

*Sussex County Board of Freeholders*

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*Financial and Market Analysis  
for Additional Nursing Beds  
at The Homestead*

*December 8, 2009*



## TABLE OF CONTENTS

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Executive Summary .....	2
Background .....	2
Recommendations .....	3
Planning Considerations .....	4
Focused Market Analysis .....	6
Market Analysis Process .....	6
Primary Market Area .....	7
Demographic Trends .....	8
Competitive Environment .....	9
Hospital Discharge Planning Calls .....	13
Depth of the Market for Skilled Nursing and Short Term Rehab Services .....	15
Grant Opportunities .....	17
Financial Analysis .....	18
Regulatory Considerations .....	18
Construction Considerations .....	19
Projected Operating Results – Year Ending December 31, 2009 .....	21
Key Financial Assumptions .....	24
Next Steps .....	27
Project Related .....	27
Existing Operations .....	27

## EXECUTIVE SUMMARY

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### Background

Sussex County Homestead (“Homestead” or “Management”) currently provides services in a 102-bed facility. Management recognizes the critical need to diversify nursing home services at the Homestead in order to sustain profitability in the future. Management has requested that ParenteBeard LLC (“ParenteBeard”) conduct an analysis to determine the feasibility of adding 18 skilled nursing beds (the “Project”).

Currently there are 12 subacute beds and 90 long term care beds (102 beds total). The additional 18 beds will change the configuration to 18 subacute beds and 102 long term care beds (120 total). Homestead has 10 bed rights currently, but will need to acquire bed rights for the additional 8 beds.

Management has requested assistance with the following:

- What is the financial viability, at stabilized occupancy, of adding 18 beds (configured as described above)?
- Is there a market need to support the proposed expansion?
- What is the most efficient preliminary concept design for the expansion?

The Financial and Market Analysis has been prepared for use by Management and the Board of Chosen Freeholders exclusively. The document summarizes focused market analysis conducted by ParenteBeard as of December 4, 2009 and financial analysis based upon financial information for the years ended December 31, 2007 and 2008 and the ten-months ended October 30, 2009.

We have assembled, from information provided by Management, the accompanying projected financial analyses and significant projection assumptions for Sussex County—The Homestead for a twelve-month period assuming expansion of 18 nursing beds. We have not compiled or examined the projected financial information, and express no assurance of any kind on it. Further, there will usually be differences between the projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. In accordance with the terms of our engagement, this report and the accompanying projected financial information is restricted to Management’s and the Board of Chosen Freeholders’ internal use only, and may not be shown to any third party for any purpose.

**Financial, regulatory and market conditions may change in the future; however, ParenteBeard is under no obligation to update the report for events and circumstances occurring after the date of this report. Please note that the data contained herein cannot be relied upon by any third party and is restricted for Management and the Board of Chosen Freeholders internal use only.**

## EXECUTIVE SUMMARY

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### **Recommendations**

- The addition of 18 skilled nursing beds and reconfiguring the bed mix to 102 long term care beds and 18 rehabilitation (subacute) beds is supportable by demographic trends, subacute service utilization in the market area, and the projected financial returns associated with the Project (based on current assumptions).
- The 18-bed addition will enable the Homestead to attain operating efficiencies and economies of scale associated with a 120-bed nursing home vs. a 102-bed nursing home. The Project's incremental revenue is projected to exceed the incremental expense by approximately \$1,600,000.
- The payback period (incremental contribution to operations related to the Project cost) for the 18-bed addition is approximately 22 months. The estimated project costs are \$2,974,600. Two sensitivity analyses were considered should the project cost estimate be 10% less (\$2,677,100 and a 20 month payback period) or 10% more (\$3,272,100 and a 24 month payback period).
- Implementing the Project by using a general contractor will reduce the timing for completion of the Project from 76 months (over 6 years) to 32 months (slightly under 3 years).
- Assess the benefit of implementing a pilot project previously considered by the County, as part of this Project, for a photovoltaic system to enhance energy conservation and cost containment. Changes over the past 12 months have enhanced the program and is currently providing for a higher return on investment than anticipated previously.

### Planning Considerations

- Proposed changes to Medicare and Medicaid reimbursement will likely require nursing facilities to realign their service offerings to enable enhancement of their revenue stream while maintaining control over expenses. The 18-bed addition is projected to enable the Homestead to expand its ability to care for and serve Medicare patients as well as attain operating efficiencies.
- The optimal design for the 18 rehabilitation (subacute) beds should provide autonomy from the long term care unit and offer an inviting atmosphere.
  - Continue enhancements to any rooms within this unit to include upgrades to the amenities and décor.
  - Consider developing some private rooms with private baths as a way to differentiate your services in the market.
  - Provide a separate dining and lounge area for these residents.
  - Increase the light within the unit and hallways.
  - Evaluate the cost / benefit of offering additional amenities, including modern hotel-like amenities such as flexible dining options, flat screen TVs, high speed internet access, coffee and snack services, and concierge services.
- Adapting future operations to be consistent with current trends in service delivery currently offered in the nursing home industry such as neighborhoods, household model, etc.
- Identify and secure short term rehab referral sources.
  - Continue to maintain the Homestead's positive relationship with the local smaller hospitals, while strengthening relationships with larger hospitals such as Morristown Memorial and Hackettstown Regional Medical Center.
  - Enhance response time and clearly communicate the Homestead's services and 7 day a week admission process.
  - Hire a hospital liaison to direct the admission process and gather feedback from the discharge planners.
  - Develop a relationship with one or several physician groups as a way to capture selected patient types.
- Identify target market (income levels, social class, age, etc.) considering competitors' services and perceived target markets.
- Establish and conduct a branding campaign for the new unit.
  - Create a new name and tagline specifically for the short term rehab and launch an advertising campaign focusing on these new services. This will encourage people to visit (or revisit) the Homestead, which will increase awareness of the facility within the community.
  - Schedule an open house for the unit which will maximize interest in the unit. Advertisements and public relations pieces in the local paper can reach potential residents, including those planning an elective surgery.
  - Consider increasing external marketing of the Homestead, such as placing signs on county transit vehicles and an update to the website.
- Record and market positive resident satisfaction and resident outcomes.
  - Residents should be asked to complete a brief questionnaire that evaluates their satisfaction with case receive, interaction with staff, food, and amenities. This

## EXECUTIVE SUMMARY

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will provide the Homestead with regular feedback that can be used to adjust programming and can also be included in marketing materials.

- Resident outcomes such as: Admissions to the Unit, Patient Length of Stay in Relationship to Diagnosis, Measurable Improvements to Patient Condition, and Return to Functional Independence Back Home or in the Community should be monitored.

