Executing a Payroll Play: How Labor Strategies Factor into Investment Decisions

Joel Mendes:

Welcome, everyone. I want you to start by imagining this scenario: you're a director of acquisitions; you're sitting at your desk, and you're reviewing a new deal. It's an AL memory care property. Physical plant looks good; the market looks good. The property has averaged 90-plus percent occupancy over the last 12 months. But the NOI just isn't there. Margins are around 20%. You think they should be closer to the low 30s. So, you decide maybe it's a revenue issue. You look at the rents; you look at the level of care fees. There's some movement there, but it's just not enough. So, you think to yourself, "It must be expenses." So, you add up all the payroll-related expenses, and it adds up to about 50% of total revenue. Then you ask yourself, "Is that high? Is that low? If it's high, can it be fixed?" And it's that question that we're going to help you answer today.

Joel Mendes:

My name is Joel Mendes. I work at JLL, in our senior housing capital markets team. We provide debt equity and invest sales advisory services to senior housing owners and operators nationally.

Joel Mendes:

I'm lucky to be joined up here with an all-star panel of three individuals, all of which uniquely have expertise in both the financial and personnel related aspects of our industry.

Joel Mendes:

Jerry Taylor brings extensive onsite and corporate level operational experience to the panel. While in college, he started working at a senior housing community in a sales and marketing role, and he was quickly promoted to executive director, as well as a regional role. And he's also been the director of business development for a REIT, a senior housing REIT. And he was EVP of corporate growth for a senior housing operator.

Joel Mendes:

Christy Stone is the senior vice president of relationship management at Welltower. She's responsible for developing and managing relationships with senior housing operators and health systems, as well as integrating growth initiatives across the broader Welltower portfolio. So, just to pare that down a little bit, part of her role includes what people in this room would refer to as "doing deals". However, she was previously the head of HR at Welltower, and has an extensive human capital background, including having designed and executed most of the company's workforce initiatives, and consulted with their operators in that regard as well.

Joel Mendes:

Chris Wettig is the CFO of Legend Senior Living, Legend is based in Kansas, is an owner, operator, and developer of over 40 properties. Chris has been the company's CFO for 15 years, and during that time he's executed a number of payroll plays, one of which we'll hear about later. And he started his career as a CPA, but spent most of his time before Legend in corporate leadership positions at large restaurant companies, which included eight years helping to grow one of them from 1500 employees to over 20,000.

Joel Mendes:

So, now we're going to talk about what's written on the screen here: real actual data. Believe it. It exists. What we did was we compiled a number of portfolios across a number of operators across a number of states; and we analyzed various labor categories to try to see how labor expenses were trending over time across these various categories. Spoiler alert: it's much higher than core inflation, which the target is around 2%. And it's also much higher than rent growth, which we see in most markets of being around 3%.

Joel Mendes:

So, in a word, managing personnel while managing to a bottom line is very, very difficult. So, we wanted to make sure to say that upfront, because what you're going to hear today are some innovative strategies to do just that, but we don't want to have anyone under the impression that it's easy.

Joel Mendes:

So, let's talk about a few of these payroll-related items. First, let's walk through sort of the lifecycle of an employee.

Joel Mendes:

First is recruiting. So, we looked at a portfolio that included five operators across 10 states and 21 buildings, over a three year period. So, 2016 to '19. That's three years. Their recruiting expenses increased 48%; and for the math people in the room, that's a compound annual growth rate of 14%. Obviously much higher than the other two metrics I mentioned earlier with respect to rent growth and inflation.

Joel Mendes:

Payroll. We looked at a portfolio of seven operators of 17 states, 38 buildings, for pre-employment. And this is when you hire someone, there's training, there's orientation. It's those types of matters. Increased 47%, which is a 10.1% compound annual growth rate.

Joel Mendes:

Overtime. When, depending on the state, someone works over a certain number of hours... In Ohio, it's 40. You have to pay them a certain amount above their going wage. Three operators, 11 states, 22 buildings. Overtime expenses increased 69% over a four year period, which is a compound annual growth rate of 14%.

Joel Mendes:

You guys see a recurring theme here.

Joel Mendes:

Agency. This is when usually you're in a bind at a property, and you need immediate labor, sometimes within the next hour, and you call a staffing agency, and they say, "Yes, we'll send two people there for $28 an hour." We looked at six operators, 17 states, 35 buildings. Use of agency, from an expense perspective, increased 23% over a three year period, and that's a 7.1% compound annual growth rate.

Joel Mendes:

So, now the magic number: total staffing. Seven operators, 17 states, 38 buildings over a four year period. 6.6% compound annual growth rate. How in the world could you execute a payroll play in this environment? My goodness!

Joel Mendes:

So, Jerry, what I'm hoping you can do is talk about how investors and operators are underwriting labor nowadays and how that's changed over time.

Jerry Taylor:

Yeah, yeah. See if I can figure out how to manage this clicker first.

Jerry Taylor:

Joel touches on a good point. And I think really the basic premise of what I'm going to talk about today is trying to make sure as an underwriter or somebody looking at a deal that you're looking in the right places to underwrite staffing, all encompassing of all of the different variables that go into a higher retention, et cetera.

Jerry Taylor:

Traditionally as an industry, we've kind been in the habit of going and focusing on rates and occupancies when we're doing underwriting, and utilizing basic assumptions across the rest of our expense side. And I think today I would challenge that mode of thinking, as those assumptions today, in 2020, are drastically different market to market across the board.

Jerry Taylor:

And so, that's what I'm going to talk through today, is really trying to change that mode of thinking, that an underwriting is not all about revenue. You got to make sure that you're digging into the right pieces on the expenses, like Joel mentioned.

Jerry Taylor:

So, we'll run through some of those same topics that Joel talked about. And the first piece, and the biggest piece, is accuracy of wages. We're in a time right now with labor pressures, increases in minimum wage, other things like that, it's extremely important that you identify accurate wages during your underwriting process. And what does that look like? Right? I think there's a few different methods to that madness, if you will. But if you're underwriting a current deal or an acquisition, really digging into the numbers deeper from a payroll perspective, and pulling those check registers, and understanding what are you paying on an average hourly wage, and what is necessary as you move forward during the course of that model to make sure you're capturing that same wage, and the correct wage, throughout the life of the deal.

Jerry Taylor:

A couple of things to think about, or tools that we have used and utilized as operators: mystery shops. This concept of mystery shops is something that we've utilized forever and ever on the rate side and to understand occupancies. But having the ability to call your competitive set and see where they're hiring, right? If you've got a deal you're underwriting to 12.50 an hour for your care staff, and you make a few

calls to your comp set, and you realize they're hiring at 14, 14.50, 14.75, what does that do to your underwriting and your model going forward?

Joel Mendes:

So, just to be clear, you're talking about calling as a prospective employee-

Jerry Taylor:

Absolutely.

Joel Mendes:

... the same way you would call as a prospective resident or resident family member, and asking about wage rates at their community, and then comparing that research to the rates that are being charged at the community you're considering buying or that you currently operate.

Jerry Taylor:

Correct, correct. I think oftentimes the easiest way to better understand what the actual necessary wage is is to know exactly what you're hiring at.

