Predicting and Preventing Financial Distress

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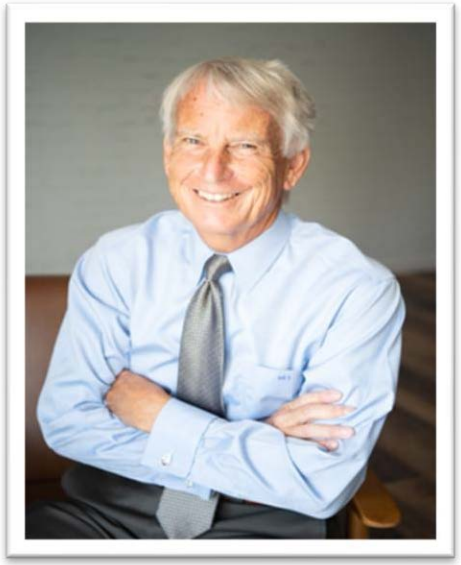

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Learning Objectives

1. Understand what causes the failure of nonprofit senior living organizations.
2. Identify the lessons to be learned from those failures.
3. Rethink management metrics and the data/information that Boards receive.

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A Brief History of Continuing Care Contracts

1. Probably evolved from asset turnover arrangements
2. Modern form developed in the 1970s
3. Affordable by most middle class with defined benefit pensions
    a. Many were populated by retired teachers, based on observation
    b. Environment likely enhanced resident lifespans
4. Uses managed care techniques to mitigate long-term cost risks
5. Absolutely **the best financial security option** for seniors

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Impact of Bankruptcies/Financial Distress

1. Pacific Homes in the 1970s
2. Prudential and John Knox Village in the 1980s
3. No examples of financial difficulties due to runaway utilization
4. More recent cases associated with refundable fees
5. Raises question of whether this concept is still viable
6. Need for an academic study of causes for troubles

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Some Basics for Today

- There are many ways to define failure; bankruptcy is just one
- Financial health is not solely defined by bond covenants

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Ten Failures

ID	Bankruptcy/ Affiliation/ Sale/Closure	Reason(s) for Failure					
		Occupancy	Lacked capital/failed to invest	Imprudent Development	Expense Mismanagement	Fill-up	Other
1	A	✓	✓				
2	A	✓	✓		✓		
3	S	✓	✓				
4	S,B	✓	✓	✓			
5	A	✓	✓				
6	A			✓	✓		
7	S	✓	✓				
8	S,B,A,C	✓	✓	✓			
9	S,B	✓	✓	✓			
10	S	✓	✓				
%		90%	90%	40%	20%		

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Deterioration Destiny

	Before Occupancy Deteriorates *1 to 5 years before occupancy declines*	**Occupancy Deterioration**	**Post Occupancy Deterioration** *3 to 5 years after occupancy nadir*
How it begins	Dinosaur in a new dress – creates an illusion that all is good	Typically, gradual – but exposed more quickly in a crisis (COVID & Recession)	Capital $ trend to 0
What happens	Wait list (W/L) deteriorates, if any. Age, frailty, and finances shift. New programs try to move dated units	Marketing and sales team flogging. Turnover up, required marketing $ up. Run out of "whippersnappers"	Capital spend is wasted. "We always get by"
How it ends	W/L for dated units disappears (even if W/L for newer units grows)	Occupancy, financial position, and capital capacity all drop	No affiliation options available
The learning	If caught at this point – plenty of options. Residents see it happening first, but . . .	Optimism is dangerous. Decreased occupancy = fewer options	Objectivity is the coin of the realm
What can Boards do?	Track W/L metrics and resident-profile trends over time, plus turnover and benevolence. Greenlight big projects	See previous column. Connect with the consumer. Q is what do we need to do, not what can we afford to do	Replace those who are responsible and get a good attorney

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Before Occupancy Deteriorates

1 to 5 years before occupancy declines

How it begins	Older community (or portion) may have been updated over time, but only cosmetically. High occupancy creates an illusion/delusion that everything is great. W/L compounds this.
What happens	If a wait list: (1) it's deteriorating for older units, but the metric used is # on W/L vs. total units; and (2) if there's a new project, majority of new residents might not have been on the W/L. Whether or not there's a W/L: (3) move-ins' financial position and/or frailty is changing, but won't be obvious until a sharp increase in turnover; (4) management promises prospects first preference on a larger unit if they take a dated one now; and (5) the market area may change.
How it ends	W/L for a dated unit is: (a) disappearing, though it could be growing for newer units; or (b) an illusion, comprised of people waiting on their own timeline, not the community's.
The learning	If caught at this point, plenty of options exist to remedy the problem and avoid further deterioration. Rather than dismissing resident concerns about the "type" of new resident— accept it and dig for data
What can Boards do?	Cross the great divide: change the info that's tracked on wait lists, know where residents come from, and track turnover and benevolence. Greenlight big projects while the organization can afford it. "Stewardship" is doing what's needed, not downsizing the spend.

