

National Federation of Municipal Analysts

Recommended Best Practices in Disclosure for Long-Term Care/Senior Living Debt

The National Federation of Municipal Analysts (NFMA) is an organization of nearly 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of the main initiatives of the NFMA is to promote timely and complete disclosure of the financial and operating information needed to assess the credit quality and risk of a municipal debt issue. The NFMA's efforts have ranged from global disclosure-related issues to more detailed, sector-specific work such as these Recommended Best Practices in Disclosure. For further information on the NFMA's continuing work in the area of disclosure, please see the "disclosure guidelines" and "position statements" pages of the organization's web site at www.nfma.org.

In order to develop our Recommended Best Practices in Disclosure, diverse groups of NFMA analysts worked with non-analyst professionals in each sector to develop "best practices" guidelines for certain market sectors. These Recommended Best Practices are descriptions of the sector-specific financial and operating information needed to help analysts do their jobs. The NFMA believes that the best practice in disclosure will always be the one that provides a steady flow of timely information from borrowers to the market. Initial drafts of our Recommended Best Practices in Disclosure were widely circulated, and an industry comment period was used to seek input from interested parties. Subsequent to the comment period, the papers were revised. For certain sectors, Comment and Response papers were drafted; these papers are available on the NFMA web site, providing additional information on the comments received.

Following is the most recent version of the Recommended Best Practices in Disclosure for this sector. This document is not intended to supplant the amendments to SEC Rule 15c2-12, but to be used in conjunction with the guidance provided in those amendments. It is important to note that the NFMA's disclosure efforts are a continuing process. These guidelines are not static documents, and will be revisited and changed as market conditions warrant. We encourage interested parties to submit comments at any time to lgoodnfma@adelphia.net, so that they can be considered in the development of future versions of these Recommended Best Practices in Disclosure.

The NFMA Recommended Best Practices in Disclosure are not intended to be "one size fits all" recommendations, and all the information requested may not apply to every transaction in the sector. We encourage the providers of information to indicate when a specific item requested in the Recommended Best Practices is not applicable to a specific transaction.

Background

The NFMA Long-Term Care/Senior Living Debt Disclosure Subcommittee was formed to draft Recommended Best Practices for the sector. Members of the subcommittee include buy and sell side analysts, rating agency representatives, insurance company analysts, and issuer representatives.

Goals

The goals of the best practice recommendations for disclosure are as follows:

- Provide regular, consistent disclosure of financial information as well as a management discussion and analysis to assist interested parties in their analysis of an existing investment or a potential future investment.
- Provide a framework to enable borrowers to best meet the needs of those investors in this sector with a special emphasis on clear and concise information while avoiding onerous or burdensome requests. Additionally recognize that the different operating entities within the long-term care sector each have special characteristics and that any informational requirements should recognize such.
- Provide guidance to allow for the “best possible/most available” form of dissemination of this information.

While we recognize that over time these guidelines will need to be revisited and revised to keep abreast with current standards and industry changes, we believe this document should provide an efficient and informative disclosure methodology for the applicable stakeholders in this sector.

The following are the Subcommittee’s recommendations:

- All borrowers should establish an investor contact whose name and contact information should be reported on all disclosure statements by the obligor. Regular investor conference calls are encouraged in order to augment the communication between investors and obligors, especially when disclosing complicated statements and situations. Notification of investor calls should be made via the mailing list and the NRMSIRs.
- All information should be made available to anyone who requests such. No ownership or minimum holdings should be required.
- Quarterly disclosure is the recommended minimum frequency of disclosure. Frequency of financial disclosure along with the actual informational requirements should be included in the loan agreements/bond documents of all future transactions.

- Actual distribution of the disclosure document should come directly from the borrower. It is also recommended that borrowers submit all ongoing disclosure documents to the NRMSIRs. This should enable those who have not been able to obtain information from the borrower on a timely basis to do so. All disclosure documents should include the CUSIP numbers of bonds that relate to a particular obligor. The CUSIPs should be obtained from the underwriter at the bond closing. Borrowers are encouraged to use actively maintained websites. The date information was last updated should be prominently listed. Dissemination via a broker/dealer is not recommended due to the potential for a delay or conflict of interest in terms of all interested parties.

