Marquette Elder's Advisor

Volume 4
Issue 3 *Winter*

Article 3

Affordability: What it Means for Aging People and Some Ways to Achieve It

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Affordability: What It Means for Aging People and Some Ways to Achieve It

By Jim Moore

Assisted living is an attractive model for many who suffer the frailties of aging. Why? Because services and their costs are limited to those that are actually needed. Yet few communities exist to provide assisted living to elders who are not affluent. Is affordability possible without substantial continuing subsidies? This author says yes—with care and planning.

Frequently, well-intentioned people make statements about affordability that are the equivalent of political sound bites from inside the Washington Beltway. They're meant to sound great, and they do. But most of them fail to pass the reality test. And that's because we conveniently avoid answering these six defining questions:

1. What is a reasonable financial definition of "affordable"?

2. What pricing actually covers assisted living operating expenses and debt service costs?

3. What can millions of seniors with modest incomes really afford to pay?

4. What is the financial impact on the resident's budget; or, what additional financial help (subsidies) must be provided by either not-for-profit sponsors or for-profit owner/operators?

5. Is cost-shifting fair? Is it desirable? In many instances, assisted living includes less affluent seniors by shifting a portion of their actual costs, utilizing the ability of better-off retirees to cover the cost of subsidized units.

6. Can elders depend on Medicaid waivers and other state and local initiatives to remain universal, multi-year, predictable entitlements, or are they just limited experimental programs?

After all the well-intended rhetoric, the bottom-line question is, "what's the required monthly service fee—and how many seniors can afford to pay it?" This article will address four key issues to better understand the possible answers:

- defining affordability;
- what Sponsors and Owner-Operators Need;
- what Seniors Can Afford to Pay; and
- pathways to Identifying (or Achieving) Affordable Assisted Living and Defining Affordability

Delivery of legitimately affordable assisted living must factor in three economic classes of seniors. These are referred to as the "entitlement" group, the "gap income" group, and the "market rate (private pay)" group.

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The "Entitlement Group" — Income Under $12,000

Seniors with reported incomes under $12,000 per year typically qualify for various government entitlement programs, such as the HUD 202 and Section 8 senior housing, which offer low monthly rent initiatives. But keep in mind that the original concept of the HUD 202 or Section 8 programs assumed that seniors would live *independently* (preparing their own meals, etc.).

It was initially presumed that seniors would not need assistance with typical activities of daily living. But many of these programs started twenty-five years ago. Thanks to improved health care, among other advances, the number of low-income seniors who have aged in place and need assisted living has skyrocketed beyond the initial projections of a quarter-century ago. Sadly, but predictably, no consistently-funded entitlement programs pays for these additional services.

The "Gap Income Group" — Income Between $12,000 and $25,000

The greatest unmet need in senior housing today is the obvious lack of affordable services and living options aimed at serving seniors with incomes that are moderate, but not low enough to qualify for subsidies or government entitlements. Nor can they afford to fully private pay for assisted living.

Labeled the "Gap Income Group," this sector of the senior market has annual incomes between $12,000 and $25,000. In 2003, these seniors will represent about twenty-eight percent of all households over the age of seventy-five in the United States.

The "Market Rate (Private Pay) Group" — Income Over $25,000

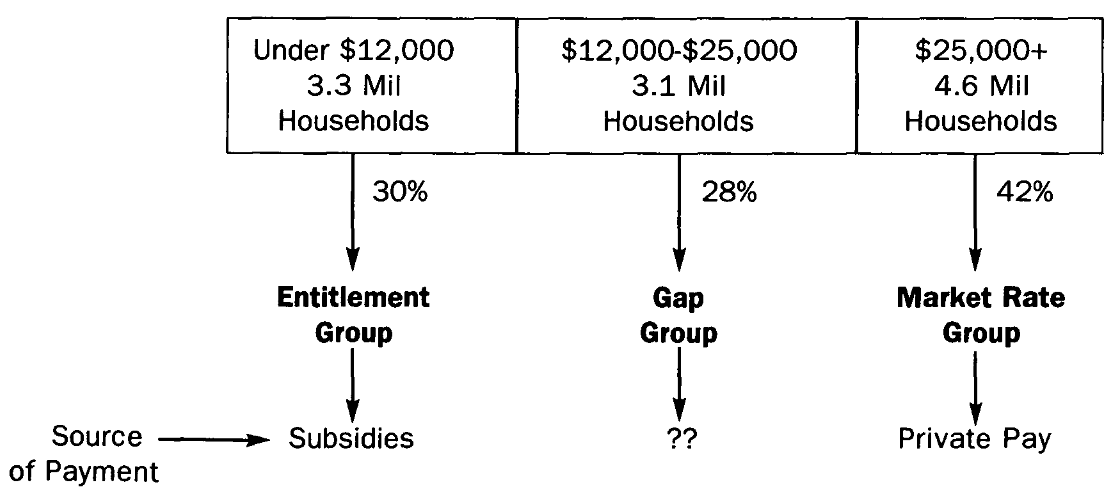
Many seniors with incomes in excess of $25,000 qualify for "market rate" assisted living. That means they can afford to pay prevailing rates beginning at the lower end of today's assisted living private pay pricing spectrum.

