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Retirement Planning Challenges With CCRCs

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Editor's note: John B. Cumming is an actuary who became involved with the economics of Continuing Care Retirement Communities after he moved to one 14 years ago. He has been an actuary for over 50 years. He qualified by examination as a Certified Aging Services Professional, and he has published extensively on matters relating to senior living. During his working career, he was active in life insurance, pensions, and health insurance. The author acknowledges the help of Anna Rappaport, FSA, in developing the reasoning in this paper.

At first glance, Continuing Care Retirement Communities (CCRCs) seem like an excellent living choice to ensure a secure retirement. Residents pay an entry fee to move in after which most of their living and care needs seem to have been met. No less an authority than the Government Accountability Office, however, concluded that such communities "… can provide benefits, but not without some risk."[1]

A deeper reading of the report discloses that the risks are such that people considering retirement should approach such a living option with great caution. This paper explores those risk exposures and how actuarial principles might be applied to make CCRCs more attractive. This is a paper grounded in principle, so it's appropriate at the outset to declare what those principles are before we go into their practical application.

CCRCs are a form of residential housing with standby care for those who are aging, requiring the payment of an entry fee for admittance. The CCRC name originated with an actuary, Walt Shur, though the industry has recently sought to rebrand these entities as Life Plan Communities.[2] Still, the original name continues in widespread currency and will be retained here.

APPLICABLE PRINCIPLES

1. **Inter-cohort equity.** The first principle applicable to CCRCs is that each cohort of entrants should be priced and managed to be financially self-sustaining over the expected lifetime of that cohort. This principle was first applied to life insurance mutual company dividend cohorts by New York Life's actuary, Rufus W. Weeks.[3]

2. **Speculative discounting.** Another principle is that hypothetical, speculative future gains should never be discounted to offset concrete losses in the near term.

3. **Financial sustainability.** This principle is like the preceding. Contract and other promises made to induce a sale should be priced to ensure that the promises can be fulfilled over the lifetime of the contract.

4. **Fair marketing.** Principled illustrations of future rate increase patterns should be plausibly related to changing macroeconomic scenarios so as not to be misleading.

5. **Projection integrity.** Contracts that include lifetime rights should be treated as lifetime undertakings, just as single premium life annuities and whole life insurance contracts are considered lifelong undertakings.

These principles are not exhaustive, but they provide a framework for evaluating CCRC enterprises. Some CCRCs employ actuaries though financial statements are, for the most part, prepared according to accounting practices rather than actuarial principles. A deeper actuarial engagement could help ensure that CCRCs operate with scientific and financial integrity.

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CCRC VARIATIONS

CCRCs, which promise availability and access to care over a resident's remaining lifetime, usually require an entry fee. The entry fee is a special kind of single premium life annuity in that monthly rental fees that would otherwise be required are usually reduced by the income stream generated by the entry fee.

The balance between the entry fee and recurring fees varies from CCRC to CCRC. A typical entry fee for an attractive, modern CCRC might be $400,000, say, for a two-bedroom residential unit, with a monthly fee that might be $3,500 for the first resident, increased typically by a second resident fee of about $1,000 per month for a couple. Entry fees are strictly contract consideration and convey no ownership.

There are a number of options typically associated with CCRC contract sales, most of which can be priced to be actuarially equivalent. Although these options could be consumer choices, generally CCRCs offer only one or two. Despite the lifelong commitments undertaken, most CCRC developers and operators have little understanding of human life contingencies.

CARE INCLUSIVE VARIATIONS

What the industry calls Type A contracts include the possibility of future assisted living or skilled nursing costs within the pricing structure. With these contracts, residents do not face increases in fees if their care needs change during their residency. Thus, Type A contracts provide a kind of managed long-term care protection.

Type C contracts are at the other end of the continuing care spectrum. With a Type C contract, residents are entitled by contract to receive care on the campus where they live but they have to pay for all such care. Often, the charges for care are organized into pricing "tiers" so that those who need some, though relatively little, care are grouped into tiers with others who may need more care.

