

Philosophies of Financial Budgeting & Performance- Updated as of Fiscal Year 2022

By Kevin Goyette, Chief Financial Officer, The RiverWoods Group

As State of New Hampshire charitable corporate entities, the Trustees of the RiverWoods communities: Exeter (RWE), Manchester (RWM) and Durham (RWD), agree to fulfill the Mission established under the Articles of Agreement. The duty to further the Mission of the corporations is the most fundamental fiduciary duty of a Trustee. Supporting the Mission is all-encompassing; covering financial security, a safe community to live and work in, and quality of life for both residents and staff.

Because we offer Type A “All Inclusive” and Type B “Modified” contracts, our communities are both housing/health care organizations and insurance providers. We have a perpetual commitment to our ongoing flow of residents. To meet that commitment, we must act in a way that ensures the best opportunity for ongoing financial strength. To do that we have established certain basic financial tenets and goals that guide the budgeting and pricing process. It is our intent to charge the lowest rates possible that will allow us to attain our financial goals in support of our Mission.

Financial Goals – Basic Tenets – Because of our ever-changing population and our long-term commitment (for housing, health care, insurance and return of capital), the most basic financial tenet is that all financial decisions will be made with a long-term horizon. The Trustee’s primary fiduciary duty is to protect and further the Mission of the organization in perpetuity. Additionally, as most contracts allow for significant refunds upon death/move out and resale, to fully keep its commitment to residents and their estates, we must maintain a level of service quality, physical appearance and financial health that continues a reasonable flow of people moving in and encourages high occupancy levels. This includes planning for long-term capital projects and maintaining adequate financial strength to fund or borrow for those projects.

Each community is its own separate legal entity and is solely responsible for its own financial performance. There is no co-mingling of assets.

On an annual basis, general, basic financial tenets include:

RiverWoods Exeter

- RWE will generate total cash revenue that is sufficient, at a minimum, to pay all cash operating expenses and the current year debt principal payment. Non-cash items such as earned entrance fee revenue, depreciation and amortization expense, and changes in unrealized gains/losses on investments are excluded.
- Cash from net entrance fees will cover cash needed for capital expenditures (in a normal year).
- Some projects related to larger renovations or repositioning will require an investment of not only RWE cash (through capital reserves) but also of long- or short- term borrowing. RWE will maintain adequate financial resources to either directly fund these larger projects or to provide collateral for borrowing at appropriate rates of interest.

RiverWoods Manchester

- RWM will generate total cash revenue that is sufficient, at a minimum, to pay all cash operating expenses. Non-cash items such as earned entrance fee revenue, depreciation and amortization expense are excluded.
- Cash from net entrance fees will cover cash needed for capital expenditures and the current year debt principal payment (in a normal year).
- RWM's model differs slightly from RWE's and RWD's models due to its Type B contract, smaller number of total units and different primary market.

RiverWoods Durham

- RWD will generate total cash revenue that is sufficient, at a minimum, to pay all cash operating expenses and the current year debt principal payment. Non-cash items such as earned entrance fee revenue, depreciation and amortization expense are excluded.
- RWD is in the early stage of its life cycle. We expect cash from net entrance fees to cover cash needed for capital expenditures as well as to build reserves.

For each community, if cash operating expenses rise in any given year there will likely be an associated increase in resident monthly service fees.

RWE, RWM and RWD will use industry accepted financial ratios and actuarial calculations to be the practical measure of its basic financial goals. Actuarial studies will be commissioned on at least a triennial basis to ensure that each community has sufficiently planned to meet all of its resident obligations. The organizations may choose to have this

work performed off-cycle as business conditions warrant (such as evaluating new resident contracts, undertaking large projects, etc.). “Funded status” is the appropriate actuarially based target. A funded status surplus indicates that the combination of net actuarial assets and the present value of projected monthly fees for the residents as of the fiscal year end will exceed the present value of the contractual liabilities of these residents over the course of their lifetimes. Continuing Care Actuaries, our actuary, targets a Funded Status of 110% to allow for an appropriate buffer should adverse situations arise. We target a Funded Status range of 108% - 112%.