### **Market Analysis Process**

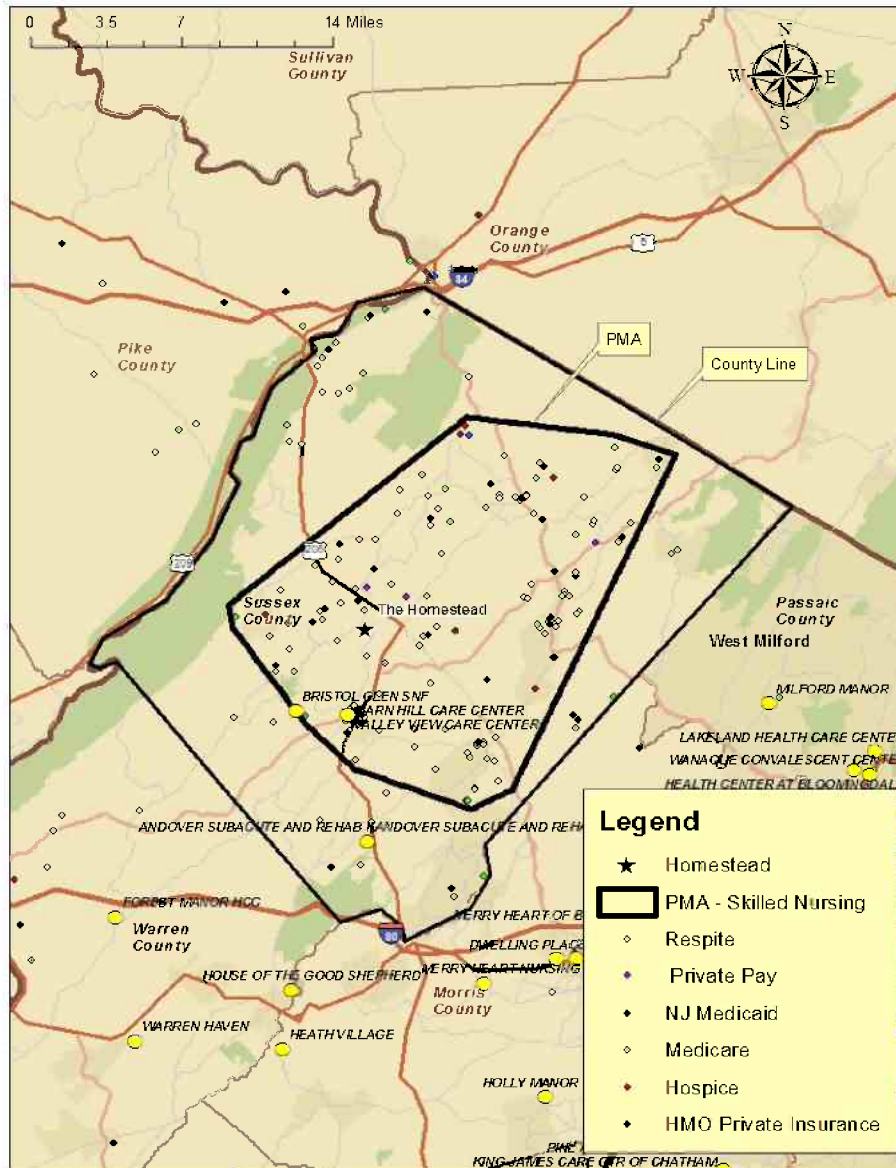
ParenteBeard utilized the following research methods as part of the Market Analysis process:

- Toured the Homestead campus to assess current product offering by level of service, amenities, room sizes, and available programs and services available.
- Interviewed members of Management to identify current practices and trends specifically in relation to the existing short-term rehab services offered at the Homestead.
- Investigated the depth of market for additional short term rehab beds licensed for nursing care, including:
  - Determined the primary market area or draw area for nursing care;
  - Evaluated demographic trends of seniors ages 65+, 75+, and 85+ including population change and household income statistics;
  - Investigated competitive market through site visits and telephone interviews;
  - Interviewed hospital discharge planners;
  - Determined market penetration levels/depth of market for nursing services; and
  - Conducted research on the regulatory process for obtaining approval for the transfer of the additional bed rights.

# FOCUSED MARKET ANALYSIS

## Primary Market Area

- The primary market area (“PMA”) definition was based on an analysis of nursing care residents who were admitted into the Homestead from January 2008 until November 3, 2009.
- The PMA is defined as a polygon that spans approximately 21 miles from east to west and 19 miles from north to south. The western side of the PMA borders Pennsylvania and the northern side of the polygon borders New York State. The PMA is located entirely within Sussex County, New Jersey.
- Approximately 74 percent of all of the residents analyzed resided within the PMA prior to moving to the Homestead. The overall capture percentage is consistent with the industry average capture rates of between 65 percent and 75 percent origin from within the defined PMA.



Prepared by ParenteBeard



## FOCUSED MARKET ANALYSIS

### Demographic Trends in the Marketplace

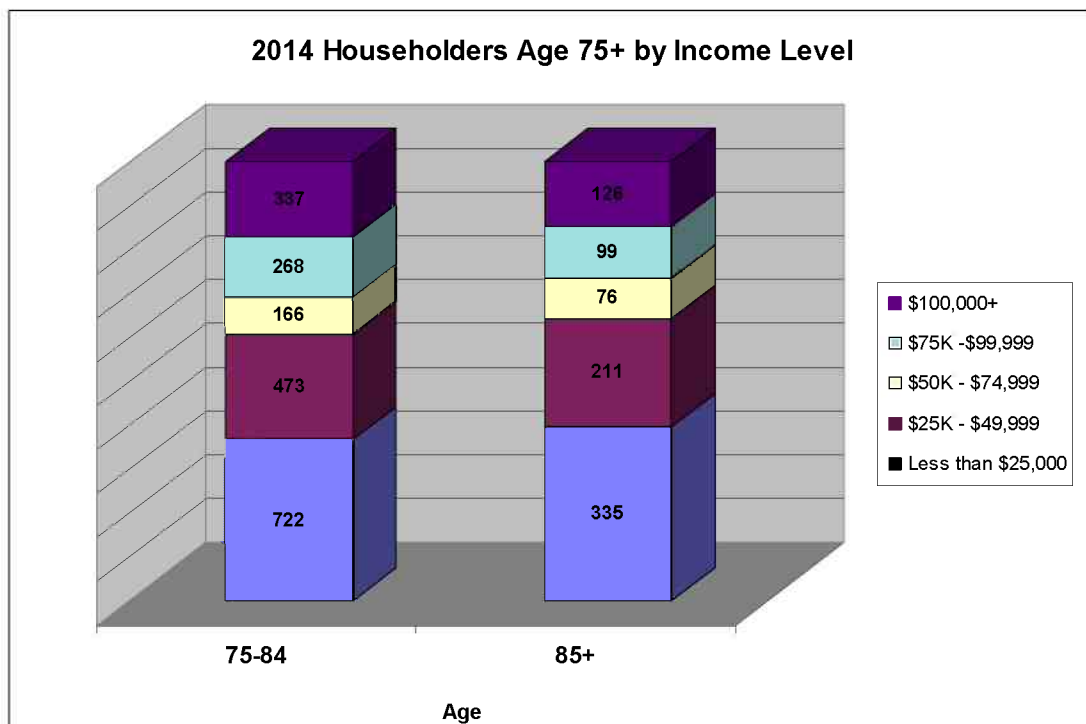
- Senior population is projected to increase between 2009 and 2014 for all senior age groups within the PMA.
- Young seniors (ages 65-74) are projected to experience the greatest amount of growth, approximately 6% annually.
- Seniors (ages 75-84) are projected to increase 0.6% annually through 2014. A slight decrease in the 75 to 84 age group is typical in most markets indicating a stronger than typical growth rate in the PMA for this age cohort.
- Seniors (ages 85-plus) are projected to increase 1% annually through 2014.

