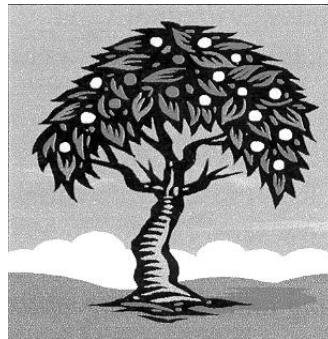


CCRC FINANCES

A Guide Book For Members Of
CCRC Resident Finance Committees

Prepared By The Finance Committee Of
The Organization of Resident Associations
of New Jersey
ORANJ



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Part I – General Information

A. Introduction

You are a new member of your CCRC's Resident Finance Committee. As such you may be faced with questions from fellow Residents such as:

- I had to dig deeply into my savings to pay the Entrance Fee. I hope the governing board and management here know what they are doing. How can I tell?
- Monthly Service Fees go up annually – and more than just the cost of living. Can I afford to live here ten more years? What happens if I run out of money?
- There are plans to go further in debt to build more apartments and a new skilled nursing facility. How can I have confidence in this organization to provide my care in the future as promised – and not go bankrupt?

Organizational and financial structures vary from one CCRC to another, as do the Residence And Care Agreements being offered. Some CCRCs are individual entities, while others are one of several managed by a separate corporate entity. Resident Finance Committee members need to be aware of these differences. **However, it is essential that they be thoroughly familiar with the specific structures, policies and practices of their CCRC (See Guide Section II.C for a description of various CCRC contract types).**

B. Purpose

This Guide Book is intended to assist you, as a Resident Finance Committee member, as well as other interested Residents, with achieving a basic understanding of your CCRC's financial position and performance as reflected in its financial statements and other key documents. In so doing you will be better able to allay the financial concerns of fellow Residents – and to represent more effectively their financial interests and concerns in discussions with management. This Guide Book provides basic information, including:

- What is needed for a CCRC to have long-term financial stability.
- How to dig useful financial information out of a CCRC's financial statements.
- A CCRC Resident's financial rights and protections under the law.

A 2006 survey of all member CCRCs conducted by the ORANJ Finance Committee found the primary financial concerns of Residents to be (1) **Rising Monthly Service Fees** and (2) **The Continued Long-Term Financial Stability Of Their Own Community**. In addition they voiced the need for more financial information, in understandable terms. The ORANJ Finance Committee, in recognition of these concerns, undertook the preparation of this Guide Book for CCRC Resident Finance Committee members, and other interested Residents.

Part II – Five Key Financial Topics

Part II of this Guide Book describes information concerning five topics pertinent to a basic understanding of the finances of any CCRC. For each topic, the Guide:

- Lists key “**POINTS TO REMEMBER**”.
- Suggests what Resident Finance Committee members should know and ask about concerning their CCRC’s finances.
- Identifies reference documents that provide additional information (Attachment A describes how to obtain a copy of each reference document).

A. Financial Statements

Background

CCRC Residents pay thousands of dollars in Monthly Service Fees. A major Resident concern is whether annual increases in these fees are warranted. CCRC contracts typically place no limitation on the amount that Providers can increase Monthly Service Fees, and no statutory or regulatory limits exist, although the New Jersey Department of Community Affairs certifies all increases (See Guide Section II.D2.). A key role of the Resident Finance Committee is to seek to limit the amount of Monthly Service Fee increases that are required – **while maintaining their CCRC’s financial soundness and high quality services that meet the needs of aging Residents.**

CCRC’s operate on an annual financial cycle. Financial statements are prepared which both identify financial plans for the future and account for expenditures during the reporting period. They can provide the basis for assessing the effectiveness of ongoing financial performance – and for making suggestions during the budget preparation process.

A1. Budgets – Typically, operating budgets and capital budgets are prepared annually by a CCRC. Hopefully, members of the Resident Finance Committee will be involved in ongoing, cooperative discussions with management during the budget preparation process.

a. **Operating Budget** – The operating budget estimates revenues and expenses anticipated for operations during the following fiscal year. Figure 1 on page 6 illustrates a type of layout one might expect to see for an operating budget as compared to the approved budget for the preceding year.

POINTS TO REMEMBER – during the operating budget preparation process.

Focus on controllable expenses and revenues. For example, Resident service fee revenues and expenses related to administration and dining services are controllable; earned entrance fee revenues and tax expenses are not. Key considerations are:

- **Monthly Service Fee Increases** – Ask your Chief Financial Officer to explain your Provider’s policy regarding the limiting of annual increases. Know what your CCRC’s contracts and Disclosure Statements say in this regard.

- Staffing – Effective utilization of a sufficient number of staff (including consultants as applicable) is essential to maintain high quality services. On the other hand, controlling staffing level creep and annual wage increases are critical to controlling expenses, as payroll costs will likely account for two-thirds of annual expenses. Ask your Chief Financial Officer to discuss comparable wage rates in the area, especially for health care positions – and key parameter trends such as those for nursing hours per patient-day; staff/Resident ratios; and per diem costs for each level of care.
- Major Purchase Contracts – for such items as insurance, health care services, food services, and other services provided by consultants. Ask if they are considered for open bid contract renewal annually to obtain best available prices without adversely affecting quality.
- Projected Occupancy And Unit Turnover Rates – Both strongly affect operating revenue, as well as long-term financial stability and the availability of cash to fund obligations in the future.

Compare budget proposals with historical results – to gain perspective on current actual results; to assess the reasonableness of budget assumptions (such as occupancy/turnover rates and salary/wage increases); and to support suggestions for limiting Monthly Service Fee raises while maintaining high quality services.

- b. Capital Budget – Ideally, management should discuss potential major capital projects and prioritize them with Resident Finance Committee input during the budget preparation process. The amounts that management plans to spend on such items as new facilities and equipment are accounted for in the capital budget (or other similar name), which is an important consideration for any CCRC. For a mature CCRC, about 3% of total depreciable assets needs to be spent every year on replacements, upgrades, and new items. This will keep the CCRC attractive and, of equal importance, competitive in the marketplace – and will benefit future Residents. Accounting standards identify which expenses can be capitalized.

POINTS TO REMEMBER – during the capital budget preparation process.

- Financing Plans – Ask your Chief Financial Officer about the source of financing for major capital projects and the extent to which Monthly Service Fees will be impacted.
- Greater Flexibility – The capital budget may have more flexibility than the operating budget as a source of cost reduction options.

A2. Operating Statement – There is nothing magical about a CCRC’s financial operating statements. For the most part, they are fairly straightforward. The Operating Statement (Figure 2 on pages 7 and 8 illustrates a sample layout) reflects the actual income and expenses and net gain or loss from operations experienced during the reporting period – typically a calendar quarter or for the full year – compared to equivalent data for the same reporting period during the prior year. The Operating Statement also reflects, (1) nonoperating gains or losses from activities associated with Unrestricted Assets (such as investments) and with Restricted Assets (such as

bequests and benevolence funds); (2) the increase or decrease in Net Assets; and (3) the Net Assets or Deficiency at the beginning and end of the reporting period.

CCRCs are a little different from many other institutions because they typically receive a lot of money “up front” from new Residents, and only a small portion of these funds is considered as income for the accounting period in which the money is received (included in “Earned Entrance Fees” in Figure 2). The rest is set aside for future periods and is accounted for in various ways, as described in Attachment B.

POINTS TO REMEMBER – when reviewing periodic operating statements.

- Focus On Large, Controllable Items – such as health care and maintenance expenses, rather than large uncontrollable items such as interest expense and depreciation.
- Check Net Assets (Deficiency) – A large surplus or loss at year end deserves an explanation, and discussion of planned remedial steps.
- Check Major Variances – Get an explanation for major differences between actual figures as compared to the budget and/or last year’s actual figures.
- Get Behind The Numbers – Ask about the reasons for sharp increases or decreases – for example, what do expenses for consultant fees and the like really represent? Are Bond Covenants impacting operations?
- Investments – Any large non-realized investment gain or loss deserves an explanation and discussion of any planned remedial steps.
- Management Fees – Find out if management fees reflect current market conditions.