Each organization has a relationship with The RiverWoods Group (RWG) whereby an annual calculation is done to determine “available assets”; these assets are determined to be “not necessary” to hold on the community’s balance sheet and can be used to further the original Mission.

Financial Goals- Ratios – The System has identified key ratios from CARF International that are pertinent to its communities. Depending on the community, expectations are to perform, in the aggregate, in the 25th to 75th percentile of “like communities” (accredited single site communities with Type A (all- inclusive) or Type B (modified) contracts. Establishing performance as such provides a confidence level that each community is performing in a manner that will ensure long term existence and the ability to meet the contractual obligations it has made and will continue to make to current and future residents. To eliminate annual fluctuations and allow for more consistent expected performance, we utilize a five-year rolling average of the CARF International reported performance to set the targets. As a secondary measure, we also evaluate Fitch investment grade rated communities for ratio comparisons. The ratio formulas and associated goals are detailed in the appendix. It is important to note that these ratios are interdependent and should be evaluated as a group. The most important ratios we have chosen to measure our businesses are as follows:

- **Capital Expenditures as a Percentage of Depreciation Ratio (CED)**- which evaluates the annual physical plant and program reinvestments. Favorable performance here ensures that our buildings and programming will support both current and future residents.
- **Cash to Debt Ratio (C to D)**- Shows the relationship between unrestricted cash/investments and total debt. Type A, and high refundable contracts, require higher cash balances than communities with other types of refunds/contract styles. Therefore, strength in this ratio shows that the entrance fee cash has not been

eroded by funding excess operating losses or capital expenses. This ratio is typically required by the lender.

- **Days Cash on Hand Ratio (DCOH)**- which reflects how many days of cash operating expenses can be covered by unrestricted cash and investments. Given a reliance on entrance fee turnover in the business model, this ratio ensures sufficient liquidity to cover operations.
- **Debt Service Coverage Ratio (DSCR)** – which shows the ability to fund annual debt service (principal and interest) with cash flow from net cash revenues (cash revenues less cash expense) AND net cash from entrance fees (new entrance fees less refunds). This ratio is typically required by the lender.
- **Debt Service Coverage Ratio- Revenue Basis (DSCR-RB)** – which shows the ability to fund annual debt service (principal and interest) with cash flow from net cash revenues (cash revenues less cash expenses). When this ratio is > 1.0 it provides comfort that the community can pay all of its cash outflows (expenses + mortgage principal) with no reliance on entrance fee cash. This is important as entrance fee cash can be uneven year to year as it is heavily reliant on items outside of the organizations control, like turnover and the real estate market.
- **Net Operating Margin (NOM)** - which measures the core, sustainable business and excludes interest expense, investment earnings, contributions and all non-cash items. NOM defines our ability to pay core, controllable expenses with core, controllable revenue. When NOM is sufficiently positive it provides a level of comfort that the community can continue as an operating entity based on its current financial trajectory. Positive NOM performance is important as it reflects the organization's ability to run the business without being overly reliant on investment markets (which are not in our control).
- **Operating Ratio (OR)** – which compares cash operating expenses to cash operating revenues. The operating ratio is more robust than NOM, as it also includes net assets released from restriction revenue, investment interest and dividends, and interest expense. An organization's ability to pay careful attention to its balance sheet, specifically managing its cash/investments and debt positions, will be reflected in the OR.

Budget Process – below is a general description of the budget process which is reviewed annually in conjunction with the Summary of Significant Assumptions in the Budget presentation.

