CCRC Industry Issues

AAHSA Meeting May 18, 2010

Aim

Today's aim is a simple one: To whet your interest to think about matters that seem evident

There are two big ideas that I hope you will take away from today's discussion.

1. The long term care and entrance fee refund options and risks involve technical specialties and are better handled by a central industry-wide facility or facilities
2. Resident ownership of CCRC apartments is practical and might help, along with other changes, to jump start the CCRC industry

Scope

Intro: The Armstrong Investigation and the maturing of the insurance industry

Our Shared Vision: The Common Dream of Providers and Residents

Discussion Points: Focus on Five Observations

A Common Dream

Residents, providers, staff share a vision

- to enable individuals to provide responsibly for the inevitable transitions of aging, without dependence on others;
- to allow for the growing frailty and vulnerability of aging;
- to preserve personal dignity and a sense of fulfillment; and
- to allow for a seamless transition from an active life of achievement and satisfaction

through the challenges of decline and loss

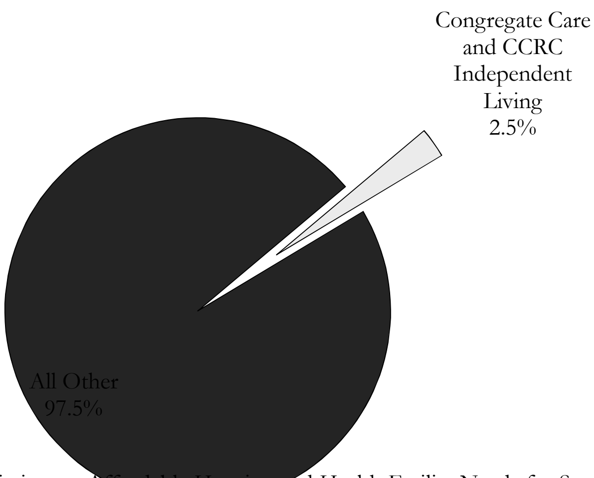
until life finds its ultimate close with dignity, with remembrance, and with celebration of a life well lived.

Five Observations for Discussion

1. Stagnation: CCRC industry market share is flat
2. Ownership: Resident ownership as a response
3. Disclosure: Fairer comparisons to win consumer trust
4. Accounting: Can revenues be better matched to costs?
5. Regulation: Lessons from insurance

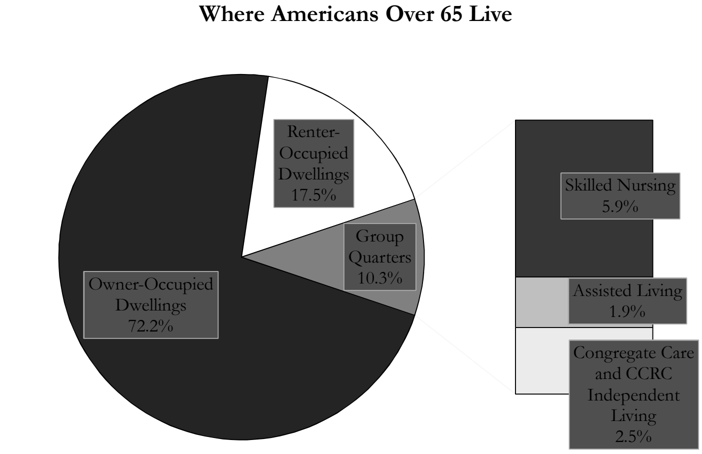
1. CCRC industry market stagnation

CCRC Living Is Just A Sliver Of The Market



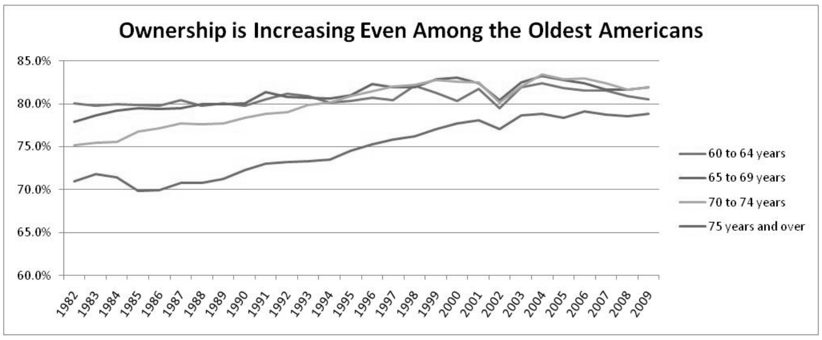
Source: Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century (2002). *A Quiet Crisis in American, A Report to Congress.* Washington, DC: Government Printing Office

