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Economic State of Skilled Nursing Facility (SNF) Industry

February 2023

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Certain information set forth in this presentation contains "forward-looking information," including "future-oriented financial information" and "financial outlook" (collectively referred to herein as forward-looking statements). Except for statements of historical fact, the information contained herein constitutes forward-looking statements and includes, but is not limited to, (i) projected median operating margin performance of national skilled nursing facilities; (ii) projected occupancy levels; and (iii) projected inflation. These forward-looking statements are provided to allow industry professionals and policy makers the opportunity to understand CLA's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating the performance of the skilled nursing industry.

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Executive Summary

For skilled nursing facility (SNF) operators, the current operating environment puts tremendous pressure on operating margins due to the heavy reliance on government payment sources. The added pressures of the COVID-19 pandemic have resulted in ongoing, increased costs and declines in occupancy far beyond historical trends. The American Health Care Association (AHCA) has commissioned CLA (CliftonLarsonAllen LLP) to perform an updated study of the current economic state of the SNF industry. Utilizing available data, this report highlights the negative operating margins, increasing costs of care, and contributing factors to revenue loss such as occupancy and staffing challenges incurred by SNFs.

Unprecedented SNF challenges were only partially captured in YE 2020 data and results. Analysis of 2021 data indicates 2020 emerging challenges have escalated with many operators continuing to struggle balancing operational and financial performance. 2021 actual negative operating margins continued to increase throughout the year. For 2022, we noted continued financial pressure with a median negative operating margin of -0.3%.

Further exacerbating the challenges, temporary Public Health Emergency (PHE)-related funding, which largely offset the negative financial impacts in 2020, were not sufficient to offset the financial impacts in 2021 or 2022 to date. Additionally, these resources have been exhausted by most providers and are no longer available.

Executive Summary

At the same time, workforce availability and wages, as well as general inflation, have continued to escalate. This escalation has resulted in notable trends including the ongoing risk of patient and resident displacement due to possible closures, as well as facility closures rising. Based on available data 47% of SNF residents are in facilities at risk of closure compared to 37% in 2021. Current data indicates 450+ SNFs have closed since the beginning of the pandemic.

On January 30, 2023, the Biden administration announced the end of the PHE effective May 11, 2023. This means the 3-day stay and spell of illness waivers will end, further impacting the slower occupancy growth.

For many SNF stakeholders, the current economic challenges are all-consuming, primarily related to workforce and slow occupancy recapture. The 2023 outlook is slightly better due to increases in occupancy and some permanent Medicaid rate enhancements, but the projected median operating margin means SNFs may barely break even.

Key Findings

- SNF occupancy rates will not return to 80% until late 2023 and will not return to pre-pandemic levels (84.7%) until 2024.
- While occupancy is slowly recovering, there are over 450 fewer facilities due to closures and more than 37,000 fewer beds.
- Inflation peaked at 9.1% in 2022, more than double pre-COVID inflation rates.
- On average, nurses have seen a 17.3% increase in their hourly wages since 2019.
- Because of workforce shortages, nursing homes are using more contract nurses. Staffing agencies are charging 22-28% higher than pre-pandemic levels for contract nurses.
- In 2023, increases in occupancy and enhanced Medicaid rates in some states may help improve median operating margins, but SNFs may only barely break even at 0.6%.
- In 2023, 28% of residents will reside in SNFs that are considered at financial risk, putting them at risk for potential displacement.

Key Findings from Staffing Mandate

The annual cost of staffing to meet a minimum staffing mandate is estimated to be between $3.8 billion and $11.3 billion, depending on the scenario. The CLA 37th Annual SNF Cost Comparison and Industry Trends report identified 7,741 out of 13,193 SNFs (59%) that had negative operating margins (excluding public health emergency funding).

The additional burden of meeting minimum staffing requirements with no funding mechanism could potentially increase the number of facilities operating with negative margins.

In addition to the cost of meeting a staffing mandate, the SNF industry would need to hire between 58,000 and 191,000 additional full-time equivalents (FTEs). Although there have been improvements in workforce availability in some areas of the country, nationally SNFs are still challenged to find the appropriate workforce.

Some facilities may need to reduce admissions or number of beds in a facility in order to meet staffing ratios. **If SNFs are unable to increase their workforce, hundreds of thousands of residents could be impacted by census reductions.**

Year to Year Financial Performance At a Glance

<table>
<tr><th></th><th>2021</th><th>2022</th><th>2023 Simulation</th></tr>
<tr><td>Median Operating Margin</td><td>4.1%</td><td>-0.3%</td><td rowspan="2">0.6%</td></tr>
<tr><td>Median Operating Margin
(excluding PHE and related support*)</td><td>-3.9%</td><td>-6.5%</td></tr>
<tr><td>Median Occupancy</td><td>72%</td><td>74%</td><td>80%†</td></tr>
<tr><td>Average Daily Census (ADC) in SNFs Financially “At Risk”**</td><td>37%
375,000 ADC</td><td>47%
≈500,000 ADC</td><td>28%
315,773 ADC</td></tr>
</table>

2022 analysis based upon facility data available through June 30, 2022

***PHE and related support** defined as Provider Relief Funds (PRF) and state funding through the American Rescue Plan Act (ARPA). This PHE financial aid will no longer be available in 2023.*

