



Financial Soundness Handbook for Residents and Prospective Residents of CCRCs*

Policies, Procedures, and Issues

**Continuing Care Retirement Community, also called
a Life Plan Community*

Prepared Especially for Members of Resident Finance Committees
and other Engaged CCRC Residents by
The National Continuing Care Residents Association (NaCCRA)

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Executive Summary

When entering a CCRC, residents make an investment in a complex financial product whose performance few are qualified adequately to monitor. This *Handbook* is intended to help residents understand budgets, financial reports, auditors' reports, and actuarial analyses, and to assess the implications of these reports for their CCRC's current fiscal health and its long-term financial viability. While written with the average CCRC resident in mind, it is hoped that this document will be especially useful to residents who serve on their community's finance committee. NaCCRA's previous publication, *Consumer's Guide to Continuing Care Retirement Communities*, includes a chapter on finance which will be accessible to beginners, and regarding which the present text is an elaboration. NaCCRA is confident that the more residents who are knowledgeable about fiscal issues, the stronger will become the CCRC way of life.

Contents

Part One: Introduction	7
Financial Aspects of Life in a CCRC.....	7
The Stakes Are High.....	8
Understanding and Monitoring CCRC Finances.....	8
Part Two: Four Key Financial Topics.....	10
Topic A: Financial Documents and Reports.....	11
Budgets.....	11
Financial Statements.....	14
Independent Auditor’s Report	18
Topic B: Long-Term Financial Stability	20
Long-Term Financial Plans	20
Future Service Obligation Calculation	22
Detailed Actuarial Analysis.....	23
Topic C: CCRC Contract Types.....	27
Topic D: Federal Agencies and Regulations Relevant to CCRCs	29
Internal Revenue Service.....	29
The Securities and Exchange Commission (SEC).....	34
References.....	36
Part Three: Conclusion.....	39
Distinctive Financial Soundness Aspects of CCRCs	39
NaCCRA Finance Handbook: Vision	39
Part Four: Appendices.....	41
Appendix A. Obtaining Copies of Reference Documents	42
Appendix B. Overview of Entrance Fee Accounting	43
Appendix C. Future Service Obligation Calculation.....	47
Appendix D. Detailed Actuarial Analyses and Typical Values	51
Condition One: Current Resident Obligations Are Covered.	51
Condition Two: New Resident Fees Are Adequate	52
Condition Three: Positive Cash Balances Currently and in the Future.....	53
Appendix E. Some Risks Associated with Entrance Fees and Monthly Fees	56

Part One: Introduction

Financial Aspects of Life in a CCRC

There are approximately 2,000 **C**ontinuing **C**are **R**etirement **C**ommunities (CCRCs) in the United States. The exact number varies depending upon the definition used. Some observers include any institution that provides independent living plus at least one higher level of care. In NaCCRA, we use the term CCRC to describe those communities that provide, under one management, facilities for (a) independent living, (b) assisted living, (c) memory care, and (d) skilled nursing; with all care levels usually on one campus. Having these levels of care at one site allows residents to have continuity, confidence, and peace of mind as they age. They will remain for the rest of their lives in a familiar setting close to spouses and friends and engaged as long as they are able in the activities in which they have come to find joy and fulfillment.

CCRCs are the home communities for many elders across the country. They are also business operations, with some very distinctive financial characteristics. CCRCs must be professionally managed to assure their long-term sustainability. Residents sign up expecting to live the rest of their lives at their CCRC, typically one or more decades. They also commit a substantial amount of their assets to pay the Entrance Fee, plus additional monthly fees comparable to or exceeding the market costs for housing, food, and supplied services.

Regrettably, there is a steady trickle of news about CCRC financial problems and bankruptcies. No central “clearinghouse” or other mechanism exists for tracking bankruptcies and other financial crises that involve CCRCs. At present, such data is gathered mainly by word-of-mouth when articles appear in local newspapers or when an alert member or like-minded supporter draws the attention of a group like NaCCRA to the situation. We at NaCCRA typically learn about two or three bankruptcies per year, and perhaps several additional cases in which the financial situation of a CCRC becomes problematic. Out of 2,000 communities, this may seem like a small percentage, but the cumulative percentage of affected institutions rises as the trickle of bankruptcies continues year after year.

In addition to bankruptcies, each year a number of CCRCs seek to consolidate with others, or to be purchased by other providers (whether for-profit or not-for-profit). This is often an indication of troubled finances.¹ Finally, a review of IRS Form 990s (the IRS form that all charitable organizations must file annually) discloses that other CCRCs are

¹ Consolidation may not always be a sign of trouble because larger groups can benefit from centralized management functions in such areas as: a) maintenance of certifications and licensures, b) the employment and contracting of personnel, c) record-keeping and reporting, d) facility maintenance and repairs, e) operations and capital budgeting, f) marketing of units and services, and g) contract negotiations with vendors and service providers.

still functioning with negative net assets. This is considered normal only in the inaugural period of a new community with robust enrollments.

Some years ago, the United States Senate Committee on Aging recommended, and many states have enacted, laws embracing a regulatory philosophy of residents' rights, disclosure, transparency, and free flow of information between residents and management to allow residents to be well informed. In addition, a few states have legislated a more hands-on oversight and intervention, usually by the state's commissioner of insurance or other agency. The underlying regulatory philosophy is the expectation that informed residents will make sound decisions as they enter and live their later years in CCRCs.

CCRCs are often marketed as an opportunity for "carefree" living. However, it is essential that residents (at least through their campus residents' associations) are engaged in, informed about, and confident in their communities' financial and managerial affairs. The CCRC industry is an exciting but still developing social innovation; residents' experiences need to be brought to bear so that the CCRC way of life can be perfected and matured for future generations; and so that existing communities do not slip into difficulty or failure.

The Stakes Are High

Many residents dig deeply into the assets they have accumulated over a lifetime to pay the Entrance Fee and monthly fees to enter a CCRC. Once enrolled, they are likely to see monthly fees increase year after year. Their communities sometimes seek to expand, raising questions about how the associated debt and the risk that the expanded facilities may not attract the intended occupants; will affect the organization's solvency.

Elderly residents, having sold their home and, in many cases, paying much of their savings as an Entrance Fee to a CCRC, have a real need for the comfort and assurance that their CCRC is financially secure and sustainable. Appendix E gives a summary of some of the risks associated with an investment in the Entrance Fee and monthly fees of a CCRC.

Understanding and Monitoring CCRC Finances

Most CCRCs have some form of resident committee or council that works with management to maintain the best possible operations. Those committees very frequently have a subcommittee focused on monitoring the financial aspects of their community's operations. Residents who are willing to serve on their CCRC's Resident Finance Committee, and other residents who are willing to engage in this crucial and

sometimes daunting area of their community's life are making an invaluable contribution to the security and well-being of their neighbors and to the overall success of the CCRC industry.

Financial structures and practices of CCRCs, as well as the contracts offered to residents, vary from state to state and from community to community. This Handbook seeks to help residents analyze the specific financial status of their own community and learn how to assess the associated challenges and opportunities. The Handbook is intended to assist prospective and current CCRC residents (especially those serving on their community's Resident Finance Committee) in achieving a better understanding of their CCRC's financial position, performance, and long-term prospects for financial sustainability. It is a guide to the proper interpretation of financial statements and other key documents and tools useful in the financial management of CCRCs.

With the understandings this Handbook seeks to provide, residents and prospective residents will be better equipped to defend and advance their financial interests. We at NaCCRA hope this Handbook will be helpful, and we welcome any suggestions for strengthening it. We expect that the Handbook will be updated and revised periodically, based on future developments in the industry and on feedback and suggestions from residents.

Part Two: Four Key Financial Topics

This Handbook presents information about four key topics essential for understanding the finances of any CCRC:

- Topic A. Financial Documents and Reports,
- Topic B. Long-Term Financial Stability,
- Topic C. CCRC Contract Types, and
- Topic D. Federal Regulations and Agencies Relevant to CCRCs.

For each topic, the Handbook:

- Suggests what residents should know and ask about,
- As appropriate, lists key “Points to Remember”, and
- Identifies reference documents that provide additional information.

Topic A: Financial Documents and Reports

Like most organizations, CCRCs operate on an annual financial cycle or fiscal year. But, as will be explained later, CCRC managers must keep in view a much longer time horizon when planning annual budgets because current income must sustain an institution whose obligations stretch far into the future.

Budgets

Budgets are a plan expressed in monetary terms. There are three main types of budgets:

- Capital Budget – lists and describes planned capital acquisitions,
- Operating Budget – lists and describes the projected costs of planned operating activities, and
- Cash Budget – summarizes planned cash receipts and disbursements.

Capital Budget – lists and describes planned capital acquisitions, also known as long-lived assets. The capital budget is usually multi-year and linked to the organization's strategic plan. It presents financial plans (projected streams of income and expense) for the renewal and replacement (and sometimes expansion) of physical facilities, which keeps equipment and buildings functioning efficiently and allows the community's appearance to remain attractive and competitive.

A mature CCRC can be expected to spend about 3% of its total depreciable assets every year on upgrades, replacements, and new items. This will keep the CCRC well-functioning, attractive, and competitive in the marketplace.

The expenses that are treated within the capital budget are defined by GAAP² accounting standards.

Operating Budget – lists and describes planned operating activities to provide the maximum amount of possible service with available resources. It presents anticipated or projected income and expenses related to the day-to-day activities required to keep the institution running while providing the services promised to residents.

The budgeting process usually begins with an estimate of anticipated revenues followed by proposed expenses that are less than or equal to those revenues. Carrying out a revenue-first budgeting policy requires considerable discipline in two respects. First, it requires a careful and prudent estimate of total revenues from all sources. Second, it requires a commitment to engage in cost-cutting if necessary. If the first approximation to the budget indicates a projected deficit, one risky course of action is to anticipate additional sources of revenue that would eliminate the projected budget deficit. This

² Generally Accepted Accounting Principles (GAAP or US GAAP) are a collection of community-followed accounting rules and standards for financial reporting.

course of action is highly dangerous. If the original revenue estimates are made carefully, all feasible sources of revenue are already included.

For CCRCs, residents are, in effect, captive customers. Captive customers means they cannot leave without losing all or part of their Entrance Fees. Further, it is late in life for residents to look for a new home. CCRCs can raise the monthly service fees as long as the CCRC remains competitive in maintaining full occupancy. CCRC residents pay thousands of dollars in monthly service fees. A major concern when considering the operating budget is whether the amount of the annual increase in these fees in any particular year is warranted when taking into account the variety of factors involved.

