



Learn. Connect. Discover.

A COMPREHENSIVE ACTUARIAL PRIMER ON CCRC FINANCIAL MANAGEMENT

at **LSN** Learn.
Connect.
Discover.

Annual Meeting and Exhibition
Navy Pier, May 2-4, 2012

Wednesday | May 2
2:00 - 3:30pm

PRESENTERS



AV POWELL
Consulting Actuary
AV Powell & Associates



WILL CARNEY
Managing Director
Ziegler

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SECTION 2

INTRODUCTION

WILL CARNEY
Managing Director
Ziegler



SECTION 2

REFLECTIONS ON GAO/SENATE AGING REPORTS

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1. 2.13.09 request by WI Senator Kohl
2. Authorized US Government Accountability Office study
 - a. Define CCRC financial structures
 - b. Assess adequacy of regulation as it relates to solvency
 - c. Identify best practices for minimizing risks



1. CCRCs face financial risks
2. “Disparate state regulations”
3. Complex financial evaluation
4. Minimum reserves
 - a. 12 months P&I
 - b. 60 days operating expense
 - c. 12 months repair and replacement
5. Periodic actuarial studies

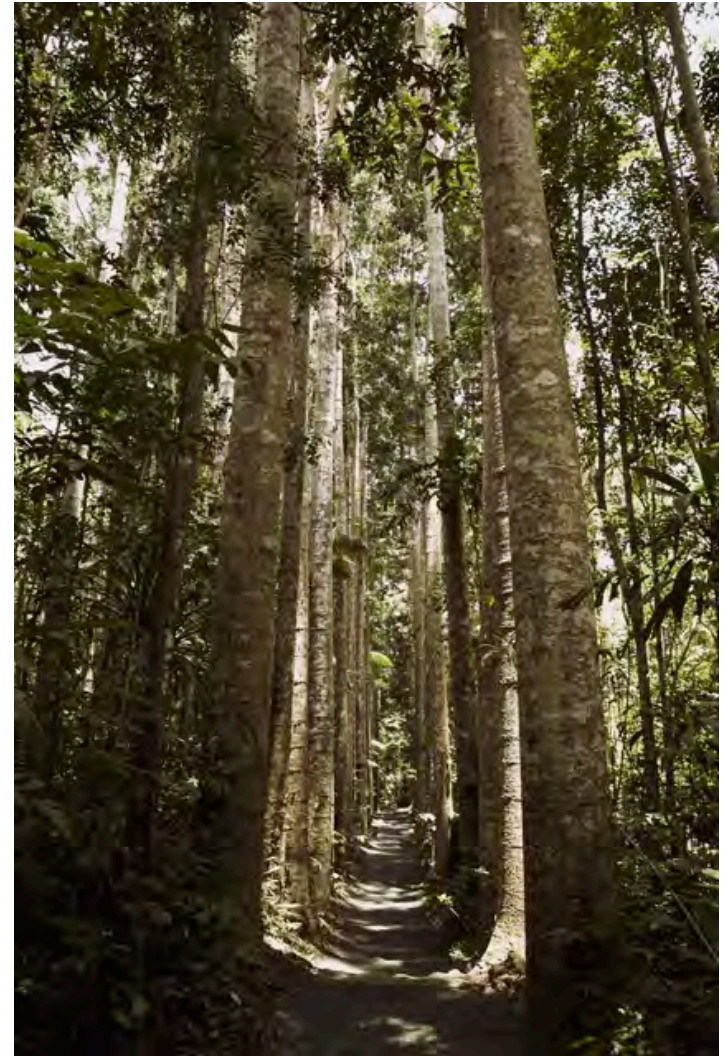
WERE SOLUTIONS PROVIDED?

1. Mitigating low occupancy
2. Refund payments
3. Favorable tax treatment
4. Solvency definition



HAS THE CCRC MOVEMENT ESCAPED FURTHER SCRUTINY?

1. No regulatory changes
2. Same financial practices
3. Expanded CCRC exposure
 - a. Type C contracts exempt
 - b. Lifecare without walls



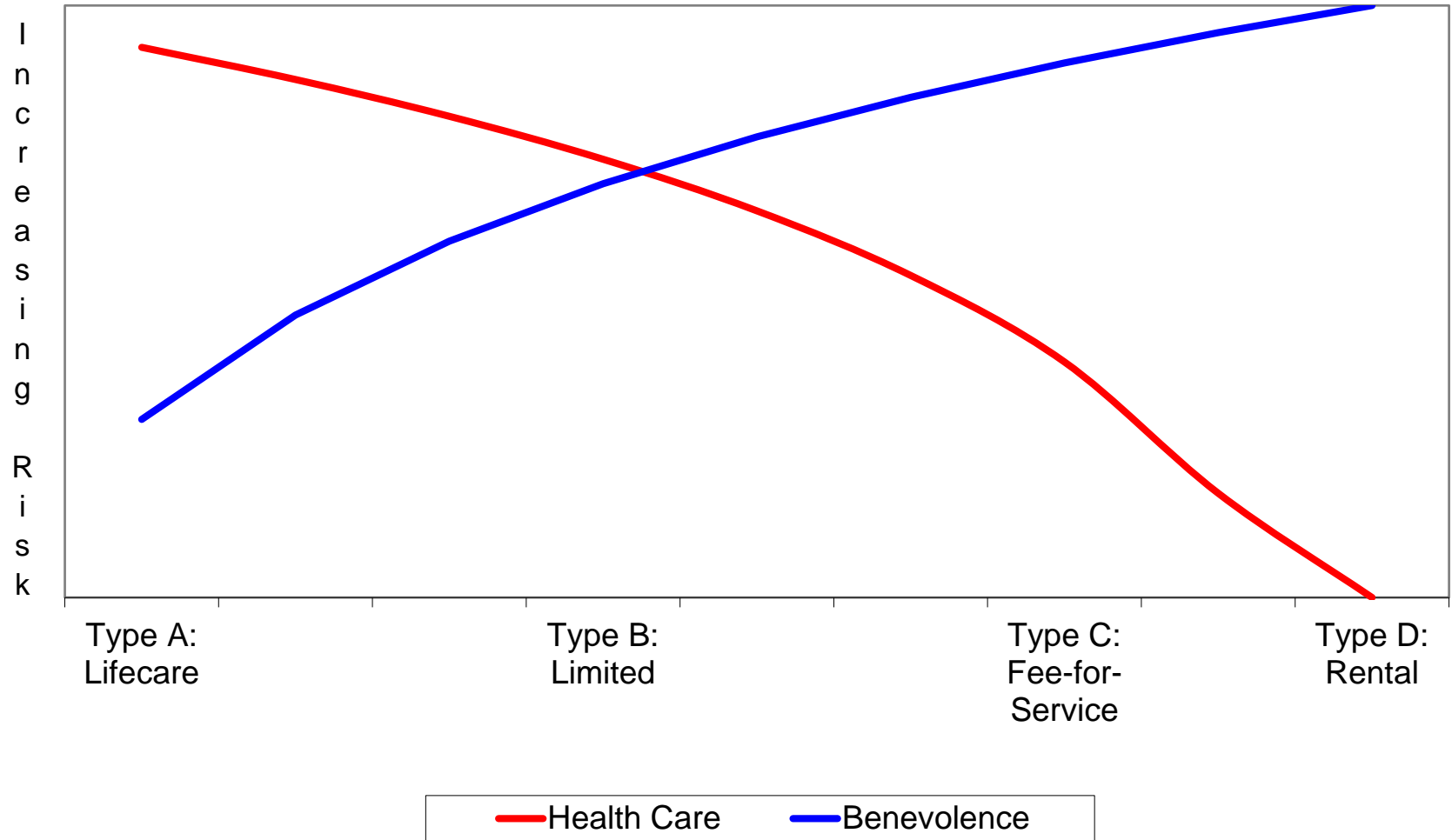
SECTION 3

ARE TYPE C CONTRACTS RISK-FREE?

