Valuation Spotlight: Is that *Really* Worth That?

Panelist:	**JP LoMonaco, MAI** Valuation & Information Group
Panelist:	**Colleen Blumenthal, MAI** HealthTrust
Panelist:	**Michael Baldwin, MAI, ASA** OHC Advisors
HUD/ORCF:	**Wayne Harris**
Moderator:	**Jenifer Williams** Berkadia

Medicare PDPM Implementation

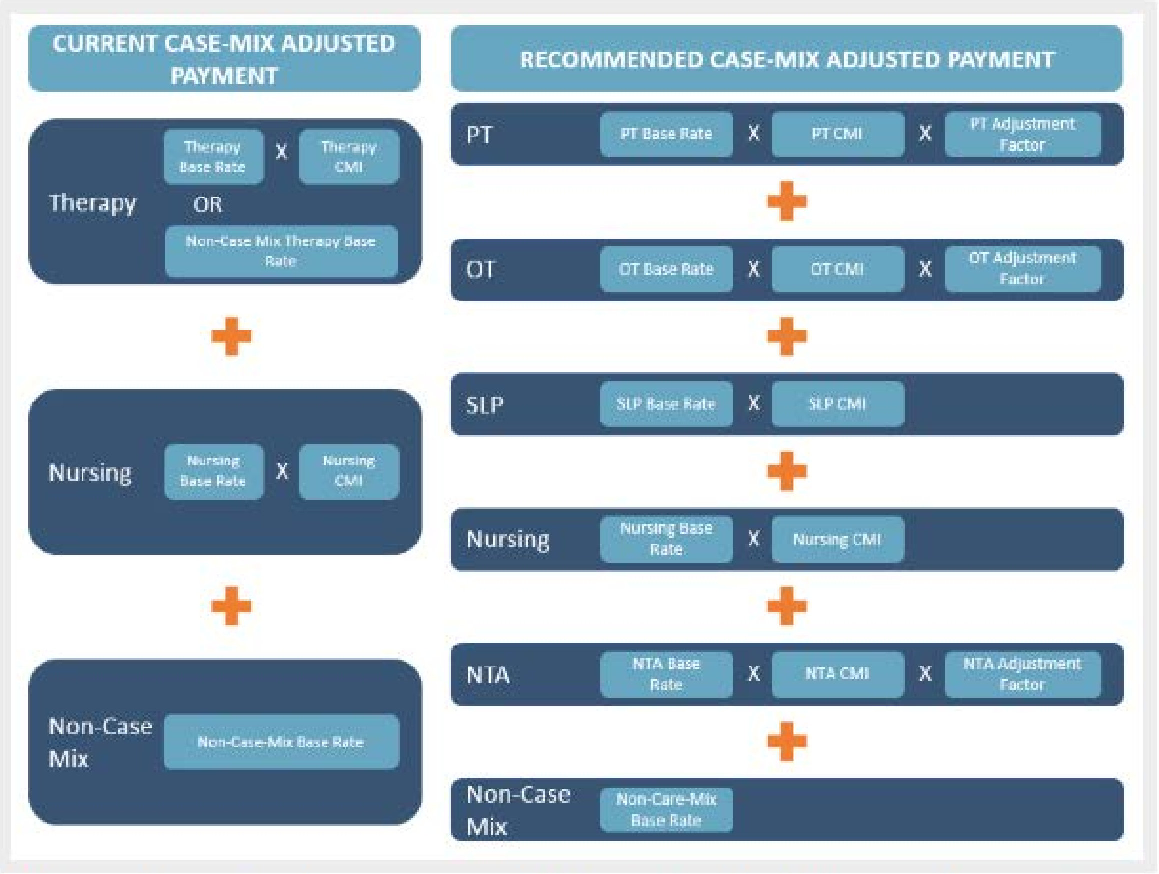
- RCS1 to be replaced with patient driven payment model or “PDPM” as of 10/1/2019
  - Goals - CMS describes three goals for the new reimbursement system:

    (1) more accurately compensating SNFs;

    (2) reducing incentives for SNFs to deliver therapy based on financial considerations, rather than resident need; and

    (3) maintaining simplicity, to the extent possible

Medicare PDPM Implementation



Medicare PDPM Implementation

Structure shift

<u>Current System – Resource Utilization Groups (RUG-IV)</u>

- Two components
  - Case-mix – A patient's RUG is based on the higher of two case mix components (Nursing and Therapy). More than 90% of patients assigned rehab based RUGs.
  - Non case-mix – board and various capital costs

<u>Proposed System - Patient Driven Payment Model or "PDPM"</u>

- Five Components
  - Physical Therapy
  - Occupational Therapy
  - Speech Therapy
  - Nursing
  - Non-Therapy Ancillary Services "NTAS"

Medicare PDPM Implementation

Conclusions

1. Funding neutral

2. Eliminates rehabilitation minutes

3. Allows for concurrent therapy

4. Assessment based on Hospital DRG and changes to assessments are more limited

5. Providers with adequate resources will adapt and are generally in favor of the new system

Potential Changes to Appraisal Dates

- Chapter 5.3B states:

  The effective date of the value estimate should be the date that the designated appraiser inspected the subject property. The date of valuation may not be a future date.