CCRC contracts typically place no limitation on the amount of the increase in the monthly service fees that providers can charge. No statutory limitation exists. On request, almost all CCRCs will provide a history of fee increases. In states with a state association of residents' councils, the state association will sometimes publish the results of a survey of fee increases collected from residents within the state. Any proposed operating budget for the upcoming fiscal year needs to be presented so the proposal can be compared with the *actual* experience of income and expenses in the recent past, not merely the past *budgeted* income and expenses.

However, an option unique to CCRCs is simply not to balance the budget and operate for a period at a loss. At times, CCRCs tend to have cash on hand from unearned Entrance Fees held for the future care of residents. This cash can be used to cover temporary revenue shortfalls. The resulting operating shortfalls carry over and reduce net assets.

A key role of the Resident Finance Committee is to ensure that proposed increases in monthly service fees balance the need to maintain high-quality services. The committee also ensures the long-term financial viability of the community against the natural desire to minimize strain on residents' household budgets. Their goal is to keep fees low enough so that the community remains competitive in the marketplace. High fees can depress the occupancy rate, which in turn can undermine long-term financial strength.

Points to Remember:

- During the budget preparation process, focus on controllable expenses and revenues. For example, fees for resident services and expenses related to administration are controllable; amortization³ into the current budget of past Entrance Fees (see Appendix B on Entrance Fee Accounting) and taxes are not controllable.
- During the budget preparation process, ask for the reasoning that governed the proposed fee increases. Keep in view anything in the residents' contracts or in the community's disclosure and transparency policies that might relate to fee increases.
- Regarding staffing, remember that the effective utilization of a sufficient number and quality of staff is essential for maintaining high-quality service. Watch for staffing levels creeping either upwards or downwards. A downward trend might indicate a decline in the services residents are led to expect, or it might mean creative strategies have improved efficiency. An upward trend might mean a growing inefficiency in operations, or it might mean that additional services have been added. Payroll costs are likely to account for two-thirds of annual operating expenses, so awareness of factors that affect such costs is crucial. Ask the Chief Financial Officer or Human Resources Director for comparative wage rates in your area, especially for healthcare positions. Explore local trends, such as those for nursing hours per patient-day, staff/resident ratios, and per diem costs for various levels of care.
- Ask about contracts for various services used by the CCRC and the bidding process for major purchases such as insurance, food services, consultants, etc. Determine whether they periodically are subject to open bid contract renewal to obtain the best available price without compromising quality.
- Note actual and projected occupancy rate and unit turnover rate. Both rates strongly affect operating revenue, long-term stability, and the availability of cash to fund future obligations.
- Compare budget proposals with historical results to gain perspective and assess the reasonableness of assumptions about such things as occupancy, resident turnover, staff turnover, and salary increases.

Cash Budget – summarizes planned cash receipts and disbursements. The need for cash arises from a combination of three factors: profit margin, changes in current assets (especially accounts receivable and inventory), and changes in current liabilities (especially accounts payable). There is a constant need for cash. If there is a shortfall of cash, organizations will frequently use debt to make up the difference. CCRCs sometimes have a large amount of cash from Entrance Fees.

³ Amortization is the gradual allocation into the current budget of portions of the Entrance Fee according to a planned schedule.

Financial Statements

Financial Statements are usually prepared annually for the purpose of disclosing the financial status, profitability, and liquidity of a CCRC. Reports are usually prepared by an independent accountant and contain the following components: the Independent Auditor's Report, the Financial Statements, and a series of attached notes. The attached notes are invaluable in understanding the operations of the CCRC.

There are usually three statements that comprise the "Financial Statements" or "Audited Financial Statements." They are, in the order usually found:

- **Statement of Financial Position (Balance Sheet)** summarizes the assets and liabilities of the organization on the last day of its fiscal year or quarter.
- **Statement of Activities (Operating Statement)** summarizes the flows of fund amounts during a period of time, such as a quarter or fiscal year.
- **Cash Flow Statement** describes the flow of funds (cash) and provides information on the use of assets and liabilities.

These statements are of two types: those describing the financial position on a certain date, and those describing the flow of funds during a specific period of time.

Statement of Financial Position (Balance Sheet)

These have two sides. "The left side lists assets, which are the resources owned or controlled by the organization. The right side lists the sources of the funds used to acquire these resources. The right side has two sections: liabilities (the amounts obtained from nonowner sources) and equity (the amounts obtained from contributors of capital and from the organization's operations)." For a CCRC, equity is mostly Entrance Fees and (to a much lesser extent) donations. There should also be a significant amount of capital from the organization's operations. Unfortunately, too often capital from the organization's operations, also called "Net Assets," is a negative amount. When Net Assets are negative numbers, the label is usually "Net Deficit."

The totals of two sides of the *Statement of Financial Position* must balance, that is, assets must equal liabilities plus equity. Equality does not mean that performance was good or bad; it is simply a fundamental characteristic of accounting.

The equity of a not-for-profit is divided into three classes: (1) Permanently Restricted Net Assets, (2) Temporarily Restricted Net Assets, and (3) Unrestricted Net Assets.

Permanently Restricted Net Assets: This class contains any amounts whose use the donor has restricted permanently and any fixed assets that do not depreciate.

Temporarily Restricted Net Assets: This class is used when donors place temporary restriction on the way an organization may use their contributions.

Unrestricted Net Assets: This class includes all equity that is not restricted by the donor. It therefore includes equity items related to the regular operations of the organization. It also includes contributions that, although intended for purposes other than ongoing operations, were not legally restricted by the donor.

While budgets and operating statements account for income and expenses over either a quarter of a year or a full year, a Statement of Financial Position (balance sheet) offers a summation or snapshot of the assets and liabilities for a particular point in time. This statement is usually prepared at the end of a quarter or a fiscal year. It answers the following question-“What is the operation worth on that date after all activities have been taken into account?” On the defined date, the balance sheet compares the present assets against the liabilities, or debts, that are owed on that date. Subtracting the liabilities from the assets gives the net assets. Balance sheets are usually prepared to compare the net assets on the date in question with the previous year’s net assets.

Points to Remember:

- It is important to compare current values to those from the previous year. As usual, significant changes should have an explanation. It is usually considered desirable for net assets to grow slowly from year to year.
- Watch for symptoms of an inability to meet current obligations, such as an increase in accounts payable from one year to the next.
- Capital improvements funded by a bank loan would show as an increase in liabilities. There should be an explanation of how the loan is to be repaid.
- Does the balance sheet show reserves available for planned expansions and/or pending major repairs?

The balance sheet should show deferred revenue from Entrance Fees. Deferred revenue is funds accumulated from Entrance Fees that will be used gradually over time as they progressively amortize into “Earned Entrance Fee” revenue.

If the net assets are negative (which means the known liabilities exceed the known assets) there should be a plan in place to repair the balance sheet to either increase the assets or decrease the liabilities so that the assets will exceed the liabilities. In an established CCRC, a negative net asset position is a cause for concern. A new CCRC might normally experience a negative net asset position during the inaugural period while it is waiting to fill up (usually about 1 to 2 years). If the rate of new enrollments remains robust, there is usually no cause for concern. But residents should be aware that there is some risk associated with entering a newly established or recently expanded and not yet fully populated CCRC. If the provider has misjudged the market, the community may fail to fill up, or it may fill too slowly to provide the resources for it to meet its obligations. Two vulnerable times in a CCRC’s life are during the inaugural period and during the “middle age” period when the organization might over-borrow to finance renovations, expansions, or improvements. These times are when bankruptcies are most likely to occur.

Statement of Activities (Operating Statement)

These reports present changes in equity during the accounting period. The net income, otherwise known as the bottom line, is the difference between revenues and expenses. Revenues are amounts earned from the sale of goods and services, contributions for operating purposes, and certain gains relating to assets. Expenses are resources consumed during the period and certain other losses. Statements of Activities are frequently broken into operating and non-operating expenses.

A Note on Differences between For-profit and Not-for-profit Organizations

“There are only two fundamental differences between for-profit and not-for-profit organizations. First, for-profit businesses have transactions with owners/shareholders, whereas not-for-profit organizations do not. Second, not-for-profit organizations receive contributed capital, whereas for-profit businesses do not.” For not-for-profit CCRCs the contributed capital is largely Entrance Fees. While not-for-profit CCRCs do not have transactions with shareholders, they do transfer funds to affiliates under terms of service contracts, providing services, loans, and investments.

Net Assets (deficit), shown at the bottom of the Statement of Activities, are carried over to the bottom of the Statement of Financial Position.

The Operating Statement, as contrasted with a budget/plan, is a report of transpired transactions in terms of income and expenses as well as net gain or loss during a defined period, usually a quarter of a year or a full year. The Operating Statement includes some non-operating gains and losses from investments, bequests, and benevolence funds. It presents the Net Gains or Net Losses that occurred, and includes the Net Change in Assets from the beginning of the period to the end of the period as a result of the changes that occurred during the period itself.

CCRCs are different from many other institutions because they typically receive a large amount of money “up front” from new residents, but only a small portion of these funds can be considered income for the time period in which the funds were received. The rest, or unearned portion of these “upfront” payments, is set aside to be used in future periods. The issues associated with accounting for this “set aside” policy are a matter of recent change and some ongoing discussion at the time of this writing and are described in Appendix B.

A Note on Depreciation

Depreciation is an accounting recognition of the gradual wearing out or obsolescence of a CCRC’s facilities and equipment. To offset this decline and remain competitive with other communities, management must continually replace, improve, or renew the plant and equipment. But, in general, the need for new equipment should not be unexpected and should not require an increase in monthly fees. Funds for such

projects ought to be built into the fee structure in recognition that depreciation is a fact of life when operating a CCRC.

Points to Remember:

- It is useful to focus any review and analysis on large controllable items, such as maintenance and administrative expenses, rather than on uncontrollable items such as interest expense and depreciation.
- A large gain or loss at the end of the year deserves an explanation and a discussion of remedial steps in the case of losses.
- There should be an explanation for variances between the actual income and expense results for the period under review, and the budgeted income and expenses for the same period, as well as variances in the current period from the actual results in previous years.
- If your community has used bonds to finance construction or renovations, there may be bond covenants. The bond covenants are legally binding agreements between the bond issuer and the bondholders. Are there bond covenant requirements? Are they being met by the CCRC?
- Any large gain or loss in investments deserves an explanation, and in the case of loss, a plan for remediation.
- It should be determined whether management fees reflect current market conditions.
- Occasionally and for good reasons, CCRCs may operate for a short period at a net loss and still carry on successfully. CCRCs often have a short-term financial cushion thanks to the receipt of new Entrance Fees. But, if Entrance Fees from new residents are routinely used to fulfill promises made to earlier cohorts of residents, the financing begins to become a de facto Ponzi scheme. Eventually, financial disaster is inevitable, although many “generations” of residents and managers may be able to postpone the inevitable.
- Although ample operating surpluses and net assets are generally desirable, there is an optimum level of surplus. Very large surplus revenues, especially if they occur repeatedly over time, could indicate that residents are being charged more than is necessary.
- Get behind the numbers. What do the expenses for consultant fees and similar services truly represent?

