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An Empirical, Financial, and Legal Analysis

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Continuing Care Retirement Communities

An Empirical, Financial, and Legal Analysis

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To our children:
Amanda, Cameron, & Tyler
and
Thandi & Sibongile

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PURPOSE OF THE COUNCIL

The Pension Research Council was formed in 1952 in response to an urgent need for a better understanding of the private pension mechanism. It is composed of nationally recognized pension experts representing leadership in every phase of private pensions. It sponsors academic research into the problems and issues surrounding the private pension institution and publishes the findings in a series of books and monographs. The studies are conducted by mature scholars drawn from both the academic and business spheres.

Foreword

Those familiar with the interests and past activities of the Pension Research Council may be surprised that it is publishing a book on continuing care retirement communities. Over the years, the Council has been concerned principally with the actuarial and financial soundness of pension plans and the protection of the rights of individuals who look to them as a source of old-age financial support. In other words, the Council has traditionally sponsored research with the underlying purpose of strengthening those mechanisms designed to provide the financial resources needed for a secure old age. In contrast, this book is concerned with a relatively recent institutional arrangement that seeks to provide old-age security and health care *in kind.*

Almost from the moment The Commonwealth Fund and the Robert Wood Johnson Foundation approved a grant to the Wharton School to study continuing care retirement communities, the Council expressed an interest in reviewing the findings of the study, with a view toward its publication. The sponsors of the project had the same concerns about this new institution that the Pension Research Council has about the pension institution—its ability to deliver the benefits and services promised. The nature of the arrangement raises questions about its actuarial soundness, financial stability, and protection of members' rights.

The author of this Foreword participated in the study in an oversight capacity and was in a position to judge the quality of the research involved. The project director, Dr. Howard E. Winklevoss, a member of the Wharton School faculty and the Council, kept the Council fully apprised of developments and of progress being made on the project. The final draft of the report was reviewed by members of the Council—and by the project's advisory committee—who recommended publication by the Council, if permissable. The project sponsors (The Commonwealth Fund and the Robert Wood Johnson Foundation) suggested several guidelines for selecting an entity to publish the study results but left the choice to the dean of the Wharton School. On the basis of his knowledge of and confidence in the Pension Research Council, Dean Donald C. Carroll designated the Council to publish the study.

The Council is proud to publish the results of this pioneering study. The study and its recommendations should be a constructive influence on the future growth of this new social organism, embodying an innovative approach to old-age financial security.

The Council extends its congratulations to The Commonwealth Fund and the Robert Wood Johnson Foundation for conceiving this project, and it expresses its profound gratitude to them for making the necessary financial resources available.

Funds for the publication of this volume were drawn from the Ralph H. Blanchard Memorial Endowment of the Pension Research Council. Mr. Blanchard was one of the founders of the organization now known as the National Health and Welfare Mutual Life Insurance Association, which provides pension and insurance facilities for the staffs of social welfare agencies. Mr. Blanchard served as president of the organization for 14 years, and at the time of his death in 1972 he was honorary president. The Memorial Endowment was established and funded by the NHW Mutual Life Insurance Association to perpetuate the memory of Mr. Blanchard and to further the social goals to which he was so deeply committed. The subject matter of this study epitomizes the concern for the elderly that occupied the thoughts and energy of Mr. Blanchard throughout his life.

It should be understood, of course, that the statements made and the views expressed in this volume are solely the responsibility of the authors and should not be attributed to the funding agencies.

Dan M. McGill

Preface

Today there are about 275 continuing care retirement communities (CCRCs) in the United States where some 90,000 elderly people (average age about 80) live independently in their own apartments but have the opportunity for eating together, group recreation, and other activities that comes from being part of an organized community. Most important, in addition to having immediately available a variety of health and social services which they can call on according to their desires and needs, the residents have a virtual guarantee that they will be adequately taken care of no matter what happens to their health. The fear of someday being a burden on relatives or friends or of finding oneself helpless among uncaring strangers is effectively removed.