- However, often by the time the appraisal is being reviewed, the financials analyzed in the report are over six months old, resulting in many requests to appraisers to update the financials in the report.

Potential Changes to Appraisal Dates

UPDATING WITHOUT REINSPECTING	
Pros	**Cons**
- Saves time and money	- Changes may have occurred at the property
- Allows appraisal and underwriting to be more in sync	- Market conditions could be different with new supply, closing of a primary economic producer, etc.
- Appraiser can customize scope of work to what adds value	- Concerns exist already when the date of the report is months removed from the date of value

Potential Changes to Appraisal Dates

- There is no consensus.

- ORCF will be open to inspection and date of value waiver requests.

- Appraisers will have to assess the scope of work needed to minimize liability and update the report.

Corporate Adjustments

The income approach premise that value equals the present worth of future benefits means:

- Owner-specific income and expenses should not be modeled in cash flow projections, such as owner distributions, interest, etc. Projected cash flow should reflect market-supported assumptions.
- Historical statements are not to be adjusted to market. Please do not modify the Standardized HUD tables/Decision Circuit to show the adjusted history. If for discussion purposes you want to show how the adjusted history would look, do it below the standard tables.
- The adjustments should not be applied to the NOI used to calculate the Debt Service Coverage.
- Ultimately, keep adjustments transparent.

Corporate Expense Adjustments

Transparent, But Inappropriate:

SUMMARY OF SUBJECT'S ADJUSTED FINANCIAL STATEMENTS																
Year	**TTM August 2018**				**YE 2017**				**YE 2016**				**YE 2015**			
	Total $	$/Unit	$/RD	% EGI	Total $	$/Unit	$/RD	% EGI	Total $	$/Unit	$/RD	% EGI	Total $	$/Unit	$/RD	% EGI
Total Effective Gross Revenue	$10,884,080	$120,934	$355.75	100.0%	$10,475,990	$116,400	$350.88	100.0%	$9,490,925	$105,455	$320.73	100.0%	$9,128,065	$101,423	$290.26	100.0%
Expenses																
Real Estate Taxes	$39,088	$434	$1.28	0.4%	$42,359	$471	$1.42	0.4%	$38,038	$423	$1.29	0.4%	$68,120	$757	$2.17	0.7%
Insurance	$300,389	$3,338	$9.82	2.8%	$306,966	$3,411	$10.28	2.9%	$317,766	$3,531	$10.74	3.3%	$314,261	$3,492	$9.99	3.4%
Utilities	$134,312	$1,492	$4.39	1.2%	$131,567	$1,462	$4.41	1.3%	$135,831	$1,509	$4.59	1.4%	$128,459	$1,427	$4.08	1.4%
Maintenance	$161,940	$1,799	$5.29	1.5%	$143,656	$1,596	$4.81	1.4%	$144,602	$1,607	$4.89	1.5%	$157,381	$1,749	$5.00	1.7%
Administrative/General	$1,109,070	$12,323	$36.25	10.2%	$1,046,048	$11,623	$35.04	10.0%	$812,898	$9,032	$27.47	8.6%	$1,029,955	$11,444	$32.75	11.3%
Housekeeping/Laundry	$335,838	$3,732	$10.98	3.1%	$332,984	$3,700	$11.15	3.2%	$311,455	$3,461	$10.52	3.3%	$308,548	$3,428	$9.81	3.4%
Dietary	$652,999	$7,256	$21.34	6.0%	$647,521	$7,195	$21.69	6.2%	$636,995	$7,078	$21.53	6.7%	$689,638	$7,663	$21.93	7.6%
Nursing/Personal Care	$4,145,523	$46,061	$135.50	38.1%	$3,993,308	$44,370	$133.75	38.1%	$3,932,229	$43,691	$132.88	41.4%	$3,901,314	$43,348	$124.05	42.7%
Activities/Social	$316,869	$3,521	$10.36	2.9%	$309,554	$3,439	$10.37	3.0%	$248,011	$2,756	$8.38	2.6%	$248,311	$2,759	$7.90	2.7%
Other Payroll, Payroll Taxes and Benefits	$852,108	$9,468	$27.85	7.8%	$776,779	$8,631	$26.02	7.4%	$917,244	$10,192	$31.00	9.7%	$1,044,847	$11,609	$33.22	11.4%
Total Operating Expenses	$8,048,136	$89,424	$263.05	73.9%	$7,730,740	$85,897	$258.93	73.8%	$7,495,070	$83,279	$253.28	79.0%	$7,890,833	$87,676	$250.91	86.4%
Net Operating Income Before Adjustments	$2,835,944	$31,510	$92.69	26.1%	$2,745,250	$30,503	$91.95	26.2%	$1,995,855	$22,176	$67.45	21.0%	$1,237,231	$13,747	$39.34	13.6%
Plus Excess Insurance	$200,000	$0	$0.00	0.0%	$200,000	$2,222	$6.70	1.9%	$200,000	$2,222	$6.76	2.1%	$200,000	$2,222	$6.36	2.2%
Plus Actual Management Fee	$0	$0	$0.00	0.0%	$586,550	$6,517	$19.65	5.6%	$477,217	$5,302	$16.13	5.0%	$459,416	$5,105	$14.61	5.0%
Less Market Management Fee	$544,204	$6,047	$17.79	5.0%	$523,800	$5,820	$17.54	5.0%	$474,546	$5,273	$16.04	5.0%	$456,403	$5,071	$14.51	5.0%
Less Reserve for Replacement	$45,000	$500	$1.47	0.4%	$45,000	$500	$1.51	0.4%	$45,000	$500	$1.52	0.5%	$45,000	$500	$1.43	0.5%
Adjusted Net Operating Income (EBITDAR)	$2,446,740	$27,186	$79.97	22.5%	$2,963,000	$32,922	$99.24	28.3%	$2,153,526	$23,928	$72.77	22.7%	$1,395,244	$15,503	$44.37	15.3%