Statement of Cash Flows

The Cash Flow Statement provides information on the use of assets and liabilities. Increases in assets and decreases in equities indicate uses of cash. Decreases in assets and increases in equities indicate sources of cash. Transactions that do not involve a flow of cash are excluded. Cash flow is an important tool for understanding the kinds of financing decisions that management has made during an accounting period, as well as assessing management’s ability to make effective and efficient use of the organization’s assets. In particular, the cash flow statement can be used to determine

the extent to which an organization is financing itself appropriately. Appropriate financing means using short-term debt to finance its seasonal and other short-term needs; and long-term debt and equity to finance its fixed assets.

Thus, a cash flow statement analyzes cash flowing in and cash flowing out of a business or organization. It is important to always be enough cash on hand so the entity can meet its financial obligations when they are due. An organization can appear healthy on its balance sheet and operating statement, in that, over the long run, income is expected to exceed expenses, or assets to exceed liabilities. Yet, the scheduling of the organization's expenses can be such that at some point in time the cash available is insufficient to meet financial obligations in a timely manner. An organization cannot meet its financial obligations with funds owed to it but not yet remitted.

In most situations, "bridge loans" can be arranged to pay bills when there is insufficient cash on hand. But if required repeatedly, this action raises costs and undermines the confidence of stakeholders in the long-term viability of the enterprise. Therefore, competent administrators should manage cash flows so that such bridge loans are rarely or never necessary.

Cash flow statements are presented for the current reporting period and for the year-to-date. They show cash flows resulting from a) current operations, b) investing activities, and c) financing activities. As a precaution against running out of cash, most CCRCs maintain (and often are required to maintain) a cash reserve fund equal to several months of typical expenses.

Points to remember:

- Investments in plant and equipment are recorded under investing activities and reduce cash available to meet other expenses. Routine maintenance should not compromise an organization's ability to meet its obligations on time.
- Investments in plant expansion also are recorded as investing activities and reduce cash available for meeting current obligations. Residents should carefully evaluate whether a proposed expansion will compromise the organization's ability to meet current obligations.
- Wise investments in plant expansions will improve an entity's cash flow health in the long-term future, whereas an unwise investment could fatally undermine the organization. Residents need to carefully assess the degree of risk associated with proposed expansions.
- Selling assets like plants and equipment to improve cash flow and meet current expenses is a sign of financial ill-health.

Independent Auditor's Report

The Auditor's Report (typically included as part of the annual Disclosure Statement prepared by the provider organization) provides a written statement by a qualified third party—the auditor—and states that the financial reports of an organization conform to

generally accepted accounting principles (GAAP). The Report includes audited financial statements for the CCRC's two most recently completed fiscal years. The Report delineates the management's and auditor's responsibilities and includes Audited Financial Statements. Ideally, Resident Finance Committee members will have an opportunity to meet with representatives of the auditing firm to discuss the Audit Report. In any case, a "clean report" is one in which the auditor's opinion is unqualified and does not list or mention any unorthodox practices or accounting exceptions. Many of the following points to remember can be found in the notes to the financial reports.

Points to Remember:

- Seek an explanation of any variances that occur between the financial statements in the auditor's report and the financial statements used for internal reporting and planning.
- If the Auditor's Report includes a calculation of "Future Service Obligations," it deserves careful review by residents because it assesses the organization's capacity to provide for their future needs.
- Watch for other useful information in the Auditor's Report, such as financial assistance provided to residents, outstanding bank loans or lines of credit, the cost of employee pension plans, and unrestricted and restricted assets and how they are invested.

Topic B: Long-Term Financial Stability

CCRC residents typically turn over to the community's management substantial assets in the form of Entrance Fees and monthly fees. The monthly fees are likely to increase for the rest of a resident's life.

In return, the management promises to provide high-quality housing and a full range of amenities and health services as needed during the resident's remaining lifetime, which might be 10 to 20 years or more. The management is thus required to practice sound financial and actuarial disciplines and careful long-term planning to ensure its ability to fulfill its obligations to residents.

CCRC's often borrow money by issuing bonds. Associated with the issuing of bonds are "covenants", which are contractual promises by the bond issuer (borrower) made to the bond buyer (lender) that it will follow certain rules during the life of the bond arrangement. For example, the CCRC may agree not to enter into any further debt, or to maintain a certain level of occupancy, or to follow certain practices with regard to its financial management.

There is a not-for-profit accreditation agency called CARF (Commission on Accreditation of Rehabilitation Facilities) that seeks to assist service providers such as CCRCs by evaluating their financial and management practices. Some CCRC's participate in this accreditation regimen, but it is voluntary.

Some assurance regarding a CCRC's long-range health can be gained if it has a history of faithfully living up to its bond covenants, and if it has a satisfactory CARF accreditation rating. Some reassurance can also be gained from a procedure known as an FSO Calculation (FSO stands for **F**uture **S**ervice **O**bligation), which will be discussed subsequently. However, only an actuarial analysis can provide an authoritative indication of the long-term financial health of a CCRC, although even this has its limitations. This will also be discussed subsequently.

Assessing the long-term viability of a CCRC is crucial, but also elusive. It deserves the utmost care and attention by members of a Resident Finance Committee.

Long-Term Financial Plans

A CCRC's long-term financial plan is expressed in commonly called strategic planning documents. Hopefully, every CCRC has an Integrated Strategic Plan, which is developed in consultation with residents. The plan is reviewed and updated annually with resident participation. The Integrated Strategic Plan should have links to five Operational Plans, each with a financial component.

Integrated Strategic Plan:

- Five-Year Financial Plan

- Five-Year Capital Renewal and Replacement Plan
- Three-Year Information Technology Plan
- One-Year Marketing Plan
- One-Year Human Resources Plan

Both the Annual Operating Budget and the Annual Capital Budget should be developed in ways that exhibit clear links to the Integrated Strategic Plan.

Points to Remember:

- The FSO analysis depends upon some crude simplifications: it assumes no new residents and no new Entrance Fees, and it does not consider capital expenditures for facility replacement or expansion.
- The calculation can be used to help residents understand the need for reserves.
- The calculation can be an effective marketing tool, demonstrating that a CCRC is employing effective financial management practices.
- Some people believe that the FSO is not relevant to CCRCs offering only Type C plans (see the subsequent section on contracts) since residents pay for the full cost of long-term health care only when the service is provided. Others argue that in any case in which there is an Entrance Fee that will be used to help pay for services extended over the life of the resident, actuarial techniques must be employed to examine the soundness of planning. Clearly, however, these actuarial-based studies are more crucial for CCRCs offering a Type A contract than they are for CCRCs offering a Type C contract.

Considerations When Management Announces Plans to Borrow Money

Current	
	<p>Is there a current debt?</p> <p>What is the current debt structure and coverage ratio?</p> <p>If there is current bond debt, what is the CCRC’s bond rating? -BBB or higher indicates financial strength.</p> <p>Is the community in compliance with current bond covenants?</p> <p>Has the community ever defaulted on payments of debt?</p> <p>If so, what were the reasons? What provides confidence that the same will not happen again with the new project?</p> <p>Has the community undertaken similar expansion projects before?</p> <p>If so, what has the experience been both on the financial and the construction sides?</p> <p>Is the Board of Directors (or other governing body) unanimous in approving this project?</p>

Future	
	<p>Why does the community need to be renovated or repositioned?</p> <p>What is the trend in occupancy? Occupancy below 85% can be a cause for concern.</p> <p>Does the property reflect modern standards?</p> <p>Does the competition have better amenities?</p> <p>Does the Board of Directors have a strategic plan outlining the need for change and a fiscal strategy for accomplishing the changes?</p> <p>Is there evidence of a market demand for the renovations?</p>
Resident Impact	
	<p>Will the monthly fees increase?</p> <p>How much money is being borrowed?</p> <p>Where is the money coming from? Bank loan? Tax-exempt bonds? Reserves? Entrance Fees?</p> <p>How will the borrowed money be paid back?</p>

Future Service Obligation Calculation

This calculation is made to determine whether the CCRC has enough funds in view to meet its obligation to all current residents for the remainder of their lifetimes.

The calculation establishes three values:

Projected Future Costs – The estimated total cost for meeting all obligations to current residents throughout their projected remaining lifetimes. This involves an actuarial analysis of the life expectancies of the current resident population.

Projected Future Income – The estimated total income expected from residents throughout their remaining lifetimes, including all their fees and healthcare-related payments. This, too, involves the actuarial analysis of the current resident population.

Reserves – The existing amount of reserves derived from not-yet-spent Entrance Fees.

The American Institute of Certified Public Accountants (AICPA) outlines the methodology to be used in making the FSO calculation. Appendix C provides a more detailed description of the FSO calculation methodology and summarizes the typical values to be expected.

Typically, the projected monthly income from residents is less than the projected costs of the future services promised to them. The key question then is whether the amount of reserves from Entrance Fees is sufficient to make up the difference. If it is sufficient, the CCRC is deemed able to meet its future obligations to current residents.

Detailed Actuarial Analysis

Through detailed actuarial analyses, management and residents can access the most authoritative indication of whether a CCRC will remain solvent while fulfilling its contractual obligations to current and future residents. Such an actuarial analysis addresses factors not considered in the Future Service Obligation calculation. These factors include taking account of the effects of new residents, long-term debt, capital expenditures, and planned facilities expansion.

The American Academy of Actuaries has promulgated its Actuarial Standard of Practice #3, entitled “Practices Related to Continuing Care Retirement Communities.” The standard establishes three conditions to meet for a CCRC to be viewed as being in good long-term financial health:

1. All future obligations to current residents must be fully covered, as indicated by a “funded status” of 100% or more (a funded status of 105% to 110% is preferred). This actuarial analysis is roughly similar to the FSO calculation, but employs a much more rigorous and comprehensive methodology, one that accounts for the increasing medical needs of aging residents.
2. Entrance Fees and other fees paid by a typical group of new residents must be demonstrated to cover the costs of all contractual obligations assumed by the CCRC for these new residents.
3. It must be possible to project positive cash balances in the future for at least 20 years, indicating sufficient cash to pay ongoing expenses.

