



Impact of Fiscal Year 2012 Skilled Nursing Facility Final Rule and Potential Medicaid Cuts on Nursing Facility Industry-wide Overall Margin

Summary of Findings

- Avalere estimates that the payment reduction and group therapy changes in the FY 2012 skilled nursing facility (SNF) final rule **will reduce the nursing facility industry-wide overall (all-payer) margin from 3.8 percent to zero in FY 2012, and from 4.4 percent to 0.4 percent in FY 2014.**
- A 2 percent payment rate cut in FY 2013 pursuant to **the sequestration in the Budget Control Act of 2011, in addition to the impact of the FY 2012 final rule, would further reduce the industry-wide margin to -0.1 percent in FY 2014.**¹
- **An overall freeze in Medicaid payments** to nursing facilities beginning in FY 2013, combined with the impacts of the FY 2012 final rule and sequestration, **would reduce the FY 2014 industry-wide margin to -1.4 percent.** A 1 percent annual reduction in Medicaid payments to nursing facilities beginning in FY 2013 would further reduce the overall sector margin to -2.2 percent in FY 2014.

These are industry-wide margins. **Avalere previously found that the publicly-traded nursing facility companies**, which represent a relatively small percentage of the industry, **collectively have the lowest margins of any health care sector.** For the fourth quarter of calendar year 2010, the publicly-traded nursing facility companies had a net margin of 3.4 percent, compared to 3.5 percent for hospitals, 6.7 percent for DME (durable medical equipment) and 19.5 percent for devices.

Methods

Avalere calculates nursing facility industry-wide margins using its comprehensive SNF margins model. Data sources for the model include revenue and costs from the Medicare 2009 SNF cost reports, state-by-state Medicaid spending data from the CMS-64 (Medicaid cost reports), and National Health Expenditure (NHE) Accounts estimates of growth in nursing facility private payer revenues.

¹ The sequestration will be triggered if legislation based on recommendations of the Joint Select Committee on Deficit Reduction (which save at least \$1.2 trillion over ten years) is not enacted by January 15, 2012.