The Gap Group Economic Squeeze

Figure 1 illustrates how the Gap Group is caught in an economic squeeze between the other two economic classes of seniors—the very low-income group who qualify for significant entitlements, and the income-qualified market rate group who can afford to "private pay" for a wide variety of senior living options. Trapped between these two eco-

FIGURE 1

THE AGE 75+ GAP GROUP CAUGHT IN AN ECONOMIC SQUEEZE



National Estimates of Age 75+ Households by Income Projected for the Year 2003

FIGURE 2

THE GAP INCOME GROUP BY THE NUMBERS (Age 75+)
(Number of Households in Typical Markets)

	Under $12,000		**$12,000-$25,000**		$25,000-$40,000		$40,000+	
	No.	%	**No.**	%	No.	%	No.	%
Total U.S.	3,301,984	30%	**3,085,233**	**28%**	1,813,929	17%	2,733,708	25%
Atlanta	31,122	32	**24,086**	**25**	14,979	16	26,504	27
Boston	43,962	31	**41,584**	**29**	22,170	15	35,916	25
Dallas	24,804	30	**19,023**	**23**	12,816	16	26,249	31
Denver	16,119	26	**15,134**	**25**	10,418	17	19,980	32
Phoenix	30,765	25	**31,894**	**26**	23,510	19	37,005	30

Figures for typical metropolitan areas in the year 2003

Source: Claritas

nomic classes, the Gap Group is significantly underserved and represents *very* large numbers. Figure 2 depicts this economic conundrum. (Note these are 2003 demographic projections.)

Nationally, approximately thirty percent of the aged seventy-five and over households report annual incomes of $12,000 or less. The "market rate" group reporting incomes of $25,000 or more represents about forty-two percent. That leaves twenty-eight percent, or approximately 3.1 million, aged seventy-five and over households that are largely underserved.

Affordability Gap

As Figure 3 dramatically demonstrates, the Gap Group's affordability limits fall far short of adequately covering today's required independent or assisted living monthly service fees. These monthly fees typically range from $1,000 to $2,000 for independent living, and approximately $1,900 to $3,600 for various levels of assisted living.

Without considerable spend-down or help from children, a senior's qualifying annual income would likely have to exceed $25,000—and that's in after-tax dollars!

The Entitlement Group will be dependent upon just that—public- or private-sector entitlements. The Gap Group represents a national potential of over 3,800 projects, assuming an average senior housing project size of eighty units and a modest ten percent total market share for senior housing. Figure 2 depicts Gap Group gross potential within a community's primary market area in typical major metropolitan areas; while Figure 3 shows typical potential for an individual project's primary market area.

When the impacts of aging-in-place intensify and reach crisis levels, the Gap Income Group will

FIGURE 3

AFFORDABILITY OF THE GAP GROUP
Typical Primary Market Area

Gross Pre-tax Income	Ability to Pay/ Affordable Service Fee[1] Independent Living	Assisted Living	Number of Households in a Typical Market Area
$12,000-$14,999	$ 585-$ 730	$ 720-$ 900	2,800
$15,000-$19,999	$ 730-$ 975	$ 900-$1,200	3,200
$20,000-$24,999	$ 975-$1,220	$1,200-$1,500	3,400
Typical Required MSF	**$1,000-$2,000**	**$1,900-$3,600**	

Actual pre-spend-down affordability levels of the age 75+ *gap group* falls well below typical senior living *private pay* pricing requirements.

[1] Assumes a 10% *average* tax bracket and a senior's spending criteria of 65% and 80% of disposable income (after-tax) for independent living and assisted living monthly service fees, respectively—with no spend-down or help from family members.

finally be widely recognized as a huge economic and social challenge. Breaking down the existing economic barriers with creative solutions that stand the test of time and financial viability will be difficult to achieve. But if this lofty goal is accomplished, the result will perhaps be the biggest breakthrough in effectively serving seniors in the 21st century.

