# SUFFOLK COUNTY LEGISLATURE

**Gail Vizzini**
**Director**

## BUDGET REVIEW OFFICE

August 28, 2012

To: William J. Lindsay, Presiding Officer
and All Suffolk County Legislators

From: Gail Vizzini, Director *Gail Vizzini*
Budget Review Office

Subject: **JJFSNF A9-6 Certification Of Savings**

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<u>Introduction</u>

Pursuant to Article 9-6, paragraph H of the Suffolk County Administrative Code, the Budget Review Office (BRO) is required to certify whether privatization of certain Department of Health Services functions "will result in a cost savings to the County in at least each of the first five years of said plan or proposal of at least 10% in each of those first five years, as measured by net County expenditures (i.e., County appropriations less federal aid, state aid, third-party payments and/or private contributions)." For the purposes of this analysis, we define net County expenditures as the expected General Fund transfer to the facility.

BRO has completed an analysis of the plan to sell the premises and operations of the John J. Foley Skilled Nursing Facility (JJFSNF) to Sam and Israel Sherman, doing business as SSS Operating, LLC and SSS Realty, LLC, as proposed by the County Executive in Introductory Resolution No. 1811-2012. The analysis included meeting with the Department of Health Services and with the County Executive's Budget Office for clarification of certain issues and the examination of the following documents:

- JJFSNF operating budgets
- JJFSNF Financial statements
- New York State Health Department cost reporting
- New York State budget documents relating to nursing home reimbursement
- Land Sales Contract and Asset Purchase Agreement included in IR No. 1811-2012

- Rogers & Taylor appraisals of JJFSNF in 2010 and 2012, and
- The 2008 Horan, Martello and Morrone Market Value Analysis for the facility.

The Budget Review Office has concluded that the plan proposed by the County Executive in IR No. 1811-2012 will result in cost savings greater than 10% of net County expenditures on operation of the John J. Foley Skilled Nursing Facility, as compared to continuing operation of the facility. In each of the first five years (2013-2017) following divestiture of the facility, Suffolk County will likely realize annual budget savings in excess of 51% of net costs attributable to no longer providing this service. The dollars and percentages are shown on Table 3. Our assumptions and analysis are detailed in the sections that follow.

<u>Projection of JJFSNF Net Expenditures</u>

For the purposes of this analysis, the Budget Review Office examined expenditures and revenue from both the perspective of 1) the operating budget and 2) the financial statements. Table 1 shows the budget basis, which uses a modified accrual accounting basis, and Table 2 shows the financial statement basis, which uses the full accrual basis of accounting. The difference between the two accounting methods results in some differences between the net expenditures shown in the budget, and the net deficit shown in the financial statements. There are several significant differences in the two accounting methods with respect to the nursing facility, most notably depreciation, allowance for bad debt, and accounting for other post-employment benefits. The financial statements account for all three of these expenses; the budget does not account for any of them. Depreciation accounts for about $150,000 in the difference, and Allowance for Bad Debt adds about another $1.7 million annually. The Obligation for Post-Employment Benefits, required since 2007 by the Governmental Accounting Standards Board, adds approximately six to seven million dollars to annual operating expenses on the financial statements. Additionally, the financial statements reflect, if necessary, accruals for rate adjustments that are not shown in the budget; the budget realizes such items only in the estimates or in actual revenues for a given year

Using the 2008 to 2011 actual budget expenditures to develop a baseline, we estimated operating expenditures and revenues at the nursing facility for the years 2013 to 2017 inclusive. We also compared expenditures and revenues at the facility as reported in Suffolk County's Consolidated Annual Financial Reports for JJFSNF in 2008 to 2011 and in the facility's statements of revenues and expenses for 2010 and 2011. There is some variation between the figures reported in the Operating Budget and the financial reporting, attributable to the different accounting methods.

Expenditure and revenue estimates for 2012, and the adopted budget for 2012, were **not** included in the development of either the revenue or expenditure baselines. The 2012 Adopted Budget assumed revenue from a public-private partnership and savings from downsizing the facility. Neither of these assumptions occurred, making 2012 an anomaly. In 2012 the facility will require a General Fund subsidy of about $14.1 million, about $10 million more than was anticipated in the 2012 budget. This will be the largest deficit ever experienced by the facility.