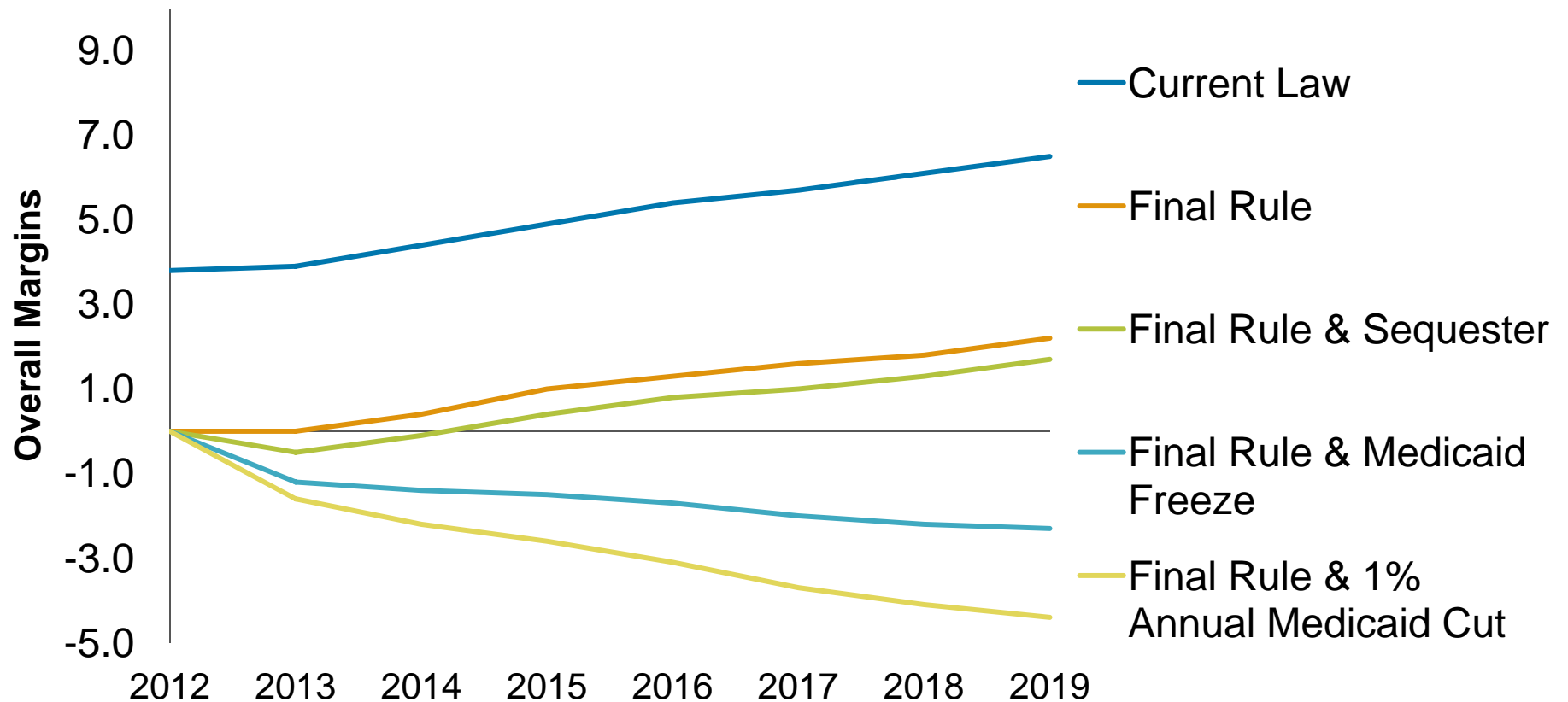
We project Medicare revenues by applying the growth estimates in the CMS Office of the Actuary (OACT) FY 2012 President's Budget baseline to 2009 Medicare revenues calculated from the cost reports. The baseline theoretically takes into account all factors that could affect Medicare spending, such as changes in patient characteristics (case mix) and utilization. The model projects total costs by applying the actual and estimated market basket updates and an enrollment assumption to the 2009 costs. The enrollment assumption (approximately a 1 percent annual increase in total nursing facility population/days) is based on Rivlin-Weiner projections², adjusted downward to account for the growth in the assisted living facility population since the projections were made. Beginning in 2013, the enrollment assumption is adjusted upward for the anticipated increase in the Medicare fee-for-service (FFS) baseline (driven by projected movement of beneficiaries from Medicare Advantage plans into Medicaid FFS).

We use the Medicaid cost reports to estimate total Medicaid payments to nursing facilities in 2009 and apply historical growth rates in Medicaid nursing facility spending to trend payments forward to FY 2011. We then rely on a range of assumptions (e.g., the freeze and 1 percent cut discussed above) to project nursing facility Medicaid revenues from FY 2012 onward. The model projects private payer revenues by applying the NHE private payer growth estimates to 2009 imputed nursing facility private payer revenues.

² Rivlin, A. and Wiener, J., *Caring for the Disabled Elderly: Who Will Pay?* 1988.

