SUFFOLK COUNTY LEGISLATURE

Gail Vizzini
Director

BUDGET REVIEW OFFICE

July 23, 2010

To: William J. Lindsay and All Suffolk County Legislators

From: Gail Vizzini, Director
Budget Review Office

Subject: Certification of Savings Pursuant to Suffolk County Charter A-9- 6 (H) for Proposed Privatization of the John J. Foley Skilled Nursing Facility

Attached is the Budget Review Office Certification of Savings as required by the Suffolk County Charter Section A 9-6 (H) pertaining to the privatization of the John J. Foley Skilled Nursing Facility as proposed by Introductory Res. No. 1474-2010. For the purposes of this analysis we reviewed both the Financial Statements and the Operating Budget; differences between the two methods are attributable to the use of modified accrual accounting for the operating budget and full accrual accounting for the financial statements. We interpreted the 10% savings criteria as 10% of the net expenditures and net expenditures is the expected transfer from the General Fund. The methodology used to project expenditures and revenue through 2016 relies on historical trends and reasonable growth rates as explained in the report.

Based upon our review of the financial statements, we estimate the annual savings associated with no longer providing this direct service to range from $5.2 million to $6.3 million, excluding the legacy costs. The legacy costs consist primarily of payments for retiree health insurance and the retention of a small number of employees. On a budget basis, we estimate the annual savings to range from $3.3 million to $4.2 million, excluding legacy costs. If the Legislature approves the sale of this asset, in all likelihood the timeframe associated with the New York State approval process will require that the County continue to fund operations through most of 2011. The 2011 budget is estimated to benefit from a one time revenue infusion of $15.6 million. This is based on the sale price of $36 million, less the required $15.9 million to be placed in escrow for debt service and other one time costs estimated at $3.5 million associated with the sale. From an accounting perspective, the proposed sales transaction is the equivalent of converting the asset to cash. Other revenues associated with 2011 include the Upper Payment Limit/IGT and lagging receivables, from 2011 and from previous years. This revenue may be realized in the budget in 2012.

My staff and I are available should you have questions regarding this analysis.

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Gail Vizzini
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BUDGET REVIEW OFFICE

July 23, 2010

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

From: Gail Vizzini, Director
Budget Review Office

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

Introduction

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 Kenneth Rozenberg, doing business as Foley LLC, as proposed by the County Executive in Introductory Resolution No. 1474-2010. 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. 1474-2010
- Rogers & Taylor appraisal of JJFSNF, 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. 1474-2010 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 (2012-2016) following divestiture of the facility, Suffolk County will likely realize annual budget savings in excess of 46% 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.

Projection of JJFSNF Net Expenditures

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. here are three significant differences in the two accounting methods with respect to the nursing facility—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 $6-7 million 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 2010 Adopted Operating Budget and 2009 actual budget expenditures as baselines, we estimated operating expenditures and revenues at the nursing facility for the years 2012-2016 inclusive. We also compared expenditures and revenues at the facility as reported in Suffolk County's Consolidated Annual Financial Reports for JJFSNF in 2007 and 2008. There is some variation between the figures reported in the Operating Budget and the financial reporting, attributable to the different accounting methods. Final audited financial statements for 2009 were not available for this analysis; therefore we used the unaudited financial information for the facility as provided by the Department of Health Services, as well as expenditures and revenues reporting for 2009 from the Integrated Financial Management System (IFMS).

Note: The Department of Health Services provided draft audited financial statements for 2009, after substantial completion of this report. The statements indicated that the allowance for doubtful accounts/bad debt in 2009 would be about $3 million dollars, versus $1.7. Correspondence with the department indicated that the additional write down was for 2009, and it would be expected to return to the $1.7 million dollar level in 2010 and 2011. BRO assumed $1.7 million dollar in bad debt for its projection of expenditures and revenues on a financial basis. The draft financial statements also eliminate the UPL payment for 2009, as it has not yet been received from New York State. The 2009 payment will likely be received in 2010-2011.

It should be noted that both our analysis and the analysis conducted by the Department of Health Services 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. Over the last three years, New York State has decreased reimbursement or otherwise proposed changes that negatively impacted 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;
- Delaying when Medicaid payments will go to a regional pricing system, which is currently scheduled for implementation in 2011;
- Reducing the reimbursement for AIDS beds;
- Designating beds as assisted living program beds, with a lower reimbursement rate.
- Changed 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, contractual settlement in 2012 and increases to the state retirement contribution in 2011. 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.

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- Employee healthcare benefit expenditure increases based on projections from the Centers for Medicaid and Medicare Services.

BRO assumptions for Projected Revenues include:

- Increases in Medicaid Revenue based on projections from the Centers for Medicaid and Medicare Services and recent history.
- Increases in Medicare Revenues based on projections from the Centers for Medicaid and Medicare Services for Nursing Home Care.
- No increase in Interest and Earnings Revenue.
- 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.

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
2012	$37,370,448	$27,904,259	$2,892,621	$6,573,568
2013	$38,712,280	$28,643,151	$2,950,474	$7,118,655
2014	$40,062,712	$29,423,700	$3,009,483	$7,629,529
2015	$41,316,922	$30,226,841	$3,069,673	$8,020,408
2016	$42,041,404	$31,088,417	$3,131,066	$7,821,921
Total Projected Cost to Suffolk County 2012-2016				**$37,164,081**

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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
2012	$37,520,448	$26,135,129	$2,892,621	$8,492,698
2013	$38,862,280	$26,827,176	$2,950,474	$9,084,631
2014	$40,212,712	$27,558,237	$3,009,483	$9,644,992
2015	$41,466,922	$28,310,459	$3,069,673	$10,086,789
2016	$42,191,404	$29,117,411	$3,131,066	$9,942,926
Total Projected Cost to Suffolk County 2012-2016				**$47,252,036.00**

*Expenditures do not include obligation for other post employment benefits. As explained above, accruals for other post employment benefits would add an additional $6-7,000,000 to each year shown.