Population Change for the PMA			
	2009 (Estimated) Population	2014 (Projected) Population	Average Annual Compounded Percentage Change 2009 - 2014
PMA			
Total Population	88,813	91,852	0.68%
Age 65 to 74 Population	5,732	7,660	5.97%
Age 75 to 84 Population	3,315	3,412	0.58%
Age 85 plus Population	1,578	1,653	0.93%
Total 65 plus	10,625	12,725	3.67%
Total 75 plus	4,893	5,065	0.69%

Note: Demographics based on 2000 Census.

Source: ESRI, November 2009.

Senior households within the PMA categorized by age and income are displayed in the following graph for 2009 and 2014.



## **FOCUSED MARKET ANALYSIS**

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- The annual income requirements for the care at the Homestead as a private pay resident are approximately \$93,000.

### **Competitive Environment**

ParenteBeard toured or conducted a telephone interview with the following communities. Management identified Barn Hill Care Center (“Barn Hill”) and Andover Subacute and Rehab Center (“Andover”) as primarily competitors and thus those two facilities were toured by ParenteBeard. Andover Subacute refused our tour as consultants and so the tour was completed as a mystery shop.

#### On-Site Tours:

- Barn Hill Care Center
- Andover Subacute and Rehab (mystery shop)

#### Telephone Interviews:

- Valley View Care Center
- Forest Manor
- Bristol Glen

The following narrative summarizes the observations of the on-site tours of Barn Hill Care Center and Andover Subacute and Rehab Centers.

#### *Barn Hill Care Center*

- Barn Hill Care Center is a nursing care facility which offers a total of 152 beds and is currently managed by Genesis HealthCare. The facility is located just outside of the town and Newton Memorial Hospital is within close proximity (within walking distance) to the facility.
- Barn Hill recently completed an expansion project which includes 20 short term rehabilitation beds and two semi-private rooms which are contracted out for hospice care. The new addition is completely separate from the existing long term care facility, including a different entrance, parking, reception, and dining areas. Residents of the new rehab section do not intermingle with the long term care residents.
- The new addition has a large reception area with glass partitions which showcase the resident dining room and rehab gym.
- The new rehab rooms are very large (approximately 250 sq. ft.) with a shared bathroom between the rooms.
- The new rehab unit is attracting a younger resident base, typically with orthopedic issues. The original long term unit also provides rehab services in the existing unit. These residents are typically older patients with chronic conditions who have had an episode such as a heart attack or stroke.
- The average length of stay in the new short term unit is approximately 5 to 15 days.
- They receive 55 percent of their referrals from Newton Memorial Hospital. The other referrals come from Morristown and St. Clare’s Hospital in Sussex County.
- Most residents originate from Sussex County.

## FOCUSED MARKET ANALYSIS

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- Barn Hill considers Andover to be their biggest competitor. Valley View is also a competitor, but is very small and does not pose a threat. The Marketing Director expressed that they do not consider The Homestead to be a competitor, because it is considered to be “The County Home”.
- The facility is 3 star rated according to Nursing Home Compare with 4 stars for Health Inspections, 4 stars for Staffing and 1 star for Quality Measures.

### *Andover Subacute and Rehab Centers*

- Andover Subacute and Rehab Center is located in a rural area and was difficult to locate. The facility consists of two buildings.
- Andover refused to participate in the study and declined to provide a tour. We gathered the following information during a non-scheduled mystery shop.
- The campus does not provide instructions or signage as to where marketing or admissions are located within the buildings or what services are provided in each building. We entered building two (during a fire drill) and were redirected to building one for a tour.
- Andover is currently renovating the common areas in building one. The flooring was under construction and common areas were being used as storage for misplaced furniture.
- The facility did not appear clean or orderly.
- There is a main dining area on the upper level where the residents can be served lunch and dinner or the residents can eat in their rooms.
- There is a very large, nice patio area on the lower level at the back of the facility which is frequently used for activities and by the residents in the spring and summer.
- The facility has 159 beds with all semi-private rooms with shared bathrooms. An electric bed is not standard per the tour. No TVs or phones are in the resident rooms unless provided by the resident or family. There are 4 different nursing units in the building but there is not a designated rehab unit.
- The tour guide, while friendly, apologized that she had not done tours frequently and was unable to answer if the renovations currently underway would extend into the resident rooms.
- A brochure was requested at the end of the tour, but unable to be obtained due to none available onsite. A business card was requested and provided with the admission’s director contact.
- The facility appeared clean; however, odors did linger in care areas during the tour and furniture, fixtures and equipment appeared old and outdated in both the common areas and the resident rooms.
- Therapy is offered in a room on the lower level. The room is small and has no windows.
- During the tour many residents were either in lounges watching TV, lined up at the nurses station in their wheelchairs or in bed. No activities were observed to be occurring and staff interaction was minimal. The activities staff was introduced during the tour; however, they were all in their office working on a project with no residents present.
- The tour guide took the time to introduce and interact with various staff members and residents on the tour. She was very friendly and engaged; however, most of the staff met on the tour was not as friendly or as interested in engaging in conversation with the tour guide.