Appendix D provides more details about actuarial analyses and offers some examples of typical values to be expected.

Rate of Occupancy

For any CCRC, the Occupancy Percentage is a very important “Key Performance Indicator.” It is used by providers, managers, and bondholders as they assess the viability of a community. So residents concerned about the future financial health of their community need to monitor carefully the current occupancy rate.

The occupancy rate is important for two reasons:

1. Low occupancy means that fixed costs must be shared among fewer people, leading to higher fees. Sometimes managements will keep fees low even in the face of reduced occupancy by deferring maintenance, which builds a problem for the future.

2. For CCRCs offering Type A contracts, occupancy which falls below what is assumed in the most recent actuarial analysis renders invalid the conclusions reached by the actuarial study regarding long-term viability.

It is important that the occupancy rate be calculated regularly and consistently. Unfortunately, the details of calculating this percentage allow for some fuzziness. To measure the Occupancy Percentage for a particular month, the terms “Billed Units” and “Total Units in Inventory” are used to specify the numerator and the denominator, respectively. The numerator, or billed units, is a clear term and easily determined.

The denominator, or total units in inventory, is subject to varying interpretations and is thus less simple to determine. The number of units in the inventory may vary from month to month for reasons such as repair, renovation, consolidation, unfinished construction or pending certification, etc. Depending on how such units are included or excluded, the occupancy percentage may look worse or better. For example, suppose a large community has 1000 units and that in a given month 900 of those units are billed. Suppose next that 30 units are undergoing major renovation and/or consolidation. If those units are excluded from the denominator, the occupancy percentage goes from 90.0% to 92.8%, rounding to 93%. That is a significant difference. For varying numbers of exclusions, the percentages change quite a bit, as shown below.

Total Units	1000	1000	1000	<i>1000</i>	1000	1000	1000
Billed Units	900	900	900	<i>900</i>	900	900	900
Excluded Units	0	10	20	<i>30</i>	40	50	60
Net Billable Units “Inventory”	1000	990	980	<i>970</i>	960	950	940
Calc Occupancy Pct	90.00%	90.90%	91.80%	<i>92.80%</i>	93.80%	94.70%	95.70%

In the interest of accuracy and consistency, all existing units should be included in the denominator, regardless of their state of readiness for occupancy, and explanatory notes should be added if there is a need to account for special cases. But residents should assure themselves that, however the occupancy rate is calculated, it is consistent with the methodology behind the occupancy assumptions in the actuarial report upon which the report’s conclusions regarding the community’s future financial strength are based.

Occupancy rates may legitimately vary from month to month because of unforeseeable circumstances, such as deaths. So it is important to work with a twelve month average of the occupancy rate, and to compare this average with the occupancy rate assumption underlying the most recent actuarial analysis. An annual occupancy rate which is lower

than that assumed in the actuarial analysis is a cause for concern. A small variation in the occupancy rate can have outsized effects on the actuarial conclusions.

A newly opened CCRC will have an occupancy rate which will begin at 0% on the opening day and which will be expected to increase to a figure above 90% in a specified period of time, usually two or three years at most. People entering a newly constructed CCRC should be aware that they are undertaking a higher level of risk than would apply in the case of a well-established CCRC, because of the possibility that the market may not behave as predicted and the community may not fill up as expected, leading to financial problems. Once populated above 90%, the CCRC should commission an actuarial analysis to confirm that, given the enrolled constituency, the financial planning for residents' future care has been sound, or, if it is shown to be off, adjustments can be made to the fee structure before problems accumulate.

Well established CCRCs which propose to expand face similar issues. The expansion will introduce a new constituency into the community. The additional units will have to fill up on a specified schedule if the financial plan is to be realized. The new constituency will introduce new elements into the community's actuarial profile. This will have to be taken into account in calculating the adequacy of the community's reserves and its expected income stream for meeting the future needs of residents.

NaCCRA's Financial Soundness Committee has begun a research project to learn more about industry practice and the specific ways different communities and provider organizations actually define and calculate their occupancy ratios. The Committee expects to present a report and recommendations from that project in the months ahead, and to include them in the next edition of this Handbook.

Points to Remember:

- Actuarial analyses are quite sensitive to the assumptions employed, especially concerning occupancy. Even a 1% decrease in the assumed occupancy for independent living units will have a significant impact on the results of an actuarial analysis. It is preferred to have the calculations performed by an independent, certified actuary with experience in the CCRC industry to provide reader confidence in an objective result based on realistic assumptions.
- Not all CCRCs commission actuarial analyses, and in most states there is no statute requiring them to do so. It is important to know whether your state requires actuarial studies.
- Even when a CCRC's management contracts with an actuary to perform an analysis, the management may withhold the study from residents, or may only share the summary and/or conclusions, even though it is residents' fees that have paid for the study. When only the conclusions are shared it can frustrate residents' efforts to assess the validity of background assumptions. When the material is not shared at all, or when management neglects to have actuarial studies carried out on a regular basis, residents should be aware that they are at a somewhat elevated risk of facing a financial crisis.
- Appendix D contains useful resource materials relating to the long-term financial health of CCRCs.

Topic C: CCRC Contract Types

The CCRC contract -- often called a Residence and Care Agreement -- is a legally binding document. It contains all the terms and conditions regarding housing and continuing care to which both the resident and the CCRC institution agree. It defines the costs of benefits and services to be received by the resident, as well as the conditions required to live in the community. The legal requirements for these contracts can vary by state.

Each CCRC may offer a variety of contract plans, which generally can be divided into three types:

Type A, All-Inclusive Plans. These are also called *Life Care Contracts*. The fees in this plan pay for shelter, residential services, and amenities while residents are living independently, and they provide for assisted living, dementia care, and skilled nursing as needed, with no additional cost except for adjustments to cover inflationary increases in operating expenses. There are slight variations among communities, but usually, under an All-Inclusive Plan, all health care costs are pooled and paid for out of the accumulated fees paid to the community by all the residents. Thus, an individual's particular health care needs do not affect their fees or costs. In effect, the residents mutually ensure each other's health care costs.

Type B, Modified Plans. These plans also include shelter, residential services, and amenities for people living independently. When advanced care of some type is needed, only a portion of the care is subsidized, usually for a specified period of time, after which the resident is charged something resembling market rates for skilled nursing, dementia care, or assisted living.

Type C, Fee-For-Service Plans. The fees under these plans usually cover residential services and amenities for people living independently, and sometimes for emergency health care. These contracts also usually guarantee access to higher levels of long-term care when it is needed, but the fees paid by the resident for these advanced services will usually resemble market rates and will usually be considerably higher than the monthly fee for independent living.

Other Plans. Less frequently used plans include a) Type D, which is a rental contract requiring no Entrance Fee; monthly fees increase according to the level of care provided; b) Equity contracts, under which residents have membership in the owning corporation and sign proprietary lease agreements; and c) Continuing Care at Home plans, for which health care and other services are provided in the individual's home by a CCRC organization.

Monthly fees in independent living for plans of Type A, B, and C will obviously be quite different, in accordance with the different services they will eventually be used to cover. Under all the different types of plans, fees will also vary according to the size of the living unit, the number of occupants, and the menu of amenities covered by the

contract. Type B and C plans sometimes offer “refundable” contracts, wherein the Entrance Fee or a portion thereof is refunded when the living unit is vacated and then rented to a successor resident. This usually occurs when the current resident dies or when they vacate for some other reason.

Members of Resident Finance Committees need to be aware of the contract type(s) at their CCRC and the particular financial management issues each present.

Clearly, Type A plans require the most sophisticated oversight and planning, since such CCRCs are, in effect, miniature unregulated insurance companies, and great care must be taken to see that the current management of assets is not undermining the organization’s ability to meet its future obligations to residents. The preceding material in Part Two, Topics A and B should support resident engagement in this vital monitoring function.

Points to Remember:

Members of Resident Finance Committees need to be conversant with the key provisions in the contract plans offered at their CCRCs, such as:

- Rights of residents and/or management(s) to challenge, revise, or terminate contracts. If such rights exist, they should be kept in view.
- Financial management decisions should be made with the implications of future liabilities for refundable contracts in view.
- Proper utilization of Entrance Fees should be carefully monitored. If the Entrance Fees of new residents are used largely to support the services promised to the cohorts of residents who entered in earlier years, there is a danger of the organization drifting toward Ponzi-type financing.

Topic D: Federal Agencies and Regulations Relevant to CCRCs

This Section will discuss two federal agencies—the United States Internal Revenue Service (IRS) and the United States Securities and Exchange Commission (SEC)—which have jurisdiction over certain activities of not-for-profit CCRCs. These agencies require certain disclosures, transparencies, and commitments by a CCRC, which are of great significance to residents.

Internal Revenue Service

Section 501(c)(3) of the Internal Revenue Code allows a CCRC to be classified as a public charity and, therefore, (a) exempt from paying federal income tax, (b) qualified for financing with tax-free municipal bonds, and (c) allowed to accept donations from the public that qualify as charitable donations on donors' income tax returns. This classification as a public charity substantially reduces the interest expense of debt financing for the CCRC and eliminates the payment of federal and many state taxes. On the other hand, not-for-profit CCRCs cannot attract the usual type of equity investment for risk capital. Without some form of risk capital, a CCRC cannot successfully offer municipal bonds to investors.

The solution to the lack of equity-risk capital is the Entrance Fee. Residents pay an Entrance Fee as a “consideration” for their admission to a CCRC. For CCRCs that offer life care, Type A contracts, the Entrance Fee might be viewed as a lump-sum advance payment for a long-term health care contract. As CCRCs have moved away from offering life care and to fee-for-service Type C contracts, and where the fee is partly or fully refundable, the fee is more to be viewed as an interest-free loan and is now recognized as such by the IRS.⁴

CCRCs Qualifying for Tax Exemption

Revenue Ruling 72-124, 1972-1 C.B. 145 is one of the latest rulings broadly affecting how a CCRC must be organized and operated to qualify for not-for-profit status as a public charity. The CCRC must commit to these provisions in its application for not-for-profit status in order to receive a favorable determination letter from the IRS that

⁴ **Below-Market Loans.** If you make a below-market gift or demand loan, you must report as interest income any foregone interest (defined later) from that loan. The below-market loan rules and exceptions are described in this section. For more information, see Section 7872 of the Internal Revenue Code and its regulations.” **Exception for loans to continuing care facilities.** Loans to qualified continuing care facilities under continuing care contracts are not subject to the rules for below-market loans if the lender or the lender’s spouse is age 62 or older at the end of the year. For the definitions of qualified continuing care facility and continuing care contract, see Internal Revenue Code Section 7872(h).” [Investment Income and Expenses, Publication 550, Mar. 28, 2019, p. 6]

recognizes the CCRC's section 501(c)(3) status and specifies whether contributions to the CCRC are tax deductible. The most relevant provisions are quoted verbatim here:

"... it is now generally recognized that the aged, apart from considerations of financial distress alone, are also, as a class, highly susceptible to other forms of distress in [the] sense that they have special needs because of their advanced years. For example, it is recognized in the Congressional declaration of objectives, Older Americans Act of 1965, Public Law 89-73, 89th Congress, 42 U.S.C. 3001, that such need includes suitable housing, physical and mental health care, civic, cultural, and recreational activities, and an overall environment conducive to dignity and independence, all specially designed to meet the needs of the aged. Satisfaction of these special needs contributes to the prevention and elimination of the causes of the unique forms of 'distress' to which the aged, as a class, are highly susceptible and may in the proper context constitute charitable purposes for functions even though direct financial assistance in the sense of relief of poverty may not be involved." "Thus, an organization, otherwise qualified for charitable status under section 501(c)(3) of the Code, which devotes its resources to the operation of a home for the aged will qualify for charitable status for purposes of Federal tax law if it operates in a manner designed to satisfy the three primary needs of aged persons. These are the need for housing, the need for health care, and the need for financial security."