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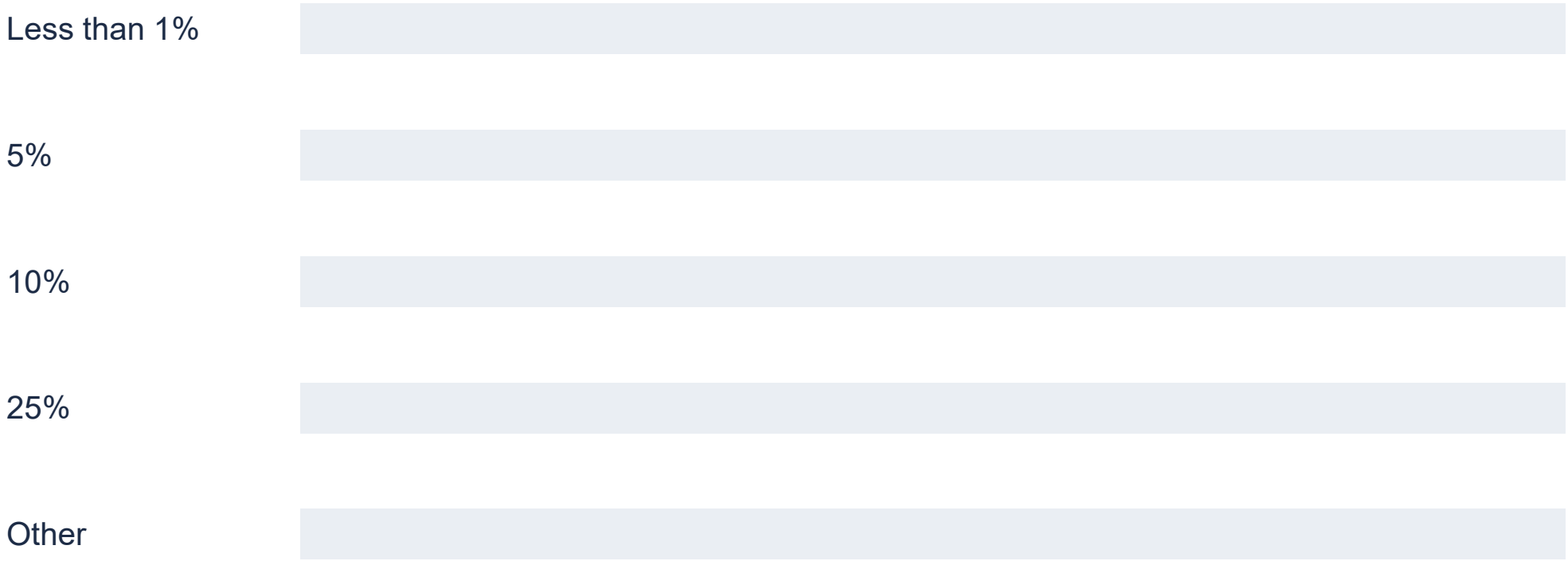
Using percentages, how many CCRCs do you believe are in the "Before Occupancy Decline" Phase?



Polled live via audience show of hands.

Occupancy Deterioration

How it begins	Typically gradual, but can be exposed during a crisis such as COVID or the Great Recession. If caught early there may be enough capital capacity to turn things around — too often, time is wasted flogging the marketing and sales staff instead.
What happens	The "take a dated unit now, we'll move you to a better one" placebo continues — as does the tendency to ignore rising frailty in new residents and looser financial screens. Turnover accelerates. Marketing dollars need to increase, adding to the operating deficit. Increasing age and frailty at entry turn the IL portion into "quasi-AL" as perceived by prospects — only those who "need" to be there will move in.
How it ends	The obvious – occupancy drops and financial position deteriorates as a result. Needed capital improvements become more difficult to make as funds are conserved (either because board/mgmt. become hyper-conservative or the $ just aren't there).
The learning	Optimism in the face of observable trends is dangerous and wastes time. Don't dismiss resident concerns
What can Boards do?	Demand trend over time data – not budgeted occupancy vs. last year's occupancy. Track resident profile at Board or Board Committee level. Connect with the consumer. When residents say "you're letting old people in," take it as fact, not an ageist joke. The question isn't what we can afford to do – it's what do we need to do. Proactively pursue options.