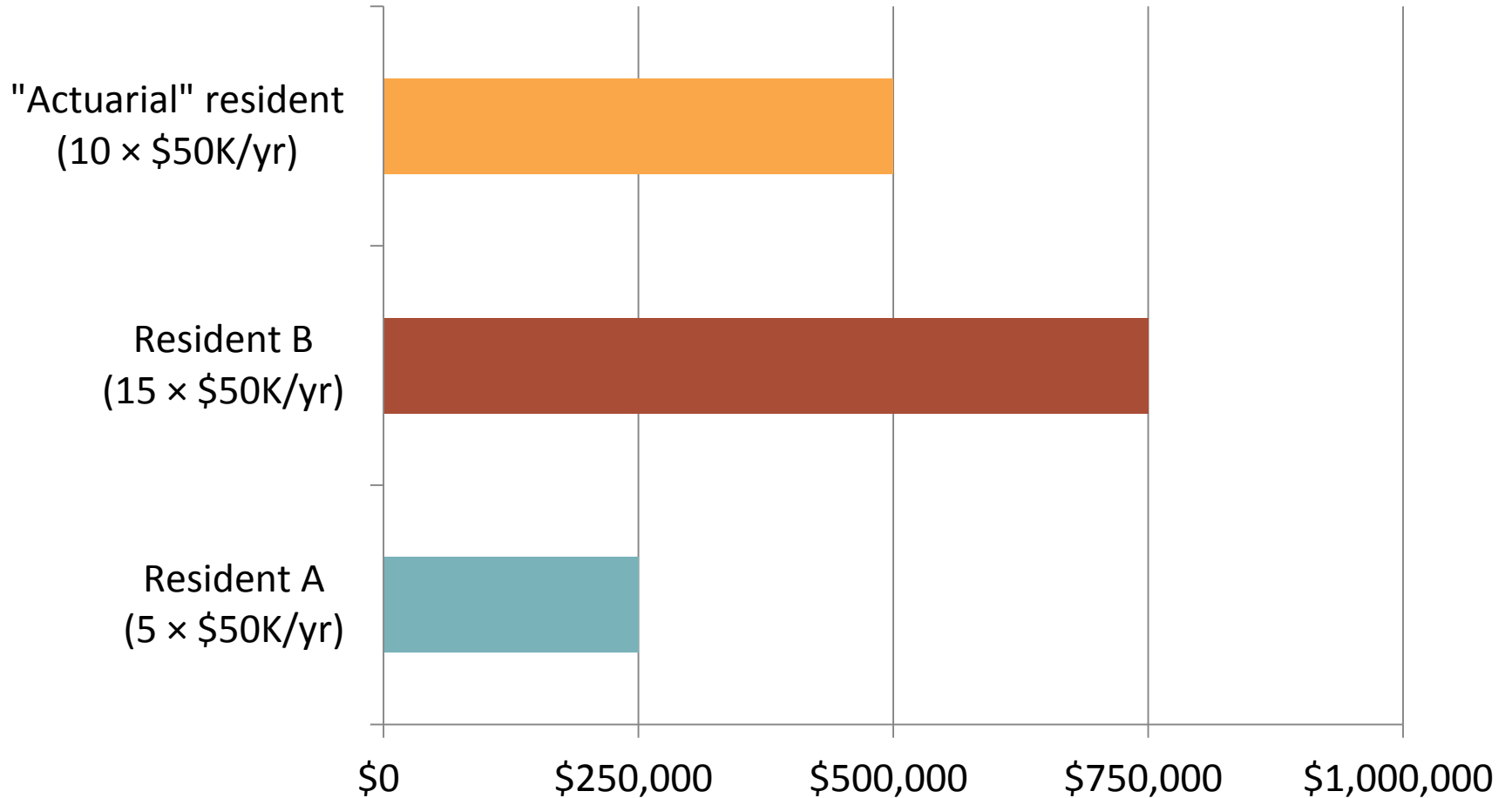
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ALL CONTRACTS HAVE RISK!