It is this health care guarantee that principally distinguishes CCRCs from other retirement communities. CCRCs provide insurance against the cost of long-term care, and supplement coverage of acute health care costs paid for largely by Medicare and private insurance. Their unique feature is that they provide this otherwise unobtainable full insurance in combination with independent living arrangements that the resident can enjoy as long as health permits.

CCRCs are intended to be fully self-supporting, and therein lies the origin of this book. The study is the first detailed analysis of the actuarial, financial, and legal issues involved in keeping existing CCRCs financially sound and providing for the formation of new communities in ways that protect the rights of residents while assuring the perpetuation of the community.

CCRCs provide essentially a new form of insurance, but until now this type of insurance has not been subjected to rigorous examination. It is fortunate that such an examination has begun, and it is to be hoped that this book will be followed quickly by other work in the field. The members of the Advisory Committee who worked closely with the research team believe that the CCRC field may be on the threshold of a major expansion, principally because for the first time large numbers of older Americans will be able to meet the cost.

The financing method combines a sizable entrance fee (average $35,000 single and $39,000 couple at the time of the study) with a monthly payment which is adjusted from time to time for inflation and occasionally other factors (average $600 single and $850 couple). About 70 percent of older people now own their homes, and in many cases they have enough equity in those homes to meet the required entrance fees. And inflation-proof Social Security plus some additional income from private pensions and investments can form a basis for meeting the monthly fee for many older people, although undoubtedly considerably less than a majority.

It is true that many who can afford CCRCs will nevertheless prefer other retirement arrangements, but for a considerable number the full health insurance, including long-term care, combined with independent living in a community setting will make CCRCs attractive.

On behalf of the other 12 members of the Advisory Committee, I wish to commend the research team—Howard E. Winklevoss, Ph.D., project director; Alwyn V. Powell, MAAA; David L. Cohen, Esq.; Ann Trueblood-Raper; and Amy R. Karash—for their efforts to address the comments and suggestions of the Advisory Committee throughout the past 18 months and for diligently pursuing the research which has produced this book. We also wish to thank Dr. Dan M. McGill, who served the study as consultant to the research team and as chairman of the Wharton School Insurance Department and the Pension Research Council.

It is our hope that the book will be useful to public policymakers, to corporations and foundations with an interest in older people and their health, to the financial community, and to potential sponsors of CCRCs.

The Robert Wood Johnson Foundation of Princeton and The Commonwealth Fund of New York City provided financial support for the work of the research team and the Advisory Committee. We are grateful for their backing and hope that the philanthropic community will continue to support important research on CCRCs and related topics.

Robert M. Ball

Chairman of the Advisory Committee
Continuing Care Retirement Community Study

Authors' Preface

Nearly four years have passed since we completed our first comprehensive actuarial study of a continuing care retirement community (CCRC). At that time, the application of actuarial science to set fees in this growing field was nonexistent. Most of the assumptions and methodologies used to set fees and establish financing were not based on scientific analysis but instead were rules of thumb or anecdotal approaches. Moreover, the literature about the industry dealt with social and health-related issues, and rarely with the financial issues associated with operating a facility.

To some degree, the limited financial sophistication was due to the newness of the concept and a misconception regarding its true nature. Many of the early marketing efforts concentrated on the real estate component of the services provided. The central theme of providing a way to finance long-term health care needs privately was a secondary and rarely emphasized issue. Actuaries and other financial analysts were basically unaware of this industry prior to publicity about the financial distress of some communities that made national headlines in the late 1970s. Even then, there was considerable controversy over the correct pricing methodologies and the appropriate types of contractual guarantees. It was even suggested that the continuing care financing arrangement to ensure lifetime health care for small groups of elderly was not viable, or was possible only with fees that were prohibitively expensive.