Both our analysis and the analysis conducted by the Department of Health Services and the County Executive assume regular growth rates for both expenditures and revenues. While necessary for the purposes of projecting the County's net expenditures as required by the

Administrative Code, this assumption masks the fundamental problem with the operation of a publicly owned long term care facility—the unpredictability of revenue received from New York State, the primary payor through the Medicaid and the Upper Payment Limit supplement programs. The State has recently decreased reimbursement or otherwise proposed changes that negatively affected JJFSNF, such as:

- Decreasing the amount of funds available for the upper payment limit supplemental payment (the intergovernmental transfer, or IGT) and delaying payment;
- Decreasing the scheduled increase (“trend factor”) in Medicaid payments, in the state budget and as budget mitigation in the course of the year;
- Implementing a regional pricing system;
- Reducing the reimbursement for AIDS beds;
- Attempting to designate beds as assisted living program beds, with a lower reimbursement rate.
- Changing rates, and therefore revenues, retroactively to account for a lower case mix index.

BRO assumptions for projected expenditures include:

- Increases in personnel expenditures to include annual step increases, a contract settlement in 2013 similar to the recent settlements, and increases to the state retirement contribution in 2013 through 2017. Our personnel expenditure estimates do not assume a separate contract for the employees at JJFSNF specifically for Fund 632 employees.
- Annual increase of 3.4% in equipment, supplies, and contracted services based on historic growth rates in the New York Region CPI, weighted for medical specific items.
- Annual increase of 4.1% applied to the energy portions of the Interfund transfer from JJFSNF to the General Fund based on projected commercial energy prices and the regional CPI.
- Debt service is based upon the bond repayment schedule currently in use by the Department of Audit and Control.
- Employee healthcare benefit expenditure increases based on projections from the Centers for Medicaid and Medicare Services.

BRO assumptions for projected revenues (which account for the above mentioned reimbursement issues) include:

- Increases in Medicaid Revenue based on projections from the Centers for Medicaid and Medicare Services and recent history, and on the analysis of the effects of regional pricing prepared by LeadingAge New York.
- Increases in Medicare Revenues based on projections from the Centers for Medicaid and Medicare Services for Nursing Home Care rate growth.
- No increase in Interest and Earnings Revenue.

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- An assumption of continuance of the Medicaid Upper Payment Limit (UPL) Intergovernmental Transfer Program for publicly owned skilled nursing facilities. The Budget Review Office assumes that the UPL program will continue to supplement publicly owned nursing homes. We do not believe that the UPL program will ever eliminate the net cost to operate JJFSNF, and it should be noted that the payment schedule has been unpredictable in recent years due to New York State's continuing budget issues. Our estimate of the revenue is based on the payments received since resolution of the settlement of the dispute between the Federal and New York State governments.

Implicit in both our expenditure and revenue assumptions is a serious attempt to operate the facility in the most productive and efficient manner possible, maximizing occupancy and minimizing costs. We also assume that the additional deficit incurred in 2012 will be paid in 2012, and not carried forward into 2013.

Projected revenues and expenditures are shown in the following tables:

## Table 1: Projected Revenues and Expenditures at JJFSNF (Budget Basis)

| Year | Estimated Expenditures | Minus Estimated Revenues | Minus Upper Payment Limit Supplement (IGT) | Equals Net Expenditures |
|---|---|---|---|---|
| 2013 | $34,247,738 | $27,684,206 | $2,950,474 | $3,613,058 |
| 2014 | $36,211,262 | $28,280,342 | $3,009,483 | $4,921,437 |
| 2015 | $37,515,037 | $28,888,658 | $3,069,673 | $5,556,706 |
| 2016 | $38,994,612 | $29,513,025 | $3,131,066 | $6,350,521 |
| 2017 | $40,496,276 | $30,156,033 | $3,193,687 | $7,146,556 |
| **Total Projected Cost to Suffolk County 2013-2017** | | | | **$27,588,278** |

## Table 2: Projected Revenues and Expenditures at JJFSNF (Financial Basis)

| Year | Estimated Expenditures* | Minus Estimated Revenues | Minus Upper Payment Limit Supplement (IGT) | Equals Net Deficits |
|---|---|---|---|---|
| 2013 | $36,230,957 | $28,714,598 | $2,950,474 | ($4,565,885) |
| 2014 | $37,452,656 | $29,288,890 | $3,009,483 | ($5,154,283) |
| 2015 | $38,750,341 | $29,874,668 | $3,069,673 | ($5,806,000) |
| 2016 | $40,131,262 | $30,472,161 | $3,131,066 | ($6,528,035) |
| 2017 | $41,603,544 | $31,081,604 | $3,193,687 | ($7,328,253) |
| **Total Projected Cost to Suffolk County 2013-2017** | | | | **($29,382,456)** |

*Expenditures do not include the obligation for other post-employment benefits (OPEB) accounting as required by the Governmental Accounting Standards Board. The OPEB accounting is an actuarially derived liability, and not an actual expenditure.

