Financial Guidelines for Long-Term Care Home Licensing Applications

Performance Improvement and Compliance Branch,
Ministry of Health and Long-Term Care

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Ontario

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Introduction

Overview

The Financial Guidelines for Long-Term Care Home Licensing Applications (the "Financial Guidelines") have been produced to assist long-term care ("LTC") home licensees and proposed purchasers[1] in the identification and preparation of materials required by the Ministry of Health and Long-Term Care (the "Ministry"), in the financial review of licence transfer requests or other applicable LTC home licence/approval transactions.[2]

The financial review is undertaken to support the Ministry's application of subsection 98(1) of the *Long-Term Care Homes Act, 2007* (LTCHA) regarding eligibility for a licence, which requires demonstration that the proposed purchaser (i) has the competencies to operate the LTC home in a responsible manner in accordance with the LTCHA and Regulation 79/10 (the Regulation), and (ii) is in a position to furnish or provide the required services.

Each licensing transfer application is reviewed on a case-by-case basis and the Ministry reserves the right to request additional information not already listed in these Guidelines, (or in revisions and/or clarifications to this guide that the Ministry may issue from time to time).

Decision Making Process

In reviewing a request to transfer a LTC home licence, the Ministry considers the financial stability of the proposed purchaser and the resulting impact of the proposed licence transfer upon the provision of resident care. As a result, during the decision making process, the Ministry may take the following into consideration:

1. The proposed purchaser's ability to finance the transaction and the post-acquisition effects on the proposed purchaser's financial position.
2. The projected financial position and performance of the LTC home after the proposed transfer would be approved.
3. The proposed purchaser's historical financial position, cash flow and viability.

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[1] The term "proposed purchaser" in the Financial Guidelines in the context of a proposed LTC licence transfer includes any proposed licensee of the home.

[2] Application of the Financial Guidelines may also be extended to other transactions as directed by the Ministry, including approvals of gaining of a controlling interest in a licensee, or approvals of a management contract, where s. 98 of the LTCHA applies to the transaction or where the Ministry requires the information in order to consider whether to provide a specific approval. For the purpose of these Financial Guidelines, the term Ministry includes the Minister and the Director under the LTCHA, as applicable to their respective duties and powers under the LTCHA.

4. The proposed purchaser's projected financial position, cash flow, viability, leverage and ability to meet its short-term obligations.
5. Any lending agreements that the proposed purchaser is party to, including all financial covenants.
6. The credit worthiness of the proposed purchaser and its affiliates, including any persons or group of associated persons who have a controlling interest (directly or indirectly) in the proposed purchaser.
7. All material agreements that the proposed purchaser is party to, including any agreement that may trigger a change of control in ownership and/or management (which may be subject to prior approval under s. 109 of the LTCHA where a person gains a controlling interest in a licensee).

Submission of Information

All applications must include full and complete information requested for each proposed licence transfer. It is the licensee's and proposed purchaser's responsibility to review all of the requested information applicable to it and to provide such information in a clear manner. The licence transfer review process will commence once the Ministry has all of the required information.

Section 1: Informational Requirements for the LTC Home Proposed to be Acquired

As part of the application, the licensee of the LTC home is required to submit the following financial information.

1.1 Audited balance sheets, income statements and cash flow statements for the past three years, including any notes to the financials.

- Historical financial information of the LTC home will be useful in analyzing how realistic the projections are.

1.2 Most recent quarterly financial statements.

- The most recent quarterly financial statements will provide a view of the LTC home's current financial position, which will also be used to evaluate the reasonableness of the projections.

1.3 A description of all changes in accounting methods and principles during the last three fiscal years.

- Changes in accounting policy can have a significant effect on financial statements, and are disclosed to enable the Ministry to recognize where such changes have occurred.

1.4 Any auditor letters, and any response thereto, concerning any deficiency or material weakness in internal controls over financial reporting over the past three fiscal years.

- Auditor response letters can contain critical information relating to the proposed purchaser's accounting policies, including whether there exists deficiencies or material weaknesses in the accounting controls.

Section 2: Informational Requirements for the Proposed Purchaser

This section identifies business and transaction specific information required from the proposed purchaser. If the proposed purchaser has one or more parent company or a entity/person holding a controlling interest, additional information for such company/entity/person may also be required.