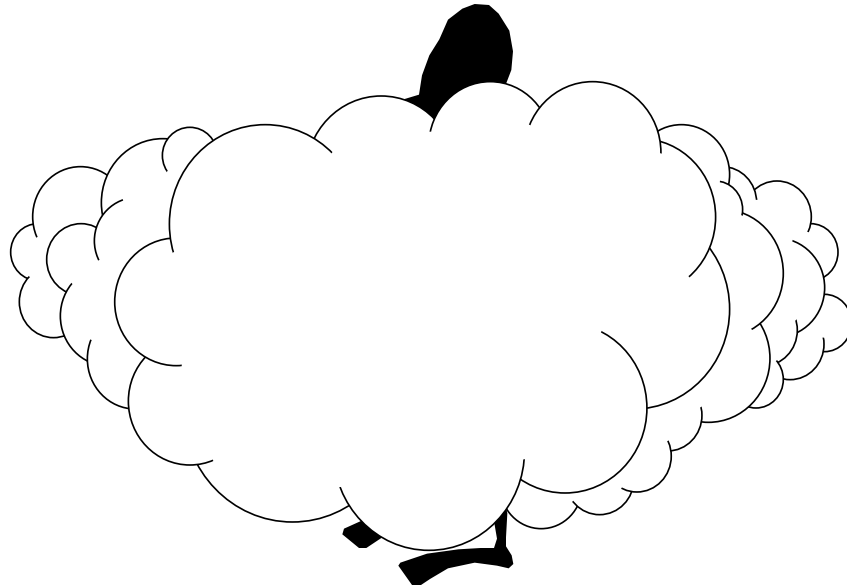


ALL ENTRY FEE CCRCs RISK POOL LIFETIME COSTS

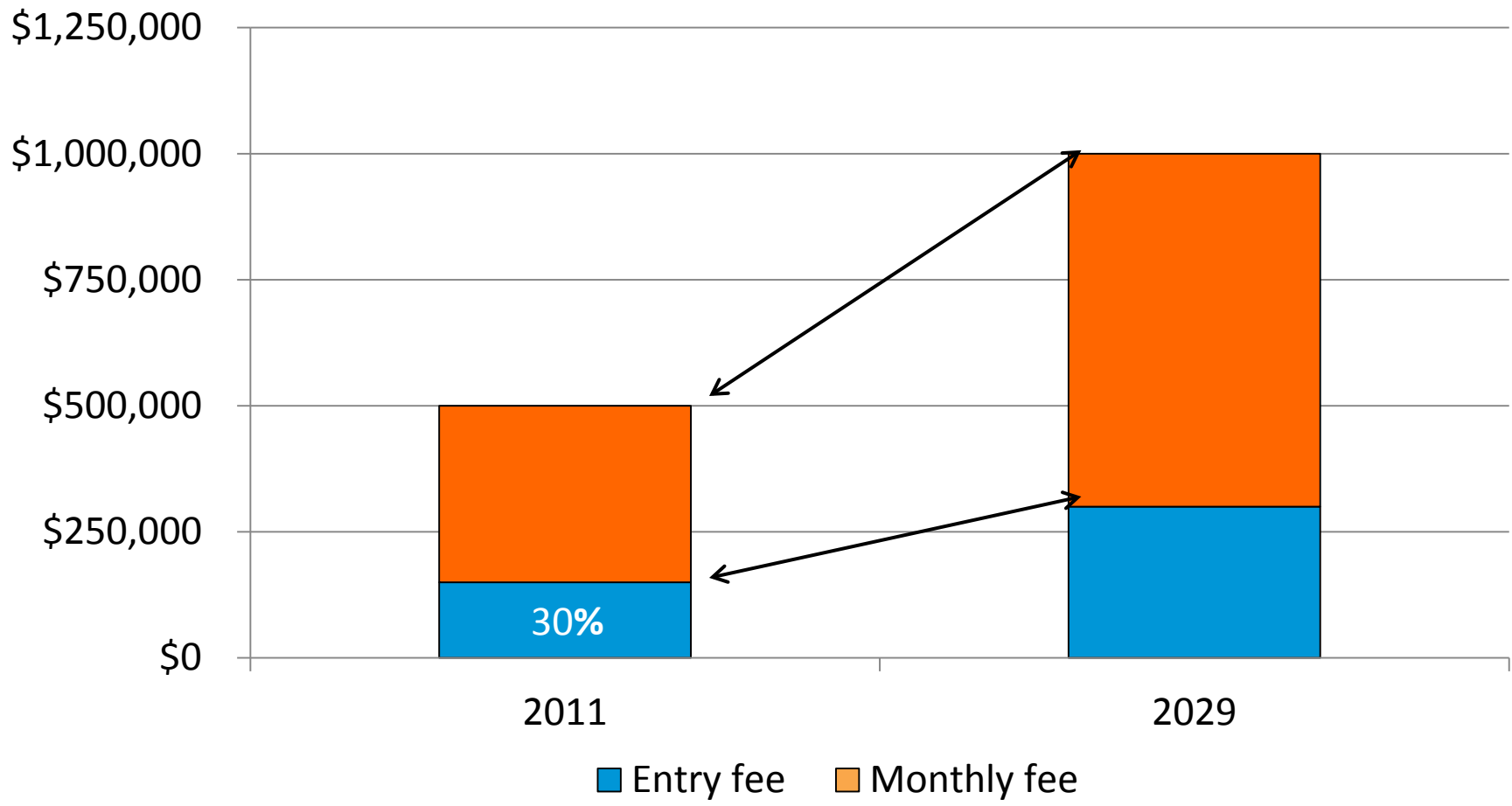


DECONSTRUCTING ENTRY FEE PRICING

1. Entry fees are a prepayment of future monthly fees
2. Lifetime costs – Monthly fees = Entry fees
3. Lifetime costs include operating, capital, **plus** refunds

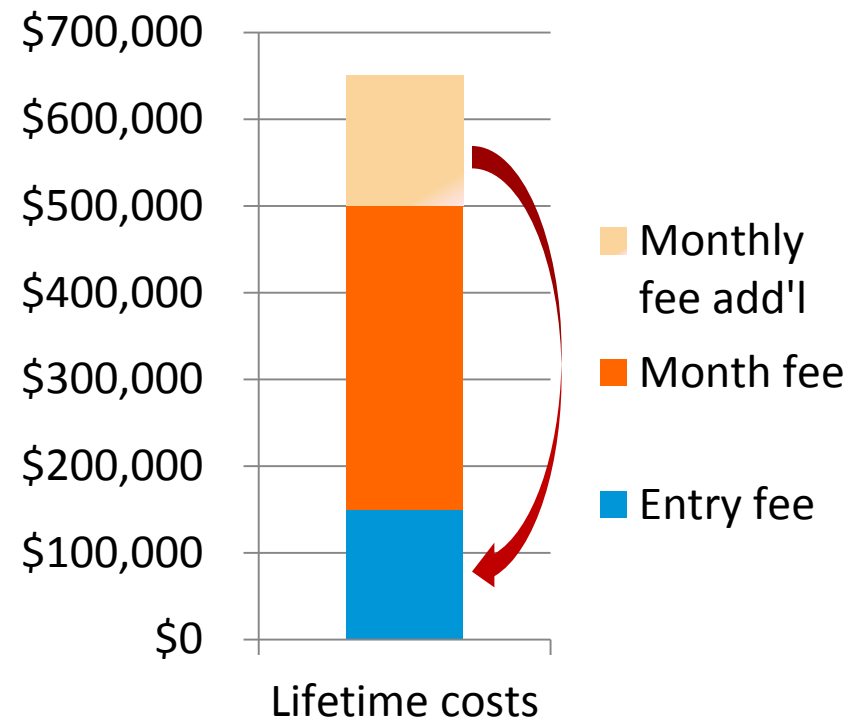


LIFETIME COSTS - MONTHLY FEES = ENTRY FEES = ACTUARIAL RESERVES



TYPE C RISK MITIGATION CLAIMS: TRUE OR FALSE?

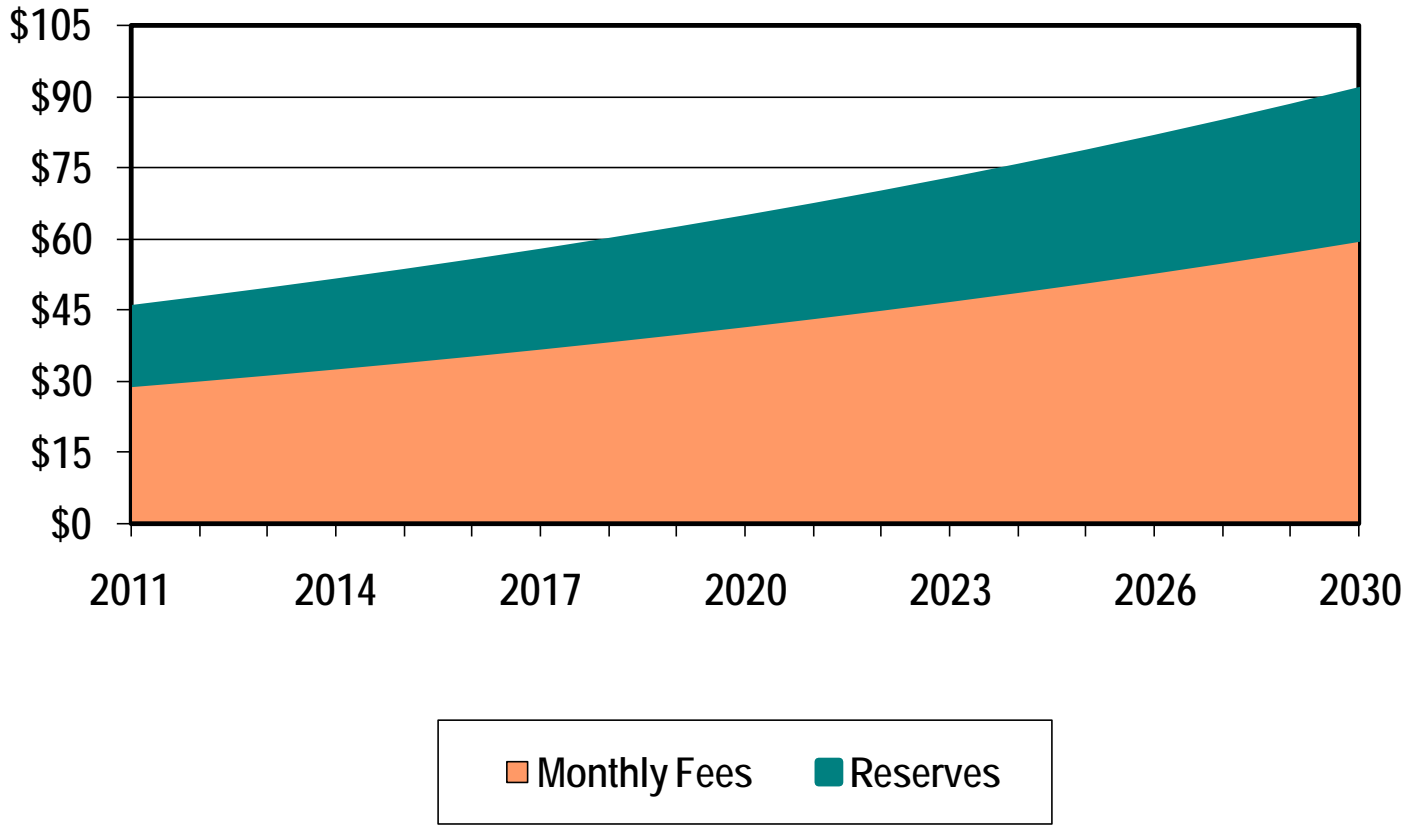
1. Monthly fees can be increased to match costs
2. Refund paid from next generation
3. Residents can afford fees higher than expected