Affordability Parameters— What Sponsors And Operators Need

A realistic definition of "affordable" is elusive. In determining how much a senior can spend for assisted living, we must first make two important qualifying income adjustments. Available demographics on seniors provide *pre-tax income,* but seniors must pay for assisted living in *after-tax dollars.* Ideally, they should not spend more than eighty percent of their *after-tax disposable income* for monthly service fees.

The Price Sensitivity of Assisted Living

Assisted living pricing sensitivity is driven by the need to cover both capital costs and operating expenses. The sensitivity of these costs cuts both ways. At the low end of the pricing spectrum, it is difficult to significantly reduce capital costs enough to create true affordability. That's because a $1,000 per unit decrease in capital costs—using borrowed money at a nine percent interest rate—provides cost savings for the resident of only $100 per year, or $8.40 per month. At the high end of the pricing spectrum, both capital costs and operating expenses come into play when trying to strike a balance between avoiding premium pricing and delivering acceptable operating margins.

Using a fancy term favored by economists, assisted living pricing is very *inelastic.* This means that monthly service fees can't realistically drop below a specific economic floor in attempting to achieve true affordability. On the other hand, moderate market price increases at the high end can lead to premium pricing, and possibly wide swings in critical operating ratios and financial returns.

The Operator's Pricing Needs Quantified

Let's look at a typical eighty-unit "market rate" assisted living community with operating expenses of $55 per resident day (in 2003 dollars), or $1,675 per resident month, and a total, all-in development cost of $120,000 per unit, financed at nine percent with seventy-five percent debt and twenty-five percent equity. Note that all-in cost includes land, site development, bricks and mortar, and soft costs—everything to bring the project on-line and achieve stabilized occupancy of ninety-three percent.

These figures, which represent average costs in 2003, require residents to pay monthly service fees of about $2,640. This fee covers operating expenses of $1,675 (sixty-three percent of the fee), a debt service payment of $785 (thirty percent), cash flow/entrepreneurial profit of $180 (seven percent), and a vacancy factor of $200 (seven percent).

Cracking the Affordability Nut By Reducing Pricing

So, for more affordable assisted living community in your area, a provider must first answer two critical questions: Where can you realistically cut costs? And by how much?

Capital Costs: Operating expenses are difficult to reduce, so most sponsors initially focus on capital costs. But if, in the previous example, you could reduce capital costs and result-

FIGURE 4

THE CRITICAL DEFINITION OF "AFFORDABILITY"

	"Moderate" Affordability	Cross-over Group (1)	**"Comfortable" Affordability**
Pre-Tax Income	$25,000-$35,000	$35k-$40k	$40,000-$50,000
After-Tax Income (2)	$22,500-$29,750		$32,000-$40,000
Assisted Living Affordability @ 80%	$18,000-$23,800		$25,600-$32,000
Monthly	$1,500-$1,980		$2,135-$2,665
Percent of Total 80+ Market in Year 2003	12.3%	3.5%	7.1%

(1) The "Affordability Cross-Over Group" ($35,000 to $40,000) accounts for 3.5% of total.
(2) Assumes 10% to 20% average tax bracket; increasing as a function of increasing income.

ing debt service payments by as much as fifty percent, you would reduce the required monthly service fees by only $390 per month, or fifteen percent—from $2,640 per month to $2,250 per month. That's because debt service costs are only about twenty-six percent of monthly service fee requirements.

So it's not easy to achieve significant affordability by tightening the reins on *just* capital costs or interest rates. In fact, someone could donate the land and building, and you might still have a significant affordability challenge!

Operating Costs: Seniors in assisted living, regardless of their economic station in life, need three meals daily, comprehensive shelter services, high quality of care, and significant assistance with their activities of daily living. If they didn't, they would be living happily in their own homes.

Whether for-profit or not-for-profit, sponsors and owners find it difficult to deliver these services for less than $50 to $55 per resident day, or $1,520 to $1,670 per month. Some are actually experiencing operating costs in excess of $60 per resident day because costs rise as residents age. Operating costs, therefore, are the economic affordability nut that must be cracked.

Some sponsors are making progress in reducing operating costs through property tax abatement or elimination, the selected use of volunteerism, deploying the universal worker concept, and providing in-kind service contributions. Others pin their hopes on revenue enhancements, trying initiatives such as shared occupancy by unrelated individuals, spend-down of senior's liquidated home equity, and endowments.

The Unbundled Services Trap

Still others have tried unbundling their services and, in effect, looking the other way. They do this by offering shelter and living services only, assuming that the seniors will otherwise fend for themselves. This appears to reduce cost, but it frequently merely shifts costs, creating major problems for low-income seniors who have escalating needs for assistance with their activities of daily living (those unbundled services), but no additional funds to pay for such help.