Recognizing that the service goals of the continuing care concept may be one answer to the growing needs of the independent elderly for housing and health care, the Robert Wood Johnson Foundation and The Commonwealth Fund solicited proposals to conduct research to address the question of financial viability for the concept. In April 1981, they agreed to fund jointly a research grant to the Wharton School of the University of Pennsylvania, with Howard E. Winklevoss, Ph.D., and Alwyn V. Powell, MAAA, as the primary investigators. So that the research would be timely, the authors decided to concentrate on the following three areas: (1) a definition and survey of the general characteristics of the CCRC industry, (2) a detailed development and explanation of the actuarial principles underlying the pricing and long-term financial characteristics of CCRCs, and (3) a discussion of the legal issues arising from the continuing care contract with suggestions for their legislative treatment.

This book is the culmination of 18 months of research. Its primary objectives are to set forth normative guidelines for pricing and evaluating continuing care retirement communities and to provide a reference that will assist legislators in assessing the advantages and disadvan-

tages of various components of continuing care regulation. This book is not designed as a "how-to" book on the financial operation of CCRCs; rather, it is intended to provide the management and board members of CCRCs with a broad understanding of the financial intricacies of their communities. Furthermore, this book provides guidelines to analysts who wish to conduct similar research by explaining in detail the methodologies developed during the course of the study.

Chapter 1 presents an overview of the industry's growth and explains why the industry is worthy of research; the rest of the book is divided into three parts, corresponding to the study's three research topics. Part One consists of Chapters 2 and 3, which summarize the empirical findings of the survey of 207 CCRCs (75 percent of the defined universe). Part Two consists of Chapters 4 through 11, which will interest those readers whose concerns embrace financial issues. These chapters develop the actuarial methodology proposed for evaluating the long-term financial condition of a CCRC. The results of applying this methodology to six existing CCRCs are discussed in each of the chapters. Part Three consists of Chapters 12 and 13. Chapter 12 discusses relevant legal issues and how they are treated by existing legislation. Chapter 13 presents the authors' recommendations for state-level legislation on each of these issues. Finally, Chapter 14 summarizes the significant research findings and recommendations and suggests a number of areas that merit further research. The appendixes contain technical explanations of the methodologies developed by the authors.

We would like to offer thanks to the members of the study's Advisory Committee, who reviewed all preliminary drafts of the book and attended 11 days of seminars to guide the research staff in the conduct of the study. Other valuable advice was contributed by members of the review panel, which consisted of providers of continuing care and legal experts practicing in the field; the members of both groups are listed on the following pages. Several members of the Pension Research Council also offered their comments prior to publication, and Dr. Dan M. McGill, chairman of the Pension Research Council, is owed special thanks for his review of the book and for his helpful guidance throughout the study.

Our collaborators made important contributions to this volume. They include Ann Trueblood-Raper, consultant in gerontology, who wrote Chapters 2 and 3; David L. Cohen, Esq., associate at Ballard, Spahr, Andrews & Ingersoll, who researched and wrote Chapters 12 and 13; Dr. Robert A. Zelten, associate professor of insurance and health care systems, who contributed to Chapter 10; and Mitchell Leon, public relations consultant, who contributed to Chapter 1.

We are grateful to the American Association of Homes for the Aging for its assistance in developing our 24-page survey instrument, for

encouraging its members to complete the instrument, and for its helpful comments and support.

The authors are particularly indebted to the following staff members, whose collective contributions were essential for the timely completion of this project: Robert Goodrich; Roger W. Hallowell; Joseph Marant; Jayaram Muthuswamy; and Catherine C. Singer. We extend our special thanks to Amy R. Karash, our administrator, who planned the logistics associated with the survey questionnaire, word-processed and edited innumerable versions of the book, and provided day-to-day support from the inception of the study.

Finally, and most important, we are grateful to our wives, Carol and Keitumetse, whose encouragement and acceptance of additional responsibilities during the course of the study enabled us to devote our time to the research and writing of this book.

Naturally, the authors remain solely responsible for any conceptual or technical errors that may remain.

Howard E. Winklevoss

Alwyn V. Powell

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