Upon the establishment of financial goals, we will evaluate external market conditions to determine the potential impact on the following year's budget. Major assumptions include:

- Occupancy at all of levels of care. This is an important consideration as it not only impacts operating revenue but also entrance fee cash flow (and related investment earnings). While the industry considers 95% independent living (IL) occupancy full capacity, we will consider budgeting at a higher level after carefully evaluating current occupancy levels, the size of the wait list, real estate market conditions, and projected move-in activity.
- Health center utilization – this includes the number of direct admits expected to be in the census (as direct admits pay market-rate fees), the number of spousal transfers, the number of temporary transfers and the number of permanent single person transfers which will then require a unit resale. Each of these potential health center residents may pay a different rate. It is our goal to run the health centers at approximately 90% occupancy, allowing a reasonable buffer for spikes in resident movements. We will utilize information derived from the actuarial studies.
- We budget 100% of the expected long-term yield as interest and dividend income (available to partially offset monthly service fee increases).
- With respect to capital gains, we budget for the long-term portfolio average return with the expectation that between 10% - 40% of these capital gains will be realized to the income statement in any given year as a non-operating gain (and thus available to partially offset monthly service fee increases). The determination will be vetted by the Finance Committee, with input from the Investment Committee, each year during the budget process with careful consideration given to market conditions as well as the value of unrealized gains/ losses residing on the balance sheet.
- Expenses are zero based budgeted. Each department head is instructed to evaluate all line items in his/her department and evaluate how to deliver the same quality service in the coming year as inexpensively as possible. The department heads meet with the Executive Director to discuss their proposed budgets prior to submission to the Finance Department. Additional discussions ensue and all appropriate adjustments are made. Periodically we will engage an external study

of a community's operating expenses (an "Operations Audit" to determine costs in conjunction with industry norms for like kind communities).

- The communities purchase certain services that are centralized within the system and are expected to provide sustainable savings over time. These costs are agreed upon annually during the budget process, as required by the Memorandum of Understanding.
- Annual pricing changes are a product of the major revenue assumptions (occupancy, health center utilization, and investment income) and major expense inflation assumptions (salary, benefits, insurances, food, property taxes, utilities).
- Capital Expenditures are normally evaluated on a rolling ten-year basis. Significant reinvestments are forecast in addition to normal replacement of equipment, furniture, fixtures, and vehicles. Similar to financial performance ratios, we regularly evaluate reinvestment metrics as compared to other comparable communities to ensure our buildings and programming support both current and future residents. Such metrics include Capital Expenditures as a Percentage of Depreciation and Average Age of Plant. Periodically we will engage an external study of our facilities (a "Facilities Audit" to provide an independent opinion on the current state of the campuses as well as the future plans of reinvestment).
- Prior to bringing a final budget draft to the CCRC Board Finance Committee for approval, each Executive Director will present a high-level budget summary to the Resident Council and/or Resident Finance Committee for consultation. Upon budget approval each ED will report back to the Resident Council/Resident Finance Committee. Additionally, all-resident presentations will take place each spring upon completion of the budget.

Other Tenets

As our communities age, capital reinvestment is important to maintain high occupancy rates. There will be "milestone" years where additional reinvestment is needed. In these years reserves from the balance sheet will be utilized to cover the short fall.

In any given year a financially solid organization could provide a 0% monthly service fee increase with no major impact to its short-term financial health. The impact, however, would be felt in the future by allowing expenses to grow at a faster rate than revenues. This has an adverse compounding effect on cash margin. Additionally, forgoing cash flow from new monthly service fees results in a drawdown of cash reserves which can also have a long-term adverse effect (fewer reserves as well as reduced investment earnings).

Hence, we do not utilize the cash on the balance sheet in lieu of a monthly service fee increase.

Each community attempts to strike a balance in its financial business model approach. Serving our Mission for today's and tomorrow's residents and staff is something we think about every day. We utilize a prudent approach to budgeting because we are always engaged in long-range planning. With this approach, we can be proactive should difficult situations arise. Should prosperous situations arise, such as higher occupancy than budget or lower operating costs, RWE has a mechanism, the MSF Rebate Policy ("Spring Break Credit"), for returning a portion of the monthly service fee back to our residents. Additionally, its Staff Discretionary Bonus Plan Policy provides the option of additional retirement funding to our staff. These programs are not currently adopted for RWD or RWM but could be adopted in the future.