## **FOCUSED MARKET ANALYSIS**

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- The facility is 4 star rated according to Nursing Home Compare with 4 stars for Health Inspections, 2 stars for Staffing and 4 stars for Quality Measures.

The following page profiles the key findings of the competitive environment as determined or reported during the competitor review.

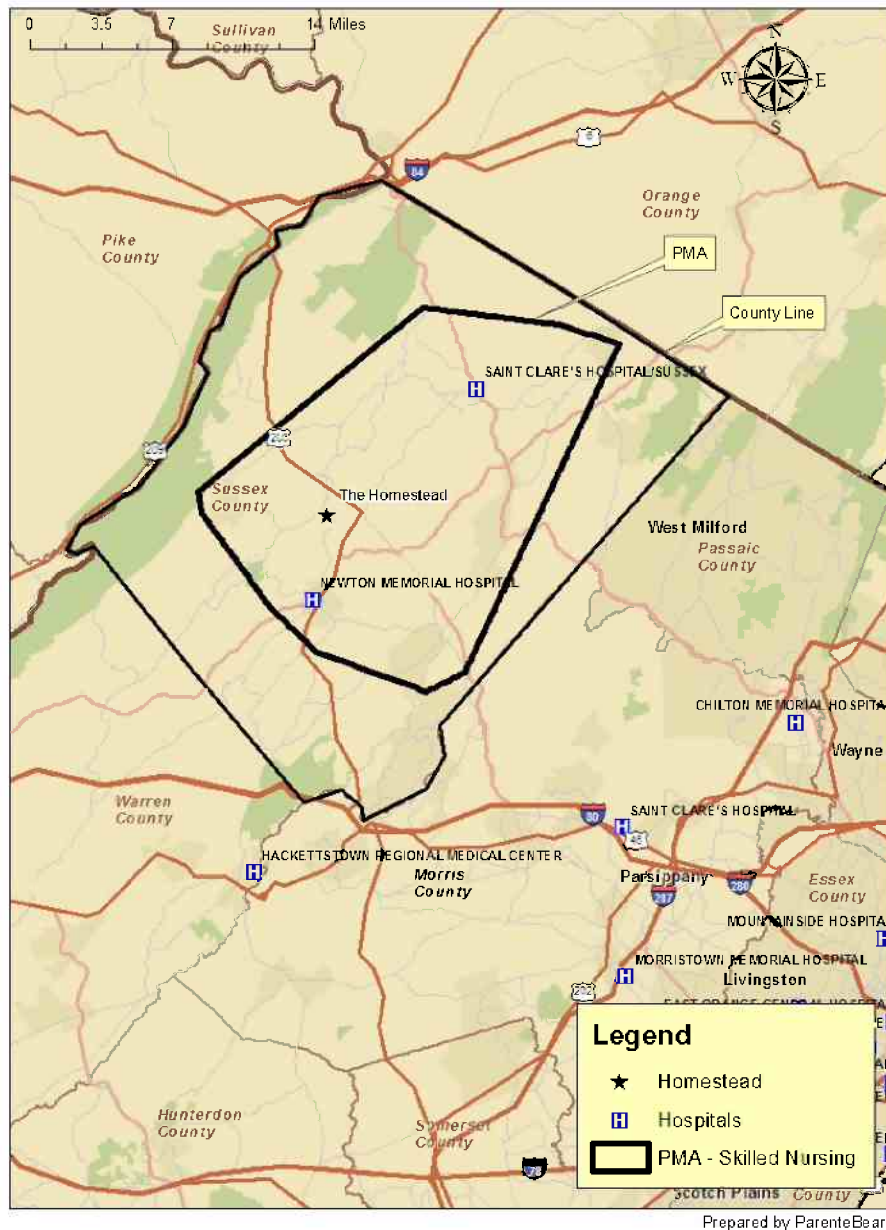
## FOCUSED MARKET ANALYSIS

Skilled Nursing	The Homestead	Barn Hill Care Center	Valley View	Andover Subacute and Rehab I and II	Bristol Glen	Forest Manor
Inside the PMA	Yes	Yes	Yes	Yes	No	No
City / Town	Newton	Newton	Newton	Andover	Newton	Hope
Miles from the Homestead	-	4.3	4.3	10.4	5.1	18.2
Year Opened	1955	Original facility 1972; Rehab Pavilion 2008	1972	1970s	2001	1942; Expansion 2009
Sponsor	County Affiliated	Privately owned; Managed by Genesis Healthcare	Privately owned	Privately owned	United Methodist Homes of NJ	Privately Owned
Type of Community	SN only	SN only	SN only	SN only	IL, AL, SN on campus	SN only
IRS Status	Not-for-Profit	For Profit	For Profit	For Profit	Not-for-Profit	For Profit
Number of Licensed Beds:	102	152 <sup>(1)</sup>	34 Licensed/ 30 Operating	702 <sup>(2)</sup>	60	120
Long-term Care	90	130	30 <sup>(3)</sup>	454 <sup>(2)</sup>	60	60
Private	2	1	0 <sup>(3)</sup>	Few	10	4
Semi-Private:	88	95	30	Majority	50	56
Short-term Rehabilitation Unit	12	22	No specific Unit	Unavailable	20 <sup>(3)</sup>	60
Private	0	20	N/A	N/A	N/A <sup>(3)</sup>	4
Semi-Private:	12	2	N/A	N/A	N/A <sup>(3)</sup>	56
Average Length of Stay	14 days	5-15 days	N/A	Unavailable	14 days	Unavailable
Daily Skilled Nursing Private Pay Rates:						
Long-term Care						
Private	\$254	\$337	\$275	Pending	\$400	\$349
Semi-Private:	\$254	\$285 - \$311	\$235 - \$258	Pending	\$375	\$299
Short-term Rehabilitation Unit			No separate rate			
Private	\$254	\$437	N/A	Unavailable	TBD	\$375
Semi-Private:	\$254	\$391	N/A	Unavailable	TBD	\$325
Other Speciality Programs						
	Balance Program (Coming Soon)	Short-Term Rehab Hospice		Behavioral Programs	Short-term Rehab	Short-term Rehab Alzheimer's Unit
Payor Mix:						
Medicaid:	75%	58%	43%	Over 75%	Unavailable	53%
Medicare:	9%	23%	Approximately 28%	Unavailable	Unavailable	20%
Private Pay:	12%	12%	Approximately 28%	Unavailable	Unavailable	27%
Other:	4%	7%	N/A	Unavailable	Unavailable	N/A
Occupancy - Skilled Nursing	99%	99%	77%	Pending	93%	76%
Occupancy - Short Term Rehab	77%	91%	N/A	Unavailable	97%	76% <sup>(4)</sup>
Top Referring Hospital:						
	Newton Memorial St. Clare's	Newton (Approximately 55%) Morristown St. Clare's	Newton St. Clare's		Morristown Netwon Kessler	Hackettstown Newton Memorial Warren
Overall Five Star Rating						
N/A: Not Applicable						
Note:						
(1) Barn Hill offers 2 and 3 bed semi-private units. They also have a 29-bed rehabilitation within their long term care facility which has a separate rehabilitation gym. This rehabilitation unit focuses on older patients with chronic conditions, while the new unit focuses on a younger population typically with orthopedic issues.						
(2) Approximately 200 beds are designated for MH/MR patients and those with behavioral issues.						
(3) In planning stages to segment one of the nursing wings into a dedicated short-term rehabilitation wing of approximately 20 beds.						
(4) Forest Manor is still in the fill-up stage for their recent short term rehab expansion. Representative could not give me occupancy of each unit; however, she indicated that most of the residents are for long term care.						
(5) The one private unit is currently offline while it is being renovated.						

