Conversion to Cooperative Ownership:

A Win-Win for Everyone

Anecdotal evidence suggests that lack of ownership is the biggest barrier causing prospective residents to resist moving to Continuing Care Retirement Communities (CCRCs). The absence of younger retirees, and the lifestyle they engender, is a secondary resistance point. The second is a consequence of the first, i.e. the lack of ownership leads people to wait to move to a CCRC until they anticipate the imminent need for care.

This currently prevalent CCRC model – with ownership, control, and decision authority exercised by nonresident executives – can be made more attractive and relevant to today's society by introducing the possibility of resident ownership and resident input into the Board and decision processes. Cooperative Conversion legislation would enable and could facilitate a shift to resident ownership and empowerment.

Today most CCRCs are owned by nonprofit organizations. Their executives and boards have the ownership authority. Still, a shift toward resident ownership is more consistent with the implicit mission of the CCRC industry – optimizing support and fulfillment for those who are aging.[1] That resident-oriented mission is often overlooked in practice by well-meaning executives who believe that they know best.

This article discusses aspects of a resident ownership concept. These include:

(1) Protection for existing residents – many of whom may not want change;

[1] http://www.leadingage.org/uploadedFiles/Content/Consumers/Paying_for_Aging_Services/CCRCcharacteristics_7_2011.pdf accessed March 30, 2013.

(2) Implicit cost – tax and other effects; and

(3) Maintenance of occupancy levels – how resales can be facilitated.

Almost all of today's CCRCs are owned by nonprofit provider organizations. This surprises many prospective residents who hear of the large Entrance Fees required to move in and who assume that this must give them some ownership or at least a say in ownership. Even marketing people – the sales people – adopt the logic that an Entrance Fee that is comparable to the equity many have in their homes must constitute a "buy-in" since that is the terminology that is often used. They speak of "sales" as if an entering resident had bought a new home.

Nothing could be further from the truth. The Supreme Court of New Jersey in the Onderdonk case has ruled that CCRC residents do not even have the status and rights that tenants have in a landlord-tenant rental relationship. Residents are merely given a license to occupy a particular dwelling unit for the duration of the Continuing Care Contract.[2] Even the presumption that such a contract provides protection for life may prove ephemeral if the provider determines that a resident needs care beyond the provider's license, leading to a forced relocation elsewhere of the resident. These limitations are seldom disclosed during the sales process.

Ownership of the typical CCRC is vested in the nonprofit provider and the ownership authority is exercised by provider executives and board. A seemingly petty incident shows the practical implications of this ownership presence. The law in at least one state requires provider holding company executives in a multi-

[2] http://www.leagle.com/xmlResult.aspx?page=9&xmldoc=198125685NJ171_1-2.xml&docbase=CSLWAR1-1950-1985&SizeDisp=7 accessed February 13, 2013.

facility enterprise to meet semiannually with the residents. One might think that the executives would work with those in the local CCRC so that the mandated meeting could occur without interfering with the other activities at the CCRC.

That's not what happens in at least one case. The owner executives simply pick a time for their convenience and designate the room that they wish for their purpose. Any conflicting activities are simply cancelled or relocated. Moreover residents are forbidden to ask questions or speak during the meeting. While this may seem trivial, it reinforces for any residents who might think otherwise that the executives are the owners and the residents are present only by license.

Cooperative conversion can help change this executive-owner mindset and the resulting imbalance of priorities and authority. Such a change would benefit residents and would improve the resident experience. It would also make the benefits of communal living more evident, more attractive, and more accessible to a wider range of prospective residents. For younger retirees, those in their 60s, It would bring the Continuing Care living model in line with the currently more attractive senior Active Living residential model.

Not only can resident ownership benefit residents but it can also help providers to advance their mission. With provider ownership the provider organization's capital is tied up in CCRC real estate and facilities. It is only available to support other mission related activities through hypothecation in support of debt.

Today's nonprofit CCRC businesses finance their communities principally with debt obtained in the tax exempt bond arena often through state or local development agencies. The bondholders have a senior claim on any assets of the CCRC in the event of financial impairment but the equity capital to protect the

bondholders' investment is provided principally by resident Entrance Fees. Of course, Entrance Fees aren't available for a startup CCRC, so some seed money is needed either in the form of philanthropic donations, a construction loan, or profits accumulated from past operations – yes, historical *profits*, i.e. the balance sheet net worth. Although profit is considered greed in some nonprofit circles, profit is essential to a financially sound enterprise.

This start up or temporary capital finances the CCRC during construction and provides the bridge to the time when Entrance Fees can take over. Entrance and other operating Fees then provide a fair capital return to the enterprise to cover the investment by the donors, loan service on temporary financing, or to pay a return for the investment of equity funding from accumulated past profits.