Jerry Taylor:

The second piece of this is kind of what it talks about: how do other industries in the market impact your hiring fees? Right? When we think about fast food, other hospitality industries... 7-Eleven, right? Those are other places that are going to be similar in nature to the type of work or the type of jobs that a lot of our clinical staff is looking at. What are they hiring at? Is it accurate? If you know the local 7-Eleven is hiring for $17 an hour, can you really underwrite a $13 clinical person in your model?

Jerry Taylor:

And so, I think just stressing that importance of accurate wages in your underwriting to make sure you don't have a budget bust in three years because you've underwritten a wrong number.

Joel Mendes:

So, this is my opinion, I'm curious to understand everyone else's, is a new thing. Particularly with regard to mystery shopping wages. I'd be curious, by a show of hands, raise your hand if someone in your company that you're aware of has mystery shopped wages.

Jerry Taylor:

Great.

Joel Mendes:

So, there's a few.

Joel Mendes:

Raise your hand if that was occurring four years ago.

Joel Mendes:

Oh, wow!

Chris Wettig:

She's a champ.

Joel Mendes:

So, still not very many, but they were ahead of the curve.

Joel Mendes:

So, I think that's a pretty neat idea.

Chris Wettig:

Right. Great.

Jerry Taylor:

Chris was probably doing it for 10 years. Chris was way before everybody else.

Jerry Taylor:

Market demand. Something else that's critically important is understanding the competitive landscape. We talked about that on the wage side. But understanding what kind of pressure does saturation and new development have on your wages? There is something to be said, in my opinion, when you have three new shiny pennies on the block and a 25 year old asset, and where do people want to work? And this goes into a Christy conversation, when we talk about culture, and retention, and other things like that. But there is something to be said about the real estate aspect, right? It's nice to work in some of the newer settings. And so, how does that impact your ability to keeps those wages where they are? And do you need to make some changes in order to recruit the high-quality talent that you need to take care of your residents?

Joel Mendes:

So, Chris, I'd be curious, from a market demand perspective when you're looking at the competitive landscape, to what degree, if at all, do you guys review not just other senior housing assets in the area, but other industries for competition of employees?

Chris Wettig:

So, we'll look at home health agencies; we'll look at hospice providers and what they're wage rates are; we'll look at hospitals and the low-level care staff, or CNAs, or RNs, or LPNs, and do a comparative analysis across all those different companies.

Joel Mendes:

That's it?

Chris Wettig:

Yeah.

Jerry Taylor:

Great. So, market demand. Pretty basic and simple. I think we're all aware of that.

Jerry Taylor:

Demographics. Demographics is something that's always interesting to talk through, particularly when we see this increase in these urban infill locations. We see them in a lot of really high-end product and high-end market. When you're building that kind of product, where does your care staff live? Where do they come from? You may be competitive in your wage set, but if somebody's got to travel 20 miles to get onsite to the community, and deal with transportation and things like that, do you need to make tweaks to that wage? Do you have to have increase to incentivize people to make the longer commute, and what does that impact have?

Jerry Taylor:

I know in past experience that goes deeply into our underwriting process. When we think about when we're running our demographic study, not only do we run it for our resident population, but we run it for our staffing population. And cost of living goes into that; local housing goes into that. Is there commutes available, trains and public transportation? There's a ton of variables that go into this concept of demographics as it pertains to your care staff in a community that in my opinion's a little bit untraditional from what we've looked at historically.

Jerry Taylor:

And so, I think it's really important to think through that.

Joel Mendes:

So, in that regard, is it the idea that there's always a way to get employees to your property, you just might have to underwrite higher wages to incentivize them to travel further?

Jerry Taylor:

I think it's-

Joel Mendes:

If you look at a new development in a very income location... We had that project in California that was this way. It's really difficult to get to unless you're a high income earner. Do you look at your wages and think, "Okay, well instead of X, it's going to be X plus two, or X plus three"? Is that logistically what-

Jerry Taylor:

I think it all depends on the operator, and so much of what we're going to talk about today is going to operator-specific. And Christy probably has some great examples of this. But I think not only is it that increase in wage itself on an hourly basis, but it's what can you do as an operator to get creative? It's ride share programs; it's different forms of carpooling; it's "Are we giving out free bus passes for our care staff?" Right? So, I think there's other ways to go about recruiting, and to creating a culture in which you want to attract people to your work outside of just the hourly wage. But I would tell you that there is an hourly wage part of that that is critically important.

Chris Wettig:

We had a perfect example of that just last week in our company. We operate eight buildings in the Dallas-Fort Worth market, and we were having agency staffing at one of the eight buildings. And we were pulling our hair out trying to figure out why just this one. So, we dug a little deeper, talked to the executive director, and found out they weren't on the commute path for public transportation. And so, what we had to do was bump the hourly wage rates for the lower level caregivers by $2 an hour, and we've already started to see results to solve that problem.

Jerry Taylor:

Yeah, yeah. Well, and I think that's a great point. And it's... Sitting here, when you hear $2 an hour, it's kind of easy to shrug that off a little bit. But you look at the lifetime of a model, which the margin piece is already thin, or coming down; and $2 an hour on your line staff is a huge impact.

Chris Wettig:

It is. But it beats, like Joel said-

Jerry Taylor:

Oh, no question.

Chris Wettig:

... a $28 an hour agency caregiver.

Jerry Taylor:

Better than 98 cents. Absolutely.

Chris Wettig:

When you can pay 14.

Jerry Taylor:

No question. So, that's kind of then demographics piece.

Jerry Taylor:

Legislation. So, we all are aware that we've seen more minimum wage increases over the last five years than we've probably seen in the history of the United States. It's been drastic, and it's something that's going to continue to impact us going forward.

Jerry Taylor:

What I would suggest, or I guess the reason that this is on here, though, I think we want to talk about collectively is the concept that the minimum wage increases that we're going to see are staged over the next five to 10 years. And so, when you're doing your underwriting, just because you're underwriting that minimum wage today, if you're not accounting for that increase in 2021, 2022, 2023, that impact can be catastrophic to your underwriting. And if you're not capturing that on the front end and accurately portraying that, it can be a huge budget bust. And when we're in a market like we are today, where I said, returns are wider than they were historically, and we're really chasing that last dollar, it's critically important that we capture all of that information on the front end.

Joel Mendes:

So, let's talk about that a little bit. Chris, let's walk through the mechanics of this. This is an important topic. And on properties that we're selling in states, or developing, or financing the development of, in states where minimum wage legislation is proposed, it comes up often. How do you underwrite it?

Joel Mendes:

So, let's just take an example. Let's say minimum wage in X state is $10 today, and it's proposed and it's been approved that it'll be ratcheted up to $15 in 2026. Most of your caregivers at your properties in this state are making 11 to $12 an hour. Some of the more seasoned employees are making $14 an hour. Mechanically, in your underwriting, how would you manage this circumstance?

Chris Wettig:

So, we do a five year pro forma on any acquisition opportunity that we look at, or new development, and that's certainly one of the things that you have to factor in. And we go down to the detail of hours by position, wage rates. And so, we have to build that into the model with those increasing rates. And that not only has an impact on the lowest level wage earner in the community, but everybody-

Christy Stone:

All the rest.