CCRC Market Share is 2.5% of the Senior Housing Market



Source: Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century (2002). *A Quiet Crisis in American, A Report to Congress*. Washington, DC: Government Printing Office

Most older Americans want to continue living in homes that they own

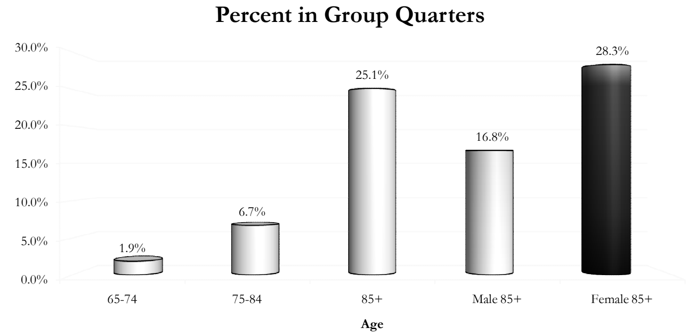


Source: Current Population Survey/Housing Vacancy Survey, Bureau of the Census, Washington, DC 20233.

Where AAHSA Members Are Found

Where Per Capita Coverage Is Lowest

Communal Living is rare; many may view it as a last resort and defer it as long as possible



The challenge is to persuade people that the active living advantages of the independent living years are an attractive option for people who do not yet have major physical or mental problems.

Source: 1993 Study "We The Elderly" US Bureau of the Census

Objections Commonly Heard

- "We're not ready for that yet", which likely means we don't want to be institutionalized.
- "We don't want to give up ownership of our home."
- "That's for old people and we're still vital and active."
- "We live in an active living community. CCRCs are assisted living."
- "I've installed precautions in my own home. Why do I need to move to a CCRC?"

2. Resident ownership as a response

- Seniors have embraced active living adult retirement communities which are ownership based
- Ownership is inherently empowering
- Ownership can reverse any tendency toward unnecessary paternalism
- Ownership preserves the sense of equity that people have in in homes they own
- Ownership preserves self-worth and human dignity.

If ownership is the challenge, what's the answer?

- Today provider ownership of communities is the norm.
- Is provider ownership necessary?
  - In the inception of the industry, homes for the aged had to be sponsored (and owned by the sponsor) because they served the indigent (and church workers living in genteel poverty) who lacked the wherewithal for ownership.
  - Today's affluent aged can afford ownership; the indigent cannot.
- Is provider ownership desirable?
  - Provider ownership facilitates end of life residential turnover.

Why Resident Ownership?

- Improve the attractiveness of community living
- Encourage realtors to support the industry
- Grow the industry to fulfill its mission and potential
- Reduce financing challenges by bringing the industry into a more conventional capital context
- Bring the industry into harmony with the trend toward home ownership into advanced age
- Free provider financing resources for other purposes or to reduce leverage.

Cooperative Conversion Concepts
An Illustration of One Approach

- 35% of existing residents must accept for conversion plan to be effective
- Vacancy conversion
- 9 Person Board; provider has a seat as long as provider continues to own more than 15% of the shares
- Provider selects managing agent, which can be itself, as long as provider owns more than 25% of the shares.
- Shares can only be held by residents or sold into treasury; smooth vacancy transition
- Residents have a lifetime occupancy lease

Is the name, itself, CCRC, a deterrent to acceptance?

- Moving to a Continuing Care Retirement Community can signal to friends, relatives, and the world that care is needed, that the need is continuing, and that the resident is retired and no longer an active member of society.
- This is not the case for seniors who downsize into an active living adult retirement community.
- Is there a more descriptive name for the service that the CCRC industry seeks to offer?