Type B contracts vary widely in what they include, and they fall between the Type A and the Type C extremes.

REFUND VARIATIONS

CCRC contracts also vary widely in the forfeiture provisions applicable to entry fees. At one extreme are communities that scale entry fee refunds down over three to four years, so that after a short period the entry fee is fully forfeited to the provider. At the other extreme, some CCRCs offer a full refund, contingent upon resale of the residential unit to a successor resident.

This is where it gets dicey since U.S. GAAP[4] accounting for CCRCs allows the provider to take the refundable entry fee into income over the accounting life of the building with the rationale that, "In those situations, the CCRC's own funds will never be used to make the refunds to the prior resident; instead, the CCRC is effectively facilitating the transfer of cash between the successor resident and the prior resident."[5]

MATRIX OF OPTIONS

Thus, the options fall into a matrix with one axis comprised of the risk assumed by the CCRC versus that which is left to residents, with the other axis including the forfeiture possibilities. Actuaries are seldom involved in CCRC pricing, so most pricing is handled by accountants or by market analysis of what the local competition permits. (See Figure 1)

Figure 1
Potential Actuarial Equivalencies

Care Continuum		Entry Fee with Minimal Refund—Declining each Month	50% Refund	90% Refund	Full Refund of Entry Fee at Withdrawal or Death
Type AAA	Full Care and all Medical Care—Not Offered				
Type A—No Added Cost for Higher Care Levels with Entry Fee Requirement	No Medical Care but Full Assisted Living & Nursing Care				
Type B—Limited Higher Care at No Added Cost with Entry Fee Requirement	Respite and short-term care; sometimes discounts small or large				
Type C—Full (or Discounted) Fee for Service with Entry Fee Requirement	No care provided; i.e. similar to staying in own home except for community and meals, etc.				
Type D—Straight Rental with No Care Commitment	Active living community model but may include some affiliated care options				

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REGULATORY APPROACHES

Over the years, some regulatory authorities have considered actuarial approaches, but they have not gained acceptance. As an example, in a conference some years ago, Bob Thompson, then the well-respected CCRC regulator for California, explained why CCRC contractual refund obligations were not required to be funded. He said, "The actuarial review does not contemplate the proceeds of the resale of the unit, so although there's offsetting revenue to the obligation, the obligation is assessed so that it leads to basically an actuarial deficiency … which then the actuary will be quick to explain has not suggested that the provider is in unsound financial condition." [6]

The "offsetting" revenue is the entry fee paid by the successor resident, if the unit is resold, which is diverted from the successor's contract to meet the obligation to the predecessor. Most actuaries would not consider that to be "offsetting," nor does it seem to accord with accounting principles by which performance obligations should be matched to the revenues that give rise to them.

Thompson went on to assert that providers (presumably with the alleged connivance of their actuaries) would manipulate the actuarial assumptions to make their operations appear sound so that their marketing would not be impacted. His hope, he asserted, then became to persuade some providers to look at the actuarial realities of their undertakings. Consequently, the regulators required providers offering Type A contracts to get an actuarial opinion every five years. To avoid the marketing challenge, the actuarial report was withheld from the public. He made it clear that he was treading a tightrope of political consequences that militated against credible actuarial soundness as a standard for all entry fee CCRCs.

Thompson's stated view is common among regulators elsewhere. There is no involvement by the National Association of Insurance Commissioners or other national bodies that might bring about a more defensible approach to CCRC regulation. A common view among CCRC operators is that entry fees are a real estate investment used to secure debt. Entry fees, however, are not regulated as securities. If they are viewed as a contract consideration, then they are the same as insured life annuities funding a stream of deferred lifetime benefits.