## FOCUSED MARKET ANALYSIS

### Hospital Discharge Planning Calls

The following summarizes telephone interviews conducted with hospital discharge planners at selected referring hospitals- Newton Memorial Hospital, St. Clare's Hospital, and Morristown Memorial Hospital. The map below indicates the location of these hospitals.



#### *Newton Memorial Hospital*

- The representative interviewed noted good experiences with the process at the Homestead and receives a call back quickly.
- They did not indicate that bed availability is an issue at the Homestead.
- They typically discharge both short and long term patients to the Homestead and the planner indicated that patient preference is mainly based on location to their home.

## FOCUSED MARKET ANALYSIS

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- Psychiatric patients may not be placed at the Homestead because a psychiatrist only visits the facility once a month posing a problem for patients requiring more frequent monitoring and/or medication adjustments.
- This representative also indicated she discharges approximately 1-2 patients a week to area nursing facilities for short term rehab services.

### *Morristown Memorial Hospital*

- The representative interviewed noted good experiences with the process at the Homestead. She did indicate that an improvement in turnaround time would enhance the process.
- The planner has had experiences where the Homestead did not have bed availability; would not deter from discharging to the Homestead.
- A typical patient placed at the Homestead may be someone who has been transferred from a smaller local hospital such as Newton or St. Clare's for more complex treatment at Morristown and now is returning home for nursing services.
- It was mentioned that the Homestead should send a case worker out to the hospital for a "meet and greet".

### *St. Clare's Health System – Sussex*

- The representative for St. Clare's noted that the discharge process with the Homestead has recently improved over the past year and is working well.
- The typical patient that is discharged to the Homestead is an elderly person who is in need of rehabilitation and younger patients with chronic muscular issues.
- It was mentioned that the Homestead has a good reputation and they she has received positive feedback from patients.

## FOCUSED MARKET ANALYSIS

### Depth of the Market for Skilled Nursing and Short Term Rehab Services

#### *Skilled Nursing Trends*

Stable occupancy rates at the profiled skilled nursing facilities indicate the acceptance of traditional skilled care for the elderly and the increase of senior population within the market area support the continuation of this trend. However, changing consumer preferences are creating a shift in the services offered at these facilities from traditional skilled nursing beds to those offering more specialized services, such as short-term rehab, and patient-centered care programming.

#### *Short Term Rehabilitation Bed Need Approximation*

Statistics for a two-month period were gathered from the American Health Care Association (“AHCA”) CMS OSCAR Data Current Surveys to determine the average annualized number of Medicare nursing facility patients in New Jersey. This information was then applied to the 2008 statewide total of the Medicare cases to determine a percentage of Medicare patients from New Jersey Hospitals within the nursing facilities.

Month	Nursing Facility Patients by Payor - Medicare
December 2008 <sup>(1)</sup>	7,862
June 2009 <sup>(1)</sup>	8,217
<b>Average Annualized Total (A)</b>	<b>96,474</b>
<b>Statewide Inpatient Medicare Cases (B)</b>	<b>403,015</b>
<b>Percentage of Medicare-qualified patients discharged to nursing facilities from New Jersey Hospitals (A/B)</b>	<b>24% *</b>

Source: AHCA, December 2009.

\* 96,474 divided by 403,015 (Statewide Inpatient Cases for Medicare) = 24%

This percentage was then applied to The New Jersey Department of Health Total Inpatient Cases by Hospital by Payor to estimate the volume of Medicare patients being discharged from the respective area hospitals to nursing facilities:

Selected Referring Hospitals	Number of Medicare Cases Being Discharged to Skilled Nursing Facilities Annually
Newton Memorial Hospital	912
St. Clare's Hospital/Sussex	153
Hackettstown Community Hospital	588
Morristown Memorial Hospital	2,843
<b>Total</b>	<b>4,496</b>

Source: AHCA and NJ DOH, December 2009.



## FOCUSED MARKET ANALYSIS

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Of all the hospitals profiled above, approximately 86 Medicare patients per week are being discharged to skilled nursing. Assuming an average length of stay of 31 days (current reality), the Homestead would have to attract 188 patients per year to keep the unit at 90 percent occupancy (16 of the 18 beds). The 188 patients represent approximately 4 percent of the market share of the Medicare patients who are being discharged from these four hospitals.

Newton Memorial Hospital and St. Clare's Hospital/Sussex are within the Homestead's PMA. Approximately 20 Medicare patients per week are being discharged from these two hospitals to skilled nursing facilities. The 188 patients represent approximately 17 percent of the market share of the Medicare patients who are being discharged from the hospitals within the PMA.

According to data provided by Management from January 2009 until November 3, 2009, 133 residents from Newton Memorial Hospital were discharged to the Homestead. Of these admissions, 78 percent were Medicare patients.

The level of discharges based on Homestead's current experience, information obtained herein, and inquiries of the selected referring hospitals indicate Management should be able to support an 18-bed rehabilitation (subacute) unit. This assumes the Homestead would continue to use best practices for attracting and retaining qualified residents.

### **Grant Opportunities**

The following grant opportunities were identified (details provided as attachment):

- Administration on Aging--Technical Assistance Resource Center: Promoting Appropriate Long Term Care Supports for Lesbian, Gay, Bisexual and Transgender Elders; Deadline is January 6, 2010
- New Jersey Department of Health and Senior Services--Healthcare Facility Preparedness Program; Deadline within Formal Application
- New Jersey Department of Health and Senior Services--Alzheimer's Adult Day Services; Ongoing for new Applicants
- State of New Jersey through Federal Stimulus Funds--Energy Efficiency and Conservation Block Grants; New Jersey expects to begin to receive stimulus funding during the month of April; however, the State is awaiting further timing details.