Depreciation is an accounting recognition of the gradual wearing out (or obsolescence) of a CCRC’s facilities and equipment. In order to offset this decline and to remain competitive with other CCRCs, management must continually replace, improve or renew the facilities. (New sidewalks don’t mean that the monthly rates will be going up; the funds for the project have already been built into the Residents’ rate structure through the recognition of the fact that depreciation is a basic expense of operating a CCRC.)

A3. Balance Sheet - The Balance Sheet (Figure 3 on page 9 illustrates a sample layout) shows what assets are on hand as of a certain date, typically the final day of a month, quarter or year, what liabilities are outstanding on that same day, and net assets – compared to the equivalent data for the prior year.

POINTS TO REMEMBER – when reviewing the Balance Sheet.

- Compare Present Values To Those Of The Prior Year – Ask for an explanation regarding significant difference in values from year to year, such as for cash and investments. It is desirable for the sum of these two to be increasing from year to year.
- Unusual Increases In Accounts Payable Or Receivable – may reflect an inability to meet current obligations and deserve an explanation.

- Capital Improvements Funded By Bank Loan – would show as a current liability, and deserve an explanation as to how this debt will be repaid. Are reserves available for planned expansions or pending major repairs?
- Noncurrent Assets Whose Use Is Limited – typically include cash reserves required by New Jersey statute (see Guide Section II.D1) and to meet Bond Covenants – including financial ratios (see Guide Section II.B).
- Deferred Revenue From Entrance Fees – represents Entry Fees that will gradually be taken as “Earned Entrance Fee” revenue.
- Total Net Assets (Deficiency) – A significant Total Asset Deficiency such as that indicated in Figure 3, may exist, especially in early operating years or associated with a bond refinancing. This is not cause for concern, so long as a CCRC maintains a high occupancy level and has cash to cover obligations.

A4. Auditor’s Report – Ideally, Resident Financial Committee members will have the opportunity to meet with representatives of the auditing firm to discuss the Auditor’s Report. At the end of each fiscal year, a certified accounting firm audits a CCRC’s financial records and transactions for the year. The Auditor’s Report, available about two months after completion of the audit, includes certified Financial Statements for the CCRC’s two most recently completed fiscal years. It also includes the auditor’s opinion as to whether those Financial Statements fairly present the financial position of the CCRC at year-end – and conform to generally accepted accounting principles in the United States. A “clean report” is one where the auditor’s opinion is “unqualified” – i.e. it does not list any “accounting exceptions”.

POINTS TO REMEMBER – when reviewing the Auditor’s Report.

- Management Practices Are Not Evaluated – Contrary to what is often assumed, auditors do not evaluate the adequacy of fiscal management practices, unless the CCRC Provider requests a “Management Letter”. If one was prepared, ask what actions are planned to address the Auditor’s recommendations.
- Auditor’s Opinion – Ask CCRC management to explain what steps are being taken to resolve any “accounting exceptions” reported by the Auditor.
- Variances - Ask for an explanation, if there are substantial differences between the financial statements in the Auditor’s Report and those in periodic reports.
- Future Services Obligation (See Guide Section II.B2) – Review the results of Future Services Obligation calculations, often described in an Auditor’s note.
- Auditor’s Notes – Auditor’s Notes include other useful information such as that related to financial assistance provided to Residents; outstanding bank loans and lines of credit; employee pension plans; and unrestricted and restricted assets and how they are invested.

Figure 1

JOLLY CCRC

Sample Operating Budget Compared to Prior Year's Approved Budget

	<u>2010 Budget</u>	<u>2009 Budget</u>	<u>Variance</u>
Revenues			
Earned Entrance Fees	\$ 5,897,000	\$ 5,841,000	\$ 56,000
Residential Service Fees	11,963,000	11,704,000	259,000
Skilled Nursing Fees	4,241,000	4,401,000	(160,000)
Assisted Living Nursing Fees	3,656,000	4,352,000	(696,000)
Interest and Dividend Income	1,260,000	1,505,000	(245,000)
Other Income	1,599,000	1,634,000	(35,000)
Total Revenues	<u>\$28,616,000</u>	<u>\$ 29,437,000</u>	<u>\$ (821,000)</u>
Operating Expenses			
Administration and General	\$ 1,272,000	\$ 1,305,000	\$ (33,000)
Finance and Human Resources	2,332,000	2,206,000	126,000
Resident Services	78,000	79,000	(1,000)
Dining Services	3,879,000	3,485,000	394,000
Marketing	682,000	595,000	87,000
Health Care	5,824,000	6,109,000	(285,000)
Maintenance and Grounds	3,114,000	2,969,000	145,000
Security	67,000	68,000	(1,000)
Housekeeping	875,000	817,000	58,000
Taxes and Insurance	1,168,000	1,330,000	(162,000)
Depreciation and Amortization	3,252,000	3,253,000	(1,000)
Interest Expense	3,480,000	2,650,000	830,000
Total Operating Expenses	<u>\$26,023,000</u>	<u>\$ 24,866,000</u>	<u>\$ 1,157,000</u>
Net Operating Revenues	<u>\$ 2,593,000</u>	<u>\$ 4,571,000</u>	<u>\$ (1,978,000)</u>

Figure 2

JOLLY CCRC

Sample Layout for Statements of Operations and Changes in Net Assets

	<u>Year Ending</u> <u>2009</u>	<u>December 31</u> <u>2008</u>
Revenues		
Earned Entrance Fees	\$ 5,721,000	\$ 5,567,000
Residential Service Fees	11,994,000	11,560,000
Skilled Nursing Fees	4,921,000	4,329,000
Assisted Living Nursing Fees	4,152,000	4,057,000
Interest and Dividend Income	1,175,000	930,000
Other Income	<u>1,634,000</u>	<u>1,175,000</u>
Total revenue	<u>\$ 29,597,000</u>	<u>\$ 27,618,000</u>
Operating expenses		
Administration and General	\$ 1,338,000	\$ 1,280,000
Finance and Human Resources	2,240,000	2,175,000
Resident Services	78,000	72,000
Dining Services	3,595,000	3,477,000
Marketing	582,000	590,000
Health Care	5,949,000	5,804,000
Maintenance and Grounds	3,059,000	2,723,000
Security	67,000	67,000
Housekeeping	826,000	756,000
Taxes and Insurance	1,128,000	1,105,000
Depreciation and Amortization	3,163,000	4,519,000
Interest Expense	2,400,000	2,400,000
Provision for bad debt	<u>64,000</u>	<u>46,000</u>
Total Operating Expenses	<u>\$ 24,489,000</u>	<u>\$ 25,014,000</u>
Gain (Loss) from Operations	<u>\$ 5,108,000</u>	<u>\$ 2,604,000</u>

Figure 2 (Continued)

Statement of Changes in Net Assets

	<u>Year Ending</u>	<u>December 31</u>
	<u>2009</u>	<u>2008</u>
Gain (Loss) from Operations	\$ <u>5,108,000</u>	\$ <u>2,604,000</u>
Nonoperating Gains (Losses), Net:		
Loss on Early Extinguishment of Debt	\$	\$ (2,345,000)
Realized Gain (Loss) on Investments	(6,143,000)	(2,218,000)
Net change in Fair Value of Derivative Instrument	3,263,000	(4,137,000)
Unrealized Gain (loss) on Investments	<u>8,164,000</u>	<u>(7,493,000)</u>
Total Nonoperating Gain (Loss), Net:	\$ <u>5,284,000</u>	\$ <u>(16,193,000)</u>
Increase (Decrease) in Unrestricted Net Assets	\$ <u>10,392,000</u>	\$ <u>(13,589,000)</u>
Temporarily Restricted Net Assets:		
Contributions	\$ 46,000	\$ 88,000
Interest Income	33,000	24,000
Unrealized Gain (loss) on Investments	108,000	(45,000)
Realized Gain (Loss) on Investments	<u>(64,000)</u>	<u>(8,000)</u>
Increase (decrease) in Restricted Net Assets	\$ 123,000	\$ 59,000
Increase (Decrease) in Net Assets	\$ <u>10,515,000</u>	\$ <u>(13,530,000)</u>
Net Assets (Deficiency), Beginning of Year	\$ <u>(9,697,000)</u>	\$ <u>3,833,000</u>
Net Assets (Deficiency), End of Year	\$ <u>818,000</u>	\$ <u>(9,697,000)</u>