Chris Wettig:

... that's an hourly wage earner in the community.

Joel Mendes:

So, would you make a corresponding revenue adjustment as well?

Chris Wettig:

We would hope that we would be able to pass some of those costs through. But in an environment like we're in today, with hyperactivity, hypercompetition, and sometimes the inability to pass those on to the residents in the form of rate increases is sometimes difficult and you just have to figure out a way that you're going to save on a different line item expense.

Joel Mendes:

So, in those models, do you see the margin 34, 33, 32, 31, 30, and...

Chris Wettig:

Yeah.

Joel Mendes:

And that's just the reality of it?

Chris Wettig:

Yes, that is.

Joel Mendes:

Interesting.

Jerry Taylor:

I think the last thing on here is kind of this concept of retention at minimum wage, right? If we're in a market where every single job makes $15 an hour... I know I've got a couple of executive directors that are here. We know how hard it is to be a care team member day in and day out. And if you know that every job in the market is at $15 an hour, is it realistic that you're going to be able to retain staff at that same dollar amount? Is underwriting that minimum wage accurate, or is there some premium to minimum wage to attract and retain the necessary staff?

Jerry Taylor:

So, that would be kind of my last question when it comes to the minimum wage piece, is yes that's an easy par, but does that allow you to move the needle and make sure you are fully staffed the way you need to and not utilizing agency, like Chris talked about?

Jerry Taylor:

Non-traditional labor. So, this is an interesting one, and I think the statistics that Joel utilized are fascinating. We are going through a time that retention is extremely difficult. We're at all-time highs in turnover as an industry, and with that comes along an addition of non-traditional labor expenses. And when we're turning over the number of positions that we are consistently, how do we recruit to backfill those positions? And certainly the time and energy that goes into that is drastically different than it has been historically.

Jerry Taylor:

And so, just some different concepts here. It used to be you could post your job on Indeed, and you would have 50 applicants, and you could select from those applicants, and hire away. And unfortunately, that's not the truth of 2020. We've got to be strategic in how we go and find right people and attract them to seniors housing. And that includes job fairs, different educational programs. Right? How do we partner with local community colleges, or other resources?

Jerry Taylor:

Paid marketing and advertising. Your marketing and advertisement expense historically has all been around occupancy growth. And I'm guessing, if you asked a number of operators today, they are spending a lot more dollars on marketing to attract potential employees than they ever have before.

Jerry Taylor:

Bonus structures. You're hearing a lot in big markets with lots of saturation that there's bonus structures being offered, or kind of signing bonus concepts. And as an operator, what do you have to do to differentiate your benefits from the competitor's benefits?

Jerry Taylor:

So, there's an expense that goes along with all of this. And trying to identify yourself as a leader in market, it costs money. And so we've seen that increase in the non-traditional labor expenses.

Joel Mendes:

And by non-traditional labor, you're referring to expenses that go towards anything labor-related that's not specifically paying someone?

Jerry Taylor:

Correct, correct. Anything outside of that traditional hourly wage that somebody's providing hands-on care.

Joel Mendes:

And recruiting is in this, of course.

Jerry Taylor:

Yep.

Joel Mendes:

And the compound annual growth rate of recruiting due to the increase in turnover over the last three or four years was 14% in one of the prior slides.

Jerry Taylor:

Correct. And so again, another non-traditional... I'm struggling up here. The next one, non-traditional, is just pre-employment expenses. With that same turnover and retention, there's time and money that goes into training, pre-employment testing, certifications, whether it's CPR or other state-mandated certifications, as well as other regulatory requirements that may be outside. So, when you are, on an annual-basis, hiring three to four times what you were five years previously, that's going to have an impact.

Jerry Taylor:

I promise this is not an all grim panel. Chris has got a lot of exciting stuff. So, I hate that I'm sounding like the negative guy at the moment, but we've got some other good stuff.

Christy Stone:

We're counting on you.

Jerry Taylor:

Yeah, we're counting on Chris.

Christy Stone:

Bring the sunshine.

Chris Wettig:

Don't.

Jerry Taylor:

We're counting on Chris.

Joel Mendes:

Pull it all together.

Jerry Taylor:

Overtime and agency. So really, as those underwriters, with that same hat that Joel talked about, it's making sure that we dig into the right places to understand where that acquisition is currently today.

Jerry Taylor:

Chris is going to give some great stories about taking an asset from that low margin situation and creating that upside. But I think, as potential investors and underwriters, getting a clear picture of the day is really important. Digging into those payroll registers and understanding exactly how much overtime are we running? Digging into previous invoices and understanding how much agency have we been paid in the last 24 months? And painting that accurate picture on the front end, if you go and make an acquisition that's operating at 50% overtime, with 30 shifts a month of agency, and you underwrite to a zero sum when you take over that acquisition, you're setting yourself up for failure. It doesn't mean that we're not going to scale it down over time, and say, "We think we can make an impact and take that overtime to 3% instead of 15%." But if you're not capturing the accurate numbers as that community is currently operating, you're leaving yourself up to be hurt.

Joel Mendes:

So Chris, in terms of overtime and agency, they're both filling a gap where you'd much rather have a full-time or regular employee in that role. Can you talk about which is preferred? It's kind of obvious, but I'd still like to hear it, as well as what information you actually request when you're looking at a new opportunity as to how the current operator is doing in this regard. And what is acceptable from an overtime and agency usage perspective, just given the frictional nature of the business?

Chris Wettig:

Well, certainly we'd rather pay overtime at time and a half, on a $14 an hour caregiver versus paying agency $28 an hour, and having somebody that doesn't know the residents. You might get one contract worker in on Monday, and get a different one in on Tuesday. And so, there's no continuity with the residents, and the knowledge that it takes in order to care for the residents on a day-to-day basis.

Chris Wettig:

So certainly, overtime is preferable over agency.

Chris Wettig:

What was one of the other questions, Joel?

Joel Mendes:

Well, I think... Just to reiterate what you just said, if you're looking at a financial statement and you might see OT, which in this circumstance stands for overtime, as opposed to occupational therapy. Sometimes it is. And there's a number there. The next thing that I would do is I would go down and try to find... to see if there's a corresponding agency usage number. Because overtime is the first line of defense, and then comes the agency usage.

Joel Mendes:

The second question is what's an acceptable amount of either of those?

Chris Wettig:

That's kind of on a case by case basis. It's hard to say what is acceptable versus not acceptable. We've got, out of the 41 communities that we operate today, probably five or six that are utilizing agency labor today. And those aren't the same five or six that were using agency labor three months ago. So, we'll go in and attack a problem where we've got agency usage, and it might be an issue where the resident director's not utilizing the applicant tracking system appropriately. So, that we've got plenty of applicants, but nobody's working those applicants. So, that's one of the first things that we'll do. We'll do the job fairs that Jerry talked about, are very effective in trying to fill those positions.

Chris Wettig:

One of the things that I think is also important to understand is that if you're going to hire an agency worker to fill the position, oftentimes those agencies will charge a fee of-

Christy Stone:

A fee. Sure.

Chris Wettig:

A placement fee of anywhere from three to $5000. So, you'd rather not have to pay that, and go outside and find the people on your own.