What Seniors Can Afford to Pay For Assisted Living

Solving the affordability challenge will require the execution of realistic, hard-nosed strategies, not just politically correct rhetoric.

Is Affordable Assisted Living an Oxymoron?

Some sponsors and owner/operators consider assisted living service fees of $1,500 to $1,800 per month affordable. Well, at $1,500 per month, or $18,000 per year, a senior in the *average* ten percent tax bracket paying eighty percent of her after-tax income for assisted living would need a gross annual pre-tax income of approximately $25,000 (see Figure 5). In 2003, approximately forty-two percent of those aged seventy-five and older will have this much.

Even at a monthly service fee as low as $1,000, Figure 5 shows that a senior would need a gross pre-tax income of at least $16,700 a year to qualify. In 2003, about sixty-two percent of people aged seventy-five and older will be in this bracket. But this becomes largely an academic exercise, because sponsors cannot realistically offer assisted living for that $1,000/month figure.

Seniors Need Relatively High Qualifying Incomes

The magnitude of the challenge to make assisted living truly affordable is enormous. By 2003, only about thirty percent of those aged seventy-five and older will be able to afford typical assisted living offered for total monthly service fees starting at $2,000. To meet such fees, they would need pre-tax incomes of almost $35,000 (refer to Figures 4 and 5).

Figure 5 shows that the percentage of qualifying households might go as high as thirty-five percent for a $2,000 monthly service fee—assuming that many assisted living prospects are current homeowners who could sell their houses, adding the net home sales proceeds to their existing income-earning savings portfolios. But that leaves approximately sixty-five percent of those aged seventy-five

FIGURE 5

PERCENT AFFORDABILITY AT VARIOUS MONTHLY SERVICE FEES

Required Monthly Service Fee	"Theoretical" Qualifying Income[1]	Percent of 75+ Households Who Qualify In 2003[2]
$1,000/mo.	$16,700	62%
$1,500/mo.	$25,000	42%
$2,000/mo.	$33,400	30%

[1] Assumes a 10% average tax bracket and spending 80% of their after-tax disposable income for the monthly service fee.

[2] These percentages would increase modestly for seniors selling their homes and putting their liquidated home equity to work.

FIGURE 6

THE THEORY OF ASSISTED LIVING QUALIFYING INCOME

(For Assisted Living With a Base MSF of $2,500/Month)

Required "Base" – *Net* MSF **After-Tax** Income Needed:	Qualifying Income Impact: Monthly	Qualifying Income Impact: Annual
80% for Base MSF	$2,500/mo.	$30,000/yr.
20% for Discretionary Spending	$ 625	$7,500
After-Tax Income Needed	$3,125/mo.	$37,500/yr.
Gross Pre-Tax Income Requirement @ *Average* Tax Bracket of:		
15%	$3,675	$44,115
20%	$3,900	$46,875

Before any spend-down, a senior typically needs a gross pre-tax income of over $40,000 in order to have sufficient after-tax income to pay the monthly service fee and have modest discretionary income.

MSF = Monthly Service Fee

and older— over eight million seniors— unable to meet the $35,000-plus affordability criteria.

Some Surprising Aspects of Assisted Living Qualifying Income

Many sponsors and owner/operators are surprised when they conduct a thorough analysis of the required qualifying income for seniors with respect to their assisted living community. Some of the key issues they routinely overlook when generally referring to monthly service fees—absent a more detailed analysis—include:

Discretionary Income Factor

Seniors should be able to reserve approximately twenty percent of their *after-tax* income for discretionary spending; the remaining eighty percent can be allocated to the assisted living monthly service fee. Note that as time passes a typical assisted living resident's need for services. When this happens, more of their discretionary spending shifts to pay the increasing obligations to the owner/operator for higher (tiered) monthly service fees.

Seniors Must Pay Taxes

Many forget that common demographic sources we all access, (including the U.S. Census) report senior incomes in *pre-tax* dollars. I conduct a detailed analysis each year with the help of professional accountants and have determined that the *average* (not marginal) tax brackets of seniors typically fall in the range of ten to fifteen percent. Since seniors can only pay for their obligations in *after-tax* dollars, this factor must also be considered.

Figure 6 summarizes the "theory" of assisted living qualifying income. Note that because of the above factors, qualifying income requirements escalate quite rapidly; frequently presenting surprises to both the owner/operators and the market analysts.