At this time, there does not appear to be a significant opportunity for general grants. However, we recommend Management continue to explore options, including those that may be specifically available to County-related organizations.

## **FINANCIAL ANALYSIS**

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### **Financial Analysis Process**

The financial analysis utilized the following information provided by Management:

- Medicare cost reports for the years ended December 31, 2007 and December 31, 2008;
- Current period operating results through November 12, 2009 with comparison to the current year's budget; and
- Census information for the current period through October 31, 2009.

SFCS (an architect, engineering and planning firm specializing in senior living projects) provided an estimate of construction costs for the addition as well as recommended options related to LEED certification for the Project and changes related to the Homestead's current infrastructure.

The aforementioned information was utilized to assemble projected operating results for the year ending December 31, 2009 for the existing operations as well as projected operations assuming the additional 18 beds were placed in service as of January 1, 2009.

### **Regulatory Considerations**

#### *Certificate of Need*

New Jersey regulations enable a nursing facility to add the lesser of 10 beds or 10% of licensed capacity every five years. The Homestead currently has 10 of the 18 bed rights for the desired addition. The following options are available for the acquisition of the additional 8 bed rights:

- Obtain from another county nursing facility;
- Purchase from another nursing facility, average cost \$20,000 to \$25,000 per bed right, potentially totaling between \$160,000 and \$200,000;
- Initially place 10 beds in service and the remaining 8 beds at such time that the automatic increase in licensed beds is available; or
- Request a waiver from the New Jersey Department of Health for the additional 8 beds by demonstrating a need in the market for the additional beds.

Acquisition of additional 8 bed rights through transfer, purchase, or construction of the addition will require the submission of a Certificate of Need ("CON") application, subject to a full review, to the New Jersey Department of Health and Senior Services, Office of Certificate of Need and Healthcare Facility Licensure (the "Department"). The full review process involves the review of a CON application by the State Health Planning Board, as well as the Department. The State Health Planning Board shall forward recommendations to the Commissioner within 90 days after the application is deemed complete for processing unless a fair hearing is requested by an applicant. A final decision will be rendered by the Commissioner between 120 days and 180 days after receipt of recommendations from the State Health Planning Board or a decision from the Office of Administrative Law, as applicable. The timing of the CON process is assumed simultaneous with initial steps prior to construction and is estimated to be completed within a 16-month timeframe.

## **FINANCIAL ANALYSIS**

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### *Reimbursement Considerations*

#### Medicaid

The New Jersey Medicaid reimbursement system is currently undergoing an analysis to develop a case-mix reimbursement system for nursing facilities. The revised system is anticipated to be implemented beginning July 1, 2010.

Overall, the case-mix reimbursement methodology is to be budget neutral (i.e., no change in total Medicaid reimbursement for New Jersey nursing facilities). Currently, there may be special dispensation for County facilities, a special add-on to the Medicaid rate, but this consideration is in discussion stages only.

Upon initial rate setting, increases are anticipated to be between 2.0% and 3.0% annually.

For purposes of the financial analysis, the Medicaid rate reflects the weighted average rate based on the existing effective rates for the Medicaid program for fiscal year ended June 30, 2009 and fiscal year ending June 30, 2010.

#### Medicare

Effective October 1, 2009, Medicare reimbursement rates decreased approximately 3.0%. Additional changes to Medicare reimbursement anticipated to be implemented beginning October 1, 2010 include:

- Reduction of the number of RUGs categories;
- Realignment of reimbursement rates to decrease reimbursement rates for RUGs therapy intensive rates and increase reimbursement rates for RUGS nursing intensive rates; and
- Additional reductions in market basket rate adjustments.

The potential impact of the proposed Medicare changes will require the Homestead to assess the profile of the current Medicare patient population to evaluate its opportunities to realign the service offerings for future Medicare patients. The Homestead will want to develop a Medicare patient profile to enable the Homestead to maintain and enhance the current level of Medicare reimbursement.

### **Construction Considerations**

#### *Location*

Two locations were considered for the 18-bed addition; extending the front portion of the building or expanding off the middle of the building. Factors considered included:

- Construction cost;
- Invasion of existing space concerning disruption of operations, beds out of service, and asbestos considerations;

## FINANCIAL ANALYSIS

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- Minimize incremental operating costs (i.e., stay within the current regulatory requirement of not exceeding 64 beds per nursing unit); and
- Adapting future operations to be consistent with current trends in service delivery currently offered in the nursing home industry.

Extending the front end of the building achieves each of the aforementioned factors and is the most cost-effective approach from a construction cost standpoint and an operating standpoint.

### *Project Cost*

Project cost estimates were provided by the architectural firm, SFCS, Inc. The addition will provide a portico over the entrance to the building and additional square feet on the second and third floors of the building.

The Project cost estimate provided assumes the addition is designed similar to the existing building (double-loaded corridors) and is estimated at \$2,975,600.

	<b># of Floors</b>	<b>Sq Ft / Floor</b>	<b>Total Sq Ft</b>	<b>Avg \$ / PSF</b>	<b>Total Cost</b>
<b>Second and Third Floor</b>					
Renovation	2	1,563	3,126	\$ 20	\$ 62,520
Addition	2	2,905	5,810	\$ 225	1,307,250
<b>Subtotal Second and Third Floor</b>			8,936		1,369,770
<b>Gound Floor</b>					
Stair tower			208	\$ 225	46,800
Construction over existing area			500	\$ 150	75,000
Open area below addition			2,197	\$ 115	252,655
Site Work					250,000
<b>Subtotal Gound Floor</b>					624,455
<b>Subtotal</b>					1,994,225
<b>Design and construction contingencies</b>					13% 259,249
<b>Other (fees and permits, soft costs, finishes, FF&amp;E, etc.)</b>					32% 721,112
<b>Estimated Project Cost</b>					\$ 2,974,586

### *Solar Energy Assessment – Photovoltaic System*

The Homestead engaged a consultant to study to cost and benefit associated with installing a photovoltaic system on the campus of the Juvenile Detention Center and the Homestead. At that time, December 2008, the decision to move forward was tabled. During the past 12 months, the program in New Jersey has matured and the following changes have occurred:

- System installation costs have declined about 25%;
- The value of SREC's (Solar Renewable Energy Credits) have increased between 12% and 22% per credit;
- Net metering was not addressed in the consultant's report that essentially provides the facility "credit" when the system produces more power than the facility is consuming; and

## FINANCIAL ANALYSIS

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- The cap on the federal subsidy has been removed.

