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Looking Under the Hood at CCRC Stability

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By James Ciprich, CFP®
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Choosing to move from a single-family home or apartment to a Continuing Care Retirement Community (CCRC) can be overwhelming from an emotional standpoint. Once a retiree has made that qualitative decision, perhaps with the support of family members, the remaining questions tend to be financial ones, like "Can I actually afford this community?" or "What impact will these new costs have on my estate?"

Once you or a family member has a plan in place to accommodate the potentially large upfront entry fee for the CCRC, as well as the projected ongoing monthly fees, you may have another important financial question: "Will this community remain financially solvent enough to provide me with care for all of my years?"

Following the financial crisis and the housing bubble implosion, CCRCs were under significant financial pressure--so much so that a handful filed for Chapter 11 bankruptcy protection. Why the difficulty? Seniors who may have typically have sold their primary home to fund their CCRC entry fees might not have been able to do so during this period, due to lower-than-expected profits from the sale. Also, because entry fees tend to fund both operations and debt service of the communities, lower profits pushed down the occupancies and the ability of some communities to keep up their service levels and refund entry fees when required.

Fast forward from the financial crisis to today. What are some of the ways today's retirees can determine the financial strength and sustainability of the communities they're considering?

1. Ask to see financials. While financial statements may seem intimidating to review, there are some benchmarking ratios that your financial advisor can use to compare communities on a financial "apples-to-apples" basis. The industry organization CARF.org (Commission on Accreditation of Rehabilitation Facilities) also publishes the "Consumer Guide to Understanding Financial Performance and Reporting in CCRCs," a resource that can serve as your comparison guide.

2. Talk to the CFO. With financial data in hand, you should have access to the community's chief financial officer (CFO). Talk to him/her if the marketing representative doesn't have adequate information on criteria such as bond-debt ratings, operating revenues and net worth.

3. Learn about the endowment. Communities with non-profit sponsors may have endowment funds that provide benevolent care to residents who deplete their personal assets. Ask questions about how this endowment is used—both for charitable help and to help fund ongoing operations.

4. Ask about occupancy rates. Every community's occupancy rate may fluctuate in the short term,. However, a strong community that attracts new residents will typically run more than 90% occupied. Ask about the average occupancy rate over the past five years and also the current occupancy rate to determine if the community is attracting new residents.

5. Research expansion plans. Communities that are adding living units, including independent condos and nursing/assisted living wings, typically are in growth mode. If your potential community is growing, ask for details on how those expansions are being financed. Does the community have readily accessible capital or are they taking on significant debt? Your financial advisor can help you determine whether the community is expanding in a responsible, sustainable way.

Investing Your Nest Egg

Investing in a CCRC may be the biggest financial decision a senior will make during retirement. In some instances, it may be the equivalent of handing over your entire home proceeds to cover an entry fee, as well as giving up an entire pension and all Social Security benefits to cover the ongoing monthly fees.

While access to lifetime healthcare and a safe social environment may justify those costs, it's important to make sure you're handing over your hard-earned assets to a community that is financially strong enough to keep its promises. For help evaluating your decision, be sure to work with an advisor who is familiar with the financials associated with CCRCs.

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Why Should You Care About Continuing Care? Potential Tax Breaks, That's Why!

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One of the tougher decisions we face as we get older is where and how we'll receive care as our health declines. One environment that has been appealing for those who can afford it is the Continuing Care Retirement Community (or CCRC). The CCRC has evolved as a community which typically provides a progressive level of care for its residents as follows:

- Independent Living
- Assisted Living
- Skilled Care

The benefit of the CCRC is that the resident does not need to move from one location to the next, and remains a part of the retirement community through end of life. To pay for this benefit, the individual or couple would usually pay a one-time entry fee and an ongoing monthly maintenance fee. According to AARP, this one-time fee can be anywhere from $100,000 to $1 million, and monthly charges can range from $3,000 - $5,000 per month and are subject to increases over time.

Make the Most of Your Tax Deductions

What many individuals miss is the potential tax benefits of the fees paid to the CCRC. Most people are aware that medical expenses in excess of 7.5% of adjusted gross income (AGI) are deductible against income. What is sometimes missed is that a percentage of the entry fee and the ongoing monthly fee may be deductible as a medical expense. This was supported by a US Tax Court ruling in 2004 (Delbert L. Baker v. Commissioner (122 TC, 2004?)). In this ruling, the court determined that a percentage method of accounting was acceptable and was based on the proportion of the facility's costs attributed to medical care. In this specific instance the court found that approximately 40% of fees paid could be counted towards a medical deduction.