Jerry Taylor:

The only other thing that I would add to that, and I think like you said it is on a case by case basis. And I think as an operator we generally never budget overtime and agency. We don't want to set a culture of precedent that we're open to that concept. But I think as investors, there's a different cap on, and there's the ability to be more accurate in your underwriting and say, "Hey, in Christy's portfolio, are there any communities that operate with zero overtime all the time?" And that's probably not realistic.

Christy Stone:

Not realistic at all.

Jerry Taylor:

Yeah. It's okay to kind of wear those two different caps of the operator cap and the investor cap and painting two different pictures, because there is things... When executive directors are seeing allocation for overtime, you kind of set a precedent that that's expected and kind of anticipated, even though culturally you're not really trying to instill that.

Chris Wettig:

Five years ago, we didn't budget anything for overtime. And today, it probably represents about 1% of the total payroll spend.

Joel Mendes:

Interesting.

Christy Stone:

It's significant.

Chris Wettig:

Mm-hmm (affirmative)

Jerry Taylor:

[crosstalk 00:25:57] next slide... I apologize. Staffing ratios. So, this is a very high, upper-level slide here. I think the goal was as an underwriter, when you're looking at these types of models to better understand what are realistic staffing ratios. Every operator is different. Let's just start and preface that. We wanted to put these ratios in here as a little bit of a heartbeat, if you will, so that you could understand them as that investor piece and that underwriter. But like I said, everybody's going to be little different.

Jerry Taylor:

As an industry, I think the average staffing ratios for assisted living are kind of that 1:12 to 1:16 number. And like I said, there's a lot of different variables that go into this. But I think as an underwriter, having this in your head would be a good starting point, and then spending some time with your operator to better understand what their viewpoint is and what their position is.

Joel Mendes:

So, let's walk through this a little bit.

Jerry Taylor:

Please.

Joel Mendes:

Assisted living, 1:12 to 1:16. The one is the resident.

Jerry Taylor:

Correct.

Joel Mendes:

Right?

Jerry Taylor:

Correct.

Joel Mendes:

The 12 is what?

Jerry Taylor:

No, I'm sorry. The 12 is the...

Joel Mendes:

[crosstalk 00:27:03]

Chris Wettig:

There you go. Yeah.

Joel Mendes:

The 12 is the resident; the one is what?

Jerry Taylor:

The one is the caregiver.

Christy Stone:

The caregiver.

Joel Mendes:

The caregivers.

Jerry Taylor:

So, generally these staffing ratios is going to be in the clinical model. So, this is not necessarily representative of dining staff, housekeepers, other things like that. This is going to be your onsite, hands-on care. Med techs, caregivers. Kind of that 1:12, 1:16 staffing ratio in assisted living; 1:6 to 1:8 in memory care; and then that kind of 1:4 or 1:6 in your skilled nursing.

Joel Mendes:

Now, is that an average across the 24 hour day? Or is that based on any given shift?

Jerry Taylor:

I would say that would be an average across the day. Obviously, your overnight staff is going to be different, particularly from a regulatory perspective. The requirements are going to look drastically different when the majority of the residents are asleep. But when you're looking at that underwriting model and staffing schedule for your typical first-second shift waking hours, these would be the ratios you would look at.

Joel Mendes:

Okay. So, you would request a staffing schedule?

Jerry Taylor:

I absolutely... If I'm underwriting, I would like to know exactly what's going on at that community, exactly what those staffing schedules look like, top to bottom: clinical staff, housekeeping staff. And one, that's going to allow you to make sure that your underwriting is accurate; but two, it's going to allow you to understand what does the day-to-day look like. Are we utilizing a universal worker that does laundry, housekeeping, serves, and the caregiving, where in that case your ratios are going to look

drastically different because their workload is so drastically different? Or do we have designated caregivers that do only hands-on care, and those other pieces?

Jerry Taylor:

So, better understanding of the staffing model is just going to make sure your underwriting is that much more accurate.

Joel Mendes:

So, you'll get the staffing schedule; you'll add up the employees that would fall into clinical staffing ratios, some of the positions you mentioned earlier; and then factor in shifts, and then divide that into the number of residents.

Jerry Taylor:

Yeah. So, generally what you're going to see in your underwriting, particularly if you're dealing with a quality operator, is you're going to get that full schedule for every department and it's going to lay out very clearly first shift, second shift, third shift, and you're going to be able to make that directly correlate with the current census of that community.

Joel Mendes:

Okay. Makes sense.

Chris Wettig:

And even beyond that, not only looking at the census, but looking at the care level of the census and the population-

Jerry Taylor:

The acuity.

Christy Stone:

The acuity

Chris Wettig:

... has a lot to impact in the number of hours that are required.

Jerry Taylor:

That's 100% right. So, kind of building off of that, that's the first and foremost, right? If we are in an AL model with extremely heavy care, and that acuity is extremely high, those staffing ratios may be even lower than what we saw on the slide previously. Vice versa, if you're in an IL/AL, where you are in a very much an AL light, and you're only providing meds and less hands-on care, that staffing ratio might be higher. So, I think acuity is huge.

Jerry Taylor:

The concept of universal workers, and then regulatory requirements, is the last thing. A state like Nevada requires a 1:6 staffing ratio in memory care. It's an uncompromised situation. If a state regulator

walks in and you have less than 1:6, it's a tag. So, you have to be cognizant of what the regulatory requirement looks like in every state as you're looking at those ratios.

Jerry Taylor:

The last one is this, and I may default to both Christy and Chris on this one, but this concept of physical plant. How does the physical plant actually impact the staffing of that community? When we're talking about these urban infill high rise locations across multiple floors, are those staffing ratios realistic? If somebody's got to cover two floors, do they have the ability to do that and take care of that?

Jerry Taylor:

Same thing from a census perspective. If you have a long first floor community, and you're only 50% occupied, and you've got staffing and residents all over the building, can that 1:12 work in that setting?

Jerry Taylor:

Other thoughts: cottage style, which I know a lot of people can speak to. Other thoughts on physical plant?

Christy Stone:

Well, and I think just looking at the efficiency of the design, and the flow, and being really conscious of how the work processes fit in the work environment. And does that create some efficiency where maybe you need less people, or does it lend itself to you needing more?

Jerry Taylor:

Yeah, absolutely.

Joel Mendes:

I'm of the opinion, and I could be wrong, that this particular matter, it's unrealistic to expect that an investor would be able to understand physical plant and staffing in the way that it needs to be understood. I would guess that this is something... And Christy, maybe correct me on... you guys have a huge portfolio, so maybe Welltower is different..that would be discovered by asking questions of the operator.

Christy Stone:

Right. Right.

Joel Mendes:

But it's important to know how to ask those questions, and what those questions are. But I wouldn't expect an investor to be able to understand how the physical plant, particularly stacked urban settings, is appropriately staffed. But I don't know, am I wrong, Christy?

Christy Stone:

We're getting smarter about that. And as we have two high-rise buildings that will come online in New York in the coming months, I think we're going to learn about that. So, we have some hypotheses based on our current measures and our metrics around resourcing in more traditional or campus-like buildings,

more suburban buildings, and we're going to apply that with some adjustments to the high-rises, and probably adjust from there.