Specific recommendations for the long-term care/senior living sector are split into three different areas: Continuing Care Retirement Communities (CCRC), Assisted Living Facilities (ALF), and Skilled Nursing Facilities (SNF). The recommended levels of disclosure requirements are similar but tailored for each of the three components.

General Format for Disclosure:

I. Financial Statement Requirements

Financial statements submitted should cover the appropriate periods (audits for the fiscal year and quarterly year-to-date reports for the interim periods) and include income statements, balance sheets, and cash flow statements. Financial statements should include related notes and schedules, if available. Statements should be sent no later than 45 days after quarter end for interim reports and no later than 120 days after year-end for annual audits. The Subcommittee recommends interim disclosure for all four quarters as well as an annual audited financial statement.

Along with current year-to-date period disclosure, comparisons with the prior year period as well as the current budget should be included. It is understood that budgets change over time, and we are in no way recommending that the borrowers update investors each and every time adjustments are made. However, prior year period and budget comparisons are important in order to measure against historical performance and management expectations. We recommend that in all disclosure statements management notes that budgets are subject to change. In addition, we would recommend that management state on all interim financial statements that they are subject to audit adjustments.

All financial information should be provided in a format that is consistent with generally accepted accounting principles, and the interim statements should be comparable to and consistent with the annual audits. The Subcommittee utilized the 2000 AICPA Audit and Accounting Guide for “Health Care Organizations with conforming changes as of May 1, 2000.”

The financial statements, both annual audits and interim reports, should reflect the financial condition of the entire obligated group. Non-obligated group affiliates’ financial statements should be separated from the obligated group. Management should also provide system financials if the obligated group does not encompass the entire organization. Individual entities

and corporations should be shown in consolidating statements. If the obligated group guarantees debt of another entity, that entity's financial condition should be included with the obligated group disclosure. However, this information could be included in the Management Discussion and Analysis (MD&A) depending upon the level of support given or financial condition of the guaranteed entity. Additionally, in order for there to be no confusion regarding an obligor, the committee recommends that when non-obligated group information is provided, mention should be made that the obligation rests solely with the members of the obligated group. Additionally, if another entity provides a financial or debt guarantee to the borrower, its financial statements should be provided in GAAP format along with the borrower's financial statements on an interim and annual period basis.

The following recommendations are intended to enhance and standardize disclosure reporting, and may require information beyond, but not in place of, generally accepted accounting principles.

II. Management Discussion and Analysis Statement

Management statements should be brief explanations of the borrower's performance. These explanations should translate information to interested parties beyond what the financial statements and occupancy reports convey. Bullet point, graph, or matrix formats may be used to help communicate ideas if the formats are easily understandable to the reader.

Long-Term Care/Senior Living Sector Components:

I. CCRC Disclosure

CCRC disclosure recommendations include Continuing Care Retirement Communities, facilities with independent living services only, and those facilities with a combination of independent living services and assisted living and/or nursing services.

Financial Statements and Reports

Income Statements should provide separate line items for:

- Amortization of deferred revenues from entrance fees
- Each line of business contributing over 5% to total operating revenues (lines of business include health facility revenues, independent living revenues, assisted living revenues, ancillaries, home health, management fees, etc.)
- Other operating revenue (including lines of business that contribute under 5% to total operating revenues)
- Dividend and interest income
- Realized gains and losses on investment portfolio
- Donations with separate line items for unrestricted, temporarily restricted, and permanently restricted donations
- Unrealized gains and losses on investment portfolio
- Depreciation and amortization expense

- Interest expense
- Salaries, wages, and benefits expenses
- Bad debt expense

Balance Sheets should include separate line items for:

- Unrestricted and board designated cash and investments, noting breakout between equities and fixed income instruments
- Unrestricted investments, noting breakout between equities and fixed income instruments
- Bond trustee held funds, including debt service reserve fund, debt service fund, construction fund, and operating reserve funds, if any
- Donor restricted funds
- Regulatory required funds
- Current portion of long term debt
- Refundable and non-refundable deferred revenues from entrance fees
- Total debt (not including current portion listed above)

Cash Flow Statements should provide separate line items for:

