Capital Budgeting, Facility Assessment & Strategic Planning

DOUG MCMILLAN, P.E., President
dmcmillan@zumbrunnen.com
zumBrunnen, Inc. – Atlanta, GA

LISA HARDY, President & CEO
lisah@emeraldcommunities.com
The Emerald Communities – Redmond, WA
Objectives

- Understand facility/physical plant challenges facing Senior Living Owners in today’s environment
- Planning for a comprehensive facility assessment and capital budget study
- Understanding the process and methodologies
- Discussion of funding plan options and getting to an executable plan

Current Facility Issues Facing Owners...

- Deferred maintenance from 2008 – 2013 slow down
  - Near term budgets are high and priorities must be established
- Aging facilities – Avg. age at all time highs for the past 30 years
- Buildings built prior to 1990 are harder to renovate or reposition
  - Structural
    • Requirements due to natural disasters (earthquakes and weather)
  - Life Safety Codes
    • Fire sprinklers and alarms
    • Accessibility - ADA & Fair housing
  - Energy Codes
    • Latest - “Energy Disclosure Laws for non-residential buildings”
Current Facility Issues Facing Owners...

- **Complexity of building codes, materials, systems and equipment**
  - Technology is growing exponentially
  - Buildings and construction are more complex to build and maintain
  - Directors of Facilities should be professionals and be able to manage computer based maintenance and capital replacement software

- **Baby Boomers’ effect on design**
  - Upscale living areas, kitchens, baths, amenities

- **Increased “For-profit” competition**
  - For-profit facilities can enter the market place quickly
  - Pressures all providers to remain competitive by renovation, repositioning

The Challenge: Appropriate And Timely Responses

- **Executives Need Facility Information**
  - Short- and long-term expenses/replacements
  - Maintenance performance
  - Energy efficiency
  - Cost reduction/improvement
  - Executable Plans – not just a list of problems and jumbled list of recommendations
Strategic Facility Planning

• Facility condition assessment and budgeting
• Methodologies and proprietary techniques

What is the physical condition of your facility?

Strategic Facilities Plan Has 4 Fundamentals

1. Comprehensive understanding of the true condition of your existing facilities
2. Near-term improvement plan
3. Long-term strategic plan
4. Funding/financing plan

Existing building expenses and funding requirements as related to your overall strategic facilities plan are identified via a “Reserve Study....”
Components Of A Reserve Study

1. Professional & Independent Facility Condition Assessment – Short-Term Needs
   - Should be comprehensive, complete and objective
   - Deferred maintenance and repairs
   - Deficient design and construction
   - Life safety and code violations
   - Suggested Improvements

2. Minimum 20-Year Budgets
   - Detailed asset list and replacement schedule
   - Reports by location, building, categories, per unit/sf
   - Long-term strategic planning

3. Funding Plan Options
   - Evaluation of current funding plan
   - Creation of executable funding plan

Reserve Studies – More Than A Static Budget

- **Objective and Comprehensive Reporting to:**
  - Your residents, home owners and their families
  - Boards, agencies, lenders, auditors, other benefactors

- **Validate:**
  - Repair, renovate, reposition or replace
  - Fee rates or increases

- **Fund Reserves Per Your Business Model and Strategic Plan:**
  - Do not under-reserve or over-reserve
  - Capital campaigns

- **Identify Other Work and Future Capital Projects:**
  - Combine multiple repairs and projects into one
  - ID replacements/repairs to include with project or refinance
Assure Comprehensive And Accurate Reserve Data

Team
- Senior level independent engineering consultants, 20+ yrs.
- Coordinate inspections and interviews with all departments
- Consider all previous reports, proposals, budgets, etc.
- Other specialty consultants as needed
- Managed by an executive officer (CFO or other professional) in your organization

Create a dynamic budget versus a static budget by including:
- Items with life beyond one year for a given price threshold (i.e. $1,000)
- Every budget item regardless of remaining useful life
- Code violation items, regardless of cost
- Critical repairs not already identified in current budgets
- Improvements - discretionary items
- Software to update data

Pricing and scheduling data based on:
- Your business model
- 1st - historical data
- Local contractor and vendor
- Consultant’s resources
- Published unit cost data from industry sources
- Reflects the manner work is to be executed

Reporting format & filters:
- Separate budgets for each building and income sources
- Budget categories and capital
- Priorities: capital, operating, code, improvements, critical repairs

Review process – this is critical:
- Consensus and ownership
- Defendable and executable
Strategic Considerations To Evaluate A Building

1. Emotional Equity
   – Historical or emotional significance

2. Marketability of Old vs. New
   – Historic marketing advantage
   – Latest trends and features

3. Life Safety
   – Are your residences as safe?

4. Old vs. New Floor Utilization
   – Floor area efficiencies
   – Maintenance expenses

5. Old Systems vs. New Systems Efficiency
   – LEED and Energy Star Improvements
   – Utility expenses

6. Old vs. New Cost: FCI
   – Cost of capital

“Are We Throwing Good Money After Bad?”
(Investment for a repair or renovation vs. replacement??)