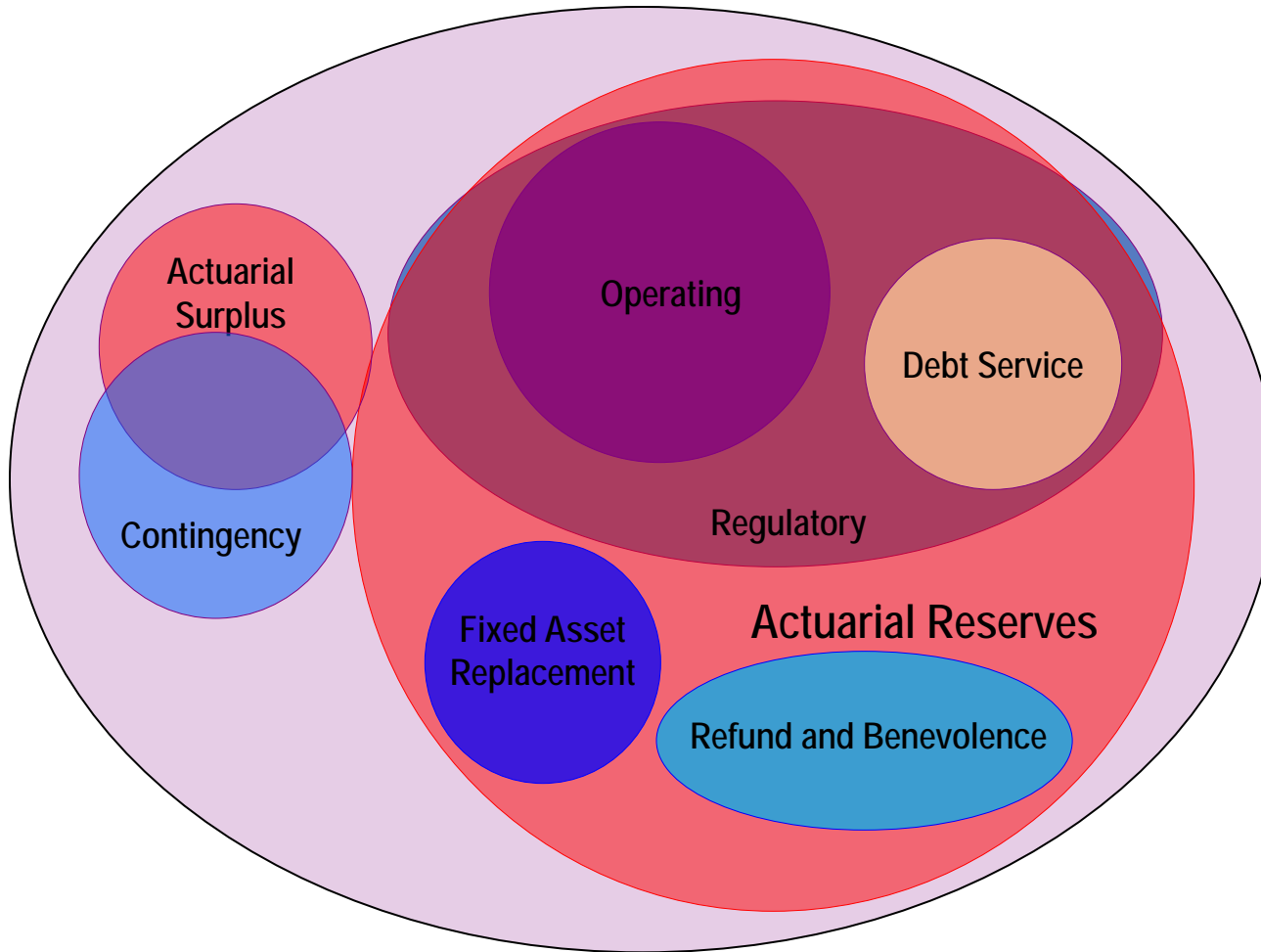
ACTUARIAL RESERVES CAN BE SUBSTANTIAL

1. If adopt ASOP#3 and 100% funded status
2. Typical liability is \$300K to \$600K/contract
3. Average of 250 contracts/CCRC
4. Entry fees cover 30% of costs
5. 100% funded reserves range from \$22M to \$45M

ENTRY FEE CCRCs SHOULD ACCUMULATE SIGNIFICANT RESERVES



ASOP#3 RESERVES COVER GAAP/FINANCING



SECTION 4

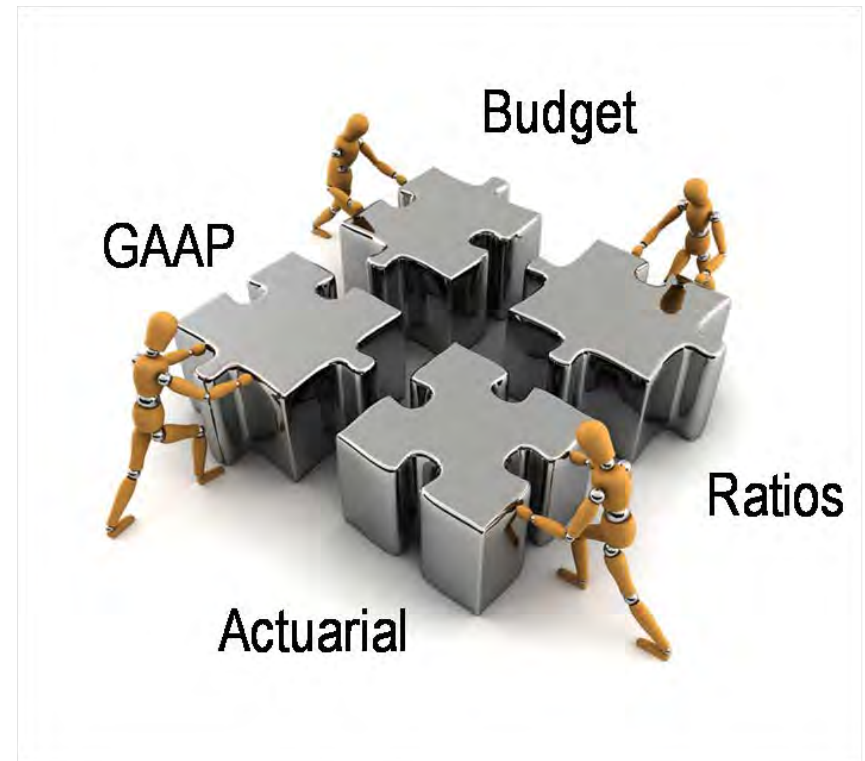
ASOP #3

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HOW DO YOU KNOW IF YOU ARE SOLVENT?