Business Information

Corporate Documents of the Proposed Purchaser and Certain Affiliates

2.1 Organizational chart of the proposed purchaser and its affiliate(s) that illustrates the structure of the organization, relationships between entities, hierarchies of roles.

- An organizational chart provides an understanding of decision making authorities, hierarchies and key responsibilities.

2.2 Ownership chart of the proposed purchaser and its affiliate(s).

- An ownership chart identifies which corporate entities or other parties are part of the ownership structure and identify the person(s), the entities they own and share of ownership.

Financial Information for the Proposed Purchaser

2.3 Audited balance sheets, income statements and cash flow statements for the past three years, including any notes to the financials.

- Historical financial information is needed to make an adequate assessment of the proposed purchaser's financial performance/capacity and are useful in analyzing how realistic the projections are.
- The proposed purchaser must also disclose the use of or anticipated transactions with any special purpose vehicles/entities.

2.4 Most recent quarterly financial statements.

- The most recent quarterly financial statements will provide a view of the proposed purchaser's and LTC home's current financial position, which will also be used to evaluate the reasonableness of the projections.

2.5 A description of all changes in accounting methods and principles during the last three fiscal years.

- Changes in accounting policy can have a significant effect on financial statements, and are disclosed to enable the Ministry to recognize where such changes have occurred.

2.6 Any auditor letters, and any response thereto, concerning any deficiency or material weakness in internal controls over financial reporting over the past three fiscal years.

- Auditor response letters can contain critical information relating to the proposed purchaser's accounting policies, including whether there exists deficiencies or material weaknesses in the accounting controls.

Material Agreements

2.7 Credit agreements, debt instruments, security agreements, financial or performance guarantees or other agreements evidencing outstanding loans or other material financial obligations (i.e. a guarantee) to which the proposed purchaser or a controlling person is a party.

- Lending agreements contain critical information such as the term, interest rate, and financial covenants, all of which assist in determining the risk of financial difficulty in the future and whether the proposed purchaser can finance the transaction.

2.8 Any other material agreement, including any agreement that may cause a change of controlling interest or change in management.

- Various material agreements may exist which could affect the proposed purchaser's ability to adequately operate a LTC home. For example, a particular event could lead to the proposed purchaser being controlled or owned by a third-party.

Credit Report and Bankruptcy

2.9 Dun and Bradstreet or other comprehensive commercial credit report for the proposed purchaser and any company with a controlling interest in the proposed purchaser.[3] If the

[3] An entity is generally deemed to have a controlling interest in a proposed purchaser if such entity, either alone or together with one or more associates, directly or indirectly owns or controls (i) at least 10% of the proposed purchaser's equity, and (ii) sufficient voting rights to direct management. Where the proposed purchaser is not a corporation, an entity is deemed to have a controlling interest when such entity has the ability to direct the management of the proposed purchaser. See LTCHA, s. 2(2)-(5) and s. 109 for more detail.

proposed purchaser does not have credit history and another person holds a controlling interest, provide a corporate or personal credit report for such person.

- Credit reports have the ability to demonstrate if the proposed purchaser has a strong history of making payments on time, whether the proposed purchaser has almost maximized its credit or whether there has been principal forgiveness, etc. Each of these circumstances will be a factor in determining the proposed purchaser's capacity to adequately operate a LTC home.

2.10 Provide details of any voluntary or involuntary bankruptcy, receivership, assignment for the benefit of creditors, creditor protection or principal forgiveness within the last seven years of the proposed purchaser, any person or entity with a controlling interest in the proposed purchaser, and officers and directors of the proposed purchaser and/or of persons with controlling interest.

- The occurrence of a voluntary or involuntary bankruptcy is a consideration that may be relevant in determining the proposed purchaser's ability to operate the LTC home.

Litigation

2.11 Summaries of any ongoing material litigation.[4]

- The Ministry must be made aware of any ongoing material litigation that the proposed purchaser is or has been a party to, as a judgment against the proposed purchaser could have a significant impact on such proposed purchaser's financial position.

2.12 Summaries of any ongoing material litigation of any persons with a controlling interest in the proposed purchaser, within the meaning of the LTCHA.

- Similarly, the Ministry must be aware of any ongoing litigation involving any person or company with a controlling interest in such proposed purchaser as that person or company may look to the proposed purchaser as a source of funds in the case that there is a judgment against them.