Figure 3
JOLLY CCRC
Sample Layout for a Balance Sheet

	<u>December 31</u>	
	<u>2009</u>	<u>2008</u>
<u>Assets</u>		
Current Assets:		
Cash	\$ 5,408,000	\$ 2,323,000
Investments	23,446,000	21,336,000
Assets Whose Use is Limited, Current Portion	5,667,000	2,038,000
Accounts Receivable	1,083,000	698,000
Supplies and Other Current Assets	549,000	334,000
Total Current Assets	\$ 36,153,000	\$ 26,729,000
Noncurrent Assets Whose Use is Limited	4,982,000	8,670,000
Property and Equipment, Net	58,424,000	56,269,000
Deferred Financing Costs, Net of Amortization	744,000	803,000
Total Assets	\$ <u>100,303,000</u>	\$ <u>92,471,000</u>
<u>Liabilities and Net Assets (Deficiency)</u>		
Current Liabilities:		
Current Portion of Long-Term Debt	\$ 3,360,000	\$ 0
Accounts Payable and Accrued Expenses	1,694,000	1,427,000
Accrued Interest Payable	605,000	243,000
Total Current Liabilities	\$ 5,659,000	\$ 1,670,000
Refundable Waiting List Deposits	280,000	312,000
Refundable Entrance Fees	11,410,000	11,115,000
Deferred Revenue from Entrance Fees	17,901,000	18,087,000
Deferred Revenue from Forward Delivery Agreements	1,881,000	2,007,000
Long-Term Debt Less Current Portion	61,480,000	64,840,000
Derivative Instruments	874,000	4,137,000
Total Liabilities	\$ <u>99,485,000</u>	\$ <u>102,168,000</u>
Net assets:		
Unrestricted Net Assets (Deficiency)	\$ 106,000	\$ (10,286,000)
Temporarily Restricted Net Assets	712,000	589,000
Total Net Assets (Deficiency)	\$ 818,000	\$ (9,697,000)
Total Liabilities and Net Assets (Deficiency)	\$ <u>100,303,000</u>	\$ <u>92,471,000</u>

B. Long-Term Financial Stability **Background**

Long-term financial stability and solvency are essential to the continuing existence of your CCRC. Your Residents typically have handed over substantial financial assets to pay an Entry Fee and must pay increasing Monthly Service Fees for the rest of their lives. In return, your CCRC Provider promises to provide high-quality housing and the full range of health care services needed during each Resident's remaining lifetime, perhaps ten to twenty years or more. For your Provider, this requires sound financial and actuarial management and long-term planning – to ensure fulfilling its obligations to all Residents.

CCRC Accreditation and the ability to continue meeting Bond Covenants, such as financial ratios and occupancy level, provide some assurance in this regard. However, only actuarial analyses can provide an authoritative indication of the long-term financial health of your CCRC. Two techniques, both employing actuarial principles as described below, can be used for this purpose, (1) Future Services Obligation (FSO) Calculations and (2) Detailed Actuarial Analyses.

The following are appropriate items to discuss with your Chief Financial Officer:

Bond Covenants:

- Results of the last four quarterly tests of Bond Covenants, including trends that are indicative of the financial health of the CCRC.
- Remedial steps taken, for any covenants not met or adverse trends.

FSO Calculations and Detailed Actuarial Analyses:

- How often is each type of analysis performed?
- Are they performed by an independent, certified actuary?
- How is it assured that realistic assumptions are used?
- Specific steps taken to deal with any recent adverse results or trends.

POINTS TO REMEMBER – regarding FSO Calculations and Detailed Actuarial Analyses:

- Results of actuarial analyses, while the best available indicator, do not guarantee long-term financial stability.
- Results of FSO Calculations and Detailed Actuarial Analyses are very sensitive to the financial assumptions employed. Therefore, it is preferred to have them performed by an independent, certified actuary with experience in the CCRC industry, to ensure an objective result based on realistic assumptions.
- They can be useful in explaining to Residents why seemingly excessive reserves are needed to fulfill future obligations to Residents.
- They may also be a useful marketing tool, demonstrating that a CCRC Provider is employing effective fiscal management practices.
- They do not apply to CCRC Providers offering only Type C plans, as their Residents pay for the full cost of long-term health care services when that care is received (See Guide Section II.C3).

Ask your Chief Financial Officer to describe steps taken to assure that the long-term financial health of your CCRC is being maintained – such as actuarial studies, independent assessments, financial ratio trends, and an annually updated Strategic Plan. Know what your CCRC’s Disclosure Statements specify in this regard (See Guide Section II.D3).

B1. Long-Term Financial Plans – The long-term financial plans for your CCRC are most likely reflected in the strategic planning documents prepared by your Provider. Hopefully, your CCRC already has an Integrated Strategic Plan, reviewed and updated annually, which clearly links to five Operational Plans, each with a financial component.

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

Ideally, members of the Resident Finance Committee were consulted in the process of developing both Strategic and Operational Plans – and during annual updates as well.

POINTS TO REMEMBER – concerning long-term financial plans.

- Operating Budget Preparation – Annual operating budgets should be consistent with both Strategic and Operational Plans.
- Capital Budget Preparation – Annual capital budgets should be consistent with the Strategic Plan and the Five-Year Capital Repair and Replacement Plan.

B2. Future Services Obligation Calculation – The term “Future Services Obligation”, FSO for short, refers to the amount of additional funding, if any, required for a Provider to cover the anticipated cost of providing **current Residents** with all contractually obligated services for their remaining lifetimes. The FSO calculation establishes three values:

- Projected Costs - The estimated total cost for meeting all obligations to current Residents throughout their projected remaining lifetimes.
- Projected Income - The total income expected from Residents throughout their remaining lifetimes, including all their 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 Entrance 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) outlines the methodology to be used in making the FSO Calculation, in its “Audit and Accounting Guide, Health Care Entities”, using actuarial methods to establish projected costs and income. Attachment C provides a more detailed description of the FSO Calculation and typical values to be expected.

Observations:

The FSO calculation provides one indication regarding a CCRC Provider’s long term financial health. However, it is a rather simplistic one in view of its assumptions – for example, (1) it assumes no new Residents; (2) it ignores new and refundable entrance fees; and (3) it does not reflect capital expenditures, long term debt, or any planned facility replacement or expansion.

B3. Detailed Actuarial Analyses – A Detailed Actuarial Analysis provides an authoritative indication as to whether a CCRC will remain solvent and be able to fulfill its contractual obligations to **current and future Residents**. It addresses factors not considered in the FSO calculation – including the effects of new Residents, long term debt, capital expenditures, and planned facility expansion.

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 viewed as being in good long-term financial health.

- **Current Resident Obligations Covered** - All future obligations to current Residents are fully covered, indicated by a calculated “funded status” of at least 100% (preferably in the range of 105 to 110%). This actuarial analysis is similar to the FSO calculation. However, it employs a much more rigorous methodology, one which accounts for the increasing medical needs of aging Residents.
- **Adequate New Resident Fees** – Entry and other fees paid by a typical group of new Residents will cover the costs of all contractual obligations assumed by the CCRC for those new Residents.
- **Positive Cash Balances Are Projected For At Least 20 Years** – considering both current and future Residents – indicating sufficient cash to pay for ongoing expenses.