1. GAAP Financials
2. ASOP#3
3. Ratio Analysis
4. Budgeting NOI
5. CPI
6. Other



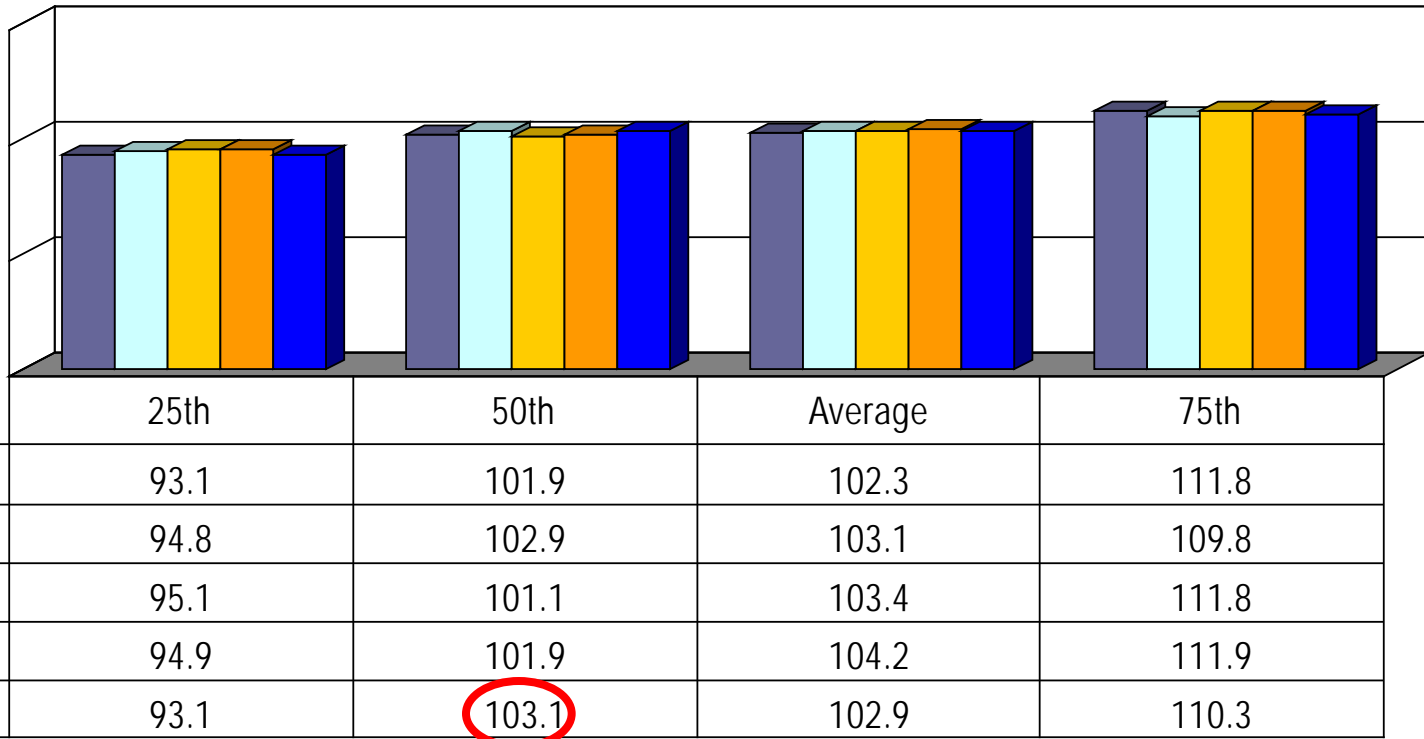
THE ACTUARIAL SOLVENCY STANDARD

1. 100%+ funded status
2. Pricing margin $> 0\%$
3. Meet debt covenants
4. Unified funded status

Satisfactory Actuarial
Balance ("SAB")

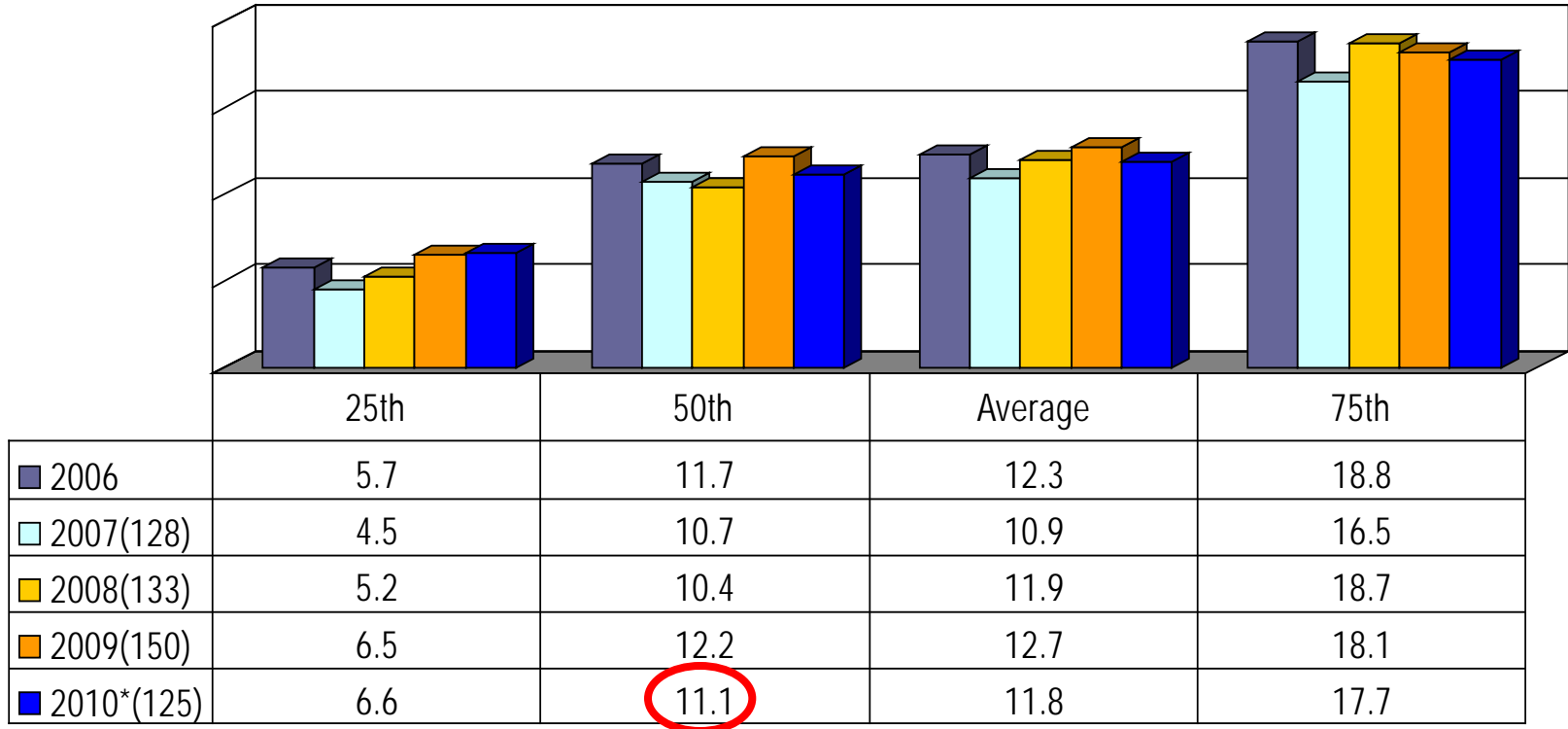


ACTUARIAL FUNDING IS MARKETABLE (SAME-SITE '10-'09 UP 1.2%)