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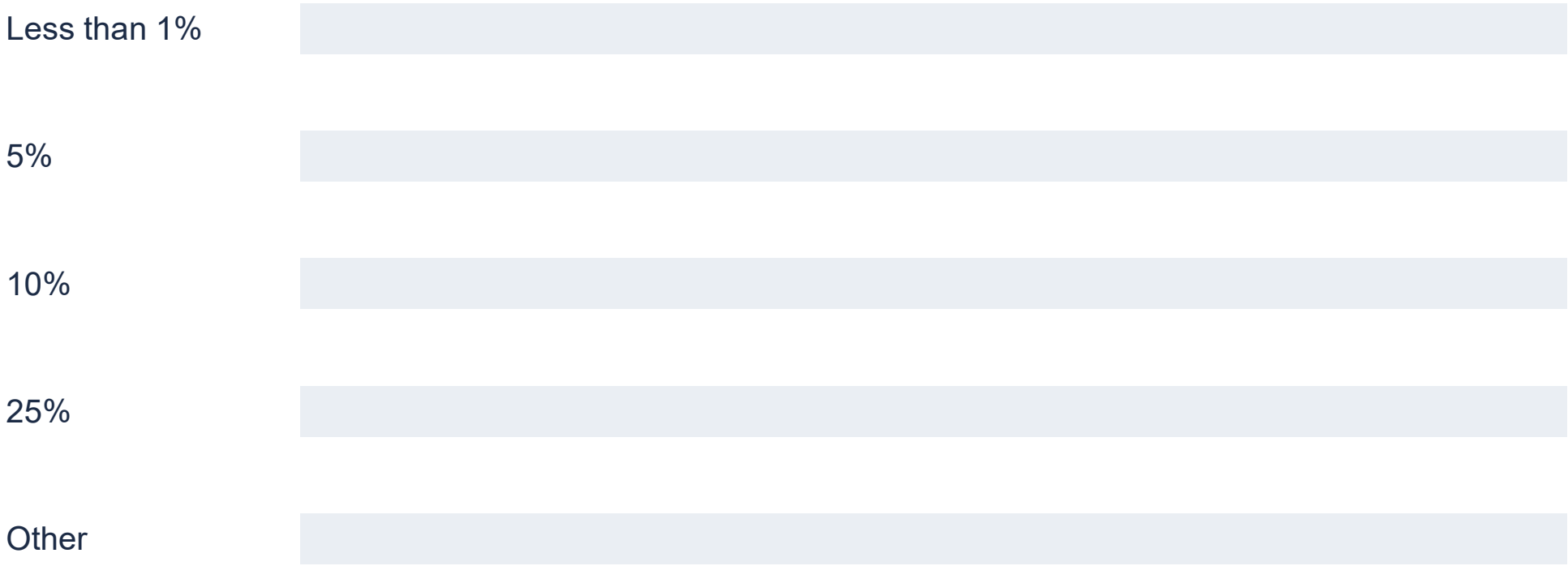
Using percentages, how many CCRCs do you believe are in the "Occupancy Deterioration" Phase?



Polled live via audience show of hands.

Post Occupancy Deterioration

3 to 5 years after occupancy hits an unsustainable level

How it begins	Capital budgets trend toward $0 to conserve cash, further compounding the deterioration. “Deepening insolvency” becomes the issue (see various court cases against boards & mgmt. for allowing it to occur).
What happens	Capital capacity has deteriorated to the point that, it would take $60 million to fix the underlying issues, the organization now has only $10 million. Spending that $10 million at this stage is essentially frittering away the last remaining chance for salvation. Half a bridge has no value. It's a full-blown crisis, but it may not always feel that way, since this deterioration has occurred over a long period and "we always seem to get by.”
How it ends	High probability that affiliation options will disappear. A management contract with an organization capable of turning the situation around may help, but capital — and access to it — remains an issue. For many in this position, the end result will be bankruptcy or sale, or both.
The learning	Those whose inaction led to this need to be replaced or ignored. Optimism no longer has a role. Objectivity is the coin of the realm – if it’s not, the ending is predictable.
What can Boards do?	Same as in the last phase — it's not what we can afford to do, it's what we need to do. Affiliation options (if any) are very limited and will disappear quickly. Simply stated — "get real, real quick!"