Attachment D provides a more detailed description of Detailed Actuarial Analyses and typical values to be expected.

Observations:

The results of Detailed Actuarial Analyses are quite sensitive to the financial assumptions employed, especially for occupancy. Even a 1% decrease in the assumed occupancy for Independent Living Units will have a significant impact on analysis results.

References – References providing additional information related to the long-term financial stability of CCRCs:

- Financial Ratios & Trend Analysis of CARF-CCAC (Commission On Accreditation Of Rehabilitation Facilities – Continuing Care Accreditation Commission) Accredited Organizations
- CARF ASPIRE to Excellence Standards Manual.
- “Audit and Accounting Guide, Health Care Entities” published by the AICPA.
- Actuarial Standard of Practice #3, “Practices Relating to Continuing Care Retirement Communities” published by the American Academy of Actuaries.

See Attachment A for how to obtain a copy.

C. CCRC Contracts

Background

The CCRC contract, referred to as 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 Resident and Provider agree. It defines costs of benefits and services to be received as well as conditions of residence. A New Jersey statute, referred to as “**The Act**”, is the law governing CCRC operations (See Guide Section II.D1). It spells out in detail the format and content to be included in contracts offered by CCRC Providers. New Jersey regulations, referred to as “**Chapter 19**” (See Guide Section II.D2), describe additional requirements concerning CCRC contracts.

The Act and **Chapter 19** require that, before signing a contract, prospective Residents receive a **Disclosure Statement** (See Guide Section II.D3) which includes a CCRC’s Certified Financial Statements and information regarding financial stability. Contracts offered by a CCRC Provider must have been certified by the New Jersey Department of Community Affairs, the regulating authority which also provides ongoing monitoring of CCRC operations (See Guide Section II.D).

Each CCRC Provider may offer a variety of contract plans, which generally can be divided into three basic types as described below – Types A, B, and C. In addition, a plan may be either “Refundable” or “Nonrefundable”, as spelled out in the contract – although those which are “Refundable” are usually Type B or C.

- C1. Type A – All-Inclusive Plans** – also called Life Care Contracts. The fees in this plan pay for shelter, residential services and amenities, and long term nursing care as needed, at no additional cost except for adjustments to cover increases in operating expenses. There are slight variations among facilities, but, usually, in an All-Inclusive Plan, health care costs are paid through all of the fees paid to the facility by all of the Residents, regardless of individual Resident needs.
- C2. Type B – Modified Plans** – This plan also includes shelter, residential services and amenities. However, the fees in this plan cover only a portion of health care offered, usually for a specified time in the long-term skilled nursing facility. After the specified time, a Resident who needs the care pays for it at an additional charge, or the Resident may pay for the health care at a fee which is less than the fee charged for non-Residents.
- C3. Type C – Fee-For-Service Plans** – The fees in this plan usually pay for shelter, residential services and amenities, and sometimes emergency health care. It usually guarantees access to long-term care, but the Resident who receives long-term care pays for it as an additional cost.

Monthly Service Fees for Types A, B, and C plans vary according to the type of plan, size of the living unit, number of occupants, and number of services included in the contract.

C4. Other Plans - There are other types of plans which are used less frequently, (1) Type D - Rental contracts which require no Entry Fee and monthly fees increase directly according to the level of care provided; (2) Equity Contracts where Residents have membership in a corporation and sign proprietary lease agreements; and (3) Continuing Care at Home Plans where health care and other services are provided in the individual's home by a certified CCRC Provider.

POINTS TO REMEMBER – concerning CCRC contracts.

Be conversant with the key financial provisions and terms in the contract plans offered at your CCRC, including ongoing revisions thereto – to assist in discussions with Residents and management. Key financial provisions include:

- The details of fee provisions in the various contracts offered by your Provider.
- The 2% per month “use of Entry Fee”, often overlooked and misunderstood.
- Rescission; termination; specific terms regarding payment of refunds (for both refundable and non-refundable contracts); and how care levels and related fees can change.
- The potential tax consequences related to imputed interest associated with refundable contracts.
- Resident rights to challenge or revise contracts.

References - References providing additional information related to CCRC contracts:

- **The Act** –New Jersey Public Law 52:27D-330
- **Chapter 19** - Continuing Care Retirement Community Regulation and Financial Disclosure Act Regulations
- Continuing Care Retirement Communities – A Guide Book for the New Jersey Consumer
- Consumer Rights in a Continuing Care Retirement Community

See Attachment A for how to obtain a copy.

D. New Jersey Statutes and Regulations Related To CCRC Finances

Background

In the mid 1980s the New Jersey Legislature recognized the potentially tragic consequences that could befall New Jersey Residents of a CCRC, should it become insolvent or unable to provide responsible care. The Legislature passed “The Continuing Care Retirement Community Regulation and Financial Disclosure Act” (New Jersey Public Law 52:27D-330) known as “**The Act**”, which became effective on March 2, 1987. **The Act** assigned responsibility for the monitoring and regulating of CCRCs to the Department of Community Affairs (DCA).

Subsequently, DCA Issued “Chapter 19 – Continuing Care Retirement Community Regulation and Financial Disclosure Act Regulations”, known as “**Chapter 19**”, to enable DCA to implement **The Act** and CCRC Providers to comply with **The Act’s** requirements. A major focus of both **The Act** and **Chapter 19** is the requirement for a CCRC Provider to prepare a **Disclosure Statement**, updated annually, intended to fully inform current and prospective CCRC Residents about the CCRC’s facilities, services offered, fees involved, and financial position. Both **The Act** and **Chapter 19** spell out in detail what must be included both in the **Disclosure Statement** and in the CCRC contracts offered to prospective Residents by a Provider.

D1. “The Act” – New Jersey Public Law 52:27D-330 – All Paragraphs of **The Act** are listed in Attachment E, with paragraphs of particular relevance to CCRC finances marked with an ***asterisk***. **The Act** includes a number of provisions that are of financial interest to CCRC Residents, particularly:

- Liquid Reserves – **The Act** requires the Provider to maintain liquid reserves for use in assuring the continuation of services, if the Provider encounters financial difficulties. The amount is relatively small, only about 15% of projected annual operating expenses, excluding depreciation.
- Disclosure Statement – **The Act** spells out format and content requirements for **Disclosure Statements** – as discussed below.
- CCRC Contracts - **The Act** also spells out in detail the format and content requirements for any CCRC contract offered by a Provider to prospective Residents (See Guide Section II.C).
- A Consumers Guide; An annual Directory Of Certified CCRCs; and A Residents’ Rights Booklet – must be made available to the public by DCA.

POINTS TO REMEMBER – when reviewing **The Act**:

- Resident Complaints – Providers are required to make knowledgeable personnel available to address any Resident complaints about the operation and management of the CCRC.
- Quarterly Meeting With Governing Body – The governing board or a designated representative, who is not the Chief Executive Officer or other staff member, must hold quarterly meetings with Residents or their elected representatives for the purpose of free discussion of various subjects including

income, expenditures, and financial matters related to the CCRC. In addition, the governing board must include at least one Resident as a full voting member and must consult and discuss with representatives of Residents any proposed action that might significantly affect the well-being of Residents or the financial stability of the CCRC, before taking the proposed action.

