

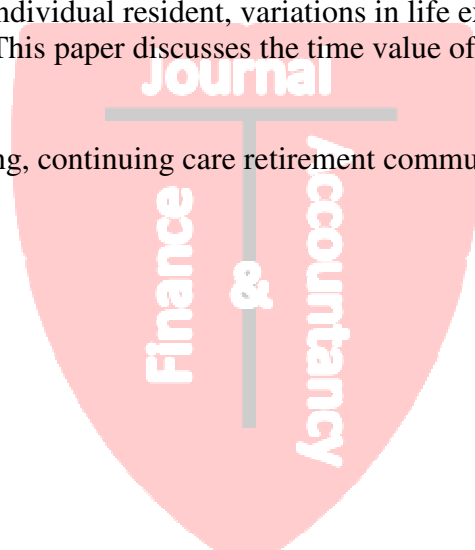
The time value of money implications of continuing care retirement community type-a contracts

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ABSTRACT

Continuing Care Retirement Communities (CCRCs) are an attractive alternative for those seeking integrated single-site, multi-stage retirement living solutions. CCRCs vary significantly in contractual terms with the most comprehensive being “Type-A”. Under such contracts, a potential resident pays a substantial up-front entrance fee which then guarantees capped expenses over the long-term if the resident progresses through the increasingly levels of assistance and care. CCRC operators are able to plan fairly accurately using the life-expectancy of pools of residents. However, for the individual resident, variations in life expectancy make evaluating such contracts problematic. This paper discusses the time value of money implications of CCRC Type-A contracts.

Keywords: retirement planning, continuing care retirement community, CCRC



INTRODUCTION

Planning for retirement, particularly late-stage retirement, is a daunting task for all but the extremely high net worth individual. The point at which an individual will need assistance in daily living is difficult to accurately predict. The cost of care in skilled nursing care facilities can easily exceed available income in retirement requiring a draw down of assets which often leads to a fear of “outliving one’s money”. Options which seek to limit the potential expense of long-term care are therefore attractive. However, even a limited degree of confidence can come at a significant cost.

Continuing Care Retirement Communities (CCRCs) are retirement living centers which offer residents a progression of levels of care at a single site. The most comprehensive CCRCs are based on a model of residents entering the community as independent residents using only the most limited of services from the institution. As the resident experiences age related physical deterioration, the resident is moved from independent living, to assisted living, and on to custodial care or even skilled nursing care. The great appeal is that once an individual has entered the Community, he or she will be able to live at the same site for the remainder of his or her life - thus reducing the disorientation and stress associated with moving from one institutional setting to the next.

CCRCs vary significantly in the contractual arrangements they offer to their residents. The different contractual arrangements are often referred to as Type-A, Type-B, and Type-C depending on the degree of fixing of long-term costs in the arrangement. All CCRCs offer multiple levels of care, but not all contractually cap costs long-term irrespective of level of care.

Type-A CCRCs are the most comprehensive in terms of the relationship with the resident. Type-A facilities offer long term caps on cost of care regardless of the level of care the resident needs at any particular stage of life. In order to accomplish this, the institution requires a significant entrance fee. In essence the resident “buys-in” to the community and then is contractually guaranteed a level periodic expense going forward - regardless of how long the individual resident lives. Depending on the number of levels of care covered, the details of the contract, and the nature of the facilities (ex. basic vs. luxury), a buy-in could range from \$50,000 to over \$1,000,000.

Clearly, from the perspective of the CCRC, the life expectancies of pools of residents can be fairly accurately predicted despite the fact that any given individual may fall far short of or beyond the statistical life expectancy. Thus the CCRC can plan its expenses and price accordingly with relatively little risk.

The individual resident is in a much different situation. He or she will face pricing which is more or less actuarially fair, but will may will end up paying substantially more for the cost guarantee. That is, for some individuals the arrangement will in hind sight be of great value, while for others the contract will have been exceedingly expensive. As such the CCRC operates as an insurance provider in which - so long as life expectancies prove accurate on average - a benefit can be provided to the entire pool of residents.

Of course, the security provided by the CCRC Type-A contract is dependent on the institution being viable in the long-term. Instances of CCRC bankruptcy have lead to particularly unpleasant situations for residents in the affected communities. This potential significant downside must also be considered in planning. In some instances, the bankruptcy of the CCRC could significantly alter the setting in which the resident might receive future care.