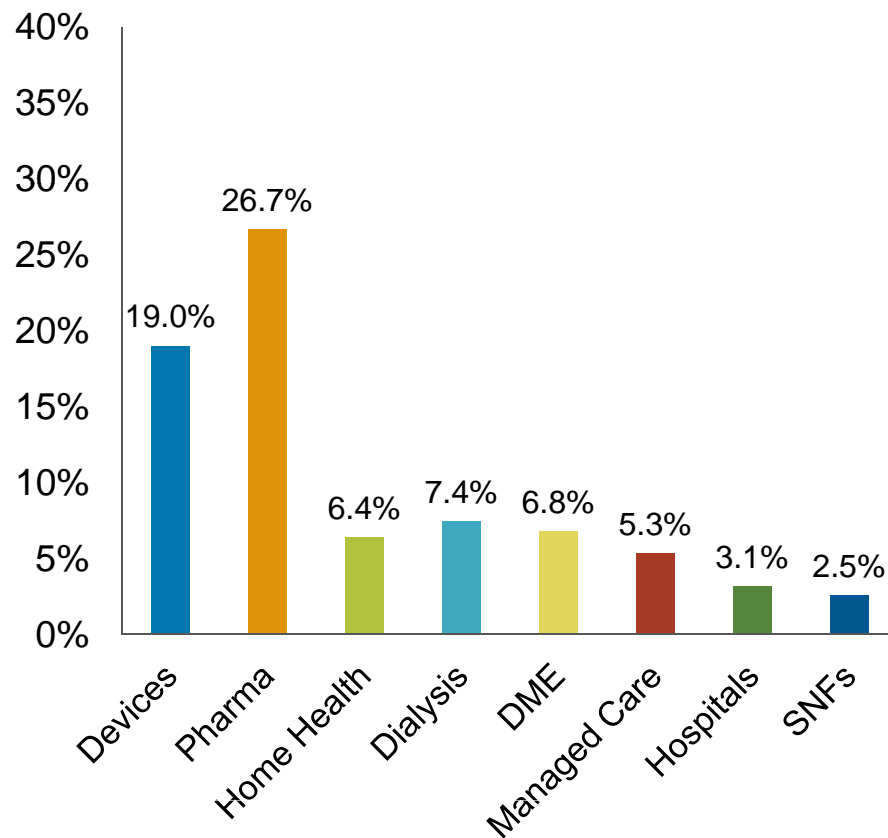
Estimated Impact of Final Rule and Potential Medicaid Reductions on Nursing Facility Industry-Wide Overall Margin

Overall Nursing Facility Margins

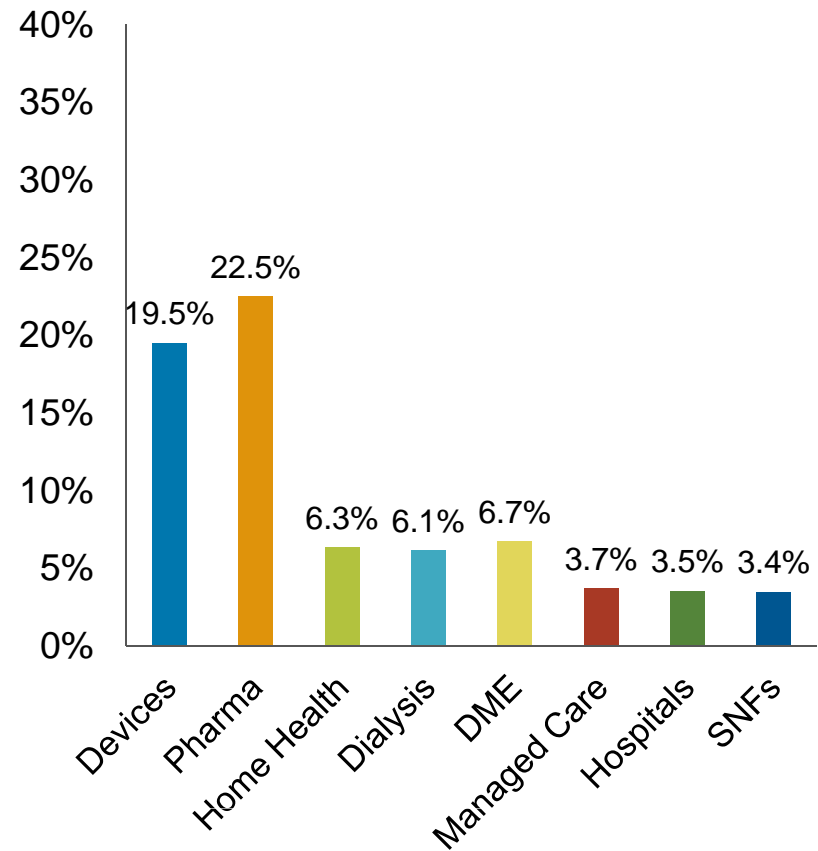


Publicly-traded Nursing Facility Companies Have the Lowest Net Margins of Any Health Care Sector

Net Margin, Q3 CY 2010*



Net Margin, Q4 CY 2010**



*Last quarter under RUG-III

**First quarter under RUG-IV

Results are normalized to remove one-time gains or losses

Source: Company financials, Factset, Avalere