The annual deficit at the facility is approximately the value of the beds (50-60) occupied by those patients who would be most difficult to place in the event of a closure of the facility. These patients are more challenging with respect to care, and have lower acuity which is reimbursed at a lower rate.

On a budget basis, the excess of expenditures to revenues has averaged 15.4% of expenditures over the 26 years of the Enterprise Fund's existence; put another way, reimbursement for the program—the Skilled Nursing Facility—has averaged 84.6%. However, the volatility of reimbursement from New York State has caused net expenditures to fluctuate considerably, from a 48% deficit in 1993 to a more than 20% surplus in 1999.

The Plan to Sell the John J. Foley Skilled Nursing Facility

The John J. Foley Skilled Nursing Facility was maintained as a county facility in the 2012 Operating Budget. However, the budget anticipated a public private partnership that failed to materialize. One proposal for a public private partnership was received by Suffolk County pursuant to a Request for Proposals let by the Department of Health Services in 2011. After evaluation of the proposal, the RFP evaluation committee decided not to award a contract in February 2012. Another 2011 RFP let by the Department of Health Services envisioned a sale or lease of JJFSNF. The evaluation committee for this committee also decided not to award a contract.

Sometime after these two RFPs were closed and not awarded, the County Executive negotiated an agreement with a finder who facilitated a possible sale with several prospects. A sales contract between Sam and Israel Sherman, doing business as SSS Operating, LLC and SSS Realty, LLC was executed at the end of July 2012, subject to Legislative and New York State approval.

The proposed sale requires execution of two separate transactions, one for the business in an asset purchase agreement, and the approximately 14 acres of land and the premises,

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constructed as a land sale contract. According to the Section 9-3 of the Land Sale Contract, the transactions are not severable; a default of either contract is a default in both.

The buyer has offered $23 million for the combined asset and land sale. That offer is lower than the $31.6 million market value appraisal estimated in the course of the 2010 RFP process by Rogers and Taylor, and the $33-$35 million estimated by the consultants Horan, Martello, and Morrone, P.C. in their 2008 Operational Study of JJFSNF. The 2012 appraisal completed by Rogers and Taylor during the sale negotiations valued the property at just under the $23 million offer.

In Section 4-6 of the Land Sale Contract, Suffolk County agrees to use its best efforts to obtain property and sales tax abatements for the buyers. According to the 2012 Rogers and Taylor Appraisal, projected property tax for the facility would be $330,000 annually; about $40,000 of this would be due to Suffolk County. The average taxpayer could see a reduction of $0.07 on the Suffolk County portion of the tax bill as the property reentered the tax rolls; in Brookhaven the potential relief could be $0.05. Suffolk County sales tax on items purchased annually by the facility would be between $35,000 and $36,000 annually.

The contract intends for all patients to be retained in place by the buyer. Employees may be retained by the buyer, subject to the following conditions:

- All employees not offered employment by Suffolk County will be interviewed by the buyer.
- Any open positions with the buyer at JJFSNF will be offered to current employees of the facility, subject to their qualifications for positions.
- The buyer is not required to offer the current employees the same pay and benefits they have received from Suffolk County.

Regardless of whether Suffolk County continues to operate the facility or not, there will be legacy costs related to contractual health benefits for current retirees. There are approximately 90 JJFSNF retirees currently receiving County-paid health insurance benefits, accounting for about $1.7 million of the $4.8 million 2011 transfer from the Skilled Nursing Facility to the Employee Medical Health Plan to pay health insurance for all current and retired facility employees.

Currently, there are approximately 24 employees eligible to retire from Suffolk County service and retain their County-paid health benefits. These employees, when added to the current pool of retirees whose healthcare is paid for through the Nursing Home Fund, constitute the projected legacy cost of approximately $2.2 million annually in 2013-2017, increasing as healthcare costs increase.