"The need for housing will generally be satisfied if the organization provides residential facilities that are specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons."

"The need for health care will generally be satisfied if the organization either directly provides some form of health care, or in the alternative, maintains some continuing arrangement with other organizations, facilities, or health personnel, designed to maintain the physical, and if necessary, mental well-being of its residents."

"The need for financial security, i.e., the aged person's need for protection against the financial risks associated with later years of life, will generally be satisfied if two conditions exist."

"First, the organization must be committed to the established policy, whether written or in actual practice, of maintaining in residence any persons who become unable to pay their regular charges."

"As to the second condition respecting the provision of financial security, the organization must operate so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization."

Application for Recognition of Exemption – IRS Form 1023

There are two requirements for an organization to be exempt from federal income tax under Section 501(c)(3). A 501(c)(3) organization must be organized and operated exclusively for one or more exempt purposes. They are:

Organization. “An organization must be organized as a corporation (including a limited liability company), trust, or unincorporated association. The organizing document (articles of incorporation if you are a corporation, articles of organization if you are a limited liability company, articles of association or constitution if you are an association, or trust agreement or declaration of trust if you are a trust) must limit the organization's purpose(s) and permanently dedicate its assets to exempt purposes.”

Operation. “An organization must be operated to further one or more of the exempt purposes stated in its organizing document. Certain other activities are prohibited or restricted,”⁵

A 501(c)(3) corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports, or prevention of cruelty for children or animals must file a *Form 1023, Application for Recognition of Exemption* as further described in *Tax-Exempt Status of Your Organization, IRS Publication 557* and *Instructions for Form 1023 Internal Revenue Service Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.

For a CCRC, Form 1023 requires attachment of Schedule F.⁶ Homes for the elderly or handicapped and low-income housing are eligible for tax exemption as charitable organizations. Homes for the elderly qualify only if they meet the special needs of the elderly for residential facilities designed to meet their physical, social, recreation, health care, and transportation needs. Homes for the elderly must also be within the financial reach of a significant segment of the elderly in the community. Once persons are admitted to the elderly housing facility, the organization must have an established policy to maintain them as residents, to the extent possible, even if the residents subsequently become unable to pay the monthly charges.

Once classified as a not-for-profit, the IRS monitors an organization's operations for compliance using *Form 990 Return of Organization Exempt from Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations)*.

IRS Form 990

Form 990 is used annually by tax-exempt organizations to provide the IRS with the information required by Section 6033. Frequently, the form also provides states with the annual information they need to monitor public charities. Some members of the public

⁵ Instructions for Form 1023 (Rev December 2017) Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. p. 2.

⁶ Instructions for Form 1023 (Rev December 2017) Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, 23-24.

rely on *Form 990* as their primary or sole source of information about a particular organization. How members of the public perceive an organization in such cases is determined by information presented on its *Form 990* return.

Parts I through XII of *Form 990* must be completed by all filing organizations; these parts require reporting on the organization's exempt and other activities, finances, governance, compliance with certain federal tax filings and requirements, and compensation paid to certain persons.

Various schedules are required to be completed depending upon the activities and type of the filing organization. By completing Part IV, the organization determines which schedules are required. The entire completed *Form 990* filed with the IRS, except for certain contributor information on Schedule B, is required to be made available to the public by the IRS and the filing organization, and it can also be required to be filed with state governments to satisfy state reporting requirements.

Public Inspection of Form 1023 and Form 990

The IRS makes both Form 1023 and Form 990 available to the public from either the IRS or the organization. The penalty imposed by the IRS on the organization and on any person who fails to comply with this IRS requirement is described by the IRS as follows:

“Failure to comply. Any person who does not comply with the public inspection requirements will be assessed a penalty of \$20 for each day that inspection was not permitted, up to a maximum of \$10,000 for each return. Organizations with gross receipts exceeding \$1 million will be assessed a penalty of \$100 for each day, not to exceed \$50,000 for each return. The penalties for failure to comply with the public inspection requirements for applications are the same as those for annual returns, except that the \$10,000 limitation does not apply (sections 6652(c)(1)(C) and (D)). Any person who willfully fails to comply with the public inspection requirements for annual returns or exemption applications will be subject to an additional penalty of \$5,000 (section 6685).”⁷

The rules on inspection and copying of IRS Forms 1023 and 990 and their required attachments by an organization are extensive and can be found in the following documents, among others:

Tax Exempt Status of Your Organization, Publication 557 (Rev. January 2019), pages 18-20.

Instructions for Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, Rev. December 2017, pages 5-6.

⁷ Instructions for Form 990 Return of Organization Exempt From Income Tax Under Section 501(c)(3), 527, or 494(a)(1) of the Internal Revenue Code (except private foundations), 2018, *Appendix D. Public Inspection of Returns*, p. 81.

Instructions for Form 990 Return of Organization Exempt from Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations), 2018, Appendix D. Public Inspection of Returns, pages 78-82. Appendix D offers the most extensive discussion on inspection and copying.

Public Inspection of Form 1023

Both the Applicant and the IRS must make the information that is subject to disclosure available for public inspection. The public may contact the IRS toll-free at 877-829-5500 to request public inspection or copies of the information. Also, copies of the information may be requested in writing by submitting IRS Form 4506-A, as further discussed below. The public may also request inspection or copy the information directly from the Applicant (CCRC).

Public Inspection of Form 990

An exempt organization must make available for public inspection, upon request and without charge, a copy of its original and amended Form 990 annual information returns. Each information return must be made available from the date it is required to be filed (determined with regard to any extensions), or is actually filed, whichever is later.

Form 990 must be filed by the 15th day of the 5th month after the organization's accounting period ends (May 15th for a calendar-year filer). A CCRC can use *Form 8868, Application for Extension of Time to File an Exempt Organization Return*, to request an automatic 3-month extension of time to file. Form 8868 can also be used to apply for an additional (not automatic) 3-month extension if the original 3 months was not enough time. To obtain this additional extension of time to file, the organization must show reasonable cause for the additional time requested.

The two 3-month extensions, when added to the original deadline of 5½ months, mean that a return might not be filed for 11½ months after the end of a fiscal year.

The IRS Form 990 for exempt organizations are readily available to the public from sources such as GuideStar (<https://www.guidestar.org>). With GuideStar, free registration is required for the basic service. The GuideStar basic service will provide the last three annual Form 990s. Expect a delay beyond the date of filing. With two readily available 3-month extensions beyond the original filing date, the IRS Form 990 might not be available for more than 1 year beyond the exempt organization's end of fiscal year. Further delay should raise suspicions as to cause for the delay.

While the free, basic GuideStar service allows access to the last three IRS Form 990s, the premium service allows access to many more years.

In most instances, the last three IRS Form 990s are a minimum for evaluating a CCRC. Data trends are more important than a single-year's data, which could be influenced by an extraordinary event.

A useful guide to Form 990 is the paper “How to Read the IRS Form 990 and Find Out What It Means,” written by Peter Swords and Victoria Bjorklund of the Non-Profit Coordinating Committee of New York, which can be found at https://roadmapconsulting.org/wp-content/uploads/2016/03/how_to_read_form_990.pdf

IRS Form 4506-A

Although an exempt organization is required to make the IRS Forms 1023 and 990 available to the public, these forms are also available from the IRS at no charge. Simply submit a separate IRS Form 4606-A (*Request for Public Inspection or Copy of Exempt or Political Organization*) for each document sought.

The Securities and Exchange Commission (SEC)

A government authorized agency, such as a state, territory, political subdivision, municipality, or government agency or authority, may issue municipal revenue bonds. The proceeds from the sale of the bonds are used to finance projects constructed in the public interest. Eventually, the buyers of the bonds are repaid with interest.

Municipal bonds are often referred to as tax-exempt bonds because the Internal Revenue Code provides an exclusion from gross income for tax purposes for most municipal bonds. The interest received by an investor from a municipal bond typically is free from federal and, in some cases, state and local personal income taxes for residents who own bonds issued in their state. The CCRC is the entity obligated to pay the interest and principal.

A not-for-profit CCRC can issue tax-exempt bonds to fund building costs or expansion plans. Paying the interest on the bonds and repaying the principal are the sole responsibility of the CCRC.

Municipal Securities Research Board (MSRB)

MSRB is a Congressionally chartered, self-regulatory organization governed by a 21-member board of directors that has a majority of public members, in addition to representatives of regulated entities, such as securities firms, bank dealers, municipal advisors, issuers, and investors. It is charged with primary rulemaking authority over municipal securities dealers and municipal advisors in connection with their municipal securities and municipal advisory activities. MSRB rules are approved by the SEC, and enforced by the SEC’s Financial Industry Regulatory Authority, Inc. (FINRA), or by federal banking regulators, depending upon the regulated entity.⁸

The MSRB is subject to oversight by the Securities and Exchange Commission, which, in 2009, designated the Electronic Municipal Market Access (EMMA®) website as the official repository for municipal securities disclosures.