USING CCRC TYPE-A CONTRACTS AS PROXY FOR FUTURE CARE COST INCREASE ESTIMATES

Because the Type-A contracts reflect the considered estimates of the institutional managers, the buy-ins required by CCRC's allows a financial planner to gain insight into the likely increases in costs faced by an elderly person as he or she transitions through the progressive levels of care. This may be particularly useful to those who are reluctant to enter into a Type-A contract for fear of a bad community fit or financial failure of the CCRC.

Although it there can be no certainty as to the actual longevity of an individual, or the time he or she might spend in a particular level of care, one can get a rough idea of potential cost increases anticipated by the CCRC management. This in turn could provide at least a starting point for estimating required financial reserves for covering future step ups in the cost of care.

Clearly using a comprehensive analysis of life expectancy based on current health and age might yield a better estimate of cost increase in the later stages of care, but using buy-ins as a rough proxy has the advantage of simplicity. In addition, the buy-in proxy is easily accepted on an intuitive basis and doesn't require the individual to directly address his or her own mortality and future rate of decline - which can prove to be an unexpectedly difficult undertaking.

AN EXAMPLE OF USING TYPE-A CONTRACT BUY-INS AS PROXIES

To demonstrate the use of the Type-A contract buy-in as a proxy for the anticipated step up in costs the following numerical example is presented. The example is simplified, but is based on actual dollar costs at a CCRC Type-A facility and a "pay as you go" type CCRC. These values are drawn from an actual real world case in which an individual was deciding which type of facility to enter.

In this case the facility with CCRC Type-A contract had buy-in of \$55,000. The CCRC offered Independent Living and Assisted Living with cost increases capped at a COLA. The beginning monthly cost at the outset was \$2,100. This cost covers room rent, meals, weekly housekeeping, and bed and bath laundry. In this particular case, the CCRC with the Type-A contract not cover skilled nursing care. The operation assumes Medicare coverage of any skilled nursing care which would be outsourced or require the individual be moved to alternate facility offering skilled nursing care.

The CCRC with the non-Type A contract had monthly cost of Independent Living at \$2,050 per month, Assisted Living at \$3,600 per month, and Skilled Nursing Care - \$5,500 per month. The non-Type A contract facility was also committed to a COLA increase, though there was no contractual guarantee.

In this case, the buy-in at the Type-A facility did not give a lifetime guarantee of cost of care, but rather just the first two levels of care (Independent Living and Assisted Living). Thus, in this case, the buy-in was really just a guaranteed for the cost increase between the first to levels of care.

The monthly savings under the Type-A Contract (two stages) is thus $\$3,600 - \$2,050 = \$1,550$. Here the buy-in is only protecting the individual from the cost increase as one moves to the second level of care, since the facility did not offer, or include, the most advanced level of

care.

If we assume a representative discount rate of 4%, we can calculate the length of time the CCRC operators offering the Type-A contract anticipate a given resident spending in the second level of care (assisted living).

$$\begin{aligned} PVA &= PMT (PVIFA_{r,t}) \\ 55,000 &= 1,550 (PVIFA_{4\%/12,t}) \\ t &= 37.82 \text{ months} \end{aligned}$$

Clearly the result is heavily dependent on the assumed discount rate, but the analyst would likely assume that the CCRC would be managing any reserves in a fairly conservative fashion. Thus the range of appropriate discount rates would be relatively limited. The duration of the implied second stage could of course be tested against historical trends if the financial analyst were able to access those.

From this perspective the analyst is able to use the buy-in both as a rough estimate of the present value of the increased costs of the second level of care over the first level of care, and to derive a rough estimate of the time the individual might remain in the second level of care. Because the cost of care in CCRC facilities varies by region, a decision maker could improve the estimate by selecting facilities in the actual region in which the individual intends to receive care.

CONCLUSIONS

This paper has explored the use of CCRC Type-A buy-ins as a method for estimating the required financial reserves to cover the step up in cost of care which occurs as an elderly individual progresses through increasingly comprehensive levels of care. The example provided used a single case to demonstrate the concept.

By examining a larger number of cases, an analyst should be able to determine the robustness of the approach. This would require assessing the consistency of the relationships across a number of facilities as implied by their contract terms. In addition, comparing Type-A contracts with three levels of care (through Skilled Nursing Care) would provide a more useful tool for a complete care financial plan. These extensions are left to future research.

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