The nonprofit form of organization offers advantages that at first seem to be incompatible with resident ownership. First, there is the tax exemption with most nonprofit CCRCs not paying property taxes. Some do, though, often in the form of Payments In Lieu of Taxes, known in the industry as PILOT fees or through other local government "service" fees.

Second, nonprofit CCRCs can finance capital outlays through the tax exempt bond markets. Such borrowings should carry a lower interest rate than taxable bonds since the interest is tax exempt, allowing a comparable rate of return to investors even with a lower debt service requirement.

These advantages, however, can be deceptive since resident ownership offers some offsetting benefits:

1. Residents in a cooperative can deduct from their income taxes a proportionate share of the cooperative's debt interest payments.

2. Residents in a cooperative can also deduct their apportioned share of property taxes.

3. Cooperative residents can feel satisfied that they have paid their fair share for governmental services that are funded by property taxes.

4. Cooperative residents are freed of the burden of "social accountability" which is an expense of questionable value which nonprofit CCRCs incur to support their tax exempt status.

5. Cooperative may have lower operating costs, since there is evidence that investor operated businesses are about five percent more efficient, i.e. expenses are roughly five percent less, than for nonprofit businesses (perhaps because the business focus is more on economics than on mission).[3]

6. Cooperatives can elect, if desired, to keep some of the central services, e.g. skilled nursing, etc., of a cooperative CCRC within a separate nonprofit organization.

7. Cooperatives may be viewed as less risky, and hence carry lower debt service costs, since capital markets may demand a higher debt return for nonprofit CCRC undertakings, offsetting the tax exemption advantage,

[3] Study of relative hospital efficiency by Jeff Stensland, Ph.D., Principal Policy Analyst, Medicare Payment Advisory Commission (MedPAC), reported during February 21, 2013 webinar (http://www.actuary.org/content/webinar-relationship-between-medicare-and-private-insurance-provider-payment-rates accessed March 30, 2013).

because CCRC investments may be viewed as riskier and more leveraged than other financial undertakings.

Thus, it is unclear that costs to residents will be greater with resident ownership than with today's predominantly nonprofit enterprise ownership. Moreover, conversion to cooperative ownership can free capital that the nonprofit enterprise can use to further its mission or for expansion. Cooperative conversion can be a win-win, both for nonprofit CCRC owners who free capital, and for residents who gain ownership and a say in how their lives are governed.

One challenge, of course, is that many residents may be reluctant to take on ownership. They may lack the means, or they may be in decline, or they may simply be content to continue with the status quo. The proposed Model Law protects those residents and allows them to continue unaffected as the conversion proceeds.

Here's how that works. The cooperative involves equity shares which are allocated to the various dwelling units with an associated proprietary lease which conveys the right to occupy the dwelling. Until residents buy those shares the shares remain vested in the nonprofit CCRC enterprise which continues to exercise the same ownership that it would have in the absence of conversion.

Thus, merely promulgating a plan of conversion does not change the fundamental relationship between the residents and the provider. That change only occurs as residents elect voluntarily to buy the shares that convey ownership.

The voluntary nature of conversion carries with it a secondary challenge. In order for resident ownership to be meaningful, there must be a minimal percentage of

residents who elect to own. Otherwise, there would be no group to exercise the ownership interest and the provider would simply continue in ownership though with a slightly different legal and financial structure. The percentage of residents who elect ownership must, therefore, be sufficient to ensure that a Board can be formed with a sufficient number of qualified resident members to be effective. As long as the provider enterprise continues to own a significant number of the cooperative shares, the provider is entitled to representation on the Board.

Also, since Board membership is a part-time activity, a relationship with a managing agent is required to advise the Board and to conduct the day-to-day operations of the cooperative CCRC. There is also a transition period while new Board members become familiar with the requirements of the cooperative CCRC and the responsibilities and obligations of Board duty. During this transition period it is common for the former owner to serve as managing agent to educate and advise the Board.

Of course, with a cooperative ownership model, family members of a resident can own the shares allocated for that residence with their financial investment protected by the value of the shares. The cooperative, however, can establish the value of the shares from time to time by professional appraisal and can require that shares only be sold back into treasury after the associated dwelling unit is vacated. This allows for the timely turnover of vacated units. Rapid reoccupancy is critical to the financial workings of a CCRC. This is a major advantage for cooperative organization for CCRCs over the condominium model which is sometimes followed.

In short, the kind of conversion to cooperative ownership which is envisioned in the exposure draft of Cooperative Conversion Model Law has been time tested and proven in New York. It can give CCRC residents the same ownership engagement which has made senior Active Living Communities so attractive. It can revivify Continuing Care Retirement and make it once more the lifestyle choice that tomorrow's seniors will welcome.