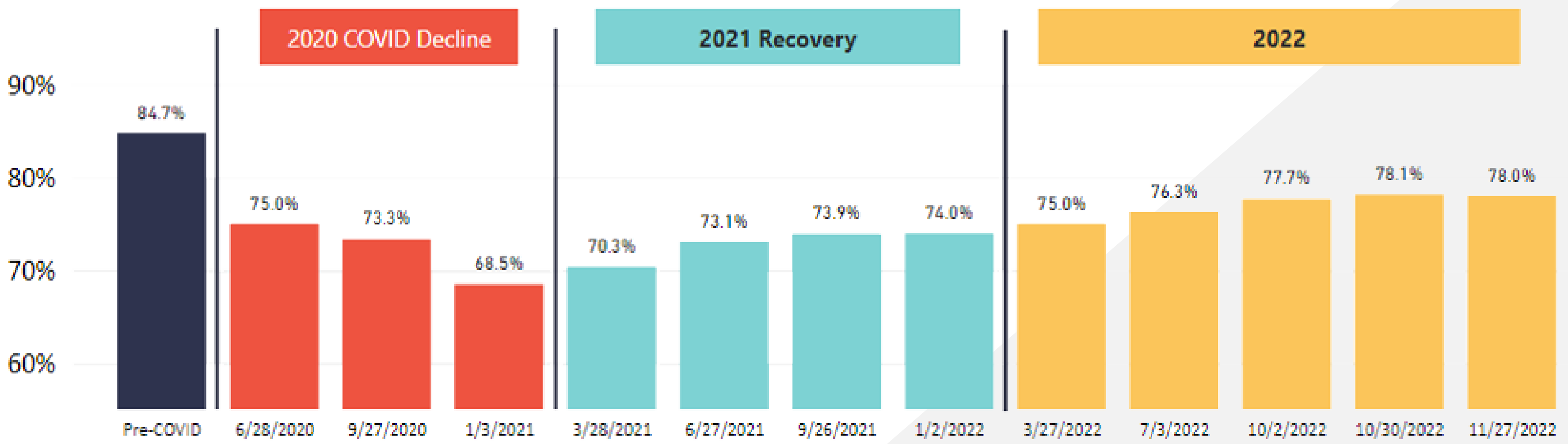
***Facilities at financial risk** defined as facilities with operating margins in the lowest quintile of performance based on 2019 industry performance (operating margins < -7.5%)*

†Improved median operating margins due to anticipated increased occupancy and enhanced Medicaid rates in some states.

Summary Information Based Upon Actual 2021 and 2022 Data

Occupancy Recovery Rate is Slow

Median Occupancy



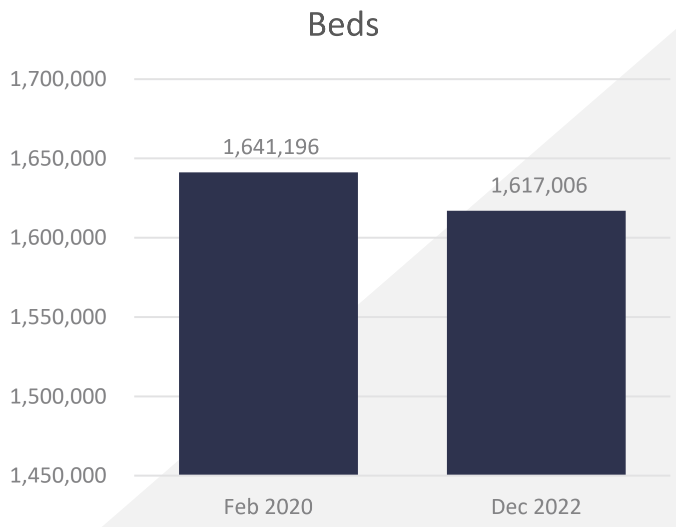
Occupancy Change	-16.2% in 2020	+5.5% in 2021	+4.0% in 2022
		9.5% Occupancy Recovery 2021 - 2022	

Two years after the 2020 COVID decline, median occupancy remains below 80% compared to 84.7% in 2019 pre-COVID.

Recent occupancy of 78% is between the trended and optimal levels used as assumptions in the initial CLA State of the Industry report in 2022.

If current pace remains, occupancy will not return to 80% until late-2023 and the pre-COVID 84.7% could remain out of sight until 2024.

Decline in Facilities and Beds Available

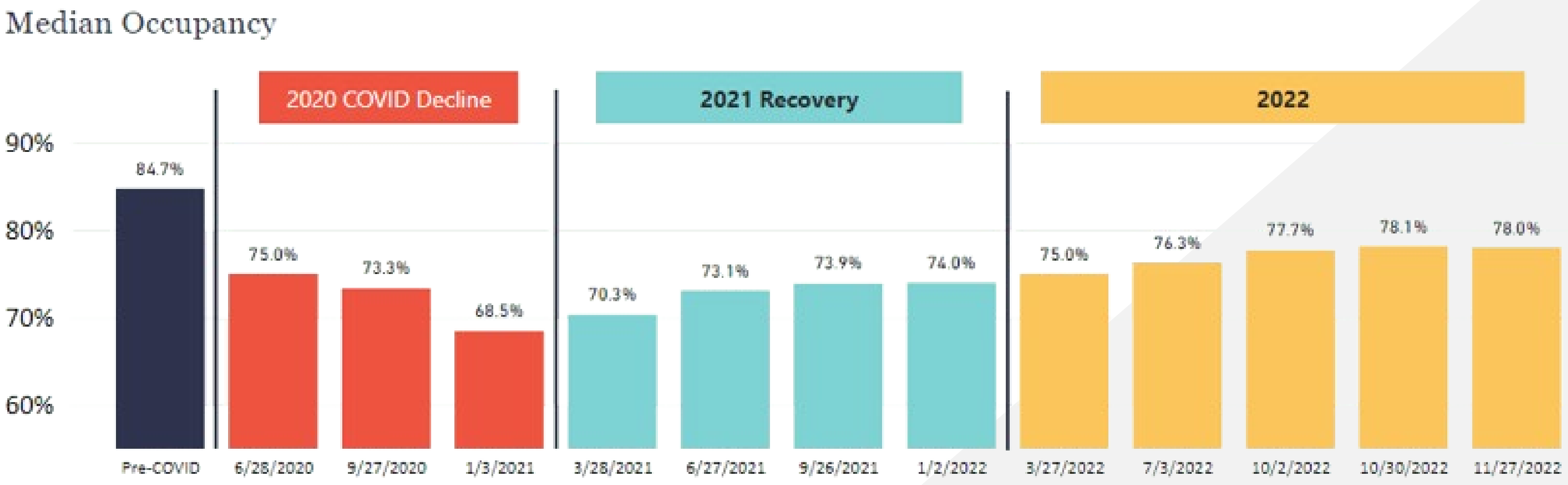


- 465 fewer facilities since February 2020
- 24,190 fewer beds available

As shown, occupancy is rebounding from the early pandemic lows. However, the occupancy percentage increase is also reflective of the decrease in the number of beds available within the system. In addition to facility closures, 54% of nursing homes are refraining from admitting new residents due to historic staffing shortages, according to a survey by the American Health Care Association.