Facility Condition Index (FCI): benchmark ratio for evaluating short- and long-term investment into a building

\[
\text{FCI} = \frac{\text{Repairs + Replacement Costs + (Other)}}{\text{Current Total Building Replacement Cost}}
\]

Short-Term Index Total:
• When the Index begins to exceed 0.30 (30%) range, replacement vs. a renovation becomes more plausible
• Efficiently built buildings should have an index below 0.01 (1% per year)
• When these values are being exceeded, a closer look may be needed, *evaluate where your risks lie*
Facility Condition Index Chart

- Gives brief and graphic assessment of whether to maintain or replace
- Developed by US Navy during WWII

20-Year Annual Capital Reserve Requirements

- Census was low during recession with a lot of maintenance/replacements deferred
- Catch up is evident during first few years of 20-Year study period
“What Are Your Strategic Plan Funding Goals?”

- Set goals to accomplish:
  - Establish replacement reserve-funding plan
  - Setting limits on debt (debt capacity) for project financing

- Replacement reserve funding options:
  1. Maintain and repair facility for life-term
  2. Renovate or reposition
  3. Replacement of a building
  4. Or any combination of the above

**Current Funding Plan**

- Current Funding Level: $398/mo./resident + 2.5% inflation
- Interest earning on reserve fund deposits are 1.5%
- Reserve Fund goes negative in 2021
Baseline Funding – Cash Flow Analysis

- Annual Reserve Funding = $415/mo./resident + 2.5% infl.
- First year with zero $ balance is 2021

Threshold Funding Plan – Executable Plan

- Annual contributions needed are based on projected expenses and an adequate contingency in the Capital Reserve Account

An adequate threshold amount is maintained in Reserve Account at all times.
“Show Me The Money...”

Options to start a reserve funding program:

- Add cash up front
- Accelerate increases over customary annual increase
  - Modify funding plan to meet tolerance levels for increases
- Capital Campaign
- Incorporate major capital replacements into new expansion/renovation/repositioning project

Liquidity – Days Cash On Hand

- 350 Days: Act Strategically
- 150 Days: Weather a Storm
- 60 Days: Stay Operational
- 0 Days: Stay Operational
Occupancy Is Down, But The Good News Is:

operating costs were really low...

Resources

White Paper
- “Fundamentals of a Reserve Study and Reserve Funding Plan” - Better understanding of the fundamentals of a Reserve Study

Available on zumBrunnen’s Blog: zumBrunnen.com/blog
- “Asset Management of Real Property – Part 2 of 9: Replacement Planning and Budgeting”
Doug McMillan, P.E.
President
zumBrunnen, Inc. – Atlanta, GA

dmcmillan@zumbrunnen.com

5881 Glenridge Drive
Suite 110
Atlanta, GA 30328

P: 404-601-4050

www.zumbrunnen.com

Doug McMillan, President of zumBrunnen, Inc., has a long-standing engineering and construction management career. With more than 35 years of diverse experience, Doug has overseen and managed a variety of projects in the senior living, multi-family, retail, industrial, and military construction arenas. Prior to joining zumBrunnen, Inc. in 1998 as a Senior Project Manager, Doug worked in both the private and public sectors. The majority of his career was with the U.S. Army Corps of Engineers advancing from Chief of Quality Assurance to Resident Engineer in both the Los Angeles and Savannah Districts. In addition to senior management responsibilities, he was the lead instructor for Corps of Engineers training courses in roofing, structural steel, and welding. He is a registered professional Civil Engineer in the State of California.

As facilities continue to age, owners, advisors, and investors are demanding independent and objective assessments of the facilities’ physical condition and accurate projections for capital replacement funding. zumBrunnen, Inc. has completed numerous assessments for homeowner’s associations, boards, management companies, private schools and senior living campuses throughout the United States. The company’s commitment to and reputation for providing comprehensive and objective reporting has earned them the endorsement of their clients and the most prominent of the financial product and service companies, design professionals, developers, and management companies servicing the multi-family and senior housing field.
Ms. Hardy joined Emerald Communities as president and chief executive officer in Jan. 2008. Since joining Emerald Communities, Hardy has led Emerald Heights, a subsidiary of Emerald Communities, through a successful master plan to reposition the community. Commencing in 2010 and completed in 2014, this comprehensive master plan included extensive renovation of existing buildings, as well as, new construction. Projects included renovation and expansion of dining venues, updating of interior corridor and common use areas, addition of a new multi-purpose/auditorium building, construction of new residential apartment homes, and replacement of the fitness and aquatic center. A new Life Plan Community, Heron’s Key in Gig Harbor, is also in development with a planned opening in spring 2017.

With experience in leadership roles in the industry since 1988, Ms. Hardy was chosen for her experience and knowledge in operations of life care retirement communities. She previously led the new development and construction of projects on several Life Plan communities during a 14-year tenure with Life Care Services. She has an additional seven years of experience with the United Presbyterian Home, a Life Plan Community in Washington, Iowa.

Hardy earned her bachelor’s degree in business administration with a management concentration from Saint Joseph’s College in Maine, as well as, an associate’s degree in health care administration. She has received licensure as a Nursing Home Administrator in the states of WA, GA, NC, IA, IN, and AL.

She currently serves on the Board of Directors for LeadingAge Washington; Caring Communities, a leader in insurance and risk management serving NFP senior housing and service providers throughout the United States; and Washington Care Services, a provider of a wide range of skilled nursing care and rehab services for people of all ages. She has also served on the Board of Directors of the Georgia Institute on Aging; as a CCAC Evaluator; and as the Alabama state delegate for the American Association of Homes and Services for the Aging.