Massachusetts PATRIOT
Massachusetts Life Care Residents' Association (MLCRA) WINTER 2018
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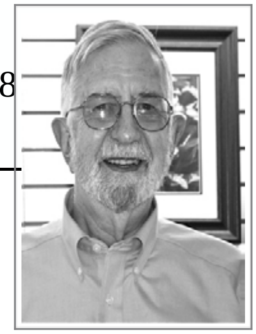

President's Message *by Will Holton*

Bankruptcies in CCRCs: Causes and Consequences

In the last issue of the *Patriot* I wrote about the importance of adequate financial reserves and appropriate accounting methods to keep Continuing Care Retirement Communities (CCRCs) financially stable. That discussion was linked to the idea that the CCRC financial model is essentially an insurance scheme with a large initial premium paid in the form of an "entrance fee" that is usually refundable in part.

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"...many residents think...(entrance fees) are held in escrow....Instead, (they)...are usually used to cover operating expenses."

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This article considers the rare but serious potential for bankruptcies in both for profit and nonprofit CCRCs. *Newsweek* reported in 2009 that Erickson Retirement Communities, managing 19 continuing-care retirement communities in 11 states, had recently declared bankruptcy. In 2014 Leading Age, representing non-profit organizations, stated that there had been only 12 bankruptcies out of almost 1,900 CCRCs since the beginning of the economic downturn in 2007. Some bankruptcies have involved multiple affiliated CCRCs.

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MLCRA ANNUAL MEETING

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Orchard Cove in Canton

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There have clearly been more instances where economic instability would have led to bankruptcies if the CCRCs had not been sold. I will take a brief look at the possible causes and consequences of either outcome.

Professor Katherine Pearson from the Dickinson Law School of Penn State University (the keynote speaker at two MLCRA annual meetings) wrote in 2014 about the consequences of bankruptcy for CCRC residents. She starts by noting that there is confusion about what happens to upfront fees (entrance fees). The contract terms determine how these fees are used but Professor Pearson recognizes that many residents think they are held in escrow to be paid back as refunds when a resident dies or moves. Instead, the upfront fees are usually used to cover operating expenses.

What happens in bankruptcy court? Upfront fees already paid by previous residents are usually not escrowed during the bankruptcy process and their upfront fees are not "secured," although the small deposits put down before moving in may be escrowed. Other "secured" creditors are usually paid before the CCRC has to make good on the "refundable portion" of ***(cont'd on p. 2)***

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residents' upfront fees. In plain words, this means that residents' upfront fees would not be refunded until after suppliers and contractors have their outstanding bills paid. Some nonprofit CCRC contracts in Massachusetts spell out this harsh reality. The somewhat good news is that at least one for-profit CCRC in Massachusetts does a better job of guaranteeing the upfront fees.

CCRCs typically get into financial difficulty when their occupancy rates drop below 85 percent. Professor Pearson writes that the key to success for attracting new residents after CCRCs are insolvent is to treat existing residents well. That can be attained if a buyer takes over who honors the refund obligations or by reorganizing debts after bankruptcy to repay upfront fees to former residents and their heirs.

The worst case scenario after a CCRC was sold occurred at the Covenant at South Hills near Pittsburgh where a strong operator took over the community during bankruptcy but "did not 'assume' an obligation to refund approximately $26 million in upfront fees paid by residents to the former owner."