https://www.mcknightsseniorliving.com/home/news/business-daily-news/ahca-calls-for-action-as-60-percent-of-snfs-limit-new-admissions/

Negative Median Margin Remains



Occupancy Change	-16.2% in 2020	+5.5% in 2021	+4.0% in 2022
Median Margin (Exc PHE)	-1.7%	-3.9%	-6.5%

The average occupancy for 2021 contributed to negative margin (excluding PHE and related support) despite its monthly recovery. Average occupancy for 2022 looks to be on par or better than 2020, providing opportunity for improved margins. We anticipate a slow recovery to 80% throughout 2023. Unfortunately, there are other critical factors to consider such inflation and lingering workforce issues.

Other Factors Impacting SNFs

Many analytic groups appear to view the SNF sector through the lens of a single, national payment system. This results in a misleading outlook about the health of the sector. Based on an evaluation of industry data, CLA believes national figures mask serious issues with the health of the SNF sector.

Factors with wide variations of impact across states and markets include:

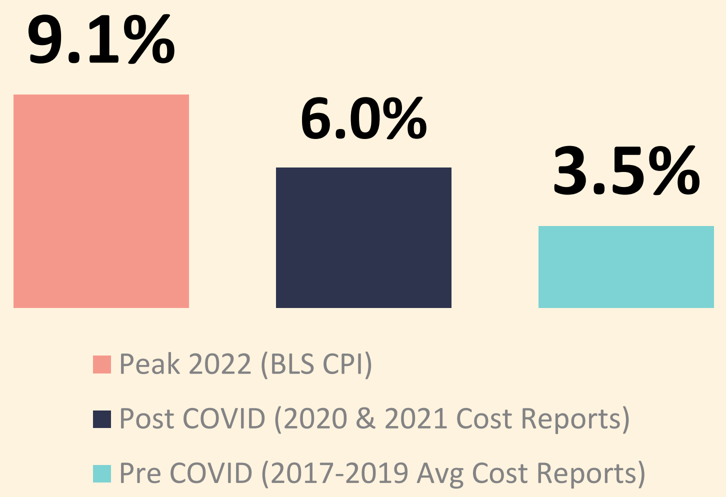
- Occupancy
- Inflation
- Labor costs
- Medicaid rates and upper payment limits on Medicaid rates
- Medicare Advantage penetration rates and payment rates

Inflation

- CLA evaluated market and state level inflation data for the pre-COVID (2017 – 2019 average) and post-COVID (2021 data [where available] or 2020) for several cost categories, including:
  - Average RN salaries / hour
  - Average LPN salaries / hour
  - Average aide salaries / hour
  - All other salaries average / hour
  - Average contracted aide cost / hour
  - RN/LPN average contracted cost / hour
  - Other dietary costs / meal
- This data indicates that post-COVID overall inflation rates have, in general, doubled from pre-COVID levels.
- This data also suggests wide variations in post-COVID inflation rates between states, markets, and cost categories.
- Additionally, current and trended BLS CPI data was considered. This data shows inflation continued throughout 2022, peaking at 9.1%, and has trended back down in the second half.

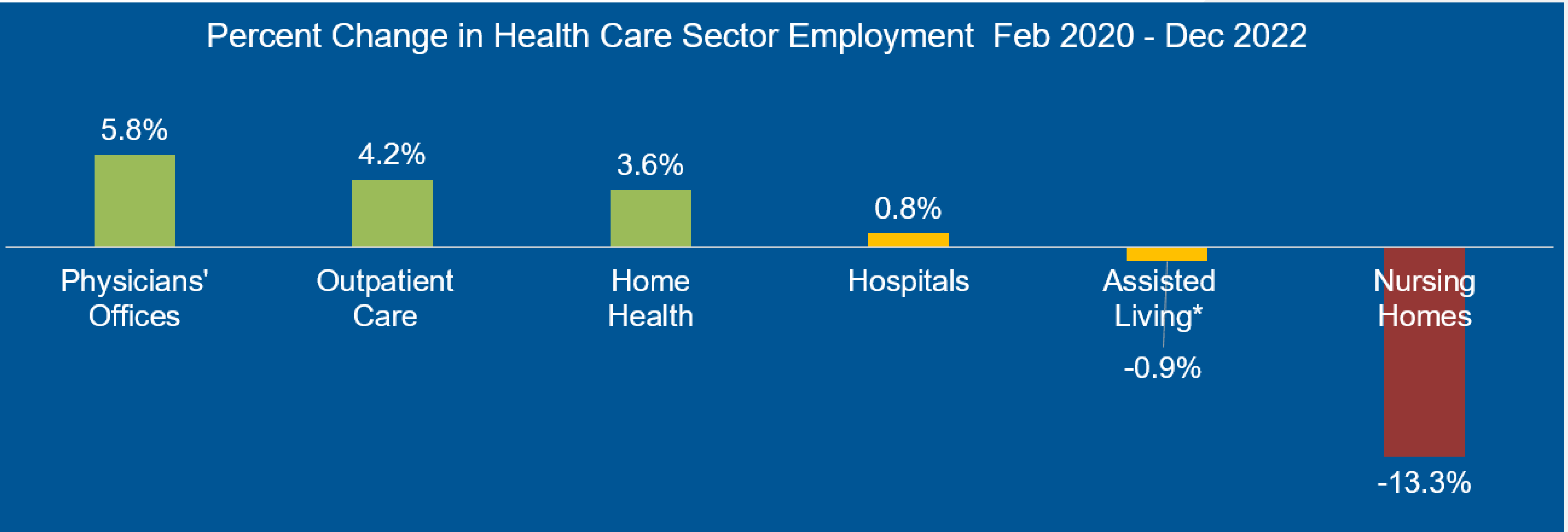
Key observation: Overall post-COVID inflation trends are significantly higher than historical pre-COVID trends. However, these trends are not consistent nationally as the data suggests wide variations in state and market levels of inflation.