So what does this mean? Let's assume a couple pays $400,000 of entry fees in January of 2012 to enter a CCRC and their CCRC has calculated that 36% of their fees are allocated to medical care. If this couple has an AGI of $200,000, then any medical expenses above $15,000 (i.e. 7.5%) could be deductible. Just on the entry fee, the couple may be entitled to a medical deduction of $129,000 (36% X $400,000) – ($15,000), which would reduce their taxable income in 2012. Additionally, if future monthly fees also have a health care component, that ongoing expense may provide future tax deductions.

Pay Attention to Contracts

Before you get excited and amend a previous return or sign up to enter a CCRC, you must understand the types of contracts these communities offer. Not all active adult, assisted living or nursing facilities are the same in the eyes of the IRS, so it's important to note the differences in these communities and the contracts they offer. In general, they include:

- Extensive Contracts - These tend to be the most expensive contracts because they require a large upfront entry fee, but they tend to have little increases in the monthly fees. These can also be the most cost efficient contracts if skilled nursing care is needed for a long time. The taxpayer is typically entitled to a deduction on the percentage of the entry fee and the monthly fees allocated to healthcare.

• Fee-For-Service Contracts – This contract may have no upfront entry fee and subsequently no prepaid healthcare expenses. If an entry fee or initial monthly fee does exist, it may be attributable to expenses associated with independent living which may not be deductible. Costs for healthcare in the community increase over time and residents are responsible for those costs on a "pay-as-you-go" method.

• Modified Contracts – This is a combination of the extended contract and the fee-for-service contract and is also referred to as a "partial risk arrangement." Residents may or may not be prepaying their healthcare cost with an entry fee, and healthcare costs typically increase over time. Deductibility of medical expenses in these arrangements is less clear, so it's important to work with your tax advisor when determining any tax benefits.

Other Considerations

Two other important things to consider are whether the cost of the community includes a purchase of the dwelling. A payment for ownership of real estate would obviously not constitute a deduction for medical expenses. Additionally, there may be a return of deposit if a resident deceases without using up their allotted prepaid medical expenses.

Conclusion

There are a number of things to look into when exploring the tax benefits of CCRCs. First, consider the environment and the type of care most appropriate for you or your loved one (don't let the proverbial "tax tail" wag the dog.) Where tax benefits exist, it's important to work with your accountant and your financial advisor to take advantage of them in relation to your entire financial picture, which may include gifting or other income realization. Because you cannot carry forward medical deductions, you may want to consider strategies like ROTH IRA conversions to fully utilize those deductions, particularly if they are large in the first year based on an entry fee. Finally, understand the types of contracts

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RegentAtlantic does not provide tax advice. Please consult with a tax advisor prior to implementing any of the strategies discussed in this article.

Barclays Aggregate Bond Index: A broad-based benchmark that measures the investment grade, U.S. dollar-donminated, fixed-rate taxable bond market, including Treasuries, government-rated and corporate securities, MBS (agency fixed-

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Jim advises clients on financial planning and investment management issues. He joined RegentAtlantic in 2007 as a Financial Advisor and has served as Chair of the Financial Planning Committee and the Risk Management subcommittee. Jim serves a broad range of clients, with a particular focus on Wealth Management for seniors and those considering retirement community options. Jim regularly speaks on this topic at retirement communities in the Tri-State area, and he works with both the individual exploring entry into a retirement community (including Continuing Care Retirement Communities) as well as with the individual's family to ensure that all needs are appropriately addressed. Jim is an active member of the Estate and Financial Planning Council of New Jersey. He has been quoted in numerous publications, including the *Newark Star Ledger*, the *Wall Street Journal online*, *Kiplinger Personal Finance*, and *Investment News*.

Prior to joining RegentAtlantic, Jim was a wealth manager with USI Bertholon Rowland and specialized in working with high net worth attorneys. In this capacity, he advised on investing, insurance and financial planning issues while working with multiple county and state bar associations.

An active member in the Rutgers Alumni Association, Jim holds a BA in Economics from Rutgers College and an MBA from Rutgers Graduate School of Business. He is a CERTIFIED FINANCIAL PLANNER™ professional and is also an Adjunct Professor at Fairleigh Dickinson University where he teaches prospective financial planners in the CFP® program. He is also a volunteer mentor to undergraduates in Rutgers Business School.

Previous to his career in financial services, Jim was a marketing representative in the music industry: he is the only RegentAtlantic employee to have RIAA certified gold and platinum albums on his office wall. Jim lives in Florham Park with his wife and two daughters.