What's in a name? How hard would it be to change the way the industry describes itself? thinks of itself? conducts itself?

3. Disclosure: Fair comparisons to win consumer trust

- Governing Premise:

  The cost of aging must be met either out-of-pocket by the consumer on a fee-for-service basis; or by prepayment for an extensive care contract (or comparable LTC coverage); or by reliance on government (primarily Medicaid); or by a combination.
- Many people choose CCRC living as a responsible way to provide for their own anticipated costs of aging (often expressed as, "We don't want to be a burden for our children.")
- Consumers tend to base their choice of a CCRC on location, quality of facility, reputation, size of apartments, cost relative to the consumer's budget, and perceptions concerning nonprofit organizations' commitment to service.

The complications that impede fair comparisons can be centrally addressed.

- Consumers assume all CCRCs are contractually similar
- The differences between Type A and Type C contracts and all variations in between are readily quantifiable.
- The differences among entrance fee refund arrangements are likewise readily quantifiable.
- Both sets of differences can be standardized and disclosed or greater contract flexibility can be made available through a central, industry facility.
- AAHSA can play a facilitating role to support providers by developing a central LTC/Refund insurance capability.

Long Term Care Protection, Entrance Fee Refund Protection and CCRC Contracts

- The difference between a Type A and Type C CCRC contract, i.e. lifecare protection, is full coverage long term care (LTC) insurance.
    - Full coverage LTC is not available on the insured market.
    - The lifecare part of a CCRC contract can have a lower net claims cost because the provider can manage care to provide quality care at the lowest possible cost. This managerial oversight is not now available to LTC insurers.
    - Lifecare coverage has a lower sales and marketing component than does open market LTC.
- Contracts also differ in entrance fee refund provisions, which are difficult for prospective residents to value or compare
    - The refund provision is analogous to a single premium life insurance benefit with a full nonforfeiture value.

A Lifecare LTC and Refund Advisory Role for AAHSA?

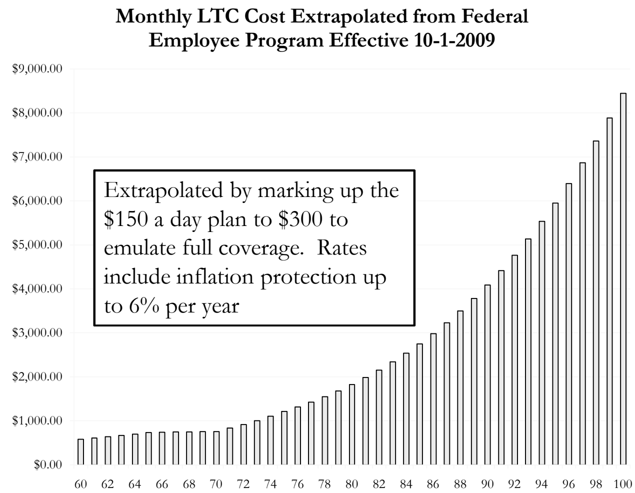
- AAHSA can foster a LTC package for CCRC and other senior housing entities (Preliminary thoughts on specifics)
    - Rates are centrally developed like the charitable gift annuity rates developed by the American Council on Gift Annuities (ACGA)
    - Rates are conservative, i.e. more than the worst case potential experience would require, with experience refunds at the community or entity level
    - An AAHSA rating manual is developed to allow facilities to give credits for resident or contract-holder pre-purchased open market LTC
    - AAHSA or a central facility (in conjunction with an insurer or insurers) can help systematize entrance requirements (risk selection); and can provide reinsurance (specific and aggregate, excess loss, or 100% quota share) to manage the risk exposure

See LifeCare Assurance Company as an example of where AAHSA might go for the specialized skills needed. http://www.lifecareassurance.com.

A Lifecare LTC and Refund Advisory Role for AAHSA?