Average pre- vs. post-COVID inflation evaluated cost categories



Industry Challenges – Workforce

As a result of the workforce shortage, providers are dealing with wage increase pressures and reliance on contracted or agency nursing, resulting in significant expense increases.



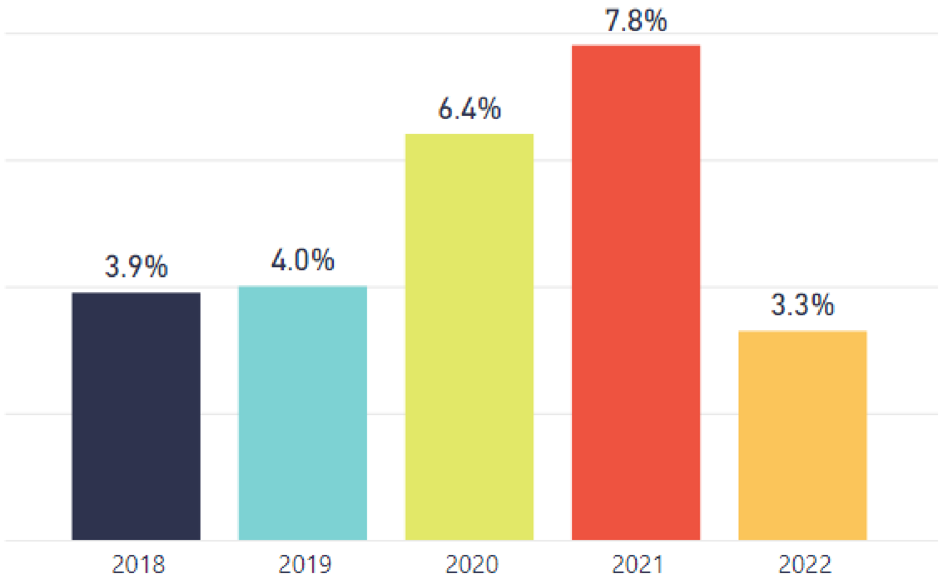
157,700 jobs gain	**42,100 jobs gain**	**55,300 jobs gain**	**43,700 jobs gain**	**(4,200) jobs lost**	**(210,000) jobs lost**

Source: Bureau of Labor Statistics (BLS) February 2020 – December 2022
**Assisted Living BLS data through November 2022*

