby boomers as they retire.

Baby boomers: Boom or bust?

Of these, the changes brought on by baby boomers may well prove to be the most daunting — and yet the richest with possibilities.

According to the U.S. Census Bureau, the number of Americans over age 65 will double to almost 90 million by 2050 as baby boomers, the nation's largest generation (those born between 1946 and 1964), continue to retire.

It has already become clear that the demands and expectations of baby boomers — who see retirement not as an ending but as a new beginning — will be quite different from those of earlier retirees:

Work

Many baby boomers will keep working — at least as part-timers or flex workers — because they'll want to continue contributing their productivity, skills and wisdom to society, because they'll embark on new adventures as entrepreneurs or serious volunteers, and, in many cases, because they'll need to earn more money to stay solvent longer.

Leisure

Boomers are going to be a lot more active than earlier generations of retirees — pursuing travel, sports, volunteer activities, higher education, community engagement, and more.

Housing

Boomers will be looking for — and needing — a wider range of housing options and modes to fill the considerable gap that exists today between aging at home and moving directly into a care facility or similar institution.

Longevity

Boomers will live to greater ages, on average, than any generation before them. Boomer men, in particular, have been closing the traditional longevity gap, meaning that the share of older women who become widows will decline.

Health

Boomers project to be in relatively good health for decades to come. According to an Urban Institute analysis, only 34 percent of adults age 80 and over reported themselves to be in fair or poor health in 2012 — versus 43 percent in 1998. The trend is likely to continue.

Rich with possibilities

Changes in expectations pose policy and planning challenges for governments and for society as a whole. For the senior living industry, they amount to a wealth of opportunities — to help seniors age safely, cater to their youthful attitudes, deliver services that maintain their independence, provide lifelong learning, and help them benefit from the latest smart technologies.

Reaching higher ground

But where should providers begin? There are many proven methods for understanding an organization's current strengths and weaknesses, developing a vision that's responsive to the opportunities of the future, and moving toward them with realistic financial plans and a strong balance sheet in place. Reaching higher ground financially will be crucial to the long-term growth and success of senior living organizations.

Opportunities abound

Organizations in a position of financial strength can explore future directions such as these:

Doing nothing

Organizations sometimes decide to stay put in a sea of change, especially if their metrics are strong, their liquid assets meet their day-to-day needs, and they are meeting a market need. This option usually isn't the best one, since eventually the market will require change.

Repositioning or expanding the business

Repositioning or expanding the business to serve new markets or develop new service opportunities. This option can stabilize or improve the organization's health. Yet it depends on having a strong balance sheet and adequate capital capacity.

Adding new business ventures

Adding new business ventures as entrepreneurial startups in order to meet new market needs. This option is the boldest and, not surprisingly, adds increased risk.

Conversely, organizations in a state of financial decline might find themselves exploring future directions more like these:

Taking on new debt or equity

Taking on new debt or equity to help stabilize credit, take advantage of a better capital structure to provide savings, and to improve capital capacity.

Restructuring the business

Restructuring the business to reflect limited new markets or service opportunities, an inability to improve financially, or poor capital capacity — or even to buy time until a new idea comes along.

Selling the business

Selling the business or affiliating it with another business to reflect limited new markets, service opportunities, or a lack of capital capacity to access new growth.

Use your mission and vision statements as the touchstones

Most organizations have a mission statement (of their current core purposes, markets, and goals) and a vision statement (of their future core purposes, markets, and goals). But organizations shouldn't just "set them and forget them." Simply preparing and employing better, nicer, cleaner versions of today's statements aren't going to be good enough. The key is to chart a course that balances the organization's financial strengths (see below) against its opportunities to meet new market needs in order to discover the area of overlap — that is, the things you can realistically do. To do even more, your organization has to build even greater financial strength. Annual revenue from current operations is usually insufficient to enable a facility to adapt to meet the demands of the coming market.

Depending on your organization's skill set, your staff and your board can re-create or update strong, on-target mission and vision statements in-house or with the help of a consultant knowledgeable about your industry.

Do it soon. It's the framework for determining the scope and nature of services for any organization and is the crucial first step organizations can take on the path to a more prosperous future — because you need to know where you're going before you can start going there.

Building financial fitness

Underlying all of the many key questions that arise in upgrading mission and vision statements is the single most important question your facility or organization needs to answer: Do we have the right financial plan and structure in place to support the mission and vision?

Six steps to building financial fitness

Financial fitness relates to a range of subsidiary questions about the organization's key financial measures now and in the future. Here are some steps your organization can take to strengthen and improve its financial fitness sufficient to have (or access) the capital required to fund strategic growth and new initiatives related to market demands.

1. Assess the status quo and know what to benchmark

Establishing the organization's financial baseline and key ratios are the first steps, giving management the feedback it needs to understand current and expected performance. The real key, however, is to look long-term — at least five years out — in order to make sure that the status quo is in fact being examined strategically, meaning there's genuine value in the process.