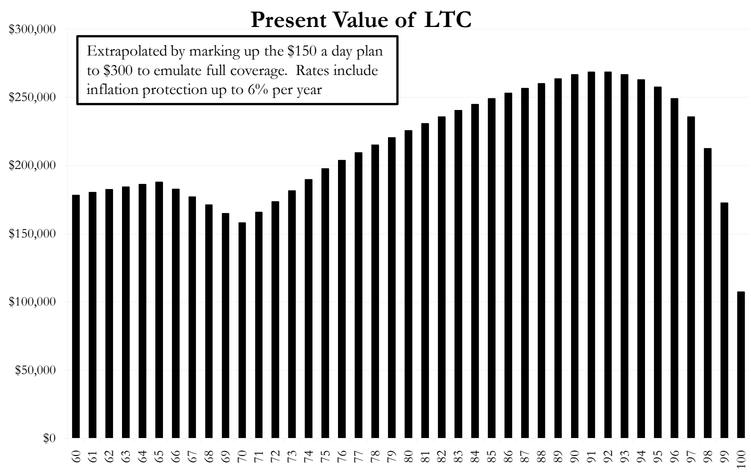
- AAHSA can also arrange an insured refund protection package.
    - Rates are likewise conservative with experience refunds at the community or entity level for lower withdrawal rates or better mortality than that assumed in the pricing
- If providers are freed of the financial risks of long term care and entrance fee refund provisions, they can focus on what they do best, resident support and care

The Differential Cost for an Extensive Contract Can Be Substantial



Disclaimer: These rates are to illustrate order of magnitude only. They are derived from the Federal Employees Long Term Care Insurance Program to illustrate the cost of "extensive contract" coverage with a minimal sales load.

The Lifetime Discounted Value of LTC Peaks
(for comparison with entrance fees)



Disclaimer: These rates are to illustrate order of magnitude only. They are derived from the Federal Employees Long Term Care Insurance Program to illustrate the cost of "extensive contract" coverage with a minimal sales load.

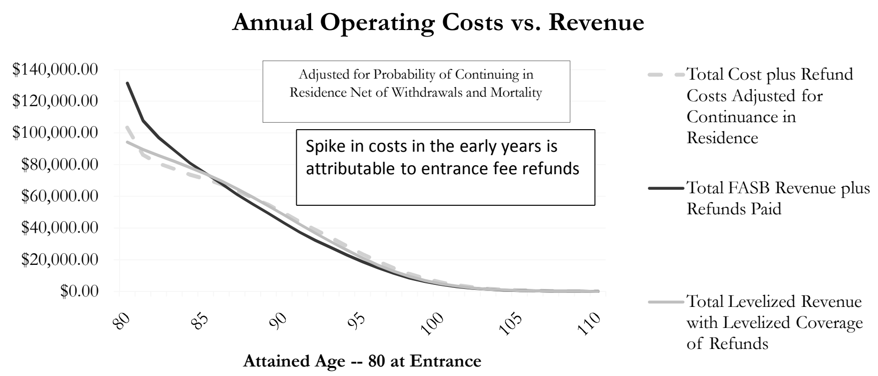
4. Can GAAP accounting better match revenue to costs?

The Matching Principle is Central to Accounting Integrity

- Accounting rules today are legislated by FASB and must be followed even when the results are contrary to fundamental accounting principles.
- FASB treats the refundable portion of the entrance fee as a liability rather than as a contract benefit like any other.
- FASB requires that the nonrefundable entrance fee be amortized into income over the remaining life expectancy of resident.
- Since approximately half of residents outlive their life expectancy, this accelerates revenue recognition and is inconsistent with the matching principle.

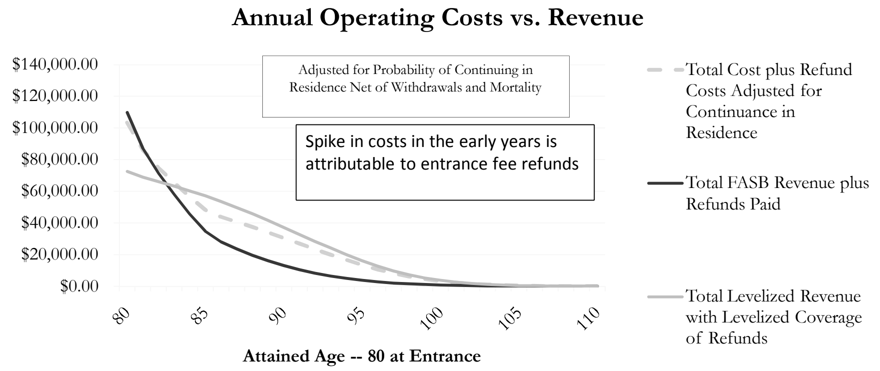
Disclaimer: These are just my observations, though they are consistent with observations made over 25 years ago by Howard Winklevoss. I make no claim of expertise in GAAP and the following projections, though considered to be reasonable, are intended to be no more than illustrative.