D2. “Chapter 19” – CCRC Regulations – Attachment F provides a summary description of the parts of **Chapter 19** that address financial interests of CCRC Residents. Much of the information presented in **Chapter 19** duplicates that found in **The Act**. Other provisions of **Chapter 19** of financial interest to CCRC Residents include:

- 30 Day Notice - Residents must be given a minimum of 30 days advance notice prior to the implementation of any change in Monthly Service Fees or in the scope of care or services provided.
- Resident Complaints – A Resident may file a complaint with DCA concerning any matter subject to **The Act** or **Chapter 19**, which will be responded to by DCA.
- Removal For Failure To Pay – The Provider may remove a Resident for “just cause”. However a Resident’s failure to pay Monthly Service Fees cannot be considered a “just cause”, until (1) the entire unearned entrance fee plus any third party insurance are earned by the Provider and (2) a minimum of 90 days has elapsed following the date of failure to pay, during which time the Resident pays a reduced fee based on current income.
- DCA Authority – DCA can issue cease and desist orders; order a Provider to take an affirmative action to carry out the purpose of **The Act**; revoke a certification for cause; and can apply for a court appointed trustee or for DCA to take over management of a CCRC to rehabilitate it, to take remedial actions, or if necessary to liquidate the facility, giving due consideration to the welfare of Residents under contract.

POINTS TO REMEMBER – when reviewing **Chapter 19**:

- Long-Term Financial Viability – The DCA has advised that it requires Providers to annually update and make available to the DCA five-year projections of revenues and expenses.
- DCA Certifications – DCA must certify all **Disclosure Statement** amendments and Monthly Service Fee increases prior to their being implemented.
- Annual Budget Reviews – While reviewing proposed Monthly Service Fee increases for certification, DCA has advised that it compares them with cost of living adjustments and Philadelphia area inflation rates. DCA also examines the Provider’s expense budget for items that are either excessive or unrelated to operation of the CCRC.

D3. Annual Disclosure Statements – A CCRC’s **Annual Disclosure Statement** must be filed with and certified by DCA within six months following the end of each fiscal year. Pertinent financial information is presented in **Annual Disclosure Statements**:

- Monthly Service Fee Increases – for the past five years.
- Financial Provisions To Ensure Long-Term Financial Stability – The Provider must identify provisions such as reserves and investments that will enable the Provider to fully carry out its future contractual obligations to all Residents.
- Monthly Service Fee Adjustments – A description of how the Provider may adjust any recurring fees and any limitation on these adjustments.
- Fees And Services – The Provider must list all fees required of current and prospective Residents and all services provided under the contracts.
- Financial Performance Statement – The Provider must explain any material differences between the operating Budget filed previously – and actual results of operations during that fiscal year.
- Investments - The Provider must indicate the manner in which funds are invested and the names and experience of persons who will make investment decisions.
- Operating Budget – A copy of the projected income statement for the next fiscal year.
- Auditor’s Report – a copy of the most recently issued Auditor’s Report and certified financial statements for the two most recently completed fiscal years.
- Description Of Any Planned Additions – including the start of construction date, the expected completion date, and contingencies that may defer same.
- Current Contracts – A copy of each CCRC contract plan currently offered to prospective Residents, including related Entrance Fees and Monthly Service Fees.

POINTS TO REMEMBER – when reviewing **Disclosure Statements**:

- Limitations – The **Disclosure Statement** is of limited value regarding current operations, since financial information, while accurate and useful for reference, tends to be late, since the **Disclosure Statement** is not filed until up to six months after the end of the most recently completed fiscal year.
- Annual Disclosure Statement – The current **Annual Disclosure Statement** must be made available to current Residents.

D4. New Jersey Income Tax Deductions – Some real estate tax and medical expense payments made by CCRC Residents may qualify as deductions on their New Jersey personal income tax returns. Instructions for preparing Form NJ-1040 personal tax returns indicate that:

- Real Estate Tax Deductions – Residents of CCRCs may qualify for a property tax deduction as a homeowner if their CCRC contract requires that they bear the proportionate share of property taxes attributable to their living unit.
- Medical Expense Tax Deductions – As a general rule, medical expenses allowed for Federal income tax purposes will be allowed for New Jersey income tax purposes.

POINTS TO REMEMBER – concerning New Jersey state income tax return deductions. The information provided herein is not to be construed in any way as providing tax advice or recommendations. CCRC Residents are responsible for making their own decisions related to their personal tax returns, and for this they are advised to consult with appropriate tax advisors (for information concerning Federal tax deductions, See Guide Section II.E3).

References - References providing additional information related to **The Act, Chapter 19, Disclosure Statements**, and New Jersey income tax deductions:

- **The Act** –New Jersey Public Law 52:27D-330
- **Chapter 19** - Continuing Care Retirement Community Regulation and Financial Disclosure Act Regulations
- Continuing Care Retirement Communities – A Guide Book for the New Jersey Consumer
- Consumer Rights in a Continuing Care Retirement Community
- 2009 Form NJ-1040 Line by Line Instructions.

See Attachment A for how to obtain a copy.

E. Federal Regulations Related To CCRC Finances

Background

Section 501 (c) (3) of the Internal Revenue Code allows incorporated CCRCs to be classified as a public charity and therefore exempt from paying federal income tax. This substantially reduces expenses and the Resident fees that would be required to support them. Organizations that qualify under this Section of the Code are referred to as Not-For-Profit 501 (c) (3) organizations. Internal Revenue Service Publication 557, “Tax Exempt Status for Your Organization”, discusses the rules and procedures required of 501 (c) (3) organizations. Further, IRS Ruling 72-124 specifies additional requirements that senior living facilities such as CCRCs must meet to qualify as a 501 (c) (3) organization. Resident Finance Committee members should become familiar with the provisions in Publication 557 and IRS Ruling 72-124 that relate to CCRCs.

Once classified as Not-For-Profit, the Internal Revenue Service monitors an organization’s operations for compliance using reporting tools such as “FORM 990 - Return of Organization Exempt From Income Tax”, the annual report required of all 501 (c) (3) CCRCs. Detailed financial data entered in the FORM 990 include information which can provide a basis for assessing the reasonableness of past financial performance – and for making suggestions during the budget preparation process regarding both revenues and expenses.

E1. 501 (c) (3) CCRCs

Points To Remember

- a. Lowest Feasible Charges - Publication 557 (Chap 3) requires that a Not-For-Profit CCRC explain in its application how charges will be determined and whether charges are based on providing service at the lowest feasible cost to Residents.
- b. Pay Market Rates - Not-For-Profit CCRCs may pay only a reasonable market rate for services which vendors and management provide to the corporation. The IRS watches to make sure such payments are not at unfair levels or disguised to take profit beyond the value of the services provided.
- c. Preserving Not-For-Profit Status – A CCRC must comply with a number of requirements on a continuing basis to preserve its Not-For-Profit status, including:
 - Must be organized and operated exclusively for charitable purposes, which are beneficial to the public interest.
 - Operate so as to satisfy the financial security needs of its Residents – by meeting two conditions:
 - 1) It must be committed to an established policy of maintaining in residence any persons who become unable to pay their regular charges. This may be done by drawing on reserves; by seeking support from local/federal welfare agencies; by soliciting funds from a sponsoring organization, other Residents, or the general public; or by some combination thereof.

- 2) It must operate so as to provide services to its Residents at the lowest feasible cost, while not sacrificing Residents' dignity and independence – taking into consideration such expenses as debt service and maintaining adequate reserves to insure lifetime care for each Resident and for physical expansion to meet the needs of the community.
 - No part of the net earnings can be used for the benefit of any private shareholder or individual.
 - Profits or “margins” must be plowed back into the charitable mission of the CCRC – for example, funding to provide senior housing and health care.
- d. Public Disclosure - Publication 557 (Chap 2) requires that exemption applications and annual returns be available for public inspection.
- e. Organization's Purposes – The organization's Articles of Incorporation must limit the organization's purposes to those described in Section 501 (c) (3).

E2. FORM 990 IRS Tax Reports

Points To Remember - When Reviewing Your CCRC's FORM 990 IRS Tax Reports.