ACCOUNTING ANOMALIES

In the absence of statutory accounting standards, GAAP accounting is prevalent. Moreover, GAAP accounting for CCRCs has held that, "Because a CCRC resident has the ability to move out and discontinue paying the monthly fee at any time, FinREC believes the resident agreement for a Type A life care CCRC resident is generally a monthly contract with the option to renew."[7]

This AICPA guidance countermands the Financial Accounting Standards Board's codification requiring that revenues from prepayments like entry fees be matched to the performance obligations that they fund and that revenues only be recognized as the obligations are fulfilled. It also violates the actuarial principle that lifelong commitments be valued over lifetimes.

A second GAAP anomaly allows for amortization of entry fees into revenue over variations of life expectancies. Thus, the accounting standards ignore any investment earnings (or debt service foregone) attributable to entry fees. This would be like taking single premium life annuity proceeds into income at a rate equal to the reciprocal of the life expectancy.[8]

Thus, all earnings from the use of the entry fee proceeds between the time of payment and the time benefits are provided are taken into revenue. This has the effect of advancing earnings in the early years making the enterprise appear more profitable than it would be according to the standards applicable to life annuities. Moreover, the accounting standards for determining the mortality to be used to determine the life expectancies are less rigorous than what actuaries would ordinarily use.

As if this weren't enough, many accountants argue that a "negative net asset position" is acceptable for a "going concern" CCRC, apparently on the premise that a "going concern" can be considered a perpetual enterprise until, and unless, it faces imminent termination. A "negative net asset position" occurs when liabilities exceed assets.

It is that deficiency that constitutes the negativity. CCRCs are deemed to be viable provided there is enough cash to meet debt and other obligations despite the reality that a large infusion of cash comes in the form of entry fees intended to fund deferred contract obligations.[9] This would seem to nullify the case for accrual accounting.

THE FUTURE

The Government Accountability Office conclusion that CCRCs involve risk remains true today as it was in 2010 when the study was first published. While from a consumer and public interest perspective, it would be desirable for CCRC reserve liabilities to be actuarially determined, this is seldom the case for CCRCs as it is, say, for insured life annuities. Stronger regulation like that to which life insurance companies are subject could make CCRC residency a more attractive retirement option especially for planning-minded consumers.

Moreover, guaranty protections could help CCRC marketing. Bank deposits, insurance policies, pension benefits, and security brokerage accounts are all protected by guaranty programs to shield customers if the enterprise fails. There are no such protections for CCRCs, so financial failures fall either to debt providers or to the residents. There is a steady stream of CCRC financial failures, most of which result in voluntary reorganization or takeover by another operator, but some of which do proceed to full bankruptcy.

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The financial collapse of Air Force Village West is one such example. In that case, Federal bankruptcy laws and courts were used to void the residents' lifetime continuing care contracts. Entry fee investments were recognized only to the extent that they were refundable. A guaranty law might have minimized the losses since it could have allowed the regulators to seize the company early. As it was, the CCRC continued as a financially troubled enterprise for several years during which the insolvency deepened.

We can hope that changes will come about to make CCRC residency less risky for consumers. Actuaries can play a leading role in making that possibility a reality. ■

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ENDNOTES

1. *https://www.gao.gov/assets/310/305752.pdf*.
2. The name change from CCRC to Life Plan community is the result of a 2015 joint initiative created by LeadingAge and Mather LifeWays (and a number of marketing consulting firms).
3. Rufus W. Weeks, "A Practical Rule for Calculating Annual Dividends," Transactions of the Actuarial Society of America, Volume IX, 1905, p. 310.
4. Generally Accepted Accounting Practices.
5. AICPA letter to FASB, March 13, 2012, Reference No. 2011-230.
6. *https://youtu.be/clMCO-cYaOI*
7. Health Care Entities Revenue Recognition Implementation Issue…. Issue #8-3 – Application of FASB 606, Revenue from Contracts with Customers, to Continuing Care Retirement Community Contracts"
8. See for instance, *https://www.bkd.com/article/2019/03/revenue-recognition-ccrcs-effect-entrance-fees-monthly-service-fees*.
9. "*Accounting for Refundable Advance Fees - Understanding the Financial Statements of CCRCs," BlumShapiro, CPAs*.

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