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Exhibit A


PLEASE DO
NOT PUSH
ELEVATOR
BUTTONS
WITH
CANES!
Use fingers!
9
7

20+ Years of Residents Talking to Me About "Success" (or "Distress") in CCRCs

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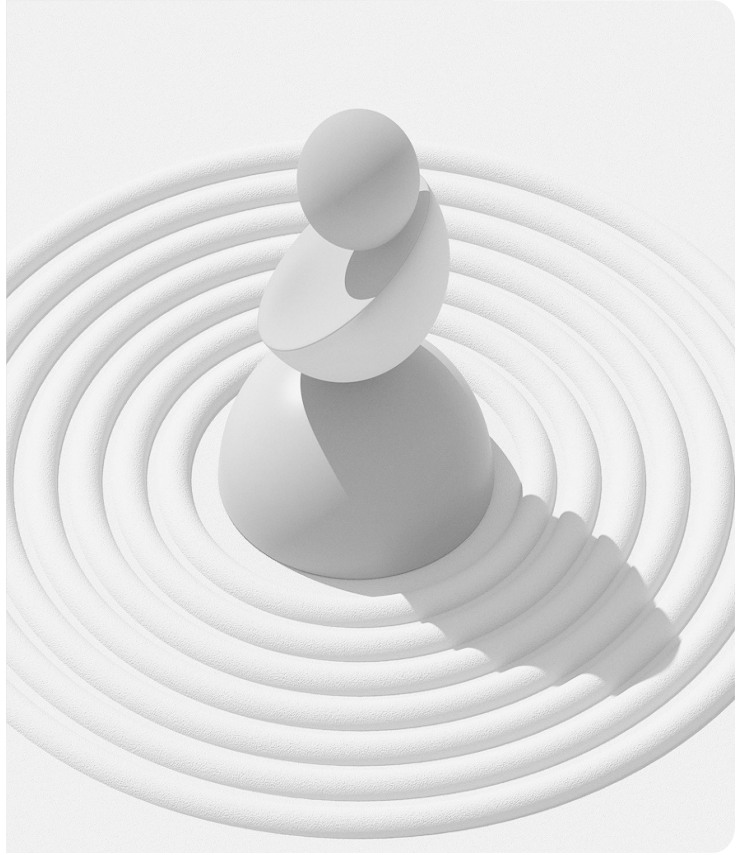
Two “Prospective Resident” Views



“How did I choose [this CCRC]? I followed my friends who chose this place, plus I liked the residents I met while touring here. I figured they knew what they were doing . . . “

“I am a [retired professional] and have recently reserved a unit in a new Life Plan community [to be constructed in the next year]. In the meantime, I would like to find a financial professional to review the financial documents, the disclosure statement and to determine if additional financial materials are needed to evaluate whether my substantial financial investment in this community is a sound one.”

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Amsterdam-Harborside Saga

- Three filings in Bankruptcy Court in nine years
- 2025: In 3rd case, Bankruptcy Court is asked to approve sale of Harborside properties for $86M
- Contingency for sale focused on reimbursement to residents who held $130+M in “unsecured” refundable fees
- Settlement? With sale of individual units occurring in two installments of $42.5M each, settlement terms proposed phased payments to residents, estimated as $0.25 on the dollar. Bondholders to receive approx. 50% of amounts owed
- New “for-profit” operations will be “independent living” only, with closure of skilled nursing, assisted living and memory care

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Comparing two “Nonprofit” Communities

Community A

1950s: Lay people, clergy, builders & guests gather to dedicate a “home for the aged” in south-central PA.

1995: “Rebranding” to honor faith and to build wider community trust, opening “home care” and hospice entities, while operating six Continuing Care Communities, with a high of around 6,000 residents

Oct. 2021: CEO reported COVID-19 downturn in occupancy and lost revenue of $20M

2023-2025: Company closes Home Care & Hospice entities

2025: Files for Chapter 11, owing $83M to primary secured lender, $19M in unsecured trade debt, $8.9M in lawsuits & judgments, plus unsecured promises of some $190M in refundable entrance fees

2026: Bankruptcy Court approves sale of all assets to new (aligned) faith group for $51M in cash, plus pledges of $45M+ cash to fund deferred maintenance & refundable fees

Community B

1973: Begun as a 55-bed nursing home with local grant support

1987: Added personal care unit, followed by independent living cottages & apartments