Nursing Average Hourly Wages: 2021 Year Ends*

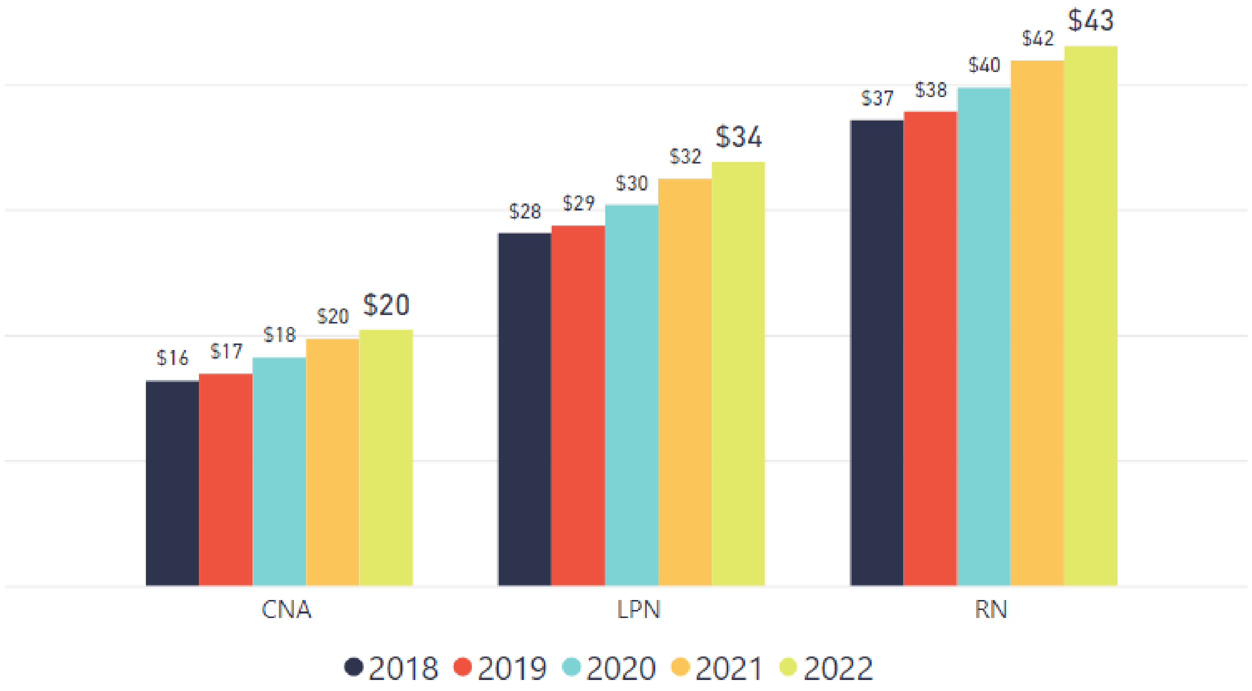
Overall Nursing

Growth rate in average overall nursing hourly wage



Nursing by Discipline

Average hourly wages by nursing discipline



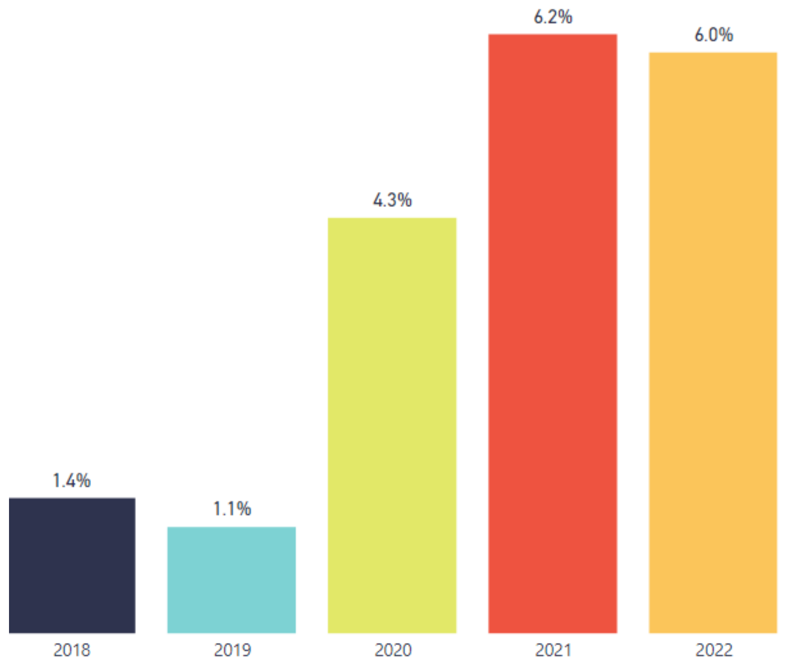
** based on public data on FYE 2021 & 2022 cost reports released by CMS on 01/18/2023 for employed nurses (excludes contracted/agency staff)*

National Skilled Contracted/Agency Nursing Cost Trend

Post COVID, contracted nursing rates per hour have increased at an accelerated rate