Joel Mendes:

Let's look at this building here. If you had this building come across your desk, what questions would you ask your prospective operating partner?

Christy Stone:

I would ask them how are they adjusting their current staffing levels, or their historic staffing levels, to accommodate for the difference in design? And then we also have kind of a proprietary staffing model that we use. You talked earlier about not just applying data analytics to the competitive market set, but also applying it to the employee base. And one of the things we do across our portfolio is we have measures on optimal staffing levels, and that's by market, and that's by community mix. IL, AL, and memory care. And so, we would take those and apply them based on the design of this particular building. And then given the multiple floors, we'd ask what hypotheses the operator had for how they were adjusting that, how they were factoring that in, and then we would compare that to our analysis.

Joel Mendes:

It would be interesting if over time you started adding more and more different categorizations of physical plant.

Christy Stone:

Correct. Correct.

Joel Mendes:

But that just means someone's entering all those in. But I think that'd be a neat tool.

Jerry Taylor:

And Joel, I think a really great... I think that's a great question, and I think Christy addressed it super well. And sometimes it is hard as an investor to be able to identify those. But other times there's some screamers, right? Let's say you're in a four story building and all the laundry's in the basement. Is it realistic that a caregiver is going to be able to manage a resident's laundry in the basement while covering a floor and answering call buttons?

Christy Stone:

Correct.

Jerry Taylor:

Right? So it's kind of... There are some times, and no offense to developers, that things happen and that are a little bit crazy that do stand out like that. That will have an impact on those ratios.

Chris Wettig:

And we learn a lot just from observing during the underwriting process and watching what's going on in the building throughout the day.

Jerry Taylor:

Good and bad, right?

Chris Wettig:

Right.

Jerry Taylor:

Inefficiencies and efficiencies.

Chris Wettig:

Correct.

Christy Stone:

Well, I'm thinking about in terms of the access to medicine and access to supplies. What is that like? How close in proximity is it? Those types of things. You're right, there are some very obvious red flags, and then there are others in terms of... We have a resource that really looks at process flow and efficiency, and we may pull her in to take a look at how work is being done versus how it could be.

Jerry Taylor:

Sure.

Joel Mendes:

So Christy, when you guys are looking at a new operator, or a new opportunity, how do you assess the operator's competency with respect to labor?

Christy Stone:

We take a really close look at it, and it's fun for me now to have shifted over to the relationship management side given that I spent the last 10 years really looking at workforce issues in our company and across the portfolio. We have a really robust investment committee process that has three steps, based on the size of the opportunity and where it is in the process.

Christy Stone:

So first, all of the different relationship teams and investment professionals will look at opportunities and analyze them at a certain level of depth in terms of potential performance, the real estate, and also the labor costs. And as we progress through that process and vote on the opportunities at the next level, the ultimate one is at our board level if it is an opportunity of a certain magnitude, we're looking at labor in increasing levels of depth, starting with the senior leadership team.

Christy Stone:

So, we look at it very intensively.

Christy Stone:

So, when we think about how workforce and labor impacts performance, we really look in three categories. One is the depth and the quality of the leadership team; two is the depth and quality in the

composition of the team throughout the organization, down to the community level; and then finally the infrastructure that supports the workforce, or the labor, across the portfolio and at the community level.

Christy Stone:

So, if we start by looking at the depth and the quality of leadership, we're really looking at three things. The experience and the track record. Who is at the helm of the organization? How long have they been there? Where did they come from? What's their track record of performance? How much confidence do we have in their ability to manage the quality first and the cost of providing care?

Joel Mendes:

So, to be clear, you're referring to the C-suite of the operator?

Christy Stone:

The C-suite of the operator, absolutely. And so, that's where we start. We take a look at that, particularly given that increasingly we're entering into joint venture partnerships. These are people that we'll be working with very, very closely, where our success, our financial success, is tied inextricably.

Christy Stone:

So, we really get to know that team at a pretty deep level, and then we look at the structure of the organization. So, beyond corporate and the C-suite, how is the organization structured? What is the leadership like at the community level? What's it like at the regional level? And then how are resources assigned inside the community? And we'll pay attention to what is the tenure? The tenure and longevity. What is the productivity of the resources at the sales and marketing level? How long have people been there? What does turnover and retention look like?

Christy Stone:

We went through an exercise a few years ago that I had the opportunity to work with Chris and others on where we recognized that there were so many different definitions of turnover and retention across our portfolio. So, we pulled together a working group and came up with a common definition of turnover and retention, and asked all of our partners to report their data in that fashion.

Christy Stone:

So, we'd look at the workforce measures at a very deep level, and we're looking at what is the longevity and the retention of people in those key or core roles? And then what is it across the organization and at the community level so that we can begin to shine a spotlight on what's going really well and shine a spotlight on those areas where some additional support is required.

Christy Stone:

And the other area we really look at is the culture. Leadership drives culture, and this is ultimately a people business, and so much of the workforce that we've talked about is working at a minimum wage level. How do you find leaders that are creating an environment where people really care about what they're doing, where they'll provide that discretionary effort, and where they're able to deliver the vision and the values of that C-suite level? How is that translating from the boardroom of the operating organization down to the community level? And what does that look like?

Christy Stone:

So, we'll ask questions about are people... What are they doing from a culture perspective? How do they define it, how do they reinforce it, and how are they measuring it?

Christy Stone:

So, those things are important to us.

Joel Mendes:

So, let me ask you this. We didn't talk about this before the panel. What amount of this goes into the investment memorandums within Welltower?

Christy Stone:

At different levels in the process, there will be more intense focus on each of these.

Joel Mendes:

But will you have an investment officer write about culture in the presentation that goes to the board?

Christy Stone:

Yes.

Joel Mendes:

That's fascinating.

Christy Stone:

Yes. So, the formality of how operators are thinking about each of these things matters because what that's showing us is what is the level of consistency? What is the level of professionalism and consistency across the organization? Because what we've seen is that you have very focused, very committed, very passionate founders; and then as the business grows, you reach a certain tipping point where the founder or the leaders can't touch every building. They can't touch every ED, or every sales director. So, you really have to have kind of institutionalized what that culture looks like so that you're seeing that consistent translation across the organization, and so that you're hiring people who reflect that.

Joel Mendes:

So, if you were to summarize in a sentence or two what a good culture write up that goes to your board would sound like, what would it sound like?

Jerry Taylor:

Not a sentence or two.

Christy Stone:

I think there would be a high degree of synergy between what the leaders espouse and what's practically delivered at the community level; and you would see a higher level of consistency community by community.

Joel Mendes:

Got it.

Christy Stone:

So, we would rather take a less sophisticated physical plant and a really strong team than a state of the art building and a mediocre team. I mean, ideally, we want both. That's what we're all aspiring to. But given the choice, the quality of that team and the quality of the people, that's the difference maker. That's the secret sauce in this industry.

Christy Stone:

So, if we shift and look at the depth and quality of the team, and the compensation is a key part of that. There's the recruiting and retention piece that we've spoken about. There are progressive benefits. What are some of the innovative things that people are doing to make it more desirable for people to join an organization and ultimately to stay there? And whether that's removing obstacles to getting to work, like transportation, or if that's looking at benefits that really truly improve the quality of life of the worker. These are things that we're looking for. And then to the staffing levels, I think the metrics that Jerry shared are a really good rule of thumb, recognizing that in every market there may be some nuances.