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 24 years of the Enterprise Fund's existence; put another way, reimbursement for the program—the Skilled Nursing Facility—has averaged 84.6%. However, as mentioned earlier, 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 operating loss at the nursing facility on a Financial Statement basis averaged approximately $9 million from 2000 to 2009, as measured in 2010 dollars. On a budget basis, Losses at the facility peaked in 2005, at $13.6 million, and remained in the $13 million range in 2006 and 2007. Minimal upper payment limit revenue, the large permanent full time staff, and exceptionally high energy costs at the facility combined to maximize the facility's deficit during this time period. As a result of these unprecedented subsidies, the County Executive retained a consulting firm (HMM) and began contemplating divestiture of the facility, either through closure or sale.

The proposed sale requires execution of two separate transactions, one for the premises and approximately 14 acres of land, constructed as a land sale contract, and the other as asset purchase agreement, for the Residential Health Care, AIDS, and Adult Day Care operating licenses for JJFSNF, the business as a going concern, and most of the equipment. According to the Asset Purchase Agreement, the transactions are not severable; a default of either contract

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is a default in both. To execute the land sale contract, the land must first be declared surplus by Suffolk County, which will require a two thirds majority of the Legislature.

The buyer, Kenneth Rozenberg, doing business as Foley Operating, LLC, has offered $18 million for the asset and another $18 million for the land, for a total sale price of $36 million. That offer is higher than the $31.6 million market value appraisal estimated in the course of the 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. A second appraisal is currently underway but the results were not available at the time of this analysis.

The two contracts describe a cash transaction with deposits in escrow by the buyer prior to closing, and a final deposit, either by wire or cashier's check for the balance of the sale price at closing.

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 85 JJFSNF retirees currently receiving County-paid health insurance benefits, which represent $1.7 million of the $5.7 million 2010 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 33 employees eligible to retire from Suffolk County service and retain their County-paid health benefits at an estimated annual cost of $416,000, resulting in a projected legacy cost for retiree health coverage of $2.16 million annually.

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 58 employees in 28 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. There may be the potential for 20 of these employees to be retained by the County.

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. The assumptions and calculations contained in this report **do not** include participation in the New York State Early Retirement Incentive Program.

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- 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.
- 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 35 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.
- Payouts of terminal pay including lag pay.
- Revenue from the Upper Payment Limit/IGT in 2011.
- Lagging revenue for services performed by Suffolk County prior to the closing of the two sales contracts, but for which we have not yet been paid. The buyer will bill for these services, but the net revenue will accrue to Suffolk County.
  - ★ In March 2010 Capital Market Advisors, the County's financial adviser, estimated the required level of funding to set up an escrow account to pay off outstanding Nursing Home (Fund 632) bonds in the event that the Nursing Home is sold. Their analysis was based on a December 11, 2011 closing date, with a return on escrow account balances based on existing State & Local Government (SLUG) rates as of March 8, 2010, and sequencing of escrow account disbursements with required principal and interest payments on all outstanding Nursing Home debt. Based on these assumptions, the required level of funding for the escrow account was estimated to be $15,934,000; this represents the amount needed to pay off the remaining principal and interest as it comes due between 2012 and 2028.

While the current costs for insurance are reflected in the transfer from JJFSNF to the Self Insurance fund, this annual amount does not currently reflect settlements in either the past or future for medical malpractice or workmen's compensation.

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 2011 in order to accommodate the NYS approval process. Anticipated net sale revenue to be received in 2011 is $15.6 million. This is based on the sale price of $36 million, less the required $15.9 million to be placed in escrow for debt service and other one time costs estimated at $3.5 million associated with the sale, terminal pay for employees and other one time expenses, including a $900,000 dollar payment to Loeb and Troper, LLP, the consultant for the RFP, based on a 2.5% commission on the final sale. Other revenues associated with 2011 include the Upper Payment Limit/IGT and lagging receivables, from 2011 and from previous years. This revenue may be realized in the budget in 2012. While all these revenues and expenditures are associated with divestiture of the facility,

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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 table below 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.

Table 3: Legacy Costs of JJFSNF (Budget Basis)

Year	(1) Net Expenditures	(2) Minus Estimated Legacy Costs	(3) Savings = (1) - (2)	(4) = (3) / (1) % of Savings
2011	$5,976,839	[redacted]		
2012	$6,573,568	$3,192,840	$3,380,728	51%
2013	$7,118,655	$3,359,203	$3,759,452	53%
2014	$7,629,529	$3,556,921	$4,072,608	53%
2015	$8,020,408	$3,777,153	$4,243,255	53%
2016	$7,821,921	$4,022,719	$3,799,202	49%

Table 3: Legacy Costs of JJFSNF (Financial Basis)

Year	(1) Net Expenditures	(2) Minus Estimated Legacy Costs	(3) Savings = (1) - (2)	(4) = (3) / (1) % of Savings
2011	$7,851,562	[redacted]		
2012	$8,492,698	$3,192,840	$5,299,858	62%
2013	$9,084,631	$3,359,203	$5,725,428	63%
2014	$9,644,992	$3,556,921	$6,088,071	63%
2015	$10,086,789	$3,777,153	$6,309,636	63%
2016	$9,942,926	$4,022,719	$5,920,207	60%

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

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private contributions). This savings is measured by the estimated subsidy required from the General Fund. The annual savings to the County ranges from $3.3 to $3.8 million over the five years 2012 to 2016 on a budget basis, and from $5.2 to $5.9 million on a financial basis.

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