- a. Information from the Form 990 can be as much as “six to twelve months old”, since the Form 990 is not required to be filed until five and a half months or more after the end of the Fiscal Year.
- b. Much of the information required for the Form 990 duplicates that found in more current, readily available reports – such as financial statements and the **Disclosure Statement**. However, the Form 990 terminology used to describe financial data is often more understandable, and the Form 990 does include useful information not readily available in other reports. For the year 2009 Form 990 and related schedules indicate:
 - Compensation of the five highest paid independent contractors for professional services (Form 990 Schedule A Part II).
 - Compensation of Officers, Directors, Trustees and Key Employees – also Highest Compensated Employees who received more than \$100,000 (Form 990 Parts VII, Section A, and if required on Compensation Information, Schedule J).
 - Information related to Not-For-profit status including sources, uses of funds, and expenses associated with fundraising and other revenue-producing activities and foundation operations (Form 990 Parts III, V, VI, VIII, and IX).
- c. Form 990 is a public document and should be made available to any Resident requesting access. (Note: Form 990 and all schedules contain the statement; “Open to Public Inspection”).

E3. Federal Income Tax Deductions – Some real estate tax and medical expense payments made by CCRC Residents may qualify as deductions on their Federal personal income tax returns. IRS Publications provide pertinent information.

- Real Estate Tax Deductions – IRS Publication 530 states that typical state and local government real estate taxes paid by a homeowner may be deductible (New Jersey CCRC Residents may qualify for a property tax deduction as a homeowner – See Guide Section II.D4).
- Medical Expense Tax Deductions – IRS Publication 502 states that the part of lump sum or monthly payments allocable to medical care under a lifetime health care contract with a CCRC may be deductible.

POINTS TO REMEMBER – concerning Federal income tax return deductions. The information provided herein is not to be construed in any way as providing tax advice or recommendations. CCRC Residents are responsible for making their own decisions related to their personal tax returns, and for this they are advised to consult with appropriate tax advisors (for information concerning New Jersey state tax deductions, See Guide Section II.D4).

References - References providing additional information related to 501 (c) (3) CCRCs, FORM 990's, and Federal income tax deductions:

- IRS Publication 557, "Tax Exempt Status for Your Organization".
- IRS Ruling 72-124 (Rev. Rul. 72-124), Requirements for "Homes for the Aged" to qualify as 501 (c) (3) organizations.
- Available FORM 990 filings for your CCRC.
- IRS Publication 530, "Tax Information for First Time Homeowners".
- IRS Publication 502, "Medical and Dental Expenses".

See Attachment A for how to obtain a copy.

Part III – Attachments

Attachment A To CCRC Finances Guide

Obtaining Copies of Reference Documents

- Financial Ratios & Trend Analysis of CARF-CCAC Accredited Organizations – Request or borrow a copy from your Chief Financial Officer. Also, available for purchase from the Web at www.carf.org/aging. Go to “eCatalog” and order in CCRC category.
- CARF ASPIRE to Excellence Standards Manual with Survey Preparation Questions - available for purchase from the Web at www.carf.org/aging. Go to “eCatalog” and order in CCRC category.
- Audit and Accounting Guide, Health Care Entities – Request or borrow a copy from your Chief Financial Officer. Also, available for purchase on the Web at www.cpa2biz.com. Search on Health Care Organizations Accounting Guide.
- Actuarial Standard of Practice #3, “Practices Relating to Continuing Care Retirement Communities” – available at no charge on the Web at www.actuarialstandardsboard.org. Go to Standards of Practice for downloading free of charge, as a PDF file.
- The Act – New Jersey Public Law 52:27D-330 – available at no charge on the Web at www.njleg.state.nj.us. Go to Statutes, then search on “52:27D-330” (must have quotes).
- Chapter 19 - Continuing Care Retirement Community Regulation and Financial Disclosure Act Regulations – available at no charge from Department of Community Affairs, Bureau of Homeowner Protection, P.O. Box 805, Trenton, NJ 08625-0805 or call 609-984-7574
- Continuing Care Retirement Communities – A Guide Book for the New Jersey Consumer - available at no charge from Department of Community Affairs, Bureau of Homeowner Protection, P.O. Box 805, Trenton, NJ 08625-0805 or call 609-984-7574
- Consumer Rights in a Continuing Care Retirement Community – available at no charge from Department of Community Affairs, Bureau of Homeowner Protection, P.O. Box 805, Trenton, NJ 08625-0805 or call 609-984-7574
- IRS Publications and Rev. Rul. 72-124 – available for downloading as a PDF file at no charge on the Web at www.irs.gov/formspubs or by calling 800-829-3676.
- 2009 Form NJ-1040 Line by Line Instructions - available for downloading as a PDF file at no charge on the Web at www.state.NJ.US/treasury/taxation/pdf/other.forms/tgi-ee/2009/091040i.pdf.
- Available Form 990 filings for your CCRC – Request or borrow a copy from your Chief Financial Officer. Also, available at no charge on the Web at www.guidestar.org/ at no cost, using "GuideStar Basic". You must register with GuideStar, then confirm your registration by exchange of e-mails (Call 800-784-9378 for help with using the GuideStar Web Site). A search for your CCRC by its "Legal Name" will take you to a list of available Forms 990 from the IRS for downloading as a PDF file.

Attachment B
To CCRC Finances Guide

Overview of Entrance Fee Accounting

The accounting for entrance fees is different for the refundable and non-refundable portions of the amount. In general terms, the non-refundable portion is amortized to income over the expected life of the Resident(s), as of the move-in date. The refundable portion of the entrance fee is amortized to income over the life of the Resident's apartment.

Example: On January 1, 2001, an 85-year old man moves into a brand new unit with a depreciable life of 30 years. He pays an entrance fee of \$300,000 under a 90% refundable contract. Refundable portion = \$270,000. Non-refundable portion = \$30,000. Estimated life of Resident = 7 years.

Year	Refundable Portion	Non-Refundable Portion
Year 1:	\$270,000 / 30 year life = \$9,000 of revenue.	\$30,000 / 7 year life = \$4,286 revenue.
Year 2:	\$9,000 revenue.	Remaining life = 6 years \$30,000 - 4,286 = \$25,714. \$25,714 / 6 years = \$4,286 of revenue.
Year 3	\$9,000 revenue.	Remaining life = 5 years. \$30,000 - (4,286 + 4,286) = \$21,428 / 5 years = \$4,286 of revenue.

On December 31, 2003 the Resident dies. Remaining non-refundable fee balance of \$21,428 - \$4,286 = \$17,142 is recorded as revenue.

On January 1, 2004 an 81-year old female moves into the apartment paying an entrance fee of \$330,000 under a 90% refundable contract. Refundable portion = \$297,000. Non-refundable portion = \$33,000. Estimated life of Resident = 10 years. Remaining apartment life is 27 years.

Year	Refundable Portion	Non-Refundable Portion
Year 4:	\$297,000 - \$27,000 (already taken into income) = \$270,000 / 27 year life = \$10,000 revenue.	\$33,000 / 10 year life = \$3,300 revenue.
Year 5:	\$10,000 revenue	Remaining life = 9 years. \$33,000 - 3,300 = \$29,700. \$29,700 / 9 years = \$3,300 of revenue.

Attachment C To CCRC Finances Guide

Future Services 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 Services Obligation calculation. The term “Future Services Obligation”, FSO for short, refers to the amount of additional funding, if any, required of a Provider 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 Future Services Obligation 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.

1. 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 of a Certified Actuary.
2. **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), less 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 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 $1.045 \times \$20,000,000 = \$20,900,000$.
- 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.

3. **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 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 $1.045 \times \$18,000,000 = \$18,810,000$.
- Similarly, for the following year the projected cash inflow would be $1.045 \times \$18,810,000 = \$19,656,450$ and so on for a total of 11 years.

4. 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 above example, the first future year deficit would be, $\$20,900,000 - \$18,810,000 = \$2,090,000$; the second year deficit would be, $\$21,840,500 - \$19,656,450 = \$2,184,050$ and so on for all 11 years.

5. 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%.