2005: Offering “continuum of care,” registered as a CCRC under PA law, with refundable entrance fee options

2013: Affiliates with a national network of Quaker-based senior living communities

2019: Structural changes & closure of adult day health program

2024: Reports approximately 132 spaces for residents, with -$1.3M in revenue over expenses

2026: Informs state authorities of plan of sale because of cumulative revenue losses, with 13-acre campus to be sold to private investment firm with for-private management company; review of sale pending with Office of Attorney General

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Against this Backdrop

1. Residents: **"What Rights Do I Have?"**
   A. They ask about what they often call "**fiduciary duties**" -- i.e., how can an industry that promises ongoing services and the "right place to age" think it is okay for "occasional companies to fail"?
   B. Refundable Fees? They ask about how to obtain **secured** guarantees
   C. They ask about state laws providing **"resident liens"** – would this matter?
   D. They ask about **"cost" ("affordability")** of "their" CCRC's **expansion** and **new development plans**
   E. They ask about **"loss of core services"** promised by contracts, especially Skilled Care/Memory Care

2. Residents seek to organize and communicate with each other – in order to ask better questions. Some Communities' Management have issued "cease and desist" letters and/or threatened eviction "for cause."

Think about "state laws" that adopt individual statements of resident rights, versus "contracts" listing some resident rights, versus a need for a shared, uniform recognition of resident rights in the industry.

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Are State Regulatory Bodies Part of the Problem?

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Statutory Purpose for Regulation

Example: Pennsylvania

"The General Assembly recognizes that continuing-care communities have become an important and necessary alternative for the long-term residential, social and health maintenance needs for many of the Commonwealth's elder citizens."

Finds and declares: "Tragic consequences can result to citizens … when a provider of service under a continuing-care agreement becomes insolvent or unable to provide responsible care"

Recognizes need for "full disclosure"

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But “Which” State Body has Authority (and Expertise Needed) to ACT?

- Insurance Department
  Pennsylvania vs. North Carolina vs. Florida?
- Departments of Social Services or Aging
- State Corporation Commission
- Departments of Health/Public Welfare
- Department of Community Affairs
- **Increasing Roles of States’ Attorneys General?**

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What Actions can State Take?

1. Require and review disclosures for completeness & accuracy
2. Conduct regular examinations
3. Issue a cease-and-desist order to the community
4. Revoke authority to operate
5. Set terms for any sale or transfer
6. Order and oversee “rehabilitation or liquidation”
7. Impose civil penalties
8. Impose criminal penalties
9. Provide trustworthy, comparative information for consumers (BUT, do states lack a consumer portal for inquiries, complaints & results?)

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What is the Impact of Trade Groups, Trade Certification, External Standards or New Money?

A. LeadingAge

B. CARF International (or emerging organizations)

C. Accounting Standards vs. Actuarial Standards

D. Private Equity Money

E. What about AI?

Final Thoughts

Strive not to be a success, but rather to be of value.

— **ALBERT EINSTEIN**

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Will Continuing Care Contracts Survive?

The Actuarial Creed

The work of actuarial science is to substitute facts for appearances and demonstrations for impressions by analyzing the financial costs of risks and uncertainty.

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Suggested Practice Changes to Ensure Longevity

1. Accept that cash is not king, but managing liabilities is!
2. Adopt sound solvency practices for all entry fee contracts
3. Ensure transparency with prospects and residents
    a. Moral responsibility to fully fund contract obligations
    b. Future-proof contract terms and remove misleading terminology
    c. Balance the risk trade-off between providers and contract holders
4. Revisit how refundable contracts are funded—legacy issues

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Senior Living Community/Organization Deterioration