Taxation

2.13 A Comfort Letter from Canada Revenue Agency indicating the business account is in good standing.

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[4] "Material" shall include any litigation with an amount at risk of 10% or more of the company's assets or market share.

- Any significant amount of taxes owing may have a negative impact on the proposed purchaser's financial position.
- Information on requesting a comfort letter can be found at: http://www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/cmfrtlltrs-eng.html

Insurance and Liability

2.14 Proof of all material insurance policies that would be required as part of the Long-Term Care Home Service Accountability Agreement.

2.15 All other relevant documents pertaining to the proposed purchaser's insurance and liability exposure.

- Proof of adequate insurance to cover losses to property and general operational insurance must be provided.

Property Information for the LTC Home being Acquired

2.16 Lease agreement and/or mortgage agreement. Only applicable where the proposed purchaser will be assuming the lease or mortgage of the LTC Home.

- A lease agreement or mortgage document is used to verify the estimated expenses of the proposed purchaser for the purposes of the projected financial statements.

Employment

2.17 Summary of total compensation for the three highest paid employees, including incentive or bonus plans.

- A summary of such compensation and incentive plans is used to evaluate the estimated expenses of the proposed purchaser for the purposes of the projected financial statements.

2.18 Any significant employment agreements, including any agreement with a clause that triggers a lump sum payment upon termination to any employee, which sum is 100% or more of such employee's previous year's salary.

- Similarly, any agreement with a large payout to an employee upon termination will be taken into consideration when reviewing financial projections.

Other

2.19 Indicate whether the proposed purchaser or any persons with a controlling interest, or any of their directors or officers, have had a licence to operate a LTC home suspended, withdrawn or revoked in Ontario or in other jurisdictions.

- Any such withdrawal, suspension or revocation of a LTC home licence may be a relevant consideration in applying the eligibility requirements under s. 98(1) of the LTCHA.

Transaction Specific Information

Purchase Agreement

2.20 Purchase agreement in connection with the sale of the LTC home.

- The purchase agreement identifies the terms and conditions of the sale, including the purchase price and method of payment.
- If the purchase agreement has not been drafted, a term sheet or letter of intent in connection with the transaction, should be provided.

Source of Funds and Capacity to Close

2.21 Detailed list of the source of funds required to close the proposed transaction. Note that all funds must be confirmed to be available prior to the approval of a licence transfer.

- A summary of the source of funds is necessary to indicate that the proposed purchaser has the financial capacity to complete the proposed transaction.

2.22 Lending agreements, financial commitment letters, or term sheets including all financial covenants.

- In the case that the proposed purchaser is receiving funding from an outside party, an agreement or documentation leading up to an agreement will provide proof of such source of funds.

2.23 Bank statements and share offering documents in connection with sources of funds.

- Where the proposed purchaser is using cash on hand to pay for a portion of the purchase price, it is necessary to provide proof of funds with bank statements.

Pro-forma Financial Statements for Upcoming Three Years for the Proposed Purchaser and the LTC Home

2.24 Pro-forma income statement, balance sheet and statement of cash flows.

- Pro-forma financial statements provide details of the proposed purchaser's anticipated financial position and cash flows, post-acquisition. The Ministry needs to be able to consider the proposed purchasers financial capacity to operate the LTC home.

- Projections of equity issuances will not be considered for the purposes of calculating the key financial ratios in sections 2.28 and 2.29.

2.25 A detailed review and opinion as to the reasonableness of the pro-forma projected financial statements by an independent accounting firm.

- The review and opinion of the projections by an independent accountant with respect to the pro-forma financial statements is required to validate the estimates.
- The opinion should reflect the following:
  - That the assumptions developed by the proposed purchaser are suitably supported and consistent with the plans of the proposed purchaser, and provide a reasonable basis for the forecast and that the forecast reflects such assumptions.
  - That the financial forecast complies with the presentation and disclosure standards for forecasts set out in the CPA Canada Handbook – Accounting.

Due Diligence Report

2.26 Independent due diligence report from a qualified company.

- An independent due diligence report provides an expert opinion on the proposed purchaser's anticipated ownership of the LTC home from an operational standpoint. This report should provide detail of any expected operational efficiencies, improvements, and changes to revenues and expenses, etc.