Corporate Expense Adjustments

Transparent and Appropriate:

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Note	**Line Item**	
(1)	Insurance	Historical Periods reflect above-market insurance expense
(2)	Plus Actual Management Fee	Includes Corporate Overhead Charged plus Owner's Salary

Corporate Income Adjustments

- If a profit center, therapy for example, is handled by a separate entity, and would not show up on the facility's income and expense statement, we have been allowing an adjustment to add the profit from that activity to be included in the appraiser's NOI conclusion.

- We don't want to see this adjustment applied to small facilities, where due to the economies of scale, the highest and best use would be to contract out those services.

- Because of the difficulty of disentangling income and expenses at the corporate level, we will also require market evidence of the profits adjustments in addition to that profit center’s income and expense reports.

As-Is vs. Stabilized Values

- Most HUD appraisals are of stabilized facilities
- What if the appraiser determines the property is not stabilized or has upside?
- Handbook: do not consider significant physical or operational changes
- However, changes are OK if a buyer could “immediately” implement them
- Must account for impact on value associated with reaching stabilization
- Not-for-profit valuations
- Recent, short-term declines in occupancy / census
- Above-market expenses

As-Is vs. Stabilized Values

- Length of time needed to reach the stabilization
- Risk of achieving stabilization
- DCF appropriate?
- Cap rate selection
    - What if it were already stable?
    - Low risk / quick timeframe
    - High risk / long timeframe

Cost Approach Concerns

- Section 232 Handbook, Section II, Production, Chapter 5.3.R.2.

  "ORCF will expect to see a fully developed cost approach in cases where there is little depreciation or in cases where the undepreciated replacement cost new would be expected to be lower than the conclusions of the Sales Comparison or Income Capitalization Approaches. For that reason, base costs of new facilities will need to be carefully discussed in the narrative justification for excluding the approach."

- ORCF underwriters need to give Loan Committee an explanation when there is a disconnect between the concluded value and the cost to build new. This discussion will need to include a discussion of the market and the likelihood of competition being built.

Cost Approach Concerns

- In cases where you are allowed to exclude the cost approach, it is acceptable to apply a simple test showing the concluded value doesn’t exceed the cost to build and reach stabilized occupancy.

  - ORCF doesn’t dictate the method of the test. The appraiser sets the scope, which should expand and contract depending on how clear the case is.

Cost Approach Concerns

- The scope may or may not need to include a full land valuation.
- The scope may or may not need to include an analysis of intangibles
- Analyzing cost comparables is a good tool to help you decide the scope.
  - Example: *" The preceding construction budgets from recently built or proposed SNFs range from $175,911 to $279,804 per licensed bed. Our subject value conclusion at $63,000 per licensed bed is significantly below the undepreciated replacement cost new comps, so there is a low possibility that a competitor may be added to the market based on financial feasibility."* In this case a fully developed Undepreciated Cost Approach or land value would not be needed.


Questions?