Christy Stone:

So, from a recruiting and retention standpoint, I think what we recognize is ours is a labor force that is increasingly challenged. It's challenged from a wage perspective; it's challenged by where we are with unemployment; and when you forecast forward, you look at varying numbers that say by 2025 we could need between one and two million workers additional to what we already have. That's not factoring in the turnover. So, we've really got to look at how are we cultivating the workforce as an industry and as organizations.

Christy Stone:

So, where are organizations creating early career talent pools? Are there internships? Are there relationships with community colleges and local high schools where you have a theater of volunteers and potential workers?

Christy Stone:

What kind of referral programs are in place? Rather than pay agency, or pay a recruiter, or pay recruiting fees, can you leverage people in your workforce who are already enthusiastic about your company and about your community to bring like-minded people to the table? Those folks will be invested in the people that they refer, which benefits everybody.

Christy Stone:

Predictive analytics. So, are organizations using technology to help them hire better and smarter? Arena is an organization that a number of our partners are using, and it is really reducing turnover. It's helping them hire smarter, hire to a profile that better aligns with the kind of worker that's going to stay and really thrive in an organization's particular environment.

Christy Stone:

We've talked a lot about competitive wages. It's a necessity. It's a requirement. And we have partners and prospective partners that are thinking about "How do we hire at a higher level knowing that we may have to pay for it? But we may need fewer people across the management level of the organization." So, thinking very differently about that.

Christy Stone:

And then we're seeing a lot in the way of progressive benefits that improve the quality of life of the worker, and I'm going to talk about those. A number of them are coming out of health systems which are trying to recruit the same types of workers, but also experience the pain at a larger scale, given the size of their workforce.

Christy Stone:

So, one health system, Loretto, reduced turnover among their CNAs, their home healthcare workers, and their LPNs by implementing a few programs that were focused on how do they improve the quality of life of this population. So, on the transportation front, how they educate people about how to buy cars, and how to build credit, and how to go about obtaining financing, and doing that in a way that is realistic and sustainable for that professional. Offering a free diaper bank and a free clinic for children of workers. Prenatal care, and then educational subsidies around getting certifications, around student debt forgiveness, and really looking at how do you invest in people so that they stay with you longer.

Christy Stone:

Both the Cleveland Clinic, and Catholic Health, and Ascension have also implemented workforce coaching, where they have counseling resources or coaching resources that are providing objective feedback on helping workers with job and personal challenges. And Ascension in particular has seen for their in-hospital nurse aides this type of support lower turnover by 20%. And the chief nursing officer said, "This is just a win across the board. We're making a meaningful difference in people's lives, our employees' lives." And they're seeing turnover plummet as a result because they're no longer competing solely on the dollars per hour with other employers in the region. There are other meaningful benefits that are being offered to their people that are making a difference in their lives.

Chris Wettig:

One of the things, Christy, that you mentioned that the need of anywhere from one to two million new workers over the span of the next eight to 10 years, one of the things that we see in our company is a tremendous amount of turnover in the first 90 days.

Christy Stone:

Right.

Chris Wettig:

And part of that is because we are attracting a new worker into this industry who hasn't been there before. So, one of the things that we are doing today are creating videos of a day in the life of a caregiver-

Christy Stone:

That's smart.

Chris Wettig:

... to show these people what it looks like, rather than having them show up and then the first day or two decide that that work is not for them. So, that's one of the elements that we're implementing and we'll be using in 2020.

Christy Stone:

That's great.

Christy Stone:

And then in terms of optimizing staffing levels, I talked a little bit about this. So, we have a proprietary staffing guide that takes some of those benchmarks that Jerry shared and really tailors them based on what we've seen across our portfolio over the years that we've been working in senior care. And we take that staffing guide and we apply the Bureau of Labor and Statistics' labor rates. And what that really tells us is what is the optimal staffing mix and the daily labor cost, by market, and by IL, AL, and memory care mix. So, we get that staffing detail and the daily labor costs for IL, for AL, and for memory care, and then based on a particular community and portfolio, we apply the right rates, the staffing level and the wage rates, to get an aggregate number, and then we extrapolate that across the portfolio. That gives us a real view of where we think, based on our experience, those wages and staffing levels should be, and then we compare what we're getting from the potential partner in the process. And that tells us where is there opportunity to be more efficient, more effective, et cetera.

Joel Mendes:

So, how often does this produce a result that shows that the existing operator is paying too much for labor or underperforming in this regard?

Christy Stone:

I'd say probably about 20% of the time.

Joel Mendes:

But 80% of the time this produces a result that is somewhat consistent with the existing operations?

Christy Stone:

Mm-hmm (affirmative). And just as important as the result that it gives us is it creates a discussion around how are you approaching this? So, it allows us to get into a different level of depth around the philosophy and the strategy that our partners or potential partners have around their labor.

Joel Mendes:

Well, it sounds like you guys are being realistic about it.

Christy Stone:

Yeah. We're trying to bring more science to the decision-making process, from a market perspective, from a competition perspective, and then from a labor perspective. But what we recognize is there's both the art and the science. So, the operator is the one that has the boots on the ground and knows the market in much greater depth.

Christy Stone:

I just had this conversation with a health system last week. We brought some data to the table that talked about the market and the physician staffing levels in that particular market. Well, the CEO of that health system had been a physician that practiced in that market for 15 years. So, we were able to combine our data with her experience, and we got a much better answer than we would have if we had relied only on one of those sources of information.

Christy Stone:

So, from an infrastructure perspective... And I'll click through this really quickly because Chris has so much perspective to bring in the case he's going to show. But how formalized is functional leadership? So, when you look at an organization, do they have a dedicated HR or human capital function? Do they have dedicated leadership in key functions that really drive the consistency of programs and performance across the organization? What are leaders focused on from an accountability perspective? And then what technology is in place in terms of supporting the workforce? So, applicant tracking systems at the front end of the process. How are we reducing the administrative burden of managing people so that you can spend more time in the business rather than on the business? So, whether that's using predictive analytics from a hiring perspective, whether that is using OnShift from a staffing perspective. So, looking at the technology, and are you managing your workforce data in an employee tracking system, or are you still managing it from a spreadsheet perspective?

Christy Stone:

And I think one of the things we learned when we assessed all of our partners on their level of sophistication in this area was probably two years ago. We had three partners of substantial size that were managing a lot of their employee data still primarily in spreadsheets. And that's something that you just... You got to move away from as you grow. And when we look at new operators, are they putting those foundational systems in place in their infancy as an organization so they're positioned to grow? Because it's a lot harder when you have a more complex organization to go back and try to implement that.

Joel Mendes:

No, I think that's a great point. And part of what we're going to hear Chris talk about right now is moving from spreadsheet to sophistication, and not just in terms of how that makes things easier, but it has a real financial impact.

Joel Mendes:

So Chris, if you wouldn't mind just setting up the deal that you're going to talk about. How'd you find it? What's the condition of the property? And just walk us through what you guys were able to accomplish.