EMMA

Electronic Municipal Market Access (EMMA®) System is “A centralized online source for free access to municipal disclosures, market transparency data, and educational materials about the municipal securities market operated by the MSRB. Among other things, EMMA serves as the official source for official statements and other primary market disclosure documents for new issues of municipal securities, as well as the official source for continuing disclosures for outstanding issues of municipal securities for which the issuer or obligated person has entered into a continuing disclosure agreement as contemplated under SEC Rule 15c2-12.”⁹

EMMA is available at <https://emma.msrb.org/>

To access information for a CCRC on EMMA:

1. Obtain a copy of the latest IRS Form 990.
2. Proceed to Schedule K to learn of outstanding bonds, take note of the CUSIP number of the bond(s). If a bond is listed, but there is no CUSIP number, the bond is likely a private placement bond and not publicly traded.
3. Go to <https://emma.msrb.org/> Search on the CUSIP number.
(At one time, it was difficult to use EMMA without a CUSIP number. In recent years, EMMA has improved its search function. If you do not have a CUSIP number, try a search on the name of the CCRC. There is no requirement for a CCRC to provide information on private placement bonds or bonds that predate EMMA. However, the MSRB encourages municipal bond issuers to maintain a presence on EMMA to maintain investor interest. The CCRC could be listed because they wish to maintain a presence or because they have publicly traded bonds outstanding.)
4. Be sure to read the Official Statement and peruse the list of documents in Continuing Disclosure.

⁹ http://www.msrb.org/Glossary/Definition/ELECTRONIC-MUNICIPAL-MARKET-ACCESS-_EMMA_-SYSTEM.aspx.

Points to Remember About the IRS and SEC:

- The IRS requires a CCRC to make certain commitments in order to receive a favorable determination letter from the IRS that recognizes the CCRC's section 501(c)(3) status and specifies whether contributions to the CCRC are tax deductible.
- Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code contains important commitments by the CCRC regarding its organization and operation, as well as important disclosures that might not be found elsewhere. The IRS requires that copies of this form as submitted to the IRS be available from a not-for-profit CCRC and from the IRS.
- IRS Form 990, Annual Return of Organization Exempt from Income Tax under Section 501(c)(3) 527, or 4947(a)(1) of the Internal Revenue Code must be filed with the IRS by a not-for-profit CCRC. It requires reporting on the organization's exempt and other activities, finances, governance, compliance with certain federal tax filings and requirements, as well as compensation paid to certain persons. The IRS requires that the last three years' forms be available from the not-for-profit CCRC and from the IRS. These forms are also readily available from Internet services such as GuideStar.
- The SEC, through MSRB, requires that CCRCs that have publicly traded municipal bonds post on EMMA, in a timely manner, information required by bondholders. <https://emma.msrb.org/>

References

IRS Revenue Ruling (Rev. Rul.) 72-124, 1972-1 C.B. 145

Tax Exempt Status of Your Organization, Publication 557 (Rev. January 2019)

Instructions for Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Rev. December 2017)

Instructions for Form 990 Return of Organization Exempt from Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations), 2018

Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Rev. December 2017)

Form 990 Return of Organization Exempt from Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations), 2012

1979 EO CPE Text, H. RENTAL HOUSING FOR THE ELDERLY UNDER IRC 501(c)(3) This document can be relied on for its historic perspective on the evolution of IRS thinking on designation of housing for the elderly as deserving of not-for-profit status.

The foregoing instructions, forms, and reports are available from the IRS. All instructions, forms, and documents referenced in this section are available to NaCCRA members on the NaCCRA website.

Part Three: Conclusion

Distinctive Financial Soundness Aspects of CCRCs

CCRCs are businesses (whether managed by a for-profit or not-for-profit provider). But, CCRCs have several core distinguishing features, as highlighted in the preceding pages.

- CCRCs combine disparate services: (a) ongoing residential and amenities support and (b) assured future higher levels of care as needed, but they operate under several distinct business models with respect to paying for higher levels of care.
- Assessing the current and near-term financial condition of a CCRC requires a detailed study of the traditional financial statements and reports.
- CCRCs operate as 501(c)(3) charitable organizations under specific terms of the Internal Revenue Code, even in cases in which the company managing daily operations may be a for-profit business.
- CCRCs typically make use of complex financing mechanisms for their development and long-term investments.
- Estimating the financial sustainability of a CCRC over the long term is fundamentally an actuarial question and requires actuarial tools applied by professionals.
- The CCRC Entrance Fee and its treatment by the accountants, the managers, the bondholders, and the residents, is a complex and evolving topic, worthy of much attention despite its arcane aspects.

NaCCRA Finance Handbook: Vision

NaCCRA is committed to continue working on behalf of residents and prospective residents in CCRCs, collaboratively with other partners and stakeholders in the broader industry of providing residential services to our fellow Americans as they become older and seek to make their best choices about where and how to live.

As mentioned in the Introduction, residents who serve on the Residents Finance Committee, in their State's Residents Association, or on NaCCRA Task Forces, perform a valuable service for all residents in CCRCs.

This is the first edition of the Handbook. We plan to refine and adapt it in the months and years ahead. We hope it is useful and invite and welcome your suggestions and comments.

Thank you!

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Members of the NaCCRA Financial Soundness Committee wish to express their gratitude to Glen Blume and Nicole Law for their excellent work copy editing this text.

Part Four: Appendices

Appendix A. Obtaining Copies of Reference Documents

1. *Financial Ratios & Trend Analysis of CARF-CCAC Accredited Organizations.* Request or borrow a copy from your CCRC's Chief Financial Officer. It is also available for purchase via the Web from CARF at www.carf.org/aging. Go to "eCatalog" and order in the CCRC category.
2. *CARF ASPIRE to Excellence Standards Manual with Survey Preparation Questions.* This is available for purchase via the Web at www.carf.org/aging. Go to "eCatalog" and order in the CCRC category.
3. *Audit and Accounting Guide, Health Care Entities.* Request or borrow a copy from your Chief Financial Officer. It is also available for purchase via the Web at www.cpa2biz.com. Search on Health Care Organizations Accounting Guide.
4. *Actuarial Standard of Practice #3, "Practices Relating to Continuing Care Retirement Communities."* This is available at no charge via the Web at www.actuarialstandardsboard.org. Go to "Standards of Practice" to download it free of charge as a PDF file.
5. IRS Publications and Rev. Rul. 72-124. These are available for download as a PDF file at no charge via the Web at www.irs.gov/formspubs, or can be obtained by calling 800-829-3676.
6. Form 990 filings for your CCRC. Request or borrow a copy from your Chief Financial Officer. These are also available at no charge via the Web at www.guidestar.org/ using "GuideStar Basic." You must register with GuideStar, then confirm your registration by exchange of emails (Call 800-784-9378 for help with using the GuideStar Website). A search for your CCRC by its "Legal Name" or EIN will take you to a list of available Forms 990 from the IRS for downloading as PDF files. You may also search at <https://www.irs.gov/charities-non-profits/tax-exempt-organization-search>.

Appendix B. Overview of Entrance Fee Accounting

CCRCs typically require a sizeable Entrance Fee, often roughly equivalent to the cost of a house, plus ongoing monthly fees. In Type A CCRCs (life-care model), the monthly fee for independent living is higher than what is required to pay for the services while in independent living but is accumulated and pooled on an actuarial basis to help pay for statistically expected later costs of higher-level care. In Type C CCRCs (fee-for-service model) especially, the Entrance Fee accounting mechanisms and utilization have been the subject of considerable confusion and controversy in the CCRC industry. Recently, the accounting profession has implemented major attempts to clarify and correct the situation. Going forward, the accounting rules and accepted practices for Entrance Fees remain presently unclear but are expected to settle down as more experience is gained.

Residents in Type A CCRCs and the federal government regard these Entrance Fees and any excess monthly fees as prepayment for future medical services. Residents are promised that their costs will not rise significantly when their condition requires advanced care in an assisted living facility, memory care unit, or skilled nursing wing. The government recognizes the nature of these fees as pre-payment for future medical expenses by allowing medical tax deductions for them. In Type C CCRCs, the logic of prepayment is less clear and less quantified.

Over the lifetime of the CCRC industry, these fees have been the subject of some ambiguity in terms of their utilization and accounting. Actuaries, in line with residents and the government, consider these assets as forward funding for health care. But banks, and investors in bonds, consider these accumulated Entrance Fees as risk capital that will protect them from default in case the CCRC cannot repay loans made to it. CCRC managements often regard the Entrance Fees as venture capital, using them to support building expansions, the launching of new programs, and even the establishment of new CCRCs in distant cities. It can happen that a CCRC will drift into the utilization of the Entrance Fees of newly arriving residents to pay for services promised to the cohorts of residents who arrived earlier, giving the operation an unmistakable Ponzi-scheme dimension. A profound ethical issue is also raised when funds paid by residents in the expectation of their utilization for their own future medical care are instead utilized for purposes or programs in which the residents who provided the funds will never participate.

In some instances, CCRCs offer plans wherein the Entrance Fee is wholly or partially refundable. What has often not been obvious to residents is that the refundable portion is presumed to be provided out of the Entrance Fee of a successor resident, in other words, it is assumed to be a transaction between the estate of a deceased resident (or

of a living resident who has decided to move out) and the new resident who replaces them. Under this approach, the promised refund does not appear on the books of the CCRC as a liability. In practice, those due a refund have often had to wait years for them if the unit cannot be quickly resold for an equal or larger amount than the Entrance Fee. The arrangement also has a Ponzi-like character in that eventually the unit will depreciate and become valueless, and someone will be left having invested without the possibility of getting the promised refund.

Although most CCRC managers have been careful not to fall into these various forms of malpractice, and most CCRC residents have been quite happy with having made the investment in their chosen CCRC, there have been occasional bad situations and losses by residents. After some years of urging by alert residents, the Financial Accounting Standards Board (FASB) has revised the procedures prescribed under Generally Accepted Accounting Principles (GAAP) intended to address these various issues related to CCRC Entrance Fees. These revised procedures are known as the American Institute of Certified Public Accountants (AICPA) guidelines 606.

First, refundable Entrance Fees, or the refundable portions of Entrance Fees, must be recorded as a liability by the CCRC and never amortized as income.

Second, the non-refundable portion of Entrance Fees must be treated according to the following five steps:

1. Each signed contract or residency agreement between a CCRC and a resident must be associated with that particular customer or resident for the duration of their residency.
2. The separate performance obligations of the CCRC covered by each contract must be identified.
3. The price of the performance obligation or service must be determined.
4. The appropriate portion of the Entrance Fee must be associated with each separate performance obligation or service.
5. The portion of the revenue from the Entrance Fee associated with each performance obligation can only be utilized when the service is provided.