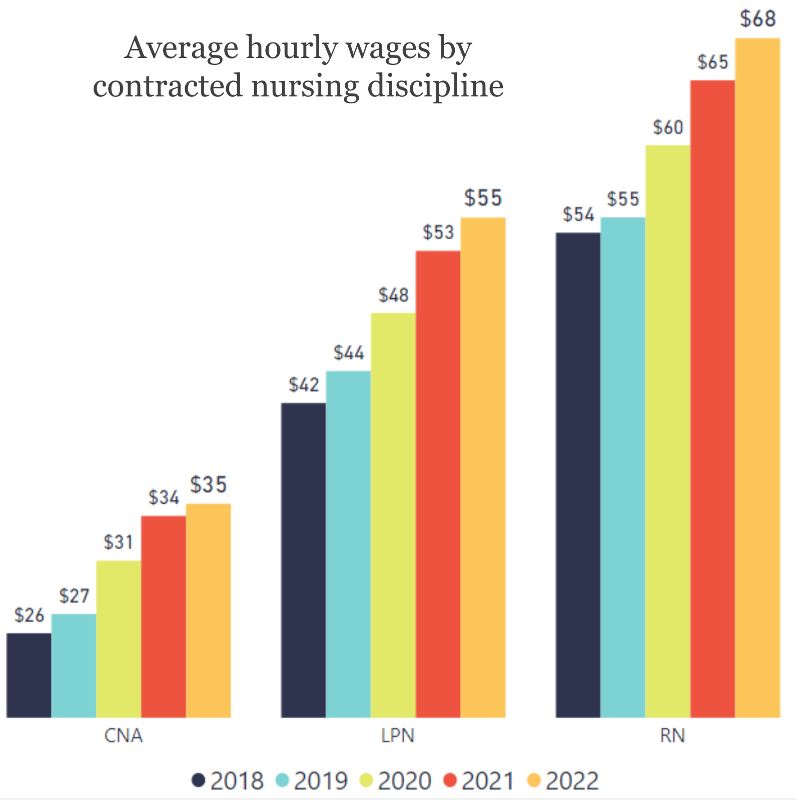
Overall Nursing

Growth rate in contracted nursing cost per hour



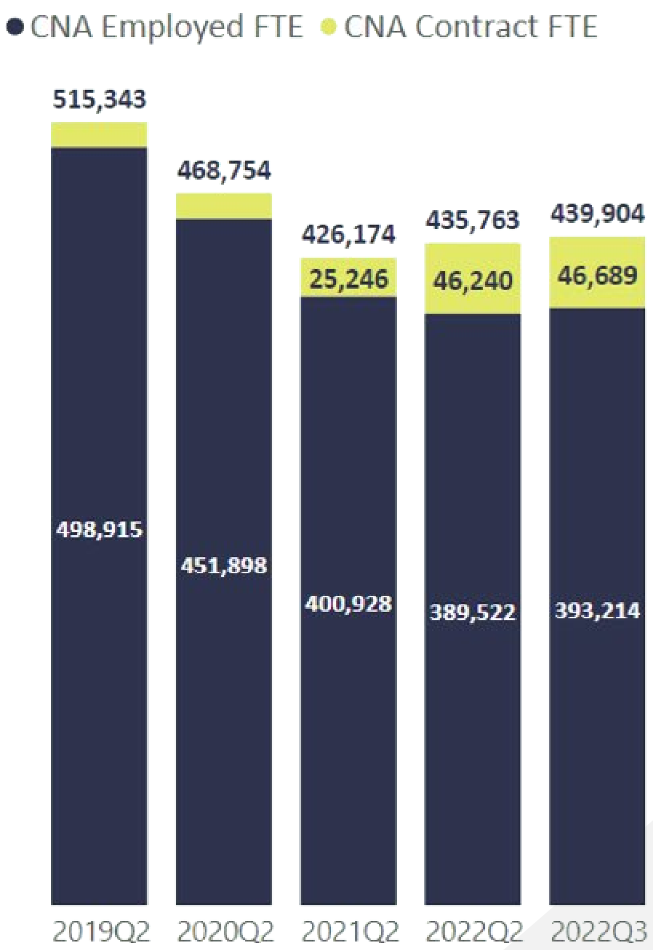
Nursing by Discipline

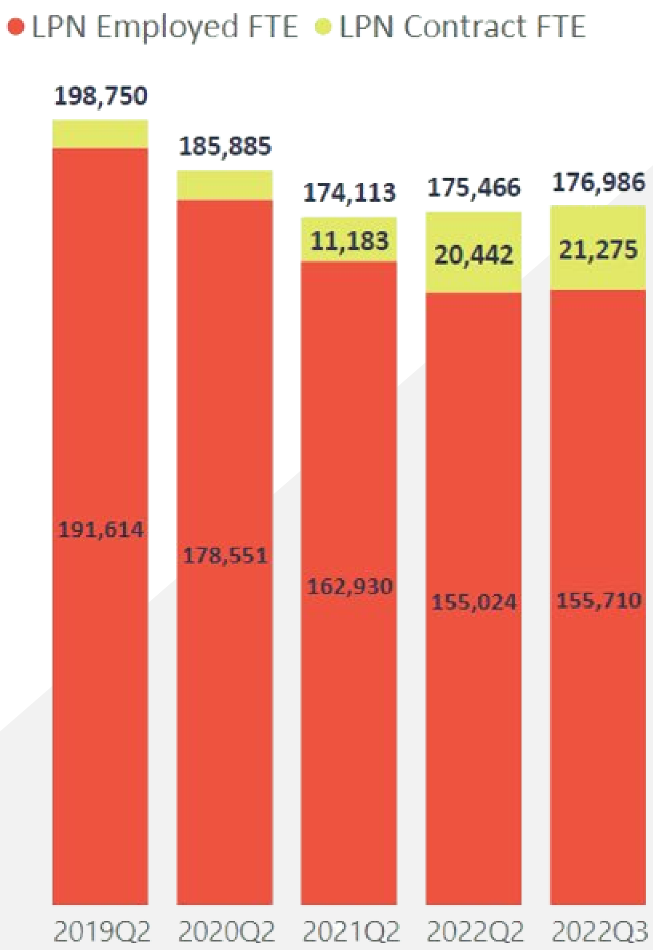
Average hourly wages by contracted nursing discipline

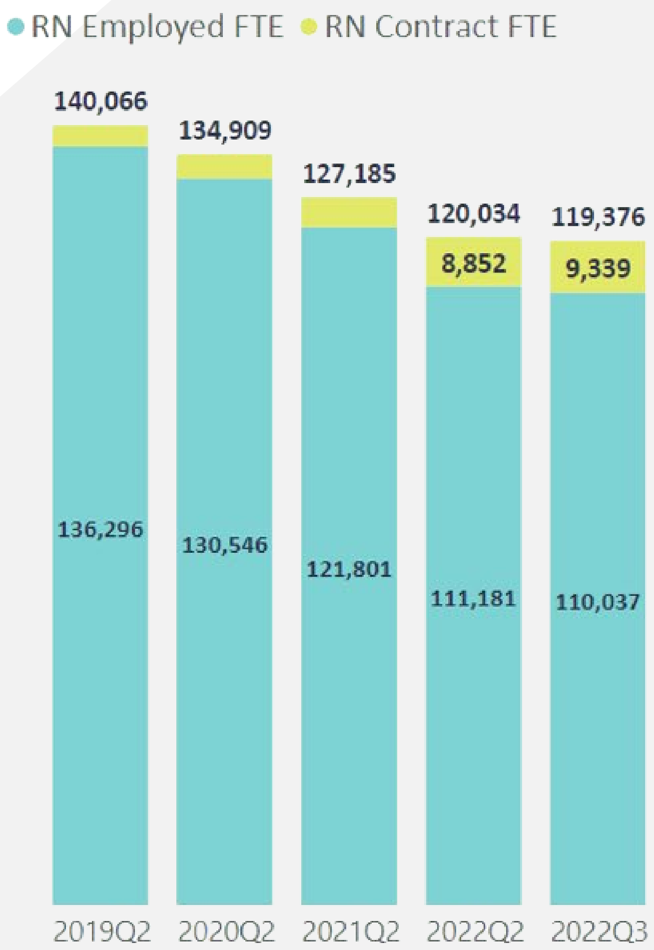


In addition to the increase in hourly rates for contracted nursing, the total hours of contracted nursing utilized has increased nationally. We have noted this increase in hours varies by state and workforce availability in given markets.