Based on the aforementioned changes, the return on investment has increased over the past year. Reassessing the cost and benefit associated with this program is recommended. Additionally, it may be beneficial to include a pilot project for the County related to implementing a photovoltaic system as part of this Project.

### *LEED Certification*

Homestead has the option to apply for LEED certification for the addition. The Project can be designed and constructed for sustainability to achieve the equivalent of the basic certification. The actual certification may be costly relative to the benefit derived. It is recommended that sustainability be considered for the Project and the benefit of seeking approval be further discussed

### *Infrastructure Improvements*

Consideration should be given to the cost / benefit for:

- Asbestos removal;
- Reconfiguration of bathrooms; i.e., locking mechanisms to attain more privacy (currently approval pending);
- Enhance décor in patient rooms; and
- Photovoltaic system, as a pilot project, to conserve energy and additional benefits for the Homestead and Sussex County.

### **Projected Operating Results – Year Ending December 31, 2009**

Considering the proposed changes in the Medicare and Medicaid reimbursement systems, which accounts for 86% of the Homestead patient days and revenue, Management has determined that the financial analysis presented should be based on the known operating revenues and expenses for the current year ending December 31, 2009.

The operating results presented below reflect the historical operating results derived from the Medicare cost reports for the years ended December 31, 2007 and 2008 and the projected operating results for the existing facility for the year ending December 31, 2009. The 18-bed addition is presented as if the beds were placed in service as of January 1, 2009. Incremental revenue is based on existing revenue rates and incremental expenses are based on Management's assumptions regarding incremental staffing and other non-salary expenses.

## FINANCIAL ANALYSIS

The financial presentation presents the operating results considering the fully absorbed cost for the Homestead (direct expenses and indirect expenses allocated from Sussex County) and the respective payback period associated with the unit design of the 18-bed addition. The analysis does not account for start up losses.

INCLUDES DIRECT AND INDIRECT EXPENSES	2007	2008	2009		2009 Total
			Existing	Expansion	
<b>Revenue</b>					
Resident service revenue	\$ 8,037,424	\$ 8,407,843	\$ 8,735,951	\$ 2,066,420	\$ 10,802,371
Ancillary revenue	430,837	483,954	509,132	82,660	591,793
<b>Total Revenue</b>	<b>8,468,261</b>	<b>8,891,797</b>	<b>9,245,083</b>	<b>2,149,080</b>	<b>11,394,163</b>
<b>Expenses</b>					
Salaries and wages	4,347,215	4,482,644	4,636,000	176,539	4,812,539
Employee benefits	2,084,925	2,134,635	2,207,663	84,068	2,291,731
Administrative and general	714,308	811,517	819,632	11,624	831,256
Plant operations	804,278	677,953	684,733	5,812	690,545
Laundry and linen	80,234	76,627	77,393	2,906	80,299
Housekeeping	55,619	78,592	79,378	2,906	82,284
Dietary	194,506	194,873	196,822	31,955	228,777
Social service	-	-	-	-	-
Patient activities	13,938	16,380	16,544	2,686	19,230
Nursing	106,229	123,117	128,042	20,788	148,830
Radiology	2,597	5,094	5,298	860	6,158
Laboratory	5,247	4,484	4,663	757	5,420
Physical therapy	163,924	203,933	212,090	34,434	246,524
Occupational therapy	63,784	136,232	141,681	23,003	164,684
Speech pathology	2,903	20,289	21,101	3,426	24,526
Drugs	57,379	86,318	89,771	14,575	104,345
Capital related costs	151,455	136,415	143,915	118,983	262,898
	8,848,541	9,189,103	9,464,725	535,322	10,000,047
Less: Balance program expenses	-	(15,000)	(155,565)	-	(155,565)
<b>Total Expenses</b>	<b>8,848,541</b>	<b>9,174,103</b>	<b>9,309,161</b>	<b>535,322</b>	<b>9,844,483</b>
<b>Excess (Deficiency) of Revenue and Expenses</b>	<b>\$ (380,280)</b>	<b>\$ (282,306)</b>	<b>\$ (64,077)</b>	<b>\$ 1,613,758</b>	<b>\$ 1,549,681</b>

## FINANCIAL ANALYSIS

The following analysis presents the operating results for the Homestead excluding indirect costs allocated from the County of Sussex. The estimate of indirect costs was based on the TAG report prepared for the year ending December 31, 2008 and reflect those costs that would remain even if Homestead's operations ceased.

### ESTIMATED OPERATING RESULTS WITH DIRECT EXPENSES ONLY

	2009 Existing	2009 Expansion	2009 Total
Revenue	\$ 9,245,083	\$ 2,149,080	\$ 11,394,163
Expenses	9,330,043	535,322	9,865,365
Less: Adjustment for indirect expense allocation from Sussex County			
Administrative and general	615,100		615,100
Plant operations	165,132		165,132
Total adjustment for indirect expense allocation from Sussex County	780,232	-	780,232
Direct expenses	<b>8,549,811</b>	<b>535,322</b>	<b>9,085,133</b>
<b>Excess (Deficiency) of Revenue and Expenses</b>	<b>\$ 695,272</b>	<b>\$ 1,613,758</b>	<b>\$ 2,309,030</b>

The following analysis presents the operating results for the Homestead based controllable expenses only. Expenses not controlled by the Homestead reflect costs that are incurred by Sussex County and allocated to the Homestead for cost reporting purposes.

### ESTIMATED OPERATING RESULTS WITH CONTROLLABLE EXPENSES ONLY

	2009 Existing	2009 Expansion	2009 Total
Revenue	\$ 9,245,083	\$ 2,149,080	\$ 11,394,163
Expenses	9,330,043	535,322	9,865,365
Less: Adjustment for expenses not controlled by the Homestead			
Employee benefits	2,207,663	84,068	2,291,731
Administrative and general	615,100		615,100
Plant operations	631,300		631,300
Total adjustment for expenses not controlled by the Homestead	3,454,063	84,068	3,538,131
Direct expenses	<b>5,875,980</b>	<b>451,254</b>	<b>6,327,234</b>
<b>Excess (Deficiency) of Revenue and Expenses</b>	<b>\$ 3,369,103</b>	<b>\$ 1,697,826</b>	<b>\$ 5,066,929</b>



## FINANCIAL ANALYSIS

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### Key Financial Assumptions

#### *Project Timing*

Management of Homestead is currently evaluating its opportunity with the Board of Freeholders and the County Council to determine if the Project can be coordinated with a general contractor in place versus the County's facilities management personnel. The interest to engage a general contractor is to expedite the planning, development, and construction of the Project with oversight by the Board of Freeholders at appropriate junctures.