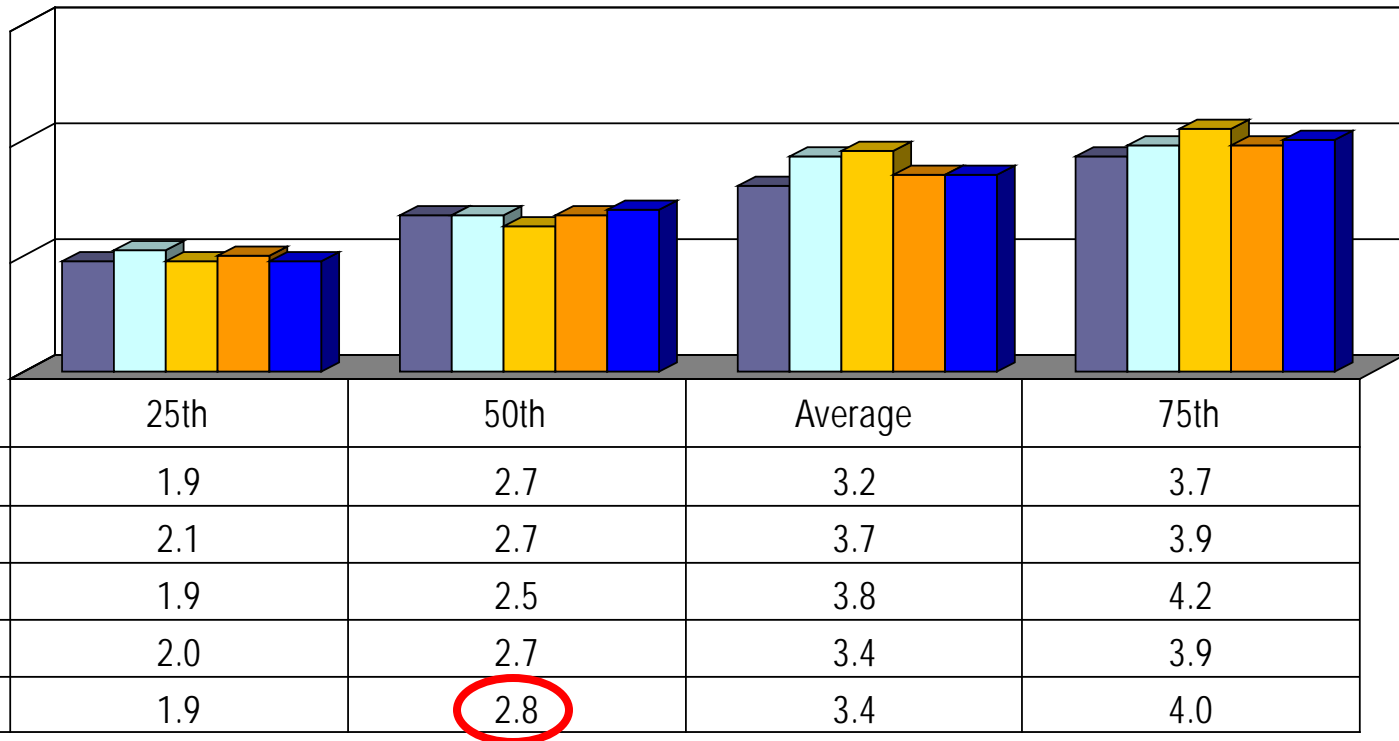
Percentages

TYPICAL FEES SHOW 11% SURPLUS (SAME-SITE '10-'09 DOWN 1.1%)



Percentages

RESERVES PROJECTED TO TRIPLE IN 10 YEARS



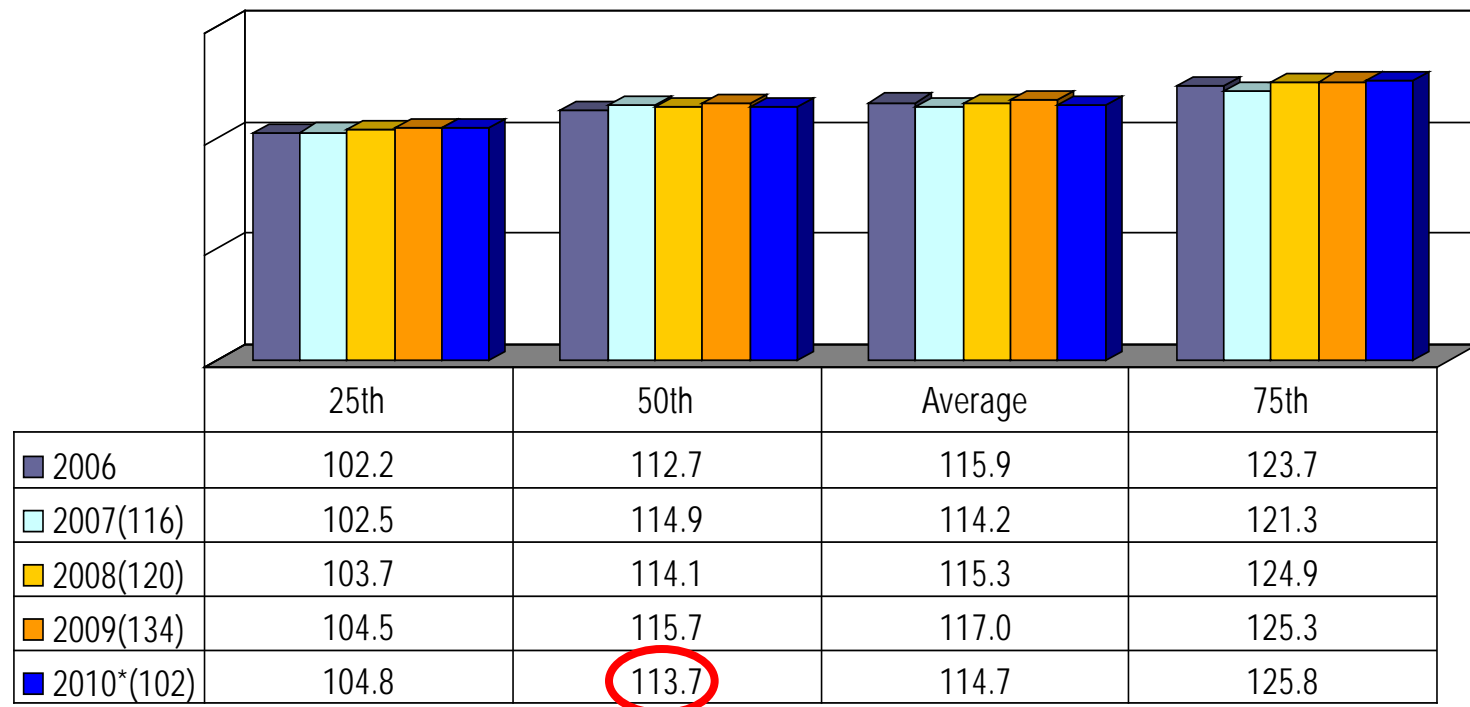
REAL WORLD SOLVENCY CAN BE TRICKY

	Case #1	Case #2	Case #3
Funded Status	Pass	Fail	Pass
Pricing Margin	Pass	Pass	Fail
+ Cash Flow	Pass	Pass	Pass
Likelihood	More than 50% of AVP database	Common, 20-to-40%	Rare, <5%

UNIFIED FUNDED STATUS[©] (“UFS”)

1. Combines ASOP#3 criteria 1 and 2
2. Recognizes FMV of fixed assets
3. Corrects traditional ASOP#3 anomaly
4. Simplifies explanation of actuarial position

>80% OF OUR CLIENTS ARE SAB (SAME-SITE '10-'09 CONSTANT)



Percentages

AVP STANDARDS AND BENCHMARKS

Unified funded status	115%
Funded status	105%
New entrant surplus	10%
10-year reserve increase	2 times
Liquid reserve ratio	50%
Actuarial ratio	70%
Return on fixed assets	10%

SECTION 5

GAAP FSO PERCEPTIONS VERSUS REALITIES?