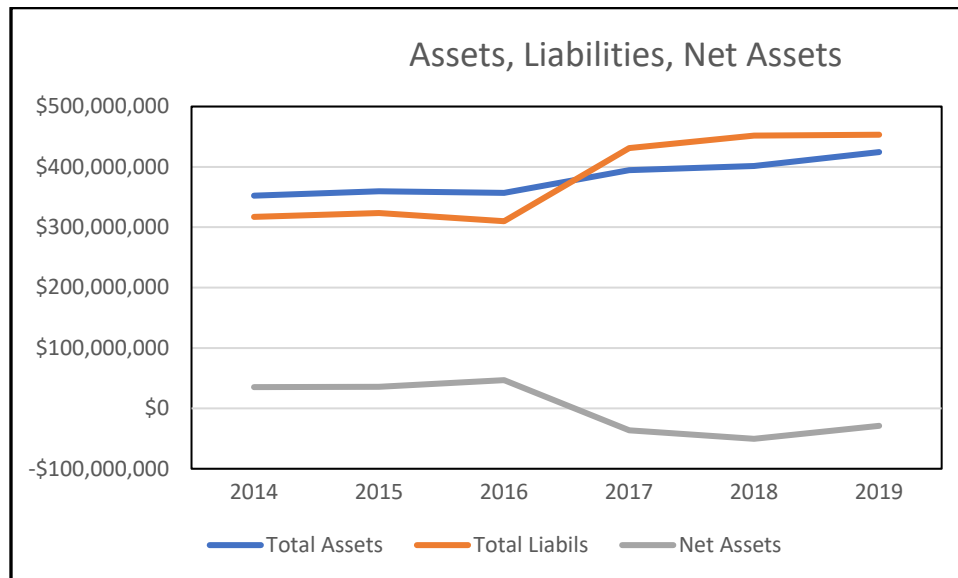
These principles, derived from practices traditionally applied to more conventional long-term contracts, are obviously applied only with difficulty in a situation in which the exact services required by each particular customer or resident are not known in advance, and when a pooling of resources is involved as members of the resident community mutually insure each other against catastrophic expenses. So, the specific way these

GAAP principles are to be applied within CCRC accounting regimens is still being worked out.

Note that whenever a CCRC implements the AICPA 606 accounting guidelines, especially with respect to refundable entry fees, there will typically be a large increase in its reported liabilities, and thus a dip in its net assets that will ordinarily persist for several years. The community likely will show a negative net asset balance on its balance sheet, something that clearly is not financially desirable.

In that situation, management often advises that everything is really the same as before and there is no cause for concern. Notwithstanding that argument, the new AICPA 606 required accounting presentation makes very visible some financial vulnerabilities that were formerly hidden. The vulnerabilities are real, and the real question is who will provide the funds needed to bring the CCRC back to a positive net asset position. Unavoidably, most of those funds will come from current or future residents. The details of this become complex and arcane, but the financial liability remains real, however it is managed.

Below is an illustration, based on real data. It shows a community whose financial reports previously had a solid positive net asset position. That CCRC abruptly changed to a substantial negative net asset position between 2016 and 2017 and remained negative in the subsequent years. The sudden change was due almost entirely to a large increase in liabilities, caused by the change in the accounting for Entrance Fees.



Future editions of this Handbook will be revised and updated as practices are clarified. In the meantime, residents should closely examine the financial reports of their own CCRC to ensure that the malpractices described previously are not occurring and that the funds intended as prepayment for medical expenses are not being dangerously misallocated to other purposes involving significant risk and are not over-utilized for current expenses in a way that introduces a Ponzi-like dimension to the CCRC's financial life.

Appendix C. Future Service Obligation Calculation

Details and Typical Values

Long-term financial stability and solvency are essential to the continuing existence of your CCRC. One technique used to assess the long-term financial health of your CCRC is the Future Service Obligation calculation. The term *Future Service Obligation*, or FSO, is used to determine the amount of additional funding; if any, that is required if a CCRC is to cover the anticipated cost of providing current residents with all contractually obligated services for their remaining lifetimes. The FSO calculation considers only the existing resident population at a selected point in time and determines three values:

- **Projected Costs** – The projected total cost (the total predicted future cash outflows) for meeting all obligations to current residents throughout their remaining lifetimes.
- **Projected Income** – The total income (the total predicted future cash inflows) expected from Residents throughout their remaining lifetimes, including all fees and health-care-related payments.
- **Reserves** – The existing amount of Entrance Fee reserves.

Typically, the Projected Income from current residents is significantly less than the Projected Costs for meeting future obligations to them. The key question is whether the amount of Entrance Fee reserves (recorded on the Balance Sheet as Deferred Revenue from Advanced Fees”) is sufficient to make up the difference. If there are sufficient Entrance Fee reserves, no FSO exists, suggesting that the provider will be able to meet its future obligations to current residents. If not, the calculated FSO amount must be recorded as a loss for that fiscal year.

The American Institute of Certified Public Accountants (AICPA) provides guidelines for making the FSO Calculation in its *Audit and Accounting Guide, Health Care Organizations*. Inherently, the cost for providing obligated services to Residents at a future time depends on the extent, timing, and duration of those services. Likewise, the resident pays for these future services through a combination of advance and periodic fees, typically before the services are provided. Therefore, actuarial methods are needed to effectively assess the adequacy of a CCRC’s reserves to provide for future promised services. The FSO Guidelines partially reflect the use of actuarial principles.

The FSO calculation considers only the current residential population as a closed group; it assumes no new Residents and no new Entrance Fees. This calculation is completed in six steps, typically using a computer program developed for that purpose.

The average life expectancy of the current residential population is predicted using actuarial principles. For example, the average life expectancy for a CCRC's 400 current residents may be 11 years, based on the analysis by a Certified Actuary.

Future cash outflows associated with providing contracted services to current residents are projected annually through the expected 11-year average lifetime of those residents. The projected total cost for providing services is defined as total operating expense (including depreciation) minus the administrative expense. Projected future cash outflows are calculated by applying an assumed cost inflation rate to the actual expenses incurred while providing those contracted services during the most recently completed fiscal year. For example:

If the total operating expense was \$22,000,000 for the CCRC's most recently completed fiscal year and the administrative expense was \$2,000,000, the cost for services to current residents was \$20,000,000.

For an assumed cost inflation rate of 4.5%, the projected cash outflow for the first future year would be $1.045 \times \$20,000,000$, or \$20,900,000.

Similarly, for the following year, the projected cash outflow would be $1.045 \times \$20,900,000$, or \$21,840,500, and so on for a total of 11 years, the average life expectancy for all current residents.

Future cash inflows for each of the next 11 years are projected in a similar manner. Total income is defined as monthly service fees plus health care revenues received during the year. Projected future cash inflows are calculated by applying an assumed revenue increase rate to the actual resident fees plus health care revenues received during the most recently completed fiscal year. For example:

If the resident fee revenue was \$15,000,000 for the CCRC's most recently completed fiscal year and the health center revenue for patient health services amounted to \$3,000,000, the total cash inflow was \$18,000,000.

For an assumed revenue increase rate of 4.5%, projected cash inflow for the first future year would be $1.045 \times \$18,000,000$, or \$18,810,000.

Similarly, for the following year the projected cash inflow would be $1.045 \times \$18,810,000$, or \$19,656,450, and so on for a total of 11 years.

The deficit for each of the future 11 years is then calculated by subtracting the projected cash inflow from the projected cash outflow. For the preceding example, the first future-year deficit would be, \$20,900,000 - \$18,810,000, or \$2,090,000; the second-year deficit would be, \$21,840,500 - \$19,656,450, or \$2,184,050, and so on for all 11 years.

The projected total deficit for the future 11 years is then calculated as the sum of the present values for each of the 11 future-year deficits, applying an assumed discount factor, such as 5.0%.

Finally, the FSO, if any, is calculated by subtracting the year-end balance in the CCRC's Entrance Fee reserve account (the Balance Sheet liability called something like *Deferred Resident Entrance Fees*) from this projected total deficit. If the calculated FSO is zero or a negative number, it suggests that the Entrance Fee reserves are sufficient to meet the future needs of the current residents. If the calculated FSO is a positive number, the CCRC Provider is required to book this amount as a loss and an additional liability, because the current deferred Resident Entrance Fee account balance is not sufficient to cover projected future service obligations to current residents.

From the preceding example:

1. With an assumed discount factor of 5.0%, the projected total deficit over the 11-year average lifetime of current residents would be approximately \$25,000,000.

If the balance in the Deferred Resident Entrance Fee account is \$28,000,000, the calculated FSO is -\$3,000,000, and no further action is required.

However, if the balance in the Deferred Resident Entrance Fee account is only \$24,000,000, the calculated FSO is -\$1,000,000, and the CCRC would be required to book a loss and an additional liability of \$1,000,000.

Observations:

The FSO calculation provides a useful (but rather simplistic) indication as to whether a CCRC has sufficient financial resources to meet its contractual obligations to all Residents. The methodology employed has several limitations:

- It assumes no new residents; it ignores new Entrance Fees.
- It assumes Net Assets are zero or positive.
- It does not consider capital expenditures or future maintenance and replacement costs.
- It neglects any planned facilities expansion.
- It assumes that the pattern of operating expenses for the year just completed validly describes future costs for current residents while in Assisted Living or Skilled Nursing.
- It neglects long-term debt and refundable Entrance Fees.

It is also essential to note that the result of the FSO calculation is very sensitive to the assumptions used in making it, especially:

- Cost inflation rate,
- Revenue increase rate,
- Discount factor, and
- Predicted life expectancy of residents.

For example: (a) a 0.5% change in either the cost inflation rate or the revenue increase rate may cause a \$5,000,000 change in the projected total deficit, and (b) a 1% change in the assumed discount factor or a 1-year change in predicted life expectancy may result in a \$2,000,000 change in the projected total deficit. For these reasons, it is preferred to have the FSO calculation performed by an independent Certified Actuary who has experience in the CCRC industry to help ensure obtaining an objective result based on realistic assumptions.

Appendix D. Detailed Actuarial Analyses and Typical Values

Continuing high occupancy, sound pricing, and effective financial management are keys to the successful operation of a CCRC. A detailed actuarial analysis provides an authoritative indication of the long-term financial health of a CCRC—whether it will remain solvent and be able to fulfill its contractual obligations to current and future residents.

Inherently, the cost for providing obligated services to residents at a future time depends on the nature, extent, timing, and duration of those services. Likewise, the resident pays for these future services through a combination of advance and periodic fees, typically before the services are provided. Therefore, actuarial methods are needed to effectively assess the ability of a CCRC's reserves to support future promised services.

A complete actuarial analysis addresses factors not specifically considered in the Future Services Obligation (FSO) calculation, including a CCRC's demographic experience; projected population movements; the effects of resident morbidity, mortality, and withdrawals; differing costs for each level of care; the value of investments; the net value of existing plant, property, and equipment; as well as the effects of new contracts, new residents, long-term debt, capital expenditures, and planned facility expansion and replacement costs.