- Amortization of deferred revenue
- Entrance fees received. Initial entrance fees should be classified as financing activities while turnover entrance fees should be classified as operating activities. An entrance fee is a broad term including all one-time, move-in payments by residents.
- Refunds paid out
- Transfers into/out of the obligated group

Occupancy Report

Reports should include:

- Units occupied versus units available by type (independent living units, assisted living units, dementia units, nursing beds, etc.), both on a year-to-date and current basis
- YTD turnover data, including reasons for move outs and transfers. Turnovers include deaths, campus move-outs, and transfers to assisted living or skilled nursing. Transfers should include both permanent and temporary move outs.
- Payor mix breakdown between life-care, no-discount/private pay, Medicare, and Medicaid residents for assisted living and nursing facilities according to census and revenues

Reports can be presented in graph or matrix format.

Management Discussion and Analysis

Management should discuss the obligor's financial condition and results from operations. The discussion should highlight the meaningful changes in financial condition, provide specific analysis of the accompanying financial statements' results, and supply rationale for variances from prior periods and budgets. Explanation of significant changes or deviations from the prior year results and budgets are essential. If an organization views itself as a Continuing Care Facility and offers other types of services, it may want to consider encompassing some of the items listed in the MD&A discussion for Nursing or Assisted Living Facilities.

Areas of discussion could include:

- Occupancy changes
- Competition and new competitive construction
- Marketing activities including the use of any outside firms
- Labor issues and management changes
- Liquidity status, including capital expenditures, planned expansions, and expected debt issuance
- Waiting list status (including cost to join list and how often it is updated)
- Definition of the waiting list
- Pricing policy for entrance fees and monthly fees
- Changes in contract offerings
- Subsidization of life care patients
- Nursing facility revenue deficiencies versus monthly payments
- Changes in governmental reimbursement
- Calculation of future service obligation
- Covenant compliance
- Reimbursement/Regulatory Issues
- Construction status/Capitalized Interest balances
- Update on litigation, if material in nature
- Liability insurance status

Covenant calculations should be included on the same schedule as required under the prevailing bond documents. Additionally, management certification should be included, if required, on each filing.

Individual elements listed in the financial reports can be presented in table format in the MD&A.

II. Assisted Living Facility Disclosure

Assisted Living Facility disclosure recommendations include facilities with assisted living services only as well as those with a combination of assisted living and nursing services.

Financial Statements and Reports

If the facility charges entrance fees, please refer to the CCRC section on Financial Statements and Reports for proper disclosure of the fees on the Income, Balance Sheets, and Cash Flow Statements.

Income Statements should provide separate line items for:

- Each line of business contributing over 5% to total operating revenues (lines of business include health facility revenues, assisted living revenues, ancillaries, home health, management fees, etc.)
- Resident revenues should be separated into different line items if governmental reimbursement or other third party payments are received
- Other operating revenue (including lines of business that contribute under 5% to total operating revenues)

- Dividend and interest income
- Realized gains and losses on investment portfolio
- Donations with separate line items for unrestricted, temporarily restricted, and permanently restricted donations
- Unrealized gains and losses on investment portfolio
- Depreciation and amortization expense
- Interest expense
- Salaries, wages, and benefits expenses
- Bad debt expense

Balance Sheets should include separate line items for:

- Unrestricted and board designated cash and investments, noting breakout between equities and fixed income instruments
- Unrestricted investments, noting breakout between equities and fixed income instruments
- Bond trustee held funds, including debt service reserve fund, debt service fund, construction fund, and operating reserve funds, if any
- Donor restricted funds
- Regulatory required funds
- Current portion of long term debt
- Total debt (not including current portion listed above)

Cash Flow Statements

- Transfers into/out of the obligated group

Occupancy Report

Report should include:

- Units occupied versus units available by type (assisted living units, dementia units, nursing beds, etc.), both on a year-to-date and current basis. Occupancy reports should be adjusted to include beds where there are semi-private units.
- YTD turnover data, including reasons for move outs and transfers. Turnovers include deaths, campus move-outs, and transfers to skilled nursing. Transfers should include both permanent and temporary move outs.
- Payor mix breakdown between no-discount/private pay, Medicare, and Medicaid residents for assisted living and nursing facilities according to census and revenues

Reports can be presented in graph or matrix format.