The chart below presents the major tasks associated with the Project and a comparison of Project timing.

<i>Timeline</i>	<b>General Contractor</b>		<b>Start date</b>	<b>County</b>	
	<b>End date</b>	<b># months</b>		<b>End date</b>	<b># months</b>
County RFP process and project manager in place	5/1/2010	4	1/1/2010	1/1/2011	12
Architect and design work, financing process	1/1/2011	8	1/1/2011	7/1/2011	6
Construction bidding	5/1/2011	4	7/1/2011	1/1/2014	30
Permitting and construction period	5/1/2012	12	1/1/2014	1/1/2016	24
Begin fill	9/1/2012	4	1/1/2016	5/1/2016	4
Stabilized occupancy			5/1/2016		
<b>Total number of months</b>		<b>32</b>			<b>76</b>
<b>Number of years</b>		<b>2.67</b>			<b>6.33</b>

#### *Project Cost*

The design for the 18-bed addition assumes continuation of the existing building at the end of the building near the front entrance.

The related project cost, before consideration of asbestos removal, is estimated at \$2,974,586 (see "Construction Considerations – Project Cost" presented previously for detail schedule). Additional sensitivity analyses were considered should the project cost be 10% less or 10% more than the estimated project cost.

#### *Bed Configuration*

Presented below is the bed configuration with and without the 18-bed addition.

<i>Bed configuration</i>	Existing	New	Total
LTC			
Private	2	4	6
Semi-private	88	8	96
<b>Total</b>	<b>90</b>	<b>12</b>	<b>102</b>
Subacute			
Private	-	-	-
Semi-private	12	6	18
<b>Total</b>	<b>12</b>	<b>6</b>	<b>18</b>
<b>Combined Total</b>	<b>102</b>	<b>18</b>	<b>120</b>

## FINANCIAL ANALYSIS

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### *Occupancy*

Presented below are the occupancy rates for the years ended December 31, 2007 and December 31, 2008. The occupancy for the existing beds is based on census data through October 31, 2009, provided by Management. Currently, occupancy in the existing subacute beds have historically experienced 75% to 77% due to the number of beds available as well as the complement of male and female residents. Increasing the number of subacute beds from 12 to 18, as well as increasing the average length of stay for Medicare patients, Management assumes the occupancy of these beds will more closely align with its competitor facilities approximating 90%.

<b>Occupancy</b>	<b>2007 Actual</b>	<b>2008 Actual</b>	<b>2009 Projected</b>	
			<b>102 Beds</b>	<b>120 Beds</b>
<b>Actual / Target</b>	<b>96.9%</b>	<b>97.1%</b>	<b>96.2%</b>	<b>95.0%</b>
LTC	104.2%	99.8%	98.7%	95.9%
Subacute	42.0%	77.0%	77.4%	90.0%
<b>Total</b>	<b>96.9%</b>	<b>97.1%</b>	<b>96.2%</b>	<b>95.0%</b>

### *Payor Mix and 2009 Revenue Rates*

Presented below is the payor mix based on census data through October 31, 2009. The payor mix for the additional 18 beds reflects the projected occupancy for all subacute beds and the remaining patient days for Medicaid and Private are proportionate to the existing census. Revenue rates are based on published rates as well as reimbursement rates from program notices from the respective Medicare and Medicaid intermediaries.

<b>Payor Mix</b>	<b>2009 Projected</b>	
	<b>102 Beds</b>	<b>120 Beds</b>
Medicaid (Region 1)	71.0%	67.8%
Medicare	9.5%	14.2%
Private	12.3%	11.7%
Hospice/Private	0.4%	0.3%
Hospice/Medicaid	6.1%	5.2%
HMO Ins (BC/BS)	0.7%	0.6%
Respite	0.1%	0.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

## FINANCIAL ANALYSIS

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### *Incremental Expenses*

Summarized below is the incremental staffing and associated salaries as well as the incremental expenses for each department.

#### **Expansion**

Staffing		FTEs	Rate	Salary
CNA	2,080 hours	5.6	\$ 15.16	176,539
Salary related expenses		<u>5.6</u>	\$ 15.16	<u>176,539</u>

Patient related per diems	Existing	Incremental
Administrative and general	\$ 22.90	\$ 2.00
Plant operations	\$ 19.13	\$ 1.00
Laundry and linen	\$ 2.16	\$ 0.50
Housekeeping	\$ 2.22	\$ 0.50
Dietary	\$ 5.50	\$ 5.50
Social service	\$ -	
Patient activities	\$ 0.46	\$ 0.46
Nursing	\$ 3.58	\$ 3.58
Radiology	\$ 0.15	\$ 0.15
Laboratory	\$ 0.13	\$ 0.13
Physical therapy	\$ 5.92	\$ 5.92
Occupational therapy	\$ 3.96	\$ 3.96
Speech pathology	\$ 0.59	\$ 0.59
Drugs	\$ 2.51	\$ 2.51

## **NEXT STEPS**

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### **Project Related**

- Seek approval from the Sussex County Board of Freeholders to move forward with exploring the options related to an 18-bed addition.
- Engage an architect to refine the construction cost estimate associated with the design options for the 18-bed addition (consideration of Small House option re: marketability, financial impact, regulatory and reimbursement considerations).
- Identify resource(s) for availability and process to obtain additional bed rights.
- Develop timetable for certificate of need process and identify professionals to assist with preparation of the application.
- Obtain approval to utilize a general contractor qualified in construction of healthcare facilities to oversee the addition.
- Begin bidding process to identify a general contractor.
- Update financial and market analysis, ongoing.

### **Existing Operations**

- Identify and further refine programmatic changes for the existing 12-bed unit in an effort to capitalize on the need for Medicare-qualified services at minimal capital outlay.
- Identify and hire a nurse liaison and develop a communication plan for the four identified hospitals and physicians within the market area.
- Establish a budget for the communication plan to adequately provide the nurse liaison with technology tools and approved educational and social programs to enhance the Homestead's visibility in the market.
- Increase physician visitation to the Homestead. Consider identifying a co-medical director for the existing subacute unit that also has a presence in the Morristown and Hackettstown area.
- Enhance Homestead's website and provide easier access to finding the website through the use of search engines.
- Consider options for the long term care portion of the facility to encompass current industry trends to provide a more home-like environment.
- Revisit the opportunity associated with solar-powered energy to quantify return on investment.