Because of the very conservative treatment by FASB of the contractual refund benefit, GAAP results are highly sensitive to that contract feature.



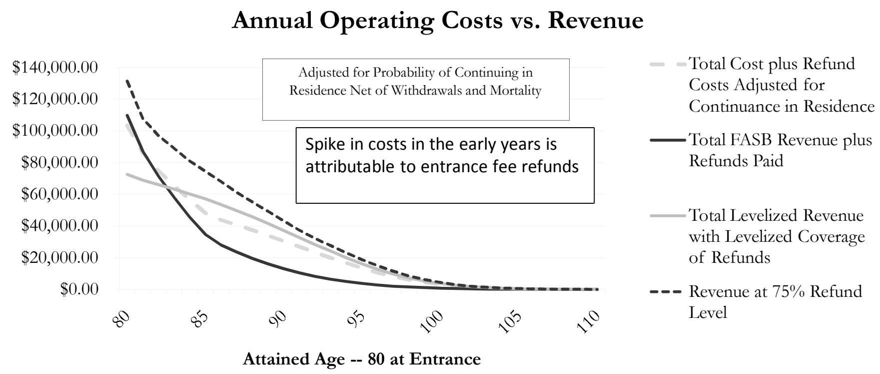
Note effect of a 75% Refund Provision
The Front Ending is Pronounced Because of the Higher
Monthly Fee Needed to Balance

Because of the very conservative treatment by FASB of the contractual refund benefit, GAAP results are highly sensitive to that contract feature.



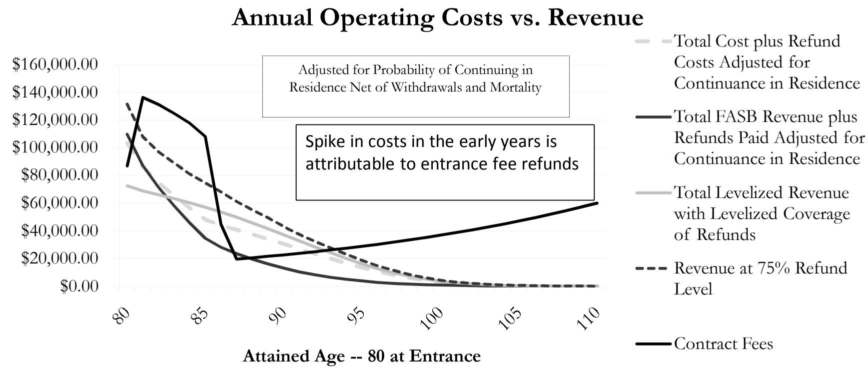
Distortion is Most Evident With a
Sharply Declining Balance Refund Provision
But the Monthly Fee Needed to Balance is Less Due to Resident Forfeitures
Compare to 75% Refund Pricing

Because of the very conservative treatment by FASB of the contractual refund benefit, GAAP results are highly sensitive to that contract feature.



This Shows How The Picture Changes If The Provider
Decides That The Market Will Allow Pricing A
Declining Balance Contract At The 75% Refund Level

Because of the very conservative treatment by FASB of the contractual refund benefit, GAAP results are highly sensitive to that contract feature.



The Financial And Accounting Challenges Arise Because Of Contract Provisions That Call For High Resident Forfeitures After A Relatively Short "Cooling Off" Period

Consequence of GAAP Acceleration of Revenues

- Nonprofit boards, eager to hold cost increases to a minimum, may not seek sufficient increases in the early years of a facility's life cycle, requiring larger make up increases in the later years when the deferred costs become evident and revenues are insufficient to meet them.
- Management may be misled to believe that more extensive contracts are too risky, driving the industry toward fee-for-service and shifting financial risk onto the residents.
- The result of the above may be to favor the initial "move in" generation of residents who do not pay their full fair share, with the difference left to be made up inequitably by later generations of residents.
- Accreditation agencies, such as CARF-CCAC, base their ratios on GAAP accounting and the results may be skewed if the evaluators do not fully recognize the limitations of GAAP CCRC accounting.