Qualifying Income for a Typical Assisted Living Community

Figure 6 shows the qualifying income for a typical assisted living community in 2003. Note that this qualifying income schedule is consistent with typical assisted living private pay pricing, along with the factors outlined in Figure 7. This is obviously before any spend-down, or help from children.

Income Qualified Seniors Have Surprisingly High Savings Portfolios

As Figure 7 indicates, many seniors must have pretax incomes in excess of $40,000 to qualify for today's private pay assisted living. Figure 8 indicates that, if such is the case, seniors must have an extensive savings portfolio or pension program to supplement their typical Social Security benefit.

A senior requiring a $40,000 pre-tax income must have approximately $460,000 earning a seven percent investment return. That's for a widow with a Social Security benefit of $800/month. Figure 8 provides additional information for a senior whose Social Security is $640/month.

Future Potential Is Difficult to Predict

Of course, the *average* entry age in assisted living is eighty-two, not seventy-five, and not every senior household will need or want assisted living. What's more, seniors in the future may be willing to spend down some of the principal in their savings portfolios, although this is still a controversial issue and has not yet become a totally acceptable assumption when assessing *initial* project feasibility. It may even become common—or at least less uncommon—for family members to pitch in and help pay the fees.

But no matter how we count them, the underserved pool of seniors is still significant. Let's assume that twenty-five percent of the eight million underserved seniors discussed earlier could benefit from assisted living at some point in their lives, *if* they could afford it. That would leave us with close to two million underserved seniors—enough to fill 25,000 eighty-unit assisted living communities, or a rough average of 500 additional communities per state.

To put some of these "macro statistics" into perspective, there are currently about 1.6 million seniors in nursing homes. About seventy percent of the bed census days are Medicaid reimbursed. This means the majority of seniors in nursing homes have very limited assets and income. Sadly, many entered as private pay residents, with reasonable financial resources. But with nursing home costs of

FIGURE 7

MINIMUM QUALIFYING CASH FLOW INCOME REQUIREMENTS FOR A TYPICAL ASSISTED LIVING COMMUNITY
(Based on Estimated 2003 Monthly Service Fees)

	Required Base Monthly Service Fees		Annual Cash Flow	
Assisted Living Unit Type	**Monthly**	**Annual**	**After-Tax**	**Before-Tax**
Assisted Living Units:				
Studio/Alcove	$2,200- $2,400	$26,400- $28,000	$33,000- $36,000	$38,825- $42,350
One Bedroom	$2,600- $2,800	$31,200- $33,600	$39,000- $42,000	$45,880- $49,410

Assumptions:
Rates based on single occupancy in 2003 dollars.
Senior's cash flow allocation for fees: 80%
Assumed average senior's tax rate: 15%

$40,000 to $80,000 per year, many seniors are spending down the assets accumulated over their lifetimes at an alarming rate. Anticipated inheritances for their children are often wiped out.

I've labeled seniors opting for assisted living as *Distinguished Achievers* for many reasons. One is economic. While reporting relatively modest incomes, a large portion of these incomes are typically realized by earnings from surprisingly significant assets.

Home equity plays a major role in a senior's personal balance sheet. Prior to making the difficult assisted living transition decision, a typical senior will likely own a home free and clear (no mortgage). Upon sale of the home, the senior will add approximately $100,000 to his or her personal balance sheet, significantly increasing his ability to private pay for assisted living.

The affordability gap is enormous—but so are the potential opportunities. Next we'll address the nine pathways to pursue in our long odyssey to crack the affordability nut.

The Nine Pathways to Affordable Assisted Living

The task of achieving practical affordability is formidable. There are, however, ways this can be accomplished. There are nine basic approaches to achieving practical affordability:

1. Reducing Capital Costs and Resulting Debt Service:
   - Reduced All-In Project Cost:
     - *Land*
     - *Building*
     - *Soft costs*
   - Lower the Cost of Capital:
     - *Lower interest rates*
     - *Use of tax credits*
     - *More equity; less debt*
   - Use Fund Raising/Endowment Proceeds to:
     - *Replace alternative debt*

FIGURE 8

INCOME QUALIFIED SENIORS MUST HAVE AN EXTENSIVE SAVINGS PORTFOLIO

	Gross Pre-Tax Income*		
	$30,000	**$40,000**	**$50,000**
I. Gross Pre-Tax Income Typical Sources			
Widow's Social Security Annual Benefit: $7,700 ($640/month)	$7,700	$7,700	$7,700
Net Income Needed From Other Sources...	$22,300	$32,300	$42,300
In Order to Realize a Gross Pre-Tax Income of:	$30,000	$40,000	$50,000
Less Income Taxes*	(3,000)	(4,800)	(10,000)
After-Tax Income	$27,000	$35,200	$40,000
Average Tax Bracket	10%	12%	15%
II. Required Savings Portfolio**			
Required Savings Portfolio Earnings (After-Tax)			
5.0%	$846,000	$446,000	$646,000
7.0%	$604,280	$318,571	$461,429

* Seniors typically have an *average* tax bracket of approximately 10%-15%—considering deductions, adjusted gross income, etc. These examples are net after-tax disposable income of $27,000, $35,200, and $40,000 respectively ($30,000 with 10% tax = $27,000 net).