Chris Wettig:

Sure. So, we knew with our geographic footprint that we ultimately wanted to be in Colorado. It was a neighboring state to where we operate and are headquartered out of in Kansas. Typically, we like to go in and try and find an acquisition opportunity as opposed to building from the ground up any time we enter a new market.

Chris Wettig:

And so, we came across this property. It wasn't on the market. They also had some land in addition that they'd gone out... They were a smaller 10 unit operator that had... These 10 communities were in six or seven different states. So, they were spread pretty thin. Not a lot of sophistication. And we were able to work out a deal where we acquired this existing community that was 71 units of assisted living and memory care, in addition to a land contract that was in place that we were able to go in and execute on, and then develop a new community.

Chris Wettig:

So, that's how it all came into being. But one of the things that we look at in any type of an acquisition is we go in and dig through the P&L, line item by line item, and certainly labor is the biggest component on the expense side in the P&L. And so, that's one area where we spend an awful lot of time and due diligence in looking at.

Chris Wettig:

But the total payroll-related expenses, everything all inclusive, for this particular opportunity was 46.9% of total revenue. And it was 71 units. And we looked at comparable communities of size and unit mix in our existing portfolio, and we ran between 37 and 39% total payroll-related costs. So, we knew that... We thought there was an opportunity. We had been successful in some previous acquisitions in going in and implementing some of the systems and procedures that we utilize in our company that weren't in place here that enabled us to do that. So, we felt pretty confident in the ability to do that.

Chris Wettig:

One of the things that you need to understand too is that there's no silver bullet. There's no magic pill. It's a host of different things that all collectively, put together, end up achieving the result that we want to achieve. And it isn't something that on the day one, after the transaction's consummated, that you go in and implement 15 things. It's a period of time because our mindset is that we want to keep the existing workforce in place. We don't like to see a lot of turnover. And so, if you throw a lot of things at people, they tend to get pretty frustrated, especially when you're talking about change.

Joel Mendes:

So Chris, if you wouldn't mind, just real quick, in terms of what's in that 46.9%... You came across this deal; you got a financial statement that was like yay long.

Chris Wettig:

Right.

Joel Mendes:

And payroll, wages and benefits, those are obviously in there. We talked about pre-employment, so training and orientation. We talked about recruiting. We talked about overtime. We talked about agency. Is all of that in the 46.9?

Chris Wettig:

It is. Worker's compensation expense; benefits; employee incentives. Just everything all combined created 46.9.% of their total cost.

Joel Mendes:

Got it.

Chris Wettig:

So, over the course of a six month period of time, we were able to take what was 46, almost 47% of the total cost of the business down to about less than 39%. And when you talk about a building that was 100% occupied when we acquired it, there wasn't a lot of opportunity on the top line that we could go in and create. So, it was maxed out from that perspective. So, it was a lot of different things that we did over that course of six months that enabled us to achieve those results. But when you're talking about a community that was generating $3.8 million dollars of revenue, that magnitude of savings was a little over $300,000 dollars of total costs that we were able to strip out of that existing community. And $300,000 on a seven and a half cap is over $4 million worth of value.

Christy Stone:

Yeah, it's a meaningful pickup.

Chris Wettig:

So, it's pretty impactful.

Chris Wettig:

So, one of the things we did was that they weren't using... As Christy mentioned, they were using Excel spreadsheets to track and schedule their labor. We've got an automated labor scheduler in place that we utilized and rolled out, and that was one of the first things that we did. And it's got tools that enable people when they call off, that it'll send out a text message to the other caregivers that they can respond to and pick up a shift, as opposed to having a healthcare director or a resident director pick up the phone and call five different people to try to fill a shift.

Chris Wettig:

So, some of those things are just really important tools that have helped us over the course of time.

Chris Wettig:

Flexible scheduling with the workforce. So, they had a lot of full-time people, and they were generating a lot of overtime. And when they would lose a position, they weren't able to fill that, so they were bringing in agency staffing to do that. We like to see our workforce kind of on a 60/40 split, with 60% full-time equivalent employees and 40% part-time. And that gives us the ability to fill these shifts a little more effectively, as opposed to what the previous operator was doing.

Chris Wettig:

Scheduling based on the number of residents and the resident care levels is an important element that this scheduler allows us to do as well.

Chris Wettig:

So, we were able reduce, just from the direct care staff, $107,000.

Joel Mendes:

So, in terms of implementing that software system, what type of resistance did you get from onsite staff that are just accustomed to doing something else?

Chris Wettig:

They accepted it with open arms because it was the technology enhancements and improvements enabled them and their lives to be a lot more capable of filling shifts and...

Joel Mendes:

This was taking the spreadsheet that was on the wall and putting it into their personal mobile device.

Chris Wettig:

Exactly.

Joel Mendes:

I can see why they would like that.

Chris Wettig:

Another thing that we did was eliminated redundancy in administrative positions. They had an administrator position for both the AL component of the business and the memory care component of the business. We don't operate with that. We've got one executive director for the entire community. And so, we were able to reduce a position with that.

Chris Wettig:

They had also an office manager and a receptionist position that we typically don't have in any of our communities. We do a lot of the back office processing out of our home office. And so, we eliminated the need to have that higher paid position, and then replaced it with what we call a customer service associate that handles a lot of the administrative duties on a day-to-day basis, but at a much lower rate than what they were paying. And we were able to strip out $40,000 in labor by doing that.

Chris Wettig:

Some of the things in terms of staffing to improve the resident experience, Jerry talked a little bit earlier about the universal worker, and we operate with that mentality that we use our caregivers to serve our residents in the dining room. We don't have a separate dietary employee that would come in and serve the meals. We want the people that are taking care of the residents on a day-to-day basis, that know them better than anybody, know their dietary needs and wants, to serve them in the dining room. And so, we were able to reduce $51,000 by doing that.

Chris Wettig:

At the same time, we also look at programing for life enrichment. And in this particular situation, they didn't have the extensive programing that we like to see in our communities, and as a result we added a position in this community and added $40,000 in order to do that.

Chris Wettig:

Being a larger company that we were and they were, they didn't have a health plan in place for any of their associates. But what they were doing was giving a stipend, whether their people required health

insurance or not. So, anybody that's under the age of 26 is able to participate, typically, in their parents' health insurance benefits, and regardless they were still getting a stipend if they were still participating in their parents' health insurance benefits. So, that was just lost money.

Chris Wettig:

More options for the associates. As opposed to just having one health plan, we like to give them a breadth of choices to fit their needs. And when you do that, you can help reduce your costs as well.

Chris Wettig:

Enhanced training and workforce development. They were outsourcing all of the training needs and the certification that was required in the community, and we do that all in-house. We've got a associate advancement and development department that does nothing but work on training and development in the company. And so, we brought that in-house. And at the same time, we enhanced their paid time off benefits and gave them a more lucrative plan. And by doing that we were able to reduce turnover and just create a more satisfied workforce.

Joel Mendes:

Thanks, Chris. That's an amazing story.