Management Discussion and Analysis

Management should discuss the obligor's financial condition and results from operations. The discussion should highlight the meaningful changes in financial condition, provide specific analysis of the accompanying financial statements' results, and supply rationale for variances from prior periods and budgets. Explanation of significant changes or deviations from the prior year results and budgets are essential. If an organization views itself as an Assisted Living Facility and offers other types of services, it may want to consider encompassing some of the items listed in the MD&A discussion for Nursing or Continuing Care Facilities.

Areas of discussion could include:

- Occupancy changes
- Competition and new competitive construction
- Marketing activities
- Labor issues and management changes
- Liquidity status, including capital expenditures, planned expansions, and expected debt issuance
- Waiting list status (including cost to join list)
- Pricing policy for monthly fees
- Changes in contract offerings
- Changes in governmental reimbursement
- Covenant compliance
- Reimbursement/Regulatory Issues
- Construction status/Capitalized Interest balances
- Update on litigation, if material
- Liability insurance status

Covenant calculations should be included on the same schedule as required under the prevailing bond documents. Additionally, management certification should be included, if required, on each filing.

Individual elements listed in the financial reports can be presented in table format in the MD&A.

III. Nursing Facility Disclosure

Nursing Facility disclosure recommendations include facilities with nursing or skilled nursing services.

Financial Statements and Reports

Income Statements should provide separate line items for:

- Each line of business contributing over 5% to total operating revenues (lines of business include health facility revenues, ancillaries, home health, management fees, etc.)
- Resident revenues should be separated into different line items between private pay, Medicare, Medicaid or other third party payments received.
- Other operating revenue (including lines of business that contribute under 5% to total operating revenues)
- Dividend and interest income
- Realized gains and losses on investment portfolio
- Donations with separate line items for unrestricted, temporarily restricted, and permanently restricted donations
- Unrealized gains and losses on investment portfolio
- Depreciation and amortization expense
- Interest expense
- Salaries, wages, and benefits expenses
- Bad debt expense

Balance Sheets should include separate line items for:

- Unrestricted and board designated cash and investments, noting breakout between equities and fixed income instruments
- Unrestricted investments, noting breakout between equities and fixed income instruments
- Bond trustee held funds, including debt service reserve fund, debt service fund, construction fund, and operating reserve funds, if any
- Accounts receivable
- Donor restricted funds
- Regulatory required funds
- Current portion of long term debt
- Payments due to or from payors
- Total debt (not including current portion listed above)

Cash Flow Statements

- Transfers into/out of the obligated group

Occupancy Report

Report should include:

- Units occupied versus units available by type (nursing beds, dementia units, etc.), both on a year-to-date and current basis. Occupancy reports should be adjusted to beds when there are semi-private rooms.
- YTD turnover data, including reasons for move outs and transfers and whether they are classified as temporary or permanent
- Payor mix breakdown between no-discount/private pay, Medicare, and Medicaid residents according to census/patient days and revenues

Reports can be presented in graph or matrix format.

Management Discussion and Analysis

Management should discuss the obligor's financial condition and results from operations. The discussion should highlight the meaningful changes in financial condition, provide specific analysis of the accompanying financial statements' results, and supply rationale for variances from prior periods and budgets. Explanation of significant changes or deviations from the prior year results and budgets are essential. If an organization views itself as a Nursing Facility and offers other type of services, it may want to consider encompassing some of the items listed in the MD&A discussion for Nursing or Continuing Care Facilities.

Areas of discussion could include:

- Occupancy changes
- Competition and new competitive construction
- Marketing activities
- Labor issues and management changes
- Liability insurance status
- Liquidity status, including capital expenditures, planned expansions, and expected debt issuance

- Waiting list status (including cost to join list)
- Pricing policy
- Changes in contract offerings
- Changes in governmental reimbursement
- Covenant compliance
- Reimbursement/Regulatory Issues
- Relationships with local healthcare facilities (i.e. referrals, affiliations, etc.)
- Construction status/Capitalized Interest balances
- Update on litigation, if material

Covenant calculations should be included on the same schedule as required under the prevailing bond documents. Additionally, management certification should be included, if required, on each filing.

Individual elements listed in the financial reports can be presented in table format in the MD&A.

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