** Reflects a combination of conventional savings portfolio and pension proceeds (if applicable). The savings portfolio requirement might be decreased by an average of $100,000 to $150,000 for a current homeowner selling a home and moving into senior housing.

2. Permanently Reduce Operating Expenses:

- Expense *avoidance*
- Expense *reduction*

3. Provide Shared Occupancy Accommodations:

- For unrelated seniors

4. Deploy Rate Shifting: Blending the Rent Roll:

- Offer a mix of both market and reduced rate units
  - *Market rate units subsidize reduced rate units*
  - *Rent roll stays "whole"*

5. Operating Subsidies, Scholarships and Endowments That

- Provide non-operating income
- Provide operating expense subsidies
- Offer reduced rate resident "scholarships"

6. Use Available Medicaid Waivers and Other Entitlements:

- Government entitlements
- Local/regional initiatives
- Food stamp equivalents

7. Encourage Financial Support From Children

- Funding the dollar gap
  - *Senior's affordability vs. required market rate*
- Dollar-matching incentive
  - *Community and family both fund subsidy*

8. Recognize Prudent Spend-Down of Assets:

- Requires prudent planning
- Make creative/responsible use of home equity

9. Exploit the Potential of Tax Advantages

- Current opportunity: Medical tax deduction for the *complete* assisted living monthly service fees?
- Future opportunity: *Complete* deduction *without* a 7.5% exclusion (a future tax reform issue)?

Each approach to affordability offers unique challenges and opportunities. As previously noted, seeking true assisted living affordability is best accomplished by matching senior consumer affordability with the real economic needs of the sponsor or owner-operator.

Both for-profit and not-for-profit sponsors have two primary economic barriers to delivering affordable assisted living to primarily the Gap Income Group (those seniors with pre-tax incomes ranging from $12,000 to $25,000 per year). These are:

1. **Funding project capital costs and covering ongoing debt service, or required return on investor equity.**

2. **Paying ongoing operating expenses for the life of the project.**

It's amazing how far some well-meaning organizations go in their affordable assisted living planning process before actually coming to grips with these fundamental, unavoidable financial hurdles.

Reducing All-In Capital Costs

Impact of Capital Costs

Some organizations with owned or donated land feel that they are well on the way to realizing a truly affordable, low-income assisted living community. But raw land costs, depending upon your geographic location, will typically be about $5,000 to $10,000 per unit. This represents only five to ten percent of the total projects capital costs, and thus has only a nominal impact on reducing required monthly service fees.

Reducing Total Project Costs

Capital costs are being reduced through donations of land, and, sometimes, through cash and in-kind contributions involving the reduction of development and construction costs for the community. Aggressive "value engineering" and the use of donated in-kind professional development and planning services are also typical initial capital cost reduction strategies.

Let's assume you can create an ideal *affordable* community with a very modest *total all-in* cost of

FIGURE 9

TYPICAL OPERATING SCENARIOS

Costs to Be Covered[1]	"Typical" $120,000 Unit Cost: Monthly Cost	"Typical" $120,000 Unit Cost: Percent of Total Cost	"Affordable" $85,000 Unit Cost: Monthly Cost	"Affordable" $85,000 Unit Cost: Percent of Total Cost
Operating Expenses @ $55 PRD[2]	$1,675	63%	$1,675	75%
Debt Service Payment	785[3]	30	410[4,5]	18
Cash Flow/Requirement Investor Return on Equity and/or Debt Service Coverage	180	7	145	7
Required Monthly Service Fee	$2,640	100%	$2,230	100%

1 93% occupancy
2 Per Resident Day (30.4 days per month)
3 @ 75% debt, 25% equity, 9% interest, 30 years
4 @ 75% debt, 25% equity/fund-raising, 6% interest, 30 years
5 Also provides acceptable and required debt service coverage ratio of 1.3x

only $85,000 per unit; clearly beating the typical capital costs of $120,000-plus. Figure 9 illustrates this comparison.

