Is Nonprofit Compatible with Senior Housing?

It all began with homes for the indigent, or at least housing for those of modest means. The concern was with the unforeseeable challenges that can come with advancing age. Many homes for the aged, to use the Internal Revenue Service terminology, were faith related. People who shared a religious community came together in communal living to look after each other and to foster a shared experience.

Mission Paradox.

As CCRCs have evolved from those early affinity communal undertakings, business principles have taken hold and financial structures have been strained. Many nonprofit CCRCs today operate with what is euphemistically called a "negative net asset" position, as if that were fine as long as entrance fee cash was consumed to meet current cash needs. Some rationalize such a condition to be acceptable. That ignores the reasonable expectations of residents with respect what their entrance fees have bought.

Is it legitimate to divert funds paid as consideration for contracted obligations to meet other corporate obligations including debt obligations? Such a diversion is not consistent with the mission-first principles to which most nonprofits are subject.

The paradoxical irony is that a principled investor-funded corporate form, i.e., a for-profit business structure, may be the solution that allows nonprofits to fulfill their mission commitments. In other words, by abandoning their cherished commitment to tax exemption, mission-oriented executives may be able to better fulfill their purpose. They can also enhance the financial security of their residents in the process.

The mission isn't the nonprofit form. The mission is the elevation of the lives of those the organization serves. Is it possible that abandoning nonprofit status, can be more principled and more mission-centric than keeping it? This requires openminded thinking to retain the goodness of CCRCs while ensuring their financial integrity.

Founders' Fees.

Those early residents chipped in founders' fees which were often supplemented by wealthy parishioners or other donors who supported the worthy cause of caring for older people. That's how it began. It was natural that it would be tax exempt as are most faith undertakings. The early "homes" were more communal than businesses-like in their thinking.

Since the community – faith or other – came together for a shared purpose, it was only natural for them to put residents first. Over time, with professional management and the natural churn of the residents, business principles came to bear. It was also only natural that identities diverged between managers and those they served. For one thing, managers were generally from a different, younger generation than residents. A side effect was that the unity of community suffered as a result.

Becoming a Business.

That trend toward a business orientation and less of a charitable undertaking was accelerated after 1972 by the promulgation of IRS Revenue Ruling 72-124. That ruling allowed profit-pursuing CCRC enterprises to qualify. The euphemism "not-for-profit" came into widespread parlance.

For a truly charitable nonprofit, customers are beneficiaries. The nonprofit is granted charitable standing and tax exemption presumably because the good for those customer-beneficiaries serves a valid welfare purpose and spares the public treasury from a burden it might otherwise have to assume.

It's different for market-priced senior housing since those nonprofits are allowed to profit from their business ventures. Regardless of profitability, they are given, by virtue of Revenue Ruling 72-124, tax exemption merely because old age is found to be "distressing", so providing housing and more to relieve that "distress" is deemed to be "charitable."

Residents Are The Mission.

Putting customers first is the guiding principle of the most successful businesses. While it may seem puzzling, the evidence is that those businesses that give their customers the best value often have the fastest growth (think Amazon) and turn out to be the most profitable. It didn't work well for Sears when owner aggrandizement began to take precedence over customers. Sears abandoned its catalog operations just as Amazon brought home delivery retailing to a new level. Customers followed that new model.

With that shift away from "charity" and toward "business", what we now call CCRCs, or what LeadingAge and others would have us call "Life Plan Communities," developed a divergence between enterprise and executive interests and resident interests. This can be particularly pronounced in conglomerate senior living enterprises with a central office removed from those who are served, the customers, residents, clients, or beneficiaries.

Guiding Principles.

This detachment creates financial, governance, covenantal, and marketing challenges. It's time… perhaps, it's past time… to consider whether the nonprofit form is still serving the mission. I can picture a time when LeadingAge, instead of requiring nonprofit ***form*** for membership, would instead require nonprofit ***principles***.