If the County privatizes the Skilled Nursing Facility, consideration *may* be given to retaining or transferring employees whose titles are appropriate for other County operations. We estimate that there are 24 employees in 14 different job titles not specific to skilled nursing facility operations, who would not likely retire if the County divested itself of the nursing facility, and who would not necessarily be hired by the new operator of the facility.

Our assumptions for the transaction and legacy costs are “worst likely” case—we estimated the most likely maximum amounts for each of the assumptions described below. Healthcare coverage for employees expected to retire under normal retirement eligibility criteria.

Increases in cost are based on projections from the Centers for Medicaid and Medicare Services. Other assumptions made in calculating legacy costs and costs of the sale include:

- A cost per retained employee that accounts for the difference in program reimbursement from about 84% at JJFSNF to the typical aid for Health Department programs, up to 36%, depending on position.
- Unemployment Benefits owed to 24 employees of the County after determination of who will be able to retain their positions under the provisions of the Civil Service Law and the current collective bargaining agreement. Unemployment is included in the cost of the sale, and not as a legacy cost.
- Payouts of terminal pay including lag pay, considered a cost of the sale.
- According to the County Executive, New York State has given permission for the HEAL-NY 21 Grant awarded this year to be used to defease debt related to JJFSNF, and to finish the required electrical and fire safety projects currently in the Capital Program. This will allow the County to set up the escrow account required to pay off the existing bonds.

Conclusions

If the Legislature approves the sale of the facility, it is anticipated that Suffolk County will continue to operate the facility until the end of 2012 to accommodate the NYS approval process. Anticipated net sale revenue to be received is $18.9 million. This is based on the sale price of $23 million, less one-time costs estimated at $3.5 million associated with the sale, terminal pay for employees and other one-time expenses. A $560,000 payment to Peter Degere, the finder for the negotiated sale is also included as a cost of sale; this cost may be reduced subject to negotiation with Mr. Degere.

Other revenues associated with 2012 will include the Upper Payment Limit/IGT and lagging receivables, from 2012 and from previous years. This revenue should be realized in the budget in 2013. While all these revenues and expenditures are associated with divestiture of the facility, neither the costs nor gains are directly associated with operation of the facility. The proposed sales transaction is not a gain, but rather conversion of an asset (the nursing home) from real property and the business carrying value to cash. The following table shows the estimated General Fund subsidy or Net Expenditures. The Legacy costs associated with retiree health insurance will have to be paid by the County regardless of whether the County owns or sells the facility. Therefore, the future liability for the General Fund is the Net Expenditures less the Legacy Costs.

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## Table 3: Article A9-6 Savings (Budget Basis)

| Year | (1) Net Expenditures | (2) Minus Estimated Legacy Costs | (3) Savings = (1) - (2) | (4) = (3) / (1) % of Savings |
|---|---|---|---|---|
| 2013 | $3,613,058 | $2,206,034 | $1,407,024 | 39% |
| 2014 | $4,921,437 | $2,338,396 | $2,583,041 | 52% |
| 2015 | $5,556,706 | $2,478,699 | $3,078,007 | 55% |
| 2016 | $6,350,521 | $2,627,421 | $3,723,100 | 59% |
| 2017 | $7,146,556 | $2,785,067 | $4,361,489 | 61% |

## Table 3: Article A9-6 Savings (Financial Basis)

| Year | (1) Net Expenditures | (2) Minus Estimated Legacy Costs | (3) Savings = (1) - (2) | (4) = (3) / (1) % of Savings |
|---|---|---|---|---|
| 2013 | $4,565,885 | $2,206,034 | $2,184,851 | 48% |
| 2014 | $5,154,283 | $2,338,396 | $2,815,887 | 55% |
| 2015 | $5,806,000 | $2,478,699 | $3,327,301 | 57% |
| 2016 | $6,528,034 | $2,627,421 | $3,900,613 | 60% |
| 2017 | $7,328,252 | $2,785,067 | $4,543,185 | 62% |

The plan as proposed by the County Executive for the sale of the John J. Foley Skilled Nursing Facility will result in a cost savings to the County in at least each of the first five years of said plan or proposal of at least 10% in each of those first five years, as measured by net County expenditures (i.e., County appropriations less federal aid, state aid, third-party payments and/or private contributions). This savings is measured by the estimated subsidy required from the General Fund. The annual savings to the County ranges from $1.4 to $4.3 million over the five years 2013 to 2017 on a budget basis, and from $2.1 to $4.5 million on a financial basis.

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