What is the alternative to GAAP?

- The CCRC Industry could work with the National Association of Insurance Commissioners (NAIC) to devise financial accounting standards with a similar rigor to those applicable to insurance companies.
- The CCRC industry can convene a group of financial officers to consider what the financial management needs of the industry are. These are likely to be different from the period earnings emphasis of a manufacturing business.
- It's possible that FASB could legislate replacement CCRC GAAP standards.
- The CCRC industry has a higher responsibility toward its mission to provide soundly for resident security than toward FASB edicts. The industry might take the lead on CCRC accounting.

5. Lessons from insurance regulation for the CCRC industry

- Regulation can foster industry growth and prosperity; regulators are the industry's friend, not its adversary
- CCRC regulation now varies widely from state to state; Life insurance regulation is mostly uniform from state to state due to the National Association of Insurance Commissioners (NAIC)'s model laws and regulations.
- The insurance guaranty laws are adaptable to protect CCRC residents.
- Actuaries are the guardians of individual equity in insurance; there is no comparable standard for CCRC pricing.
- Insurance contracts are subject to standards; CCRC contracts vary widely.
- Insurance solvency protections (regulatory intervention) are stronger than those for CCRCs

Example: An Obvious Inequity

- The industry norm is for residents who voluntarily change apartments to pay the current market entrance fee for the new unit but to only be credited with the original entrance fee for the relinquished unit.
- The provider can then remarket the relinquished unit at current market with an unearned gain equal to the difference between current market and the credit granted the relinquishing resident.
- The relinquishing resident is, in effect, required to subsidize the provider to the extent of the unearned gain. Moreover, even though the moving resident pays full market rate, any declining refund provisions are not restarted.
- This is analogous to changes of plan in life insurance and annuities for which great care has been given to preserve equity.
- The obvious unfairness of the CCRC transfer rules inhibits internal unit transfers, reducing turnover, and likely reducing the financial efficiency of the community as a whole.
- Inequities like this are not only potentially counterproductive financially but they are also a proper object for regulatory interest.

What can AAHSA do?

AAHSA has a long history of participating in forward looking study projects including the 1984 Winklevoss-Powell Study; AAHSA serves best as a facilitator and analyst.

- Study equity ownership options and how they might impact non-profit status and other aspects of CCRC operation
- Consider facilitating net cost long term care (LTC) coverage to relieve facilities of LTC risk
- Consider providing a facility to support equitably priced entrance fee refund options
- Study whether a more equitable approach to internal transfers could better optimize both facility economics and mission achievement
- Have AAHSA take an active role at the National Association of Insurance Commissioners' meetings (three times a year).

What's Omitted

- Leadership Education, Qualification, Training
- Technology
- Spirituality in Aging
- Nonprofit Justification
- Social Accountability
- Diversity, Affordability, and Mission Focus
- Hierarchical vs. Networked Organization
- Practicalities of Resident-Provider Partnership
- Executive Compensation

Though these are interesting topics they are beyond this reflection

Closing Perspectives

- Provider Quote
  - " If the Resident Council Finance Committee works to interpret financial information provided by [the provider headquarters] in a manner that facilitates harmony, trust and community you will have my support. If, on the other hand, the committee works in a manner that builds dissension, mistrust and disharmony you will not have my support." -- Executive Director
- Resident Quote
  - "We're all here because we're not all there." -- 78 Year Old Resident

Source: private conversations and, so, unattributed

Renewal

I was asked to summarize what I would like to see happen.

My answer is what I call "Renewal."

It's what I'd like to leave you with.

Renewal

- Substance
  - Central Contract Risk Facility
  - Positive Approach to Resident Ownership
- Perception
  - Aging, Not Institutionalizing
  - Empowerment, Not Detachment
  - Support, More Than Just Care
  - More Positive Name and Concept Than CCRC

Close