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A Roadmap for Evaluating a Continuing Care Retirement Community
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Directing the financials for a family of not-for-profit Continuing Care Retirement Communities (CCRCs) over the past decade and a half, I have learned a great deal. As an accounting professional with a background in for-profit manufacturing, I needed to understand the ins and outs of a new financial structure. CCRC accounting is not necessarily difficult, but it's certainly quirky.

Though accounting principles don't change very often, I've learned it takes time and some inside knowledge to understand how to assess the financial strength of a CCRC.

I've been able to share my knowledge with thousands of residents and their financial advisors, and I provide this white paper to make it easier for you to effectively analyze different communities' financial strengths. When you consider a move to a CCRC, there are many criteria to consider – location, space, culture, management, reputation. My goal is to help you with the due diligence so that you can evaluate a community's financial stability and its ability to weather future economic storms.

There are approximately 1,900 CCRCs in the United States, and each community has a slightly different definition of services; many have different contracts, and all have different costs. On top of that, there are different state regulations that govern the level and type of service provided. It is worth noting that more than 80% of these communities are not-for-profits.

What is a CCRC?

A CCRC is an over age 62 retirement community that welcomes residents who can live independently and provides the promise of community as well as the guarantee of providing future long-term health care needs within the community. A CCRC contract is an insurance contract, providing housing and nursing needs for a resident's life. It is often misunderstood as a real estate contract, but the residents do not own the units they occupy. Typically, CCRCs provide multiple levels of care; independent (IL), assisted living (AL), memory support (MS), long term and nursing care (NC), so that a resident can be cared for during the full continuum of his/her life, without having to move. This type of community may also be referred to as a Life Plan or Life Care community.

Is the CCRC a not-for-profit?

While on the surface this may seem to be a simple question, it's worth noting that the for-profit providers are skilled at presenting marketing materials that closely resemble not-for-profits. A not-for-profit organization will be organized as an IRS 501(c)(3) charitable entity. Not-for-profits have no shareholders; any positive cash margin remains with the organization. Additionally, you will typically find a benevolence clause in a not-for-profit CCRCs contract, providing financial assistance should a resident outlive his/her assets.

What type of contract does the community offer?

There are predominantly three types of contracts in the CCRC industry:

1. **Type A (all-inclusive)** This contract provides the highest level of coverage, and consequently, typically has the highest entrance fees. In these communities, residents who at some point require a higher level of care (AL, MS, NC) move into those areas without an increase in fees. Type A contract monthly services fees carry the highest insurance component. In practice, independent residents' monthly service fees can be considered a partial "pre-pay" of their possible future health care costs and are often tax deductible as a pre-paid medical expense.
2. **Type B (limited/modified)** These contracts typically provide independent residents with the ability to move to AL, MS, and NC at no additional cost initially, but only for a limited amount of time. If the resident requires these services for a longer period, the monthly service fees will increase significantly. Type B contracts have a modified insurance component in the monthly service fees.
3. **Type C (rental)** Independent residents who require access to AL, MS, and NC do not benefit from any discounts. They will pay higher monthly services fees immediately upon entering the new level of care. Typically, there is no insurance component in a Type C contract.

Does the organization charge an entrance fee, and if so, is there a provision for an entrance fee refund?

The entrance fee is defined as a one-time, up-front payment that is paid to the organization when the contract is put in force. Typically, one will see larger entrance fees with Type A contracts because the monthly service fee with a Type A contract is the same regardless of IL, AL, MS, or NC.

Refundability options can range from 100% refundable to declining balance (0%), with numerous variations in between. A declining balance contract starts out at 100% refundable but reduces by a set amount (amortizes) over a defined period, typically within 48 months. At the end of the defined time, no refund is owed.

When evaluating the refund provision, you should also understand its terms and conditions. What conditions need to be met for the refund to be paid? Is there a time limit? Is the refund amount limited by the re-sale proceeds of the unit to the next resident? What is the average length of time before a refund is processed?

Why is the entrance fee refund amount important?

The entrance fee refund is a key differentiator in many contracts. The terms of the contract are often dictated by the amount of refund, and one community will sometimes offer as many as four different contracts, based on refundability. Many older adults look at this as a component to their overall estate planning, as they see the higher refundability options as a way to preserve their assets.

Understanding the audited financial statements.

CCRC financial statements can be daunting upon first blush. However, there are certain key areas to concentrate on that will help you digest the information. The two major schedules include Statement of Financial Position (also referred to as the Balance Sheet) and Statement of Operations and Changes in Net Assets (the Income Statement). **Cash Margin, Net Operating Margin Ratio, Operating Ratio** and **Cash to Debt Ratio** are four metrics to pay close attention to.

A positive cash margin reflects the organization’s ability to cover its cash operating expenses with ongoing cash revenues. Net Operating Margin is a ratio that measures the core, sustainable business of on organization and focuses on cash revenues and cash expenses related to resident services. Investment earnings, interest expense and non-cash items are excluded. The Operating Ratio is a more robust version of Net Operating Margin, providing evidence of the organization’s ability to proactively manage its debt structure. The Cash to Debt ratio is a common measure of an organization’s capital structure and a higher ratio reflects a better ability to withstand annual fluctuations in cash.

The Cash Flow statement is the third schedule you will find in the audited financials package, and it details the “ins” and “outs” of the cash accounts. One area to pay attention to on this schedule is Purchases of Property and Equipment, found in the Investing Activities section. You will want to make sure that the organization is re-investing in its infrastructure and programs, not only for the benefit of its current residents but also for future residents. Occupancy is the “life blood" of a CCRC and having an up-to-date campus is an important driver to staying full.

After the main financial schedules, you will find the footnotes section. There is usually a wealth of knowledge here and it is highly recommended you spend time reviewing these notes.

<u>Other questions to ask a CCRC</u>

Financial strength is reflected in the numbers of the CCRC but there are other measures to consider as well:

- Ask the CCRC for its historical and current occupancy figures as well as future projections. The industry considers 95% IL as full occupancy since there are usually some units being refurbished for new residents.
- Ask the CCRC for its Funded Status %, which is computed periodically via a Comprehensive Actuarial Study. A value greater than 100% indicates that the organization is running a surplus and may be better positioned to deal with future adverse events.
- Is the CCRC accredited by CARF?
- Does the organization have a written financial philosophy, and does it make sense to you?
- Does the CCRC have a credit rating from Fitch or S&P?
- Does the CCRC have residents on the Board of Trustees?
- Does the CCRC have a resident finance committee?
- What is the experience and tenure of senior management?
- How does the organization measure its financial performance? Benchmarks?
- Is the CFO/ Director of Finance willing to meet with you?

These indicators should provide you with information to assess the community's financial strength.

The pandemic that began in early 2020 impacted all communities in the industry. Lower occupancy has adversely impacted revenue while operating costs have increased due to testing, disinfecting, and other safety protocols. Additionally, CCRCs continue to deal with high inflation and low availability of healthcare workers. The strongest communities have the resources to "weather the storm" and invest in technology and other business practices to improve their operating models going forward. As you go through your evaluation process, ask the organization what steps it is taking. While you may see declines in financial performance over the past few years, stronger organizations will also discuss their realistic expectations over the coming years.

For those of you who wish to delve deeper into the financials of a CCRC, we have created a separate white paper that provides more in-depth analysis geared towards financial advisors that can be viewed here.