Those principles need to be defined and determined but could include universal housing standards, physical and mental health care, civic, cultural, and recreational activities, an overall environment conducive to dignity and independence, and protection against the financial risks associated with later years of life.

Financial security could include a commitment to provide services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the lifetime care of each resident, and reserves for physical maintenance and expansion commensurate with the needs of the community and the existing resources of the organization. These are the principles explicitly required of "nonprofit homes for the aged" by Revenue Ruling 72-124.

Other principles are more self-evident: A CCRC principle could include full licensure to provide the promised lifetime care; a commitment that the interests of the residents, as the weaker party, not be disadvantaged by the stronger corporate party; and, ideally, that CCRC enterprises accept a fiduciary obligation toward those who trust them with lifelong care.

Beyond Nonprofit Limitations.

The nonprofit form has created roadblocks to achieving such a litany of goodness. For instance, the absence of access to equity capital has resulted in negative net asset balance sheets with a negative net worth for many nonprofit CCRCs. The business element has attracted development advisers and investment bankers who might be better able to serve a less shackled industry open to investor funding.

When an enterprise diverts entrance fees from the fulfillment of the deferred obligations of the contract toward an investment purpose as equity financing to secure debt, it operates contrary to the principle of putting customer value first. This is particularly true when the enterprise gives a higher claim on resident fees, entrance and recurring, as an obligated group for debt security than it gives to the obligations to residents owed under their contracts. In the extreme, the use of the bankruptcy courts to nullify Residence Agreements is a breaking of faith with residents.

Restoring Integrity.

In addition, to allowing strong balance sheets, access to equity investors can open various methods by which residents can keep pride of ownership. One example of that today is Beaumont at Bryn Mawr, PA, a not-for-profit retirement community that is cooperatively owned and governed. The Highlands in Topsham, ME offers a different form of cooperative ownership living.

There are also several condominium communities, but condominium ownership models present challenges to re-occupancy after death. Cooperative organization or simple corporate ownership is better suited to senior housing. *Cautionary Note:* with any conversion from a tenant mindset to ownership, intensive training and conditioning for the residents is critical to success. It's very important that the sponsor's leadership team stay extensively involved, especially in training those who influence management decisions.

Once the equity financing options of investor funded housing are available, there are many forms of corporate organization available which are precluded for nonprofits. Astute use of equity financing can avoid the negative net asset balance sheets which now are properly reason for skepticism among prospective residents and for concern among existing residents. If accounting has any credibility at all, then a balance sheet with negative net worth should be of concern to the industry since it goes directly to the issue of financial security and trust.

Principled Advantages.

Thus, there are many advantages available to nonprofits which convert to investor funding. The fear is that the business will abandon the presumably high-minded principles many associate with nonprofits. That can be precluded by adopting a set of principles that "recommended" provider organizations adhere to.

LeadingAge national would be the logical organization to develop such principles and to evaluate conformance as a path to membership beyond today's nonprofit requirement. At one time, what is now LeadingAge did have an accreditation arm, the Continuing Care Accreditation Commission, but LeadingAge sold that operation to the Commission on Accreditation of Rehabilitation Facilities.

Conformity with principles, however, can be much less costly to administer **than full accreditation**, and can bring stronger finances and greater resident empowerment to the CCRC industry. In theory, the equity needs of nonprofit organizations are met by philanthropic donations and that was common in the early years of what has now become the CCRC industry. As the market based CCRC model has moved more toward being a business, new thinking and new patterns for financing are desirable.

Author: Jack Cumming, CASP, CLU, ChFC, FSA, is a resident who believes that the senior living industry is essential to America's response to an aging population. He's convinced that the industry will thrive by better responding to resident expectations.

Mr. Cumming's career was in the life and health insurance industry. He is an actuary by training. Since moving to a CCRC in 2006, he has become active in senior housing, including qualifying by examination as a Certified Aging Services Professional.