As part of the process, the organization should look closely at benchmark goals from a variety of angles that assess financial health and competitiveness:

LIQUIDITY	CAPITAL STRUCTURE	PROFITABILITY

LIQUIDITY

Liquidity ratios measure an organization's ability to meet obligations as they become due. Strategically positioning to meet short and intermediate goals and overcome challenges is crucial for achieving one's vision. These ratios include days cash on hand, net working capital and quick ratio. Determining how much of a safety net is needed prior to embarking on significant change is a decision unique to each organization, its revenue cycle and debt service requirements.

CAPITAL STRUCTURE

Capital structure may be highly complex to measure as capital can come from debt and/or equity and organizations can finance growth and current operations via a variety of options such as owner contributions, capital campaigns (for not-for-profit organizations), financing, and operating results, to name a few. Financial ratios that measure capital structure include fixed assets to long-term liabilities and debt to equity. These ratios evaluate the percentage of equity an organization has in its fixed assets and the balance between debt and equity, respectively.

PROFITS

Unless an organization is highly dependent upon contributions to fund operations and plans to continue to be, regardless of tax status (for profit or not-for-profit) a profit margin is necessary to invest in current and future programming and weather short term issues that may arise. There are many senior living specific profitability measures that leadership can utilize as goals and objectives, trend, track and mange.

Importantly, benchmarking against peers may or may not be essential in this process. Although it is important to understand the competitive landscape, it is more important to benchmark yourself against your own goals and objectives needed to fulfill your strategic mission. Rather than considering where you are compared to your competition, consider where you are compared to where you need to be.

It is not enough to look at just one component or type of benchmark. An organization should evaluate which benchmarks are most applicable to their operations and strategic goals to achieve their mission. This evaluation should include balance sheet and profitability benchmarks to ensure targets are well rounded and will create a sound position to embark on strategic initiatives.

2. Understand your industry and facility ratios and set appropriate targets

Know what the financial ratios are in your niche of the senior living industry, and get to know how you stack up. Some of the most common ratios utilized in senior living include: evaluation and monitoring of staffing ratios, net revenue and expense per resident day, case mix, length of stay, occupancy, and payor mix.

These are all key operational metrics that an organization's leaders should be tracking and evaluating daily and/or monthly, as they drive profitability and feed balance sheet positioning and strength.

Industry regulatory initiatives can often put a strain on certain operational metrics. Remaining abreast of the political landscape in this industry and the objectives relative to payment reform and quality measures will keep you ahead of the curve and position you well for the challenges ahead.

Once you have this information, you can formulate a plan to make sure you get the ratios where you need them to propel you in the years to come. Find more information about benchmarking and ratios here.

3. Set financial targets that will put you on the right path

Establish financial targets upfront for both the short and the long term. Setting the targets allows the organization to use them to lay plans and understand your chosen direction(s) from a standpoint of financial discipline. It gives the organization guidance in charting strategies and creating a timetable for implementation. By using planning "trip wires", you can draw attention to targets that aren't being met that could throw off the timetable or increase the costs of capital. This sets the stage for timely value discussions vis-à-vis the targets, strategies, and hoped-for results, giving management opportunities to devise solutions (or to reevaluate the targets).

4. Assess capital capacity

The organization's capital capacity can send signals ranging from meeting daily needs to being financially solvent for years to come. By reviewing your capital capacity, you can determine how much capital you have to invest beyond just keeping the lights on. Look at your debt service, how much money you have coming in (and going out), savings, investments, and your ability to borrow. Review operating costs, and savings you have to handle facility emergencies or other unplanned expenditures. This will inform how much capital capacity you have, and subsequently, how much you can look to grow your business.

Some specific questions you can address:

- What is available in your current annual budget (income) to service existing debt?
- What is your current borrowing capacity?
- Do you have reserves established to meet the "normal" capital requirements/replacements?
- What liquidity do you have (after target reserves)?
- What's the current lending market like in regard to rates, covenants, underwriting, etc.? What are the projections for it during the duration of your strategic plan?

5. Assess the timing of the financial impact of your strategies

With any change comes a period of stabilization. As you consider the financial health necessary to embark on your strategic initiatives to meet the expectations of a new market (the baby boomers) or to delve into a new service line or area, be sure to factor in enough "cushion" to weather operations during start up. This "cushion" may include using liquid assets during start up, having financing available to fund operating losses during start up, or having other means to access capital during this time. Factoring this into your long-term strategic assessment is essential to success.

6. Identify shortfalls, then course-correct

To make sure the plan remains realistic, the organization needs to "begin again" at defined moments — by revisiting its initial financial baseline, checking initial assumptions with the current environment, and examining the current state of its targets and strategies. Are there shortfalls? If so, you need to reset strategies and create a revised plan to implement them.

Take it one step at a time

Whether your organization has ample amounts of assets and a clear vision for future growth, or your organization focuses solely on daily operational indicators, reviewing your mission and values, current state, and future opportunities is always good practice. Yet getting started can be difficult. It can seem overwhelming to figure out where to start, what data to gather, whom to involve, how to identify shortcomings, and how to get buy-in. We can help you begin the conversation with your board or your management team to chart and outline a path that makes sense for your organization's specific circumstance.

If you want advice from people with years of long-term care and senior living experience, look to BerryDunn.

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