The $85,000 figure assumes the total turnkey project cost is divided by the number of units. This project will require a monthly debt service per unit of approximately $410, assuming a *very low* six percent interest rate/cost of capital. We can further assume (optimistically) that the land could be donated.

Making required adjustments for seven percent vacancy and a debt service coverage ratio (safety margin) of 1.3 involves a cash flow/debt service requirement per *occupied* unit of approximately $410 per month. But, as Figure 9 demonstrates, debt service to cover these capital costs typically represents only eighteen percent of the total required monthly service fee.

Figure 9 also presents a more "typical" assisted living operating scenario that is likely to exist in many markets in the 2003 time frame. This operating scenario drives the development of a pricing strategy—approximately $2,640/month for the "typical" scenario, and $2,230/month for the "affordable" scenario.

So, if you think there should be more "affordable" assisted living pricing in your area, you first must face the reality of this financial summary. Where can costs be cut, and by how much?

Stretching the Affordability Envelope

Figure 10 presents *very best case* affordability scenarios. Note that *every* input assumption in Figure 10 has been stretched to its most optimistic limit and it's still difficult to break the $1,800 monthly service fee barrier! Simply stated, reduced capital cost alone will not get the job done.

Creative Financing

Low-interest loans and tax credit incentive programs certainly help. But remember, the real challenge is in the area of operating expenses. A higher concentration of equity can be deployed, but the results don't have a very high payoff. Revisiting Figure 9 shows that debt service represents only about eighteen to thirty percent of the total monthly service fee requirement.

Permanent Reduction in Operating Costs

Reducing capital costs and deploying creative financing must be combined with lowering day-to-day operating expenses, *without* major compromises in services provided or quality of care.

Delivering affordable assisted living involves the long-run challenge of reducing the operating expenses that are incurred by the community as

FIGURE 10

REQUIRED MONTHLY SERVICE FEES VS. REDUCED PROJECT COST

	Total (All-In) Cost/Unit — (The Very Best Cases)		
	$65,000	$75,000	$85,000
Debt Service (100% financing @ 5.5%, 30 yrs) Per Occupied Unit[1,2]	$388/mo.	$445/mo.	$505/mo.
Debt Service Coverage Factor @ 1.25x	$97	$110	$125
Subtotal	$485/mo.	$555/mo.	$630/mo.
Operating Expenses @ $45 PRD[3]	$1,370	$1,370	$1,370
Minimum/Best Case Required MSF[4]	$1,855/mo.	$1,925/mo.	$2,000/mo.

1 Assumes 95% occupancy
2 Optimum debt service; 5.5%, 30 years, 100% financing
3 PRD = Per Resident Day (an optimistic assumption)
4 MSF = Monthly Service Fee (Best Case)

long as the organization operates. In terms of operating cost reduction, progressive organizations have made substantial progress in lowering recurring operating expenses through property tax abatement or elimination, the selected use of volunteerism, utilizing the universal worker concept and realizing the advantages of ongoing in-kind service donations.

Others have considered the careful unbundling of selected services. Unbundling is a tempting strategy that does reduce costs, but it can also create other major affordability problems for many of the seniors being served. Large numbers of low-income seniors have escalating assistance needs with the activities of daily living and, often, no funds to pay for this additional help. This situation will only intensify as time goes on, so it is not usually practical to provide affordable long-term senior housing by eliminating services to reduce costs.

Covering Ongoing Operating Costs

Independent Living

Operating costs are a fact of business life. Owner/operators have found it extremely difficult to offer basic, service-enriched congregate *independent living* for a cost per resident-day under $25, or $760 per month. Add these operating expenses to the previously discussed debt service cost of $755 per month and it's easy to see a cost floor for *very basic independent living services* of approximately $1,515 per month.

Assisted Living

Assisted living operating expenses could easily be $45 to $55 a day, or approximately $1,520 to $1,675 per month. The sobering reality is that serving the Gap Group is frequently limited by the inability to effectively cover basic, ongoing operating expenses, even when land and brick-and-mortar costs are reduced significantly.

Addressing Affordability Through Revenue Enhancement

A large number of the affordability options worth considering involve the revenue side of the financial ledger.

Shared Occupancy by Unrelated Individuals

While normally a dangerous marketplace assumption for market-rate assisted living, shared occupancy often works at the lower end of the pricing spectrum in private pay assisted living. A moderately-priced assisted living unit charging market rates of $2,000 to $2,200 per month for *single* occupancy can typically offer that same unit for $1,550 to $1,650 per resident per month for *double* occupancy. While not the optimum living arrangement for most seniors, this option is being explored by more and more sponsors as a practical alternative to serve the growing needs of those seniors with modest incomes. But remember, this is a *very* tricky strategy, that may require interpersonal counseling and adjustments.