Long-Term Care Home Annual Reports (AR)

2.27 Projected LTC Home Annual Reports for 3 years following the last submitted Annual Report.

- A projected LTC Home Annual Report is used to determine the reasonableness of the projections, particularly with respect to occupancy, nursing and personal care, program and support services, and other accommodation.
- Provide detailed assumptions including:
  - Occupancy rates;
  - Conservative estimates of future increases in revenue; and,
  - Any additional assumptions and supporting rationale.

Key Financial Ratios

2.28 Demonstrate compliance with all financial covenants in respect of existing debt owed by the proposed purchaser.

- It is critical that the proposed purchaser complies with all of its financial covenants and since each financial institution may have distinct financial measures, the proposed purchaser must disclose the financial covenants that it is required to meet and show the calculations of how it is in compliance with such covenants. Any existing or anticipated breach of a financial covenant must be disclosed as a breach may result in a reduction in available credit, an acceleration in payments, seizure of assets or some other action or consequence.

2.29 Detailed calculations are required for the information submitted under section 2.24 for each of the following financial ratios :

i) Debt Service Coverage Ratio (as defined in each covenant)

- Debt service coverage ratio is a standard financial ratio used to help ensure/predict that a borrower can continue to make its principal and interest payments. Lenders may use different variations of this ratio, therefore the proposed purchaser must demonstrate that it is in compliance with the covenant as defined in its lending agreement.
- In the absence of a defined debt service coverage ratio in a lending agreement or term sheet, the Ministry will use the following calculation:

  EBITDA[5] / (Principal repayments plus Lease payments plus Interest)

ii) Fixed Charge Coverage Ratio (as defined in each covenant)

- Fixed charge coverage ratio is a indicator used to determine whether a borrower can continue to make its fixed payments. Lenders may use different variations of this ratio, therefore, the proposed purchaser must demonstrate that it is in compliance with the covenant as defined in its lending agreement.
- In the absence of a defined fixed charge coverage ratio in a lending agreement or term sheet, the Ministry will use the following calculation:

  (EBITDA less Capital expenditures, Dividends and Distributions) / (Principal repayments plus Interest and Lease payments)

iii) Current Ratio (Current Assets / Current Liabilities)

- The current ratio provides a measure of the proposed purchaser's ability to meet its short-term obligations. A current ratio of less than 1.0 may indicate that a company would have trouble meeting its short-term obligations.

[5] "EBITDA" is defined as Earnings before interest, taxes, depreciation and amortization.

iv) Working Capital (Current Assets less Current Liabilities)

- Working capital is another indication of the proposed purchaser's ability to meet its short-term obligations. Negative working capital may indicate that a company would have trouble meeting its short-term obligations.

v) Return on Equity (Net Income / Shareholder's Equity)

- The return on equity ratio is an indicator of the proposed purchaser's viability outlook.

vi) Debt to Equity (Total Debt / Shareholder's Equity)

- The debt to equity ratio provides an indication of the proposed purchaser's projected leverage. The more leverage a company takes on, the higher the risk that such company will eventually have difficulty making its principal and interest payments. Excessive leverage could also lead to a company having difficulty making other payments as a result of being constrained by high debt payments.

Section 3: Additional Information Required for Non-Profit Applications

Fundraising Activity

3.1 Provide a summary of fundraising activity over the past three years as well as projected fundraising for the upcoming three years, including any significant changes in donor or fundraising events.

- Historical fundraising information and projected fundraising information will provide some background on the consistency of the proposed purchaser's fundraising ability as well as any anticipated changes to fundraising goals.

Additional Taxation Information

3.2 For non-profit charitable organizations, information on any loss or potential loss of charitable status.

- Certain organizations rely heavily on their charitable status in order to receive significant donations due to the tax benefit that contributors receive. Therefore, the loss of such status could negatively impact such organizations fundraising activities.

Self-Sustainability

3.3 Anticipated percentage of self-sustainability in each year.

- The higher the percentage of self-sustainability of the proposed purchaser, the less it will have to rely on fundraising activities to fund its operations.

Section 4: Municipal Applications

Applications for Minister's approvals under Part VIII of the LTCHA will be addressed on a case-by-case basis. An attestation indicating the availability of financing in compliance with the *Municipal Act, 2001* (Ontario) and associated regulations, including Regulation 403/02, will also be required from an authorized signatory of the municipality (or municipalities).