Financial Condition of Minnesota's Nursing Facilities
March 2008

Key Talking Points on the Survey Results

- The typical or Median nursing facilities operating margin in 2007 was -0.01%. Over half of Minnesota's nursing facilities had a negative operating margin. Facilities need to have an operating margin of at least 3% to be successful and provide good services to residents in the long-term.
- 30% of nursing facilities are facing a financial crisis (operative margins of less than -5%). These facilities cannot sustain such poor financial performance for very long
- The average facility has just 15.6 days of cash on hand. This is enough cash to cover only one payroll and is indicative of the financial difficulty faced by providers.
- According to the survey, roughly 84.5% of the typical nursing facility's revenue is directly paid or indirectly controlled by the State of Minnesota.

More Detail on the Survey Measures

Days Cash on Hand

$$\frac{\text{Cash(including Unrestricted Investments)}}{\text{(Operating Expense - Depreciation)/365}}$$

The days cash on hand ratio measures how long that cash on hand will cover average expenses.

A high number of days cash on hand is considered favorable, however, an extremely high ratio may indicate that the facility could earn a higher rate of return by investing in longer term investments. A desirable number of days cash on hand is at least 30 days. Between 45-60 days is preferred, or 1½ to 2 months of operating reserves.

The median days cash on hand from the Imperative survey is 15.6 days on a statewide basis. Due to this lower average, facilities often experience cash shortages periodically during a month and must closely monitor the timing of payrolls and payment of accounts payable with the anticipated receipts from third party payors.

Days Revenue in Accounts Receivable

$$\text{Accounts Receivable} \times \frac{\text{Resident Revenue}}{365}$$

The days revenue in accounts receivable represents the average number of days that receivables are outstanding, or how quickly a facility converts its receivables to cash. Lower days revenue in accounts receivable is preferable since this reflects a lesser amount of time it takes for a facility to convert its receivables to cash.

This ratio from the Imperative survey was 41.6 days on a statewide basis. This may be partly due to more managed care program billing as well as delays in Medicare and private insurance payments.

Debt Service Coverage Ratio

$$\frac{\text{Net Income (Loss) + Depreciation + Interest Expense}}{\text{Principal Payments + Interest Expense}}$$

The debt service coverage ratio measures the ability of a facility to make its debt payments. The ratio divides the facility's income available for debt service (Net Income + Depreciation + Interest) by the annual required debt payments.

A high debt service coverage ratio is favorable and is closely scrutinized by lenders in evaluating the ability of a facility to incur additional financing. Most lenders look for a debt service coverage ratio of at least 1.00 and usually require 1.25 – 1.50 when extending additional debt to a facility.

The Imperative ratio was 1.5 statewide.

Net Margin Ratio

$$\frac{\text{Net Income (Loss)}}{\text{Total Revenue}}$$

The net margin measures the profitability of a facility by comparing a facility's net income or loss to its total revenue. This measure includes all income, including income from contributions and investments. The higher the net margin, the more profitable a facility.

A ratio of 3% - 5 % is considered favorable for a non-profit organization. At this level the organization is generating adequate reserves to fund future asset replacements, while at the same time using its resources to carry out its mission of caring for its residents.

Operating Margin

$$\frac{\text{Net Operating Income (Loss)}}{\text{Operating Revenue}}$$

The operating margin measures the profitability of a facility by comparing a facility's net operating income or loss to its operating revenue. This ratio represents the true profitability of a facility as it ignores contributions received and investment income. The higher the operating margin, the more profitable a facility's operations.

The minimum desirable operating margin is zero, which represents a break-even operation. As stated above, however, after adding investment and contribution income an organization should target a margin of 3% - 5%.