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TYPICAL FSO = \$0; NOT SHOWN

	Assets	Liabilities
Current	\$ 4.8 million	\$ 1.8 million
Other	19.1	37.5
Long-term	61.4	41.2
FSO	na	0
Net Assets	na	4.8
TOTAL	\$ 85.3	\$ 85.3

GAAP FSO OBJECTIVES

1. Recognize a loss on contracts when incurred
2. Are future costs + depreciation > deferred revenue?
3. Net future costs defined as:

future monthly fees – future operating expenses

GAAP FSO IS NOT A FUTURE SERVICE OBLIGATION

1. Uses actuarial techniques, but not actuarially sound
2. A component of net worth, i.e., **net assets**
3. FSO calculation is a termination liability
4. Excludes significant % of operating expenses
5. Recognition of unamortized entry fee income

GAAP FSO LIMITATIONS

1. 5% to 15% of operating expenses excluded
2. No depreciation expense for future fixed assets
3. Combination of present values with non-PVs
4. Entry fee amortization doesn't match costs
 1. Resident life expectancy
 2. Building lifetime
5. Fully refundable entry fee amortization doesn't recognize time value of money

POTENTIAL CAUSES OF FSO >\$0

1. Major capital expenditures
2. Operating expense increase >> monthly fees
3. Debt incurred for future expansion
4. Shift to smaller or no entry fee contracts
5. Significant decrease in occupancy

EXPLAINING GAAP FSO RESULTS

1. Ignore current year negative FSO value
2. Focus on annual trend in FSO values
3. Trend should be decreasing unless:
 - a. Major debt refinancing
 - b. Material decrease in occupancy
 - c. Change audit guide interpretation
4. GAAP net assets ~ ASOP#3 funded status

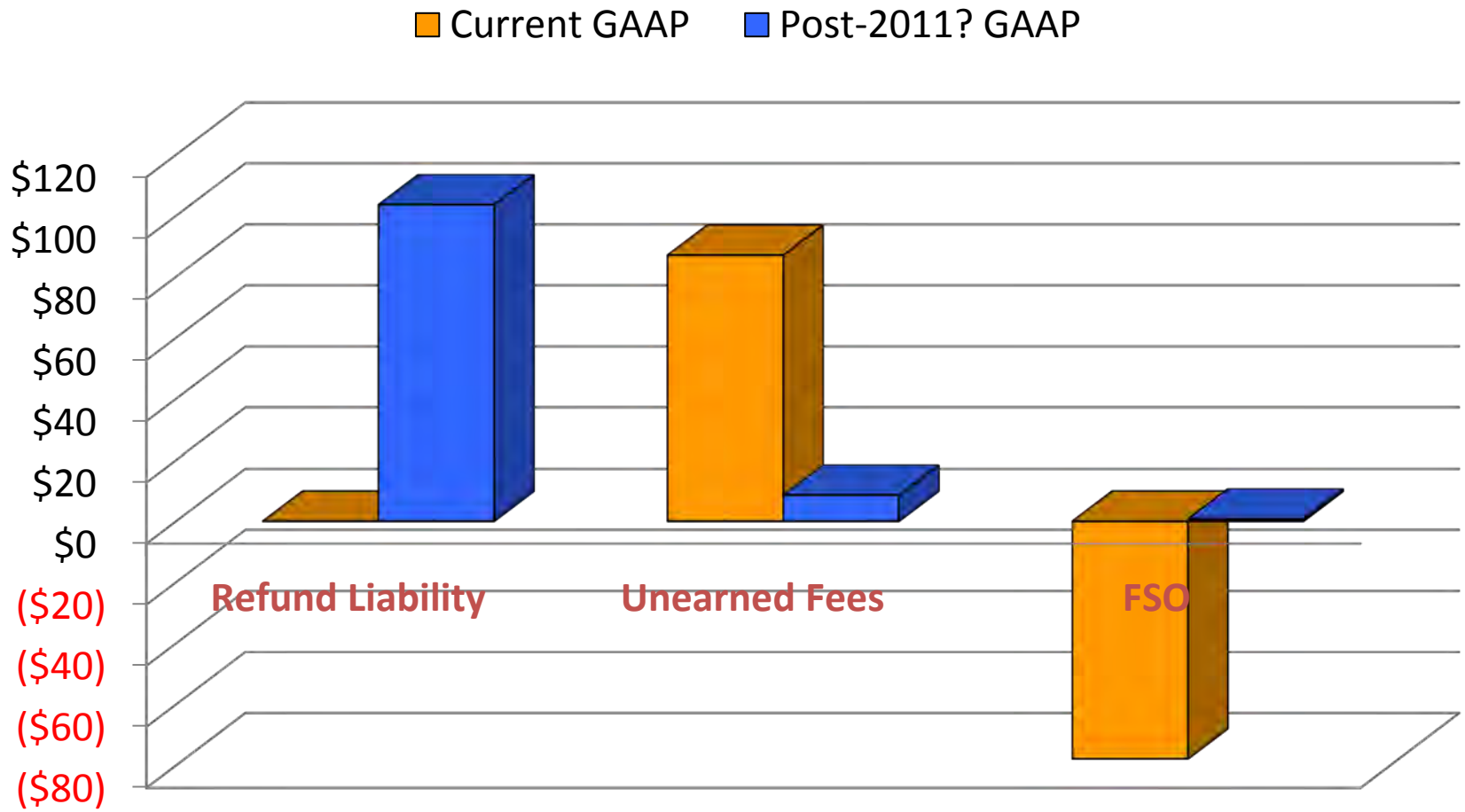
ASOP#3 & FSO PROBABLY WON'T MATCH

	Actuarial Surplus (Deficit)	GAAP FSO
Case #1 (CA)	(\$ 647)	\$ 7,269
Case #2 (FL)	\$ 1,609	\$ 2,631
Case #3 (NY)	(\$4,237)	\$ 5,391
Case #4 (AZ)	(\$4,363)	(\$910)
Case #5 (TX)	\$ 3,388	(\$7,599)

POTENTIAL AICPA CHANGES

1. Clarify contingent definition
 - a. Minimum refund amount > \$0
 - b. Refunds limited to reoccupancy proceeds
 - c. Challenges for multiple contract options
2. Possible adverse impact
3. Less than 10% became positive in AVP sample

POTENTIAL BALANCE SHEET LIABILITY CHANGES FOR REFUNDABLE FEES



SECTION 6

CAN REGULATION ENSURE SOLVENCY?

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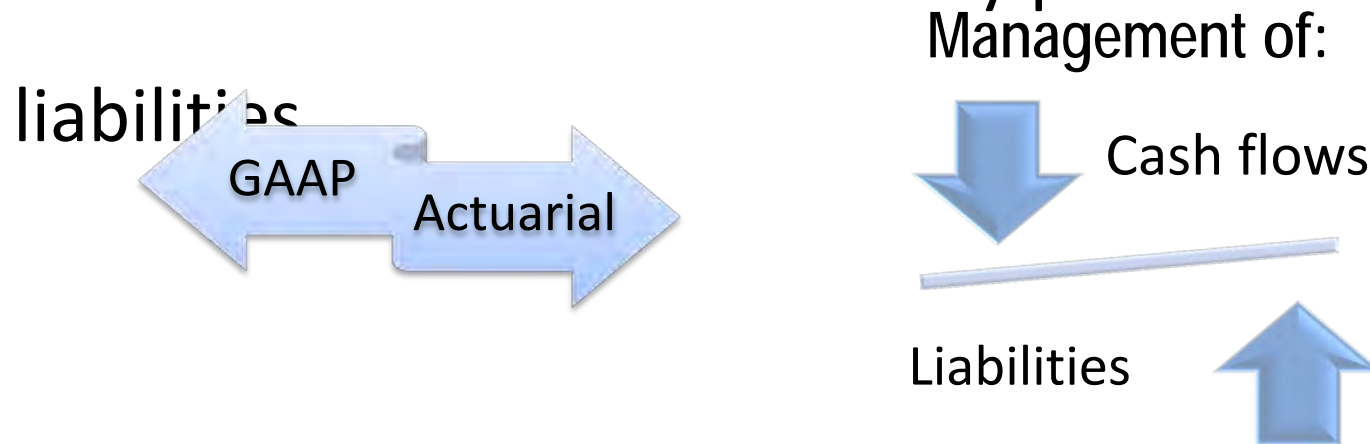