FTE Trends by Nurse Discipline

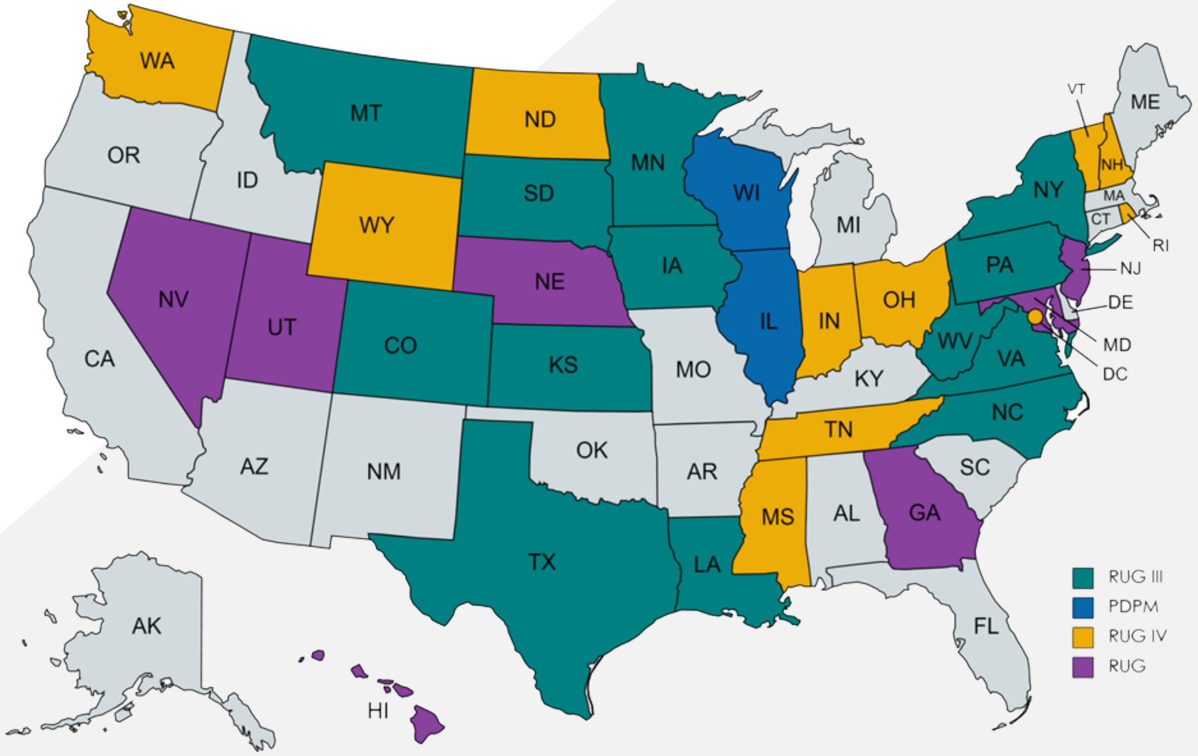






State Medicaid Financing and Payment Changes Raise Questions

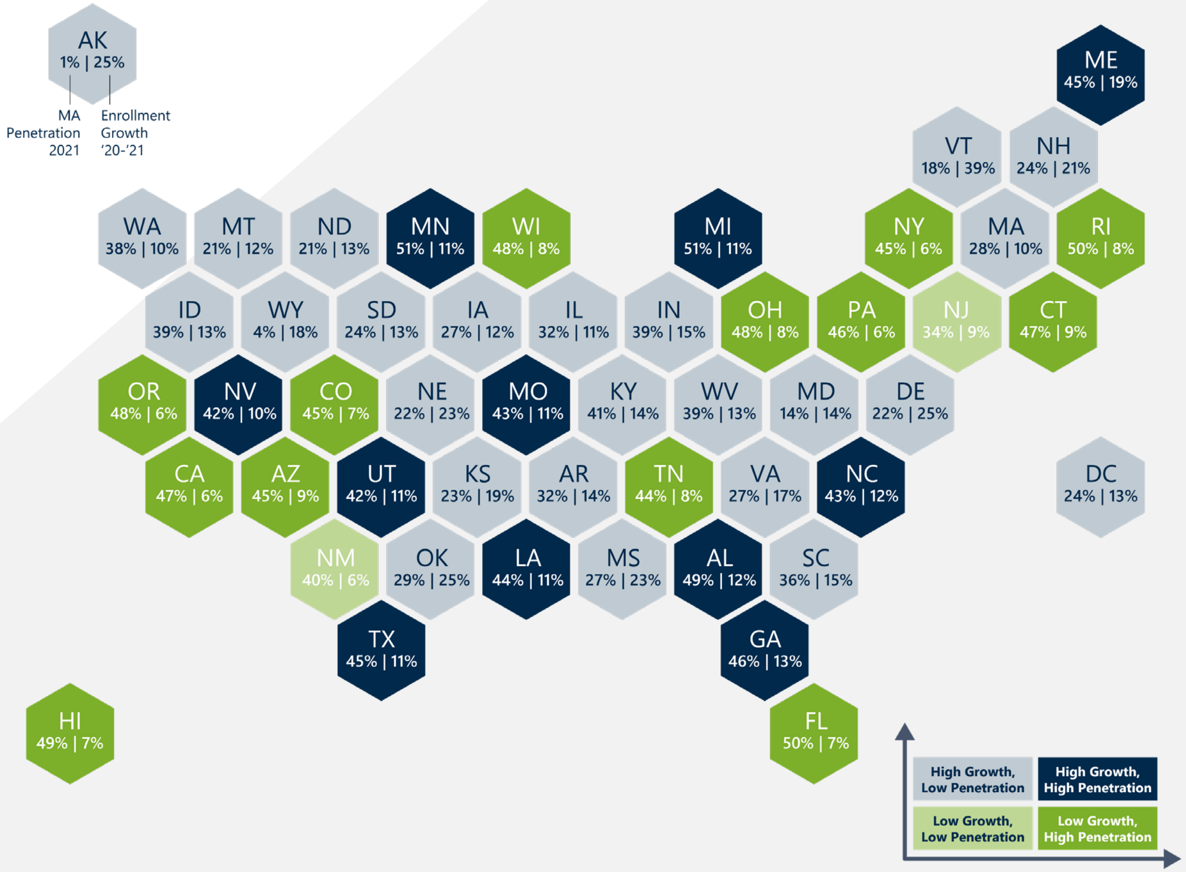
- In 2023, 6.2% enhanced FMAP will be three phased out April 1 – January 1, 2024. States may make difficult decisions about how to cover the cost of the 15 million Medicaid beneficiaries who joined Medicaid over the pandemic while FMAP decreases. Provider rates are often a key target for cost containment.
- Additionally, due to CMS policy changes, by YE 2023, 32 states will need to shift to PDPM-driven Medicaid payment systems leaving little time to develop and test such systems.