During the FY22 Budget process, the board and management spent considerable time addressing these challenges. The organization has adopted a sub-philosophy of a "Reasonable Period to Recover" (RPR). It is our belief that we should show improvement year-over-year for the next three years and by the end of FY24, each community should be operating at or above pre-pandemic levels. There are many risks and opportunities that were discussed in detail during the board meetings as well as during the all-resident meetings at each community.

Appendix A- Ratio Calculations

Capital Expenditures as a Percentage of Depreciation Ratio

(Annual Capital Expenditures)
(Annual Depreciation Expense)

Cash to Debt Ratio

Total Unrestricted Cash and Investments
Total Debt Outstanding

Days Cash on Hand Ratio

Total Unrestricted Cash and Investments
Daily Cash Operating Expenses

Debt Service Coverage Ratio

(Total Cash Margin + Interest Expense+ Net Cash from Entrance Fees)
(Interest Expense + Principal Repayment)

Debt Service Coverage Ratio- Revenue Basis

(Total Cash Margin + Interest Expense)
(Interest Expense + Principal Repayment)

Net Operating Margin

(Cash from Resident Revenues – Cash from Resident Operating Expenses)
(Cash from Resident Revenues)

Operating Ratio

(Total Cash Operating Expenses)
 (Cash from Resident Revenues + Interest & Dividends + Net Assets Released from Restriction)

Appendix B- Community Metrics.

RWE Guidelines CARF Single Site Type A Metrics - 5 Yr Avg				FY19	FY20	FY21	FY22	FY23	FY24
Metric	Percentile	Min Ratio		Actual	Actual	Forecast	Budget	Projection	Projection
Operating Ratio	75th %	95.0% or lower		96.4%	98.6%	99.5%	99.6%	95.4%	94.7%
Debt Service Coverage Ratio	50th %	2.78 or greater		4.39	2.68	2.56	4.08	3.66	3.47
Cash to Debt	50th to 75th%	104.2% or greater		158.1%	152.4%	170.5%	154.0%	179.3%	183.0%
DSCR-RB (Revenue)	50th to 75th%	1.02 or greater		2.20	1.43	0.73	0.45	0.93	1.00
Net Operating Margin	25th to 50th %	0.4% or greater		1.0%	-4.4%	-4.0%	-0.5%	3.3%	4.5%

RWM Guidelines CARF Single Site Type B Metrics - 5 Yr Avg				FY19	FY20	FY21	FY22	FY23	FY24
Metric	Percentile	Min Ratio		Actual	Actual	Forecast	Budget	Projections	Projections
Days Cash On Hand	25th - 50th %	285 or greater		232	291	275	289	246	226
Operating Ratio	25th - 50th %	101.6% or lower		101.9%	110.4%	124.3%	116.2%	107.7%	103.7%
Debt Service Coverage Ratio	50th %	2.42 or greater		2.90	3.94	2.58	3.22	3.34	3.09
Cash to Debt	25th - 50th %	65.0% or greater		65.9%	97.0%	103.8%	131.8%	134.4%	153.9%
CapEx as a % of Depreciation Ratio	50th to 75th %	145.2% or greater		100%	55%	83.5%	94.3%	130.4%	90.7%

RWD Guidelines CARF Single Site Type A Metrics - 5 Yr Avg				FY19	FY20	FY21	FY22	FY23	FY24
Metric	Percentile	Min Ratio		Actual	Actual	Forecast	Budget	Projection	Projection
Operating Ratio	50th %	100.1% or lower		n/a	148.9%	116.2%	99.5%	94.2%	95.4%
Debt Service Coverage Ratio	50th %	2.78 or greater		n/a	654.9	2.31	3.47	3.50	2.11
Cash to Debt	50th %	79.7% or greater		n/a	33.0%	59.8%	68.7%	80.9%	91.1%
DSCR-RB (Revenue)	50th %	0.73 or greater		n/a	0.00	0.24	1.08	1.55	0.89
Net Operating Margin	25th to 50th %	0.4% or greater		n/a	-47.1%	-0.6%	10.8%	14.9%	13.0%

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