6. Finally, the Future Services Obligation, **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 Future Services Obligation is calculated to be 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 Future Services Obligation is calculated to be a positive number, the CCRC Provider is required to book this amount as a loss and an additional liability, since the current deferred Resident Entrance Fee account balance is not sufficient to cover projected future service obligations to current Residents. From the above example:

- 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 Future Services Obligation 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 Future Services Obligation 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 valid (but rather simplistic) indication as to whether a CCRC has sufficient financial resources to meet its contractual obligations to **all Residents**. The methodology employed reflects 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 facility 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 and Skilled Nursing.
- It neglects long term debt and refundable entrance fees.

Also, it is essential to note that the result of the Future Services Obligation calculation is very sensitive to the assumptions used in the calculation, especially:

- Cost inflation rate.
- Revenue increase rate.
- Discount factor.
- Predicted life expectancy of Residents.

For example, (1) 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 (2) A 1% change in the assumed discount factor or a one 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 Future Services Obligation calculation performed by an independent Certified Actuary who has experience in the CCRC industry, to ensure obtaining an objective result, based on realistic assumptions.

Attachment D To CCRC Finances Guide

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 in order 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.

1. Current Resident Obligations Covered – All future obligations to current Residents are fully covered, indicated by a “funded status” of 100% or more. This actuarial analysis is similar to the FSO calculation but employs a much more rigorous methodology.

More precisely stated, 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% (preferably in the range of 105 to 110%).

This is tested by the “**actuarial balance sheet**” – to compare actuarial assets and liabilities associated with past and present Residents, as of the valuation date.

Assets – 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 fee increases.

- The actuarial value of physical property in service on the valuation date (allocated to current Residents).
- Appropriate provision for surplus.

Liabilities – 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.
 - Actuarial present value of any long-term debt.
 - The actuarial present value of the expense involved with the future use of physical property (allocated to current Residents).
2. **Adequacy of New Resident Fees** – New Residents’ fees cover the cost of all future obligations to those new Residents. This condition is met if the sum of the entry 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**” – analyzing the prospective revenues and expenses associated with a typical group of new Residents entering the CCRC.

The revenue side of this analysis reflects:

- Entry 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).
- Appropriate provision for surplus.

The expense side of the analysis reflects:

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

3. Positive Cash Balances – Positive cash balances are 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 the first two conditions.

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 entry age; if and when they moved out; and how much time they spent in Independent Living, in Assisted Living, and in 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 time spent in each level of care on average).
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 such as for dining services), 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 \$175/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 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 entry 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 about one year each in Assisted Living and Skilled Nursing on average, 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 together with the per day costs calculated earlier.

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, for an inflation rate for entry fees, for monthly fees, and for 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 Future Services Obligation 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, in Assisted Living, and in Skilled Nursing; and assessing long term solvency. Actuarial studies can also assist a CCRC with the design and pricing of financially sound residency agreements; with setting viable fee structures; with projecting changes in the future population of Residents; and with estimating future needs for health care beds.

It is essential to note that, similar to the Future Services Obligation calculation, the results of actuarial analyses are sensitive to the financial assumptions and especially to 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 above, 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 three years – and updated annually in the interim.

Attachment E
To CCRC Finances Guide

Summary Description Of The Act – New Jersey Public Law 52:27D-330

A full listing of the paragraphs of **The Act** follows. Paragraphs of particular relevance are marked with an **asterisk**.

¶330: Title of Act: Continuing Care Retirement Community Regulations and Financial Disclosure Act

¶331: Findings, declarations

¶332: Definitions, e.g. Dept. of Com. Affairs, Facility, Administration, Provider, Resident

*¶333: Certificate of Authority to operate a CCRC

¶334: Revocation of certificate

¶335: Acquisition of ownership interest

* ¶336: Initial disclosure statement. ***Describes the elements that are required to appear in the first disclosure statement after certification to operate a CCRC.***

* ¶337: Annual disclosure statement. ***Reaffirms the above elements, which are required in each annual disclosure. All Residents have a right to see the Annual Disclosure Statement. Residents Association Finance Committees in particular should exercise that right. Providers make the Annual disclosure statement available in different ways. Check with your Provider.***

¶338: False, misleading statements, advertisements, agreements

* ¶339: Liquid reserves. ***Resident Finance Committees in particular should understand these provisions.***

* ¶340: Escrow of portion of entrance fees. ***Again, Finance Committees should read.***

¶341: Lien on property

¶342: Escrow account of fees or payments received prior to occupation as condition of issuance of certificate of authority

¶343: Collateral for loans

* ¶344: Continuing care agreement; contents; rescissions; dismissal or discharge of Resident; agreements prior to effective date; required advice and statement. ***This information is fundamentally important to residents in understanding what has gone into the preparation of the Resident Care Agreement signed on***

entrance to ones CCRC. It is particularly important to Finance Committees, as a reference for ongoing monitoring of adherence to the law in any changes in the Resident Care Agreement.

- * ¶345: Residents; right of self-organization; complaints; retaliatory conduct; quarterly meetings with governing body. ***This section is basic to understanding Resident rights in their CCRC.***
- ¶346: Rehabilitation or liquidation
- ¶347: Liability of providers for violations, misstatements, or omissions
- ¶348: Investigations
- * ¶349: Examination of books and records. ***The Department of Community Affairs is required to visit each CCRC in the state at least once every four years to examine its books and records.***
- * ¶350: Consumers guide; annual directory; Resident's rights booklet. ***These are the responsibility of the commissioner of the Department of Community Affairs.***
- ¶351: Violations; cease and desist order
- ¶352: Criminal violations and proceedings
- ¶353: Filing fees, investigations and rehabilitation expenses
- ¶354: Compliance time for providers offering but not providing continuing care on effective date
- ¶355: Facilities not entering into agreements for continuing care since 1965; exclusion from act
- ¶356: Facilities with less than 50 Residents; exclusion
- * ¶357: Continuing care advisory council. ***This provision has been a focus of legislative action on the part of both ORANJ and NJAHSA. The council, designed to provide guidance to the commissioner on CCRC related concerns has not been appointed and enabled by the governor for many years. In view of the fast changing circumstances affecting CCRCs in New Jersey, the council needs to be organized and empowered.***
- * ¶358: Rules and regulations. ***In compliance with this provision, Chapter 19 regulations have been written. Chapter 19 regulations outline the ways in which the provisions of the Act will be implemented. The regulations are dealt with in Section II.D of the Guide Book.***
- * ¶359: Health care services. ***This provision refers to the Department of Health, which has licensing authority for the health care sections of the NJ CCRCs.***
- ¶360: Enforcement of otherwise applicable statutes, codes or regulations. All such statutes shall be enforced by the Department of Community Affairs.

Attachment F
To CCRC Finances Guide

Summary Description Of Chapter 19 Paragraphs Of Financial Interest

**“CHAPTER 19 - CONTINUING CARE RETIREMENT COMMUNITY
REGULATION AND FINANCIAL DISCLOSURE ACT REGULATIONS”**

This summary is prepared for the purpose of information on the aspects of Chapter 19 that are of financial interests to CCRC Residents. This summary omits those sections which deal specifically with new CCRCs or those which have been in operation for less than two years.

Subchapter 1 covers the justification and definitions of this document and other bureaucratic necessities. Subchapters 2 and 3 deal with the requirement and form of certification, and define the conditions under which such certification may be revoked. Inasmuch as we are dealing with established CCRCs, the mechanics of certification is not of interest to us. Subchapter 2 does specify that an Annual Report be filed which reflects any material changes in information contained in the original application for certification and that this Annual Report be filed together with the Annual Disclosure Statement. The requirement that the Department of Community Affairs shall visit each facility to examine its books and records at least once every four years is stated. Subchapter 5 covers the general and specific standards for advertising. Subchapter 8 addresses the nonbinding reservation agreements which are of little interest to current Residents of CCRCs.