Source: MACPAC available at https://www.macpac.gov/publication/nursing-facility-payment-policies/

Medicare Advantage Growth By State

- Medicare Advantage is a growing part of skilled nursing mix. However, growth is occurring at different rates and levels in each state.
- CLA experience suggests large variations in Medicare Advantage rates by payer, state and provider.
  - 3% more to 34% less than Medicare fee for service
  - Not enough data to evaluate implications post PDPM implementation
- Recent study indicates PPD cost rates are approximately the same while SNF utilization is significantly lower*



** The American Journal of Managed Care, April 2021, Volume 27, Issue 04*
https://doi.org/10.37765/ajmc.2021.88616

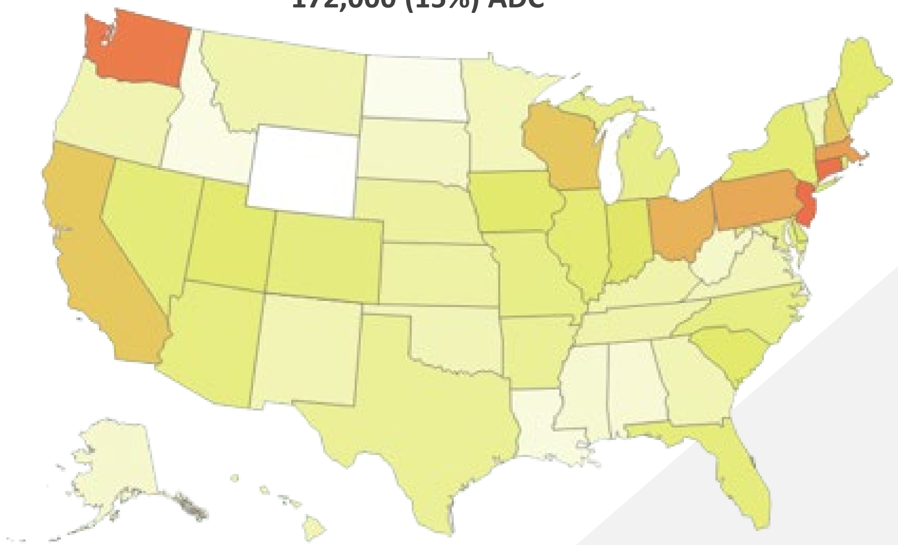
https://www.chartis.com/as-medicare-advantage-enrollment-booms-healthcare-entities-need-to-plan-around-key-trends

Implications of Facilities at Financial Risk*

There has been a significant negative shift in financial performance since 2019. The maps below compare the percentage of counties with nursing facilities at financial risk* by state in 2019 and 2022**.

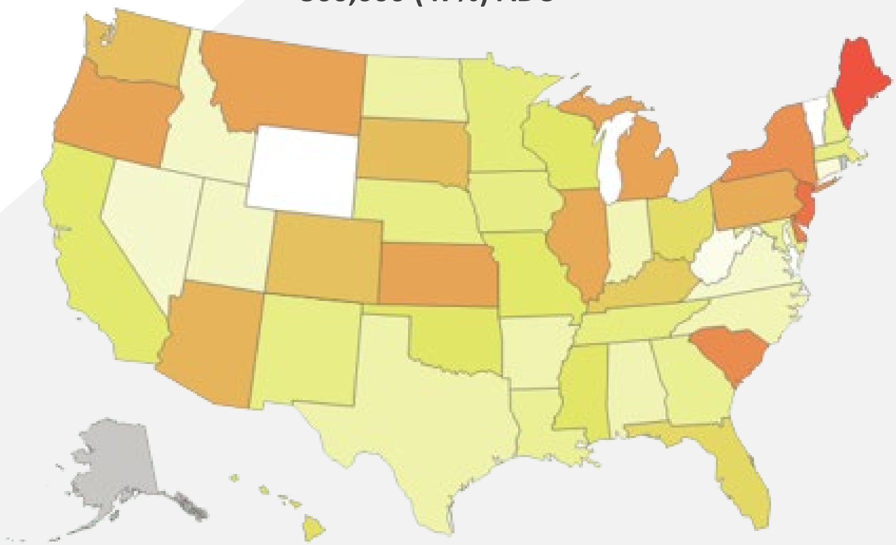
2019: % of Counties with Financially at Risk Nursing Homes

37% of Counties
172,000 (15%) ADC



2022: % of Counties with Financially at Risk Nursing Homes

57% of Counties
500,000 (47%) ADC



0% 40% 90%+

Facilities at Financial Risk *defined as facilities with operating margins in the lowest quintile of performance based on industry performance (operating margins < -7.5%)*
*** Analysis based upon facility data available through June 30, 2022.*

Summary Conclusion

For 2021 year-end SNF sector performance was a negative 3.9% median operating margin and median occupancy at 74.0%, expected to only rise to 78% during 2022. In light of our findings, in 2023 increases in occupancy will help improve median operating margins slightly; however, additional reimbursement decreases or unfunded staffing mandates likely would reverse this recovery and result in serious, continued risk of access and quality issues for residents.

Planned and likely risks include:

- the scheduled FY24 2.3% reduction in Medicare Part A fee-for-service rates
- continued increased in Medicare Advantage penetration rates
- potential Medicaid rate reductions made by states as the statutory decline in enhanced federal matching funds begins in April 2023 and phases out completely in December 2023
- the potential for a staffing mandate.

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Appendix

Datasets Utilized by CLA

Medicare cost report data

- Incorporates January 2023 data release including most 2021 fiscal year ends and most 2022 fiscal year ends through June 30th.
- Includes CLA CLArity data transformations and calculations

Payroll Based Journal (PBJ) data through 3rd quarter 2022

COVID-19 nursing home data including facility reported census through 11/27/2022

Medicare Advantage penetration data through December 2021