The American Academy of Actuaries promulgated its *Actuarial Standard of Practice #3, Practices Relating to Continuing Care Retirement Communities*. This standard establishes three conditions to be met for a CCRC to be deemed in good long-term financial health. It also details how each condition is to be tested, using actuarial methods.

Condition One: Current Resident Obligations Are Covered.

This is indicated in the Actuary's report if the "funded status" is 100% or more. This aspect of the actuarial analysis is similar to the FSO calculation, but a much more rigorous methodology is employed.

In other words, this condition is met when the resources available for current residents, including periodic fees expected in the future from those residents, will cover the

actuarial present value of expected costs for meeting all remaining obligations to those residents, with appropriate provision for surplus. When the available resources cover the expected costs, the funded status is 100% (a funded status in the range of 105% to 110% is preferred).

This is tested by the “actuarial balance sheet,” which compares actuarial assets and liabilities associated with past and present residents, as of the valuation date.

Assets in the “actuarial balance sheet” include:

- Cash and receivables taken from the accounting balance sheet,
- The actuarial present value of monthly fees payable by surviving residents in each future year, including provision for projected future increases,
- The actuarial value of physical property in service on the valuation date (allocated to current residents), and
- Appropriate provision for surplus.

Liabilities in the “actuarial balance sheet” include:

- Accruals and deposits in escrow, taken from the accounting balance sheet,
- The actuarial present value of future operating expenses allocated to current residents, including provision for future cost inflation,
- The actuarial present value of estimated future refunds to current residents.
- The actuarial present value of any long-term debt, and
- The actuarial present value of the expense involved with the future use of physical property (allocated to current residents).

Condition Two: New Resident Fees Are Adequate

New Residents’ fees cover the cost of all future obligations to those new residents. This condition is met if the sum of the Entrance Fees paid by a typical group of new residents plus the monthly and other fees they are expected to pay in the future (including those related to health care) cover the future cost of all contractual obligations to that group of new residents.

This condition is tested by a “cohort pricing analysis,” which analyzes the prospective revenues and expenses associated with a typical group of new residents entering the CCRC. The revenue side of this analysis reflects:

- Entrance Fees paid at occupancy,

- The actuarial present value at occupancy of monthly fees payable by new residents in each future year, including provision for projected future fee increases,
- The actuarial value of physical property in service on the valuation date (allocated to new residents), and
- Appropriate provision for surplus.

The expense side of the analysis reflects:

- The actuarial present value of future operating expenses allocated to new residents, including the provision of future cost inflation,
- The actuarial present value of the expense involved with the future use of physical property (allocated to new residents), and
- The actuarial present value of estimated future refunds to new residents.

Condition Three: Positive Cash Balances Currently and in the Future

This condition is met if positive cash balances can be projected with respect to both current and future residents for a period of at least 20 years, indicating that the CCRC is solvent and will be able to generate sufficient cash to pay its expenses on a continuing basis. The assumptions used in cash flow projections should be consistent with those used in testing Conditions One and Two.

An actuarial analysis, to assess whether a CCRC has met each of these three conditions and thus achieved a satisfactory overall “actuarial balance,” is accomplished in seven steps, typically using a computer program developed for that purpose.

1. Record historical demographic data concerning all current and prior residents, such as when they moved in; their entrance age; if and when they moved out; and how much time they spent in Independent Living, Assisted Living, and Skilled Nursing.
2. From this data, project the overall life expectancy in each level of care for a resident at this CCRC. Often it is longer than for the public at large because of a CCRC’s health care and wellness program. Develop an age profile of current residents. In addition, project the population flow (the anticipated average time spent in each level of care).
3. Analyze current and projected operating and capital budgets and budget history to determine key financial information such as operating expense and revenue trends, the value of fixed assets and reserves, and the amount of long-term debt. From current cost data for the CCRC (and by appropriate allocation of administrative and general costs for other services like dining), calculate the

operating cost per day for a resident when living in Independent Living (the average is about \$50/day), when living in Assisted Living (average is about \$100/day), and when living in Skilled Nursing (average is about \$255/day).

4. Generate and analyze demographic projections and key information.
 - A. Analyze the “Attained Age” distribution for both men and women, which considers the total current population at the time of the analysis (the average Attained Age is about 84.5 for women and 84 for men).
 - B. Determine the life expectancy for an age 80 entrant, man and woman, at the CCRC (the average life expectancy for a woman is about 10 years and for a man is about 8 years).
 - C. Analyze the age distribution of those residents who moved in during the prior three years (analyze men and women separately). This group or “cohort” is assumed to characterize new residents who will be moving in (the average entrance age is about 79.5 for women and 80.5 for men).
5. Project the time to be spent by a resident in each level of care for various entry ages. Generally, a resident can be expected to spend on average about 1 year each in Assisted Living and Skilled Nursing, regardless of his or her entry age. The computer model can then calculate the projected total cost for each current resident at the CCRC, based on this population flow projection and the per day costs calculated previously.
6. Complete the financial calculations and analyses necessary to complete the actuarial assessment, based on assumed occupancy in each level of care; projected capital budget expenditures for the next several years; and the economic assumptions for a discount factor, an inflation rate for Entrance Fees, monthly fees, and capital expenditures.
7. Determine whether the CCRC meets the three conditions for actuarial balance as spelled out in the Actuarial Standard of Practice #3.

Observations:

A detailed actuarial analysis provides an authoritative indication of the long-term financial well-being of a CCRC. It employs actuarial principles throughout and addresses areas not included in the FSO calculation, such as the effects of new residents and capital expenditures, including planned facility expansion; reflecting differing per diem costs for residents living in Independent Living, Assisted Living, and

Skilled Nursing; and assessing long-term solvency. Actuarial studies can also assist a CCRC with the following:

- The design and pricing of financially sound residency agreements,
- The setting of viable fee structures,
- The projection of changes in the future population of residents, and
- The estimation of future needs for health care beds.

It is essential to note that, similar to the FSO calculation, the results of actuarial analyses are sensitive to the financial and occupancy assumptions, the utilization of Assisted Living and Skilled Nursing Facilities, and the need for monthly fee increases to cover operating cost inflation. The importance of maintaining a high occupancy is underscored by the fact that even a 1% decrease in occupancy for Independent Living will have a significant impact on financial projections.

In view of the previous observations, it is preferred to have an Actuarial analysis performed by an independent Certified Actuary who has experience in the CCRC industry, to ensure obtaining an objective result based on realistic assumptions. As a general rule, Actuaries suggest performing a detailed actuarial analysis every 3 years, and suggest updating it annually.

Appendix E. Some Risks Associated with Entrance Fees and Monthly Fees

Many residents dig deeply into the assets they accumulated over a lifetime to pay the Entrance Fee and monthly fees that entering a CCRC entails. There are risks of which prospective residents should be aware:

1. Once a prospective resident becomes a resident, they are apt to see monthly fee increases year after year. A typical yearly increase might be 4% per year. At that rate, fees will double in 18 years. Residents typically live 10 to 12 years in a CCRC.
2. If a CCRC's occupancy is not high, or if it falls off because of a recession, because of a failure to maintain facilities and service, or for other reasons, refundable Entrance Fees might not be refundable. This can be an issue not only if one moves out but also if one were to downsize to a smaller independent living facility. For example, if one spouse enters assisted living, skilled nursing, or memory care and the other spouse wants to downsize to a smaller independent living apartment to economize. If occupancy falls below 85%, bond covenants frequently provide for an increasing degree of bondholder control over the CCRC.
3. Expansion of a CCRC or the addition of another CCRC using the equity of the CCRC where residents reside to secure debt for the expansion or addition puts the residents' Entrance Fees at risk because the Entrance Fees provide the CCRC's equity. Speculating on real estate development is not a recommended strategy for senior citizens.
4. A Life Care, Type A, contract provides care through the end of life with only the usual increases in fees due to inflation. With other contracts, if a resident moves to assisted living, skilled nursing, or memory care, additional fees of up to \$10,000 per month, or possibly more, can be expected. If one spouse remains in independent living, an additional \$10,000 per month can be a significant, unexpected increase in fees.
5. A prospective resident might want to view the Entrance Fee amount for a CCRC as an investment. Before making an investment decision, Prudence suggests an individual evaluate his/her tolerance for risk and have a good overall financial plan in place to manage risk, provide sufficient income, and maintain adequate savings.
6. Family situations change. Many residents move to a CCRC because of its location near their children or other relatives. If the relative's place of residence changes because of a great job opportunity, or for some other reason, can the CCRC resident adjust to that changing situation? Can the resident accept that s/he might have to walk away from the Entrance Fee, or accept a partial refund of the Entrance Fee, or accept a delay in the refund of an Entrance Fee?

7. The bonds of many CCRCs are not rated investment grade. The Entrance Fee provides the CCRC's equity to secure the bonds on behalf of the CCRC. The Entrance Fee is at risk. The usual risk-reward rule does not hold. The risk-reward rule provides that the greater the risk, the greater the reward. Entrance Fees have a downside risk but no upside reward. There are exceptions. There are a small number of not-for-profit CCRCs that offer residents cooperative or condominium ownership of the independent living facility.
8. The risk of a CCRC filing for bankruptcy protection, based on the observations of the NaCCRA Financial Soundness Committee, is approximately 0.1 to 0.2 percent per year. Rarely do residents lose their rights under their Residency and Care Agreement, including protection of their Entrance Fee, although as a result of bankruptcy many things may change, including monthly fees, the menu of services provided, and the managerial atmosphere.
9. The term *Refundable Entrance Fee* is a misnomer for the following reasons:
 - a. In the Residency and Care Agreements, a careful reading of the language surrounding the discussion of Entrance Fee frequently characterizes Entrance Fee as a "consideration" or something similar.
 - b. The CCRC's bond covenants will frequently commit the Entrance Fee to the bondholders to satisfy any outstanding debt.
 - c. In the Residency and Care Agreement, a careful reading of the text describing the refund is important. Usually, it conditions the refund on the receipt of the Entrance Fee payment of the resident to reoccupy the unit to be vacated. In other words, the Residency and Care Agreement is describing the "Refundable Entrance Fee" as a form of pyramid scheme.

The bottom line is that most CCRC residents are happy with their experience with life in a CCRC and do not regret their investment. A small minority are not so happy. Since 2010, an increasing number of prospective residents are choosing for-profit, no-entry-fee independent living, or assisted living. The purpose of this Handbook on CCRC Finance is to help prospective residents make the decision that is best for them.