DEFINE STAKEHOLDER INTERESTS AND GOALS

1. Minimize probability of failure
2. Ensure delivery of promised services
3. Promote desired funding of obligations
 - a. Pay-as-you or actuarial funding?
 - b. 12 months P&I + % of operating or ASOP#3
 - c. Social Security or ERISA pension plan
4. Early warning of financial challenges

ACTUARIAL STUDIES SHOULD NOT BE MANDATORY

1. BUT stakeholder education about CCRC risks is!
2. Residents are likely advocates for liability funding
3. Replace with a “rating” that connects higher risk for those who don’t actuarially price and manage



RESERVE REGULATION MAY NOT BE EFFECTIVE

1. Inconsistent application to entry fee contracts
2. No universal buy-in for one approach
3. Conflicts with GAAP interpretations
4. Can't legislate full occupancy
5. Financing institutions already "regulate" cash flows, so that providers could focus on managing liabilities

QUANTIFYING CCRC RISKS: CREDIBLY & RELIABLY?

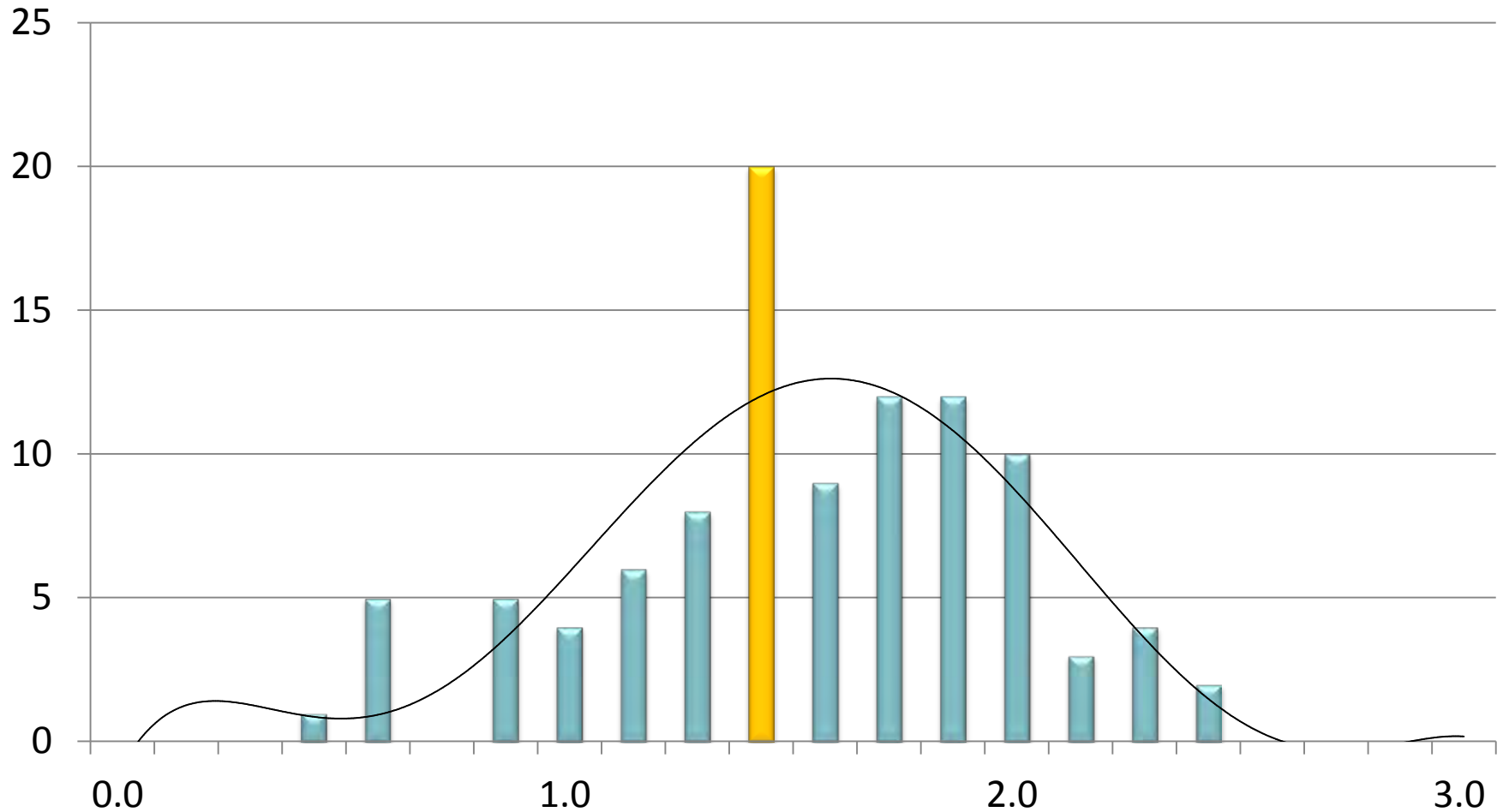
1. Assumptions, Assumptions, Assumptions
2. Trends in ILU occupancy
3. Relationship between revenues, expenses, and earnings
4. Plans for capital renovations
5. Greenfield and rebuilding occupancy



AVP FINANCIAL RISK METRIC

	High	Moderate	Low	Mitigated
Funding philosophy	Pay-as-go; ASOP#3 >5 yrs	ASOP#3 4 or 5 years	ASOP#3 2 or 3 years	ASOP#3 annually
Refundable entry fee	>50%	20 to 50%	10 to 20%	<10%
Occupancy 3-yr experience	Declining or initial fill-up	Constant \pm 2%	Constant \pm 1%	na
Occupancy projection	Increasing >5%	Increasing 3 to 5%	Increasing 1 to 2%	Constant
ASOP#3 Rev-Exp relationship	Rev >1% annual >5% lifetime	Rev +1% annual or +5% lifetime	Matching	<Matching
Exp-Earnings relationship	>3%	2 to 3%	1 to 2%	<1%
Capital plans	1 yr budget + inflation	5 yr internal	10 yr internal	10 yr expert with updates

AVP 2010* ACTUARIAL RISK METRIC SCORES



GETTING YOUR “ARMS™” AROUND A CCRC

1. AVP database is nearly 150 annually
2. CARF provides 300+ (15% of industry)
 - a. $\approx 1/3^{\text{rd}}$ are AVP clients
 - b. Others represent generally sound, but diverse CCRCs
3. Benchmark scores reviewed by 3 person panel
4. Defines standards for comparison
 - a. Robust and easy to calculate
 - b. Transparent and inexpensive
 - c. Consistent and credible?

IMPLEMENTING A CCRC RISK METRIC SYSTEM

1. State requires disclosure and accurate information
2. Independent agency to calculate risk metric scores, even though resident could do as well
3. Education on interpretation of score
4. If CCRC elects not to conduct ASOP#3, for minimal refund contracts require
 - a. Liquid reserves to match actuarial liabilities
 - b. CCRC purchase insurance to pay refunds

QUESTIONS & ANSWERS