Subchapter 4 defines the requirement, form and use of the disclosure statement, along with the procedure for amendment. The first section (4.1) defines the clarity of language. The second section (4.2) lays out the information that must be disclosed. The first four paragraphs deal with the legal definition of the provider. All officers, directors, trustees, etc. must be identified, with statements of their business experience, integrity, and any potential conflicts of interest. A statement is required of whether the provider is or ever has been affiliated with a religious, charitable or other non-profit organization, the nature of such affiliation, the extent to which the affiliate organization is responsible for the financial and contractual obligations of the provider, and the provision of the Federal Internal Revenue Code, if any under which the provider or affiliate is exempt from income tax. The fifth paragraph requires a statement of the location and description of the physical property of the facility, both existing and proposed.

The sixth paragraph of section 4.2 requires a statement of the laws and regulations which apply to the operation and maintenance of the facility, and which public agencies have jurisdiction. The seventh paragraph requires a statement of the services to be provided under contracts for continuing care at the facility, including the extent to which medical care and other services are furnished under the basic contract, and which other care or services are available at extra charge. The eighth paragraph specifies a description of application fee, entrance fee and periodic charges or other recurring fees and the limitation on the adjustments, if any. If the facility is already in operation or the operator operates one or more similar facilities with this

State, tables should be provided showing the frequency and average dollar amount of each increase at each facility for up to five years.

The ninth paragraph of Section 4.2 requires the statement of the provisions that have been made or will be made to provide reserve funding or security which will enable the provider to fully perform its obligations under contracts to provide continuing care at the facility. This statement shall include the establishment of escrow accounts, trusts or reserve funds, the manner in which the funds shall be invested and the names and experience of persons who will make investment decisions. The tenth paragraph requires the inclusion of certified financial statements of the provider; these shall include balance sheets and income statements for the two more recently completed fiscal years.

The eleventh paragraph addresses other Disclosure Statement requirements for a new facility whose operation has not yet commenced. The twelfth paragraph allows for the inclusion of other material concerning the facility or the provider as required by the Department or as the provider wishes to include.

Sections 4.3 to 4.8 deal with the mechanics and format of publishing the Disclosure Statement, and of its use. 4.9 Requires the filling of an annual Disclosure Statement.

Subchapter 6 deals with contracts. The first three sections (6.1 to 6.3) deal with the requirement of fairness of the contracts, the bold-face stipulation of the notice of no-fault cancellation of the contract in 30 days, and the requirement that all funds be held for this period in a separate interest-bearing account in a banking institution located within this State. All funds are to be refunded except for those incurred by the provider at the Resident's specific request.

Section 6.4 addresses the required provisions of the contract and is preceded by a curious statement that the contract be written in plain English and in a language understandable by the lay person. This statement is followed by 10 paragraphs in one sentence. The first paragraph describes a provision for the continuing care of one or more Residents occupying appropriate space and under appropriate procedures established by the provider. A statement showing the value of all property transferred, including donations, subscriptions, fees and any other amounts payable by or on behalf of the Resident.

The second paragraph of 6.4 requires a statement on a form provided by the Department specifying all services which are to be provided to the Resident by the provider, including all items which the Resident will receive such as food, shelter, nursing care, pharmaceuticals and burial and whether the items will be provided for a designated period or for life. The next two paragraphs require a description of the health and financial conditions upon which the provider may have the Resident relinquish his space in the designated facility and of the health and financial conditions required for a person to continue as a Resident.

The fifth paragraph of 6.4 requires a description of the circumstances under which the Resident shall be permitted to remain in the facility in the event of financial difficulties of the Resident. The sixth paragraph addresses the consequences of a Resident who marries a non-Resident.

The seventh paragraph requires a statement that the agreement may be cancelled upon giving 60 days notice by the provider or the Resident. If the agreement is cancelled by the provider because there has been a good faith determination in writing, signed by the medical director and the administrator of the facility, that a Resident is a danger to himself or others, only notice that is reasonable under the circumstances is required.

Paragraph eight requires a statement providing the terms governing the refund of any portion of the entrance fee.

The ninth paragraph specifies a statement of the terms under which an agreement is cancelled by the death of the Resident. This statement may contain a provision stating that upon the death of the Resident, the moneys paid for the continuing care of the Resident shall be considered earned and become the property of the provider.

The final paragraph of section 6.4 specifies the provision of at least 30 days advance notice before any change in fees or changes in the scope of care or services are effective. The only exceptions are changes required by State or Federal assistance programs.

Section 6.5 governs the rescission of an agreement and the removal of a Resident from the facility. A Resident has the right to rescind a continuing care agreement within 30 days after making an initial deposit or executing the agreement; in such a case all there is no penalty or forfeiture except for those costs specifically incurred by the facility at the written request of the Resident. If a Resident dies or becomes incapacitated or otherwise is precluded from becoming a Resident before the unit is available, the same entitlement to a refund applies, with the same exception as noted above.

No agreement for care shall permit dismissal or discharge of the Resident from the facility prior to the expiration of the agreement without just cause for the removal. Just cause, in this case means but is not limited to a good faith determination in writing, signed by the medical director and the administration of the facility, that a Resident is a danger to himself or others while remaining in the facility. The details of the determination are specified, but other forms of "just cause" are (properly) not identified. If a Resident is dismissed for just cause, the Resident shall be entitled to a refund of his unearned entrance fee, if any, as described below (a Resident may request a hearing to contest the facility's decision to discharge the Resident). It shall not be deemed just cause if the Resident is unable to pay monthly maintenance fees until the entire unearned entrance fee plus, where applicable, any third party insurance benefits received, are earned by the facility. In lieu of calculating the actual per capita cost of caring for a Resident, a facility may provide, in the agreement for continuing care, that the per capita cost of caring for the Resident shall be calculated as follows:

1. No more than two percent of the entrance fee for each month the Resident occupies, or is entitled to occupy, a bed in the residential unit or residential health care unit of the facility. [Note: the application to this percentage to a bed in an assisted living unit does not necessarily apply other than to “just cause” removals.]

2. No more than four percent of the entrance fee for each month the Resident occupies, or is entitled to occupy, a bed in a nursing facility.

3. No more than 10 per cent of the entrance fee as a one-time charge for processing and refurbishing.

If the entrance fees are exhausted, as described above, within 90 days from the failure to pay, the facility may not require the Resident to leave before 90 days from the failure to pay, during which time the Resident shall continue to pay the facility a reduced fee based on the Resident’s current income.

Subchapter 7 defines the financial responsibility of the provider. Section 7.2 defines a requirement, applicable only when the Department has cause to believe that additional protection is necessary to secure the provider’s performance of the terms of all residential agreements, that the provider maintain in escrow a portion of all entrance fees received. The specifics of this escrow are defined.

Section 7.3 addresses the conditions under which the Department may file a lien on the real and personal property of the provider or facility to secure the obligations of the provider pursuant to existing and future contracts for continuing care. This section also addresses the conditions for foreclosure of such a lien.

Section 7.4 addresses escrow requirements. The provider shall establish an escrow account with a bank or other such escrow agent and shall place in escrow any entrance fees or payments in excess of five percent of the then existing entrance fee for the living unit that are received by the provider and any interest earned prior to the date that the Resident is permitted to occupy the unit. If the unit has been previously occupied, then the fees or payments are released to the provider when the unit becomes available for occupancy. If the unit has not been previously occupied, then there are other conditions that must be met before the funds may be released. This section also describes further the limitations and exceptions to the escrow account.

The remaining sections (7.5 to 7.7) deal with limitations of the provider to use the assets of the facility for collateral, specifies the strictures imposed on the provider in case of insolvency or bankruptcy, and additional conditions set on the provider in the case of initial occupancy of a unit.

The final Subchapter 9 deals with the legal nuts and bolts of the enforcement of the rules. The specifics of the filing of complaints and the rights to a hearing are defined in this Subchapter.