Senior Living Communities Don't Die Quickly, They Die Slowly, Over Time

	Before Occupancy Deterioration *1-5 years before occupancy declines*	**Occupancy Deterioration**	**Post Occupancy Deterioration** *3-5 years after occupancy becomes unsustainable*
How it begins	An older community (or portion of a community) that may have been updated over time, but likely only cosmetically. High occupancy creates an illusion (or delusion) that everything is great. The presence of a wait list compounds the delusion.	Typically it's gradual – but can be exposed more quickly during a crisis such as the Pandemic or the Great Recession. If caught early enough there may be enough capital capacity to turn things around. But too often marketing/sales get blamed and valuable time is spent flogging (and firing) the team.	Capital budgets trend toward $0 to conserve cash, further compounding the deterioration. 'Deepening insolvency' becomes the issues (and see various court cases against Boards and Management for allowing it to occur.
What happens	If a wait list: • The wait list for the older units is deteriorating, but if there's a W/L metric it's aggregated (e.g. total number on W/L) and incomplete. The actual metric ought to be # of people/couples interested in the unit type vs. total # of that type of unit. • If there's a new project – rather than being filled by those on the W/L, ½ or more of the move-ins are not on the W/L Whether there's a W/L or not: • Financial position of move-ins and/or degree of frailty is changing but won't become obvious for a while until there's a noticeable increase in the # of units turning over each year and a possible increase in benevolence • Management starts a new 'program' – take a small or out of date unit now and you'll get first choice when a larger unit comes available • The market area may change – it could shrink (only locals will choose the dated units) or enlarge (new residents 'need' to be in the area for family or other reasons)	The 'take an outdated unit now and we'll move you to a better unit when one becomes available' placebo, continues. As does the tendency to ignore or not realize that degree of frailty is increasing for new residents and financial screens are not being applied with the same rigor. Turnover of units accelerates as a result and the number of units that need to be filled begins to increase, almost exponentially. Marketing dollars need to increase to reflect the higher turnover and then higher vacancies. If the $ are increased, however, it adds to the operating deficit (as those older units may still not be sufficiently updated or community areas are falling behind, etc.) The average age and degree of frailty for independent living residents increase – slowly, but surely turning the IL portion of the community into a quasi-assisted living community. That compounds the problem as only those with a 'need' to be there, will choose to move in. As one Executive Director called it *"we've run out of whippersnappers".*	Capital capacity has deteriorated so that now if it would take $60 million to fix the underlying issues, the organization may only have $10 million. Spending $10 million at this point is basically frittering away the last remaining chance for salvation. It's a full blown crisis – but sometimes it won't feel like it, since the deterioration has been occurring for so long and 'we always seem to manage to get by'.

	Before Occupancy Deterioration *1-5 years before occupancy declines*	**Occupancy Deterioration**	**Post Occupancy Deterioration** *3-5 years after occupancy becomes unsustainable*
How it ends	The wait list for the outdated units is: • Disappearing – but could be growing for the more contemporary units (and that covers the deterioration, when the aggregated # is reported) • An illusion – it's comprised of people who are waiting on their own timeline, not the community's	The obvious – occupancy drops and the financial condition of the organization deteriorates as a result. Needed capital improvements become more difficult to make as funds are conserved – further compounding the situation. The so-called 'difficulty' may be that management or the Board become hyper-conservative or it may be because the $ aren't available (or both).	High probability that affiliation options disappear. It's possible that a management contract with an organization able to turn the situation around may help, but capital and access, thereto, remains an issue. For many organizations in this position, the end result will be bankruptcy or sale (or both).
The learning	If caught at this point, the community or organization has plenty of options to remedy the problem and avoid further deterioration of market and financial position Rather than dismissing resident concerns about the 'type' of new resident (*"they always say that"*) accept it as true and dig for the data that will either prove or disprove	Optimism in the face of observable trends (if the data is being provided, appropriate – and see, below) is dangerous and wastes time. Options become more limited as occupancy declines. Same – don't dismiss resident concerns about the 'type' of new resident.	Those whose inaction led to this situation need to be replaced or ignored. Optimism no longer has a role. Objectivity is the coin of the realm – and if it's not, the ending is predictable.
What can Boards do?	If there's a wait list – know what the wait list metrics are and how those metrics are being tracked (and what they're indicating) Know where residents 'come from' Track turnover and benevolence Greenlight big projects – you can afford them now (at least for a while) and the organization can afford them. The price of inaction is high. Moreover, it is likely that an effort, based on 'stewardship' to incrementalize the investment is likely the wrong decision.	Demand trend over time data – not budgeted occupancy vs. last year's occupancy. Track resident profile – at the Board or Board Committee level. Connect with the consumer – and when the residents say 'you're letting old people in', take it as a fact not as an ageist joke. The question, from a capital and strategic perspective isn't 'what can we afford to do' – it's 'what do we need to do' Get out in front of the strategic options. If the sense is 'we don't need to do that now', it's likely that you do.	The same question as in the previous column – it's not what can we afford to do, it's what do we need to do. Affiliation options will be limited and will disappear very quickly. Simply stated: 'get real, real quick'. And finally, get a good attorney (See In Re Lemington Home, 777 F.3rd 620 (3rd Cir. 2015) and Tampa Life Plan Community Bankruptcy and arrest

Questions & Answers