Joel Mendes:

Jerry, a question for you before we open it up to the audience. Most of what Chris described is designed at the corporate level, but implemented at the community level; and at the community level by the executive director. Talk about how you incentivize and motivate an executive director to do things differently and to manage personnel to a bottom line. A lot of times the occupancy and the rates are very obvious, but the bottom line in personnel management isn't.

Jerry Taylor:

Yeah. So, I guess a couple of initial thoughts, and one is going to go right to Christy, which is on the culture piece, right? As an executive director, you have to feel the support and have that developed relationship with your corporate structure and with your team to have the buy-in that's going to allow you to take everything that Chris is trying to put down at the community level and get that fully implemented. So, I think that's certainly the first part, is feeling that support.

Jerry Taylor:

I think secondarily is trying to educate that executive director and figure out a comp structure that works, where instead of just filling a position they are investing in that bottom line and in that income statement. And there's been a lot of different people across the industry that have made a lot of different attempts to that. There's some guys that have been really, really successful in the skilled nursing side in aligning that executive director with that bottom line in having target NOI bonuses and structures based on that.

Jerry Taylor:

And so, I think in addition to the culture piece, if there is that alignment with that executive director to understand the importance of that income statement and how that drives the real estate play in giving them an opportunity to participate, even if it's at a very small level, that ownership is huge.

Joel Mendes:

So, when you were at NHI, you guys looked at lots of deals there. You've worked at some of the larger operators in the country. How often would you say that an executive director at the community level is incentivized by the bottom line in terms of their take-home pay?

Jerry Taylor:

I would say the majority of operators today in the discretionary bonus structures are at least having conversations about percentage as opposed to budget. So, I think operators have gotten much more sophisticated that in those discretionary pieces they are identifying both an occupancy bonus as well as an NOI bonus.

Christy Stone:

I would agree with that.

Chris Wettig:

Yeah, we operate under that structure in our company today.

Joel Mendes:

So, we have seven minutes left. We'd like to open up to the audience. If you guys have any questions, there's this thing, which... What do you call that?

Speaker 5:

Catchbox.

Joel Mendes:

Catchbox. There's a microphone in there.

Chris Wettig:

Whoa!

Joel Mendes:

It's a...

Jerry Taylor:

It works.

Joel Mendes:

Andrew invented it. Andrew invented that box.

Christy Stone:

[inaudible 01:06:49]

Speaker 6:

I saw up there the Welltower proprietary staffing guide. Can you talk about what kinds of things are in there? Are they similar to the best practices that we heard from Legend? Or what kind of things go into that?

Christy Stone:

So basically, if you look at the ratios that Jerry put up, the caregiver to resident ratios, we've built those based on what we've seen across our portfolio over the years. So, we've taken that and we've really tailored it in terms of what are we seeing in our best performing communities across the portfolio. And then how do we take that and use that to help us evaluate other opportunities?

Christy Stone:

So, it becomes our benchmark. And there may be very viable reasons that someone is over or under in various areas, but at least presenting the data is giving us a place to start that conversation and to have a better understanding, a more substantive understanding, of how people are approaching staffing and compensation.

Joel Mendes:

Do you guys have standardized reporting amongst all of your operators?

Christy Stone:

Yes, we do. We do. So, we have a portal through which our operators plug in all of their financial information, and increasingly their workforce information as well. So, that proprietary model is continually getting smarter and being refined by the data that we see.

Joel Mendes:

And do you guys break it down by quartile? I would be interested. Like this is what the top quartile, so we don't expect this out of everyone.

Christy Stone:

We did that. That's a great question, and we did that from a turnover and retention standpoint. Don't know if we're doing that from a workforce and compensation standpoint. But I'll follow up on that. It's a good question.

Speaker 7:

Can I ask a follow up? Payroll as a percent of total revenue, what do you typically see as a good operator?

Christy Stone:

So, I was curious about your numbers and the total cost. So, we look at payroll, but we also look at the total compensation cost. So, that 38% number was very compelling. I think we tend to look around 30.

Joel Mendes:

Just to give some perspective-

Christy Stone:

[crosstalk 01:09:13]

Joel Mendes:

... on the new development deals that we look at, that number two, three years ago was about 31%, and now it's closer to 35%.

Speaker 8:

So Christy, you talked about wanting to work with operators that have synergies between what the top wants and their intentions, and what's practically applied. What's an example of something that you've seen in an ideal world that tactically has happened?

Christy Stone:

So, it's interesting, there's the whole concept of "walking the talk", and there is the sense of what leadership says and what practically happens at the community level. So, I think the best example of that is really around values and performance, and how that is implemented.

Christy Stone:

So, it's one thing to talk about that at a corporate level, and it's another to really manage that on a day-to-day basis. So, if you take the goals that are set at corporate, how do you cascade those down to the community? How do they track them? How are they living the values?

Christy Stone:

We were in a community not long ago that actually had their whole scorecard posted in the middle of the building so that everybody could see it, so that all of the employees and all of the families knew what were the important measures in terms of satisfaction. What were the compliments or the positive feedback that they were hearing? What were the suggestions they were getting? So, how are they creating that connectivity among the workforce and what the corporate entity is tracking?

Chris Wettig:

One of the things that we saw in the restaurant business relative to that is that you often hear the term "act like an owner".

Christy Stone:

Right.

Chris Wettig:

And in theory, that sounds easy; but in practicality, it's very difficult. And so, what we did in one of the companies that we took public was we granted stock options to all of the general managers from each of the restaurants. We had eight restaurants when we went public in 1992. And over the course of the next two years, those $50,000 worth of stock options were all well worth over a million dollars for a restaurant and general manager whose average annual salary was about $50,000.

Chris Wettig:

Outback Steakhouse was another company that used a terrific model that we're toying with implementing in our company. They required all of their general managers that worked at any of their

communities to invest their own money, $25,000, in order to assume that position; and that gave them in exchange a 10% interest in the profits of that restaurant. And what you got from that was somebody that wasn't looking for another job. They were invested. They stayed there. Their turnover was lower, and they were an owner.

Christy Stone:

Well, talk about alignment of interests.

Chris Wettig:

Yeah.

Christy Stone:

Pretty profound.

Christy Stone:

I also think driving that consistency. So, an example, when I was in the consulting world, one of the things we did with a large retailer... And this'll date me, but we literally produced planners, physical planners, for every store manager that blocked out by the week and by the month what were the focus initiatives and what were you doing in terms of focusing on the goals? What were you doing in terms of focusing on the customer? How were you engaging your team? What were you doing from a merchandising standpoint?

Christy Stone:

So, trying to really create... and a Day-Timer may not be practical in today's day and age. But how are you packaging the programs and the expectations that you have from a corporate level and getting those to the community so that the executive director doesn't have to figure out how to implement it on his or her own? So that you're taking these concepts and really making them kind of plug and play, so that the executive director can implement them, and engage their workforce, and drive the consistency that corporate is looking for without a lot of brain damage on how to make it happen.

Joel Mendes:

Makes sense.

Joel Mendes:

Well, we are out of time. Thank you all for being here.

Christy Stone:

Thank you.

Joel Mendes:

I hope you took away some nuggets of wisdom, and look at financial statements and staffing schedules a little bit differently.

Joel Mendes:

Thank you again. Thanks to all my panelists as well.

Christy Stone:
Thank you.