Blending the Rent Roll

The blended rate approach typically involves *decreasing* the rates on twenty to thirty percent of the units in your assisted living community, while modestly *increasing* the rates of the remaining seventy to eighty percent. With this option, the rent roll retains a *revenue neutral* status while twenty to thirty percent of the units, in fact, serve at least a portion of the Gap Group.

The downside to this scenario is the sobering fact that market rate residents are partially subsidizing members of the Gap Group. This results in a shifting of the burden to those seniors who can afford to pay more. Figure 11 depicts a typical rate shifting model. Note that "full pay" residents are paying a premium of over $300 per month, or funding a twelve percent subsidy. This concept also requires the establishment of a pragmatic means-testing screening process to determine which residents are legitimately entitled to the below-market rate benefit.

Using Endowments for Reducing The Monthly Service Fee

Endowment, or "buying down" the rates, is a concept whose time may have come, especially for not-for-profits. In order to reduce the monthly service fee for a Gap Income Group senior by $500 per month, however, a permanent endowment fund of approximately $86,000, earning an average seven percent annual *after-tax* return, is required.

FIGURE 11

POSITIVE SPIN..."BLENDING THE RENT ROLL"
REAL WORLD...RATE SHIFTING!

I. TARGET MARKET RATE PRICING

Market Rate Monthly Fees

Assisted Living Units	Monthly Service Fee	Total Annual Revenues
Studio	$2,300	$27,600
One Bedroom	$2,760	$33,120

II. BLENDING RATES WITH SUBSIDIZED PRICING

	Subsidized Units			Non-Subsidized Units (NSU)			
Assisted Living Units	% Mix Subsidized Residents	Monthly Subsidy Amount	Effective Subsidized Mo. Fee	Remaining NSU Resident %	Additional Monthly $ NSU	Adjusted NSU Mo. Fee	Effective Total Annual Revenues
Studio	25.0%	($1,100)	$1,200	75.0%	$367	$2,667	$27,600
One Bedroom	20.0%	($1,260)	$1,500	80.0%	$315	$3,075	$33,120

The endowments would obviously have to be increased if that interest income was taxable. Reducing the monthly service fee by $750 per month would require a tax-free interest earning endowment of approximately $129,000 for a single unit. Buying down the rate by $750 per month for twenty-five units would require a tax-free, interest earning endowment of $3.2 million. Figure 12 provides some typical endowment scenarios.

While these numbers may seem daunting, many communities are gradually building endowments through fund-raising activities in order to better serve the Gap Income Group seniors of the future. Much of this endowment money frequently comes from existing affluent residents of the community who either provide endowment funds while still living or as part of their estate.

A variation of this strategy is to establish what I call a "Family Member Matching Challenge." A not-for-profit sponsor tells a family they can offer their loved one a "scholarship" of $300 per month if the family can provide an equivalent amount. This leverages or stretches available endowment funds, and provides motivation and incentives for family financial participation.

Spend-Down of Liquidated Home Equity

A modest-income senior selling a $110,000 home with net sale proceeds of $100,000 can place the proceeds in a portfolio earning approximately five percent after taxes, which would come to $5,000 a year. This would lower the senior's qualifying income level for a community requiring a threshold of $30,000 down to $25,000. In a typical primary market area, this would increase the number of income-qualified 75+ households by about five percent.

FIGURE 12

BUYING DOWN THE MONTHLY SERVICE FEE

Desired Reduction In MSF[1]	Per Unit Endowment Required at Various After-Tax Savings Rates		Total Endowment Required to Cover 25 AL or IL Units
	7%	5%	
$ 500/mo.	$ 86,000	$120,000	$2.2 mil. – $3.0 mil.
$ 750/mo.	$129,000	$180,000	$3.2 mil. – $4.5 mil.
$1,000/mo.	$170,000	$240,000	$4.3 mil. - $6.0 mil.

[1] MSF = Monthly Service Fee

A senior could also spend-down the newly acquired home equity at a pace that (statistically) does not exceed his or her expected life.

Cash Flow from Other Projects

A sponsor may tap into one of a growing number of private-pay service delivery business opportunities on their campuses to help underwrite another part of the community's overall mission. For example, an effectively designed and properly operated eighty-unit assisted living facility on a retirement community campus, with independent units and access to skilled nursing care, can yield approximately $3,000 per unit of annual cash flow after paying all operating expenses and debt service. This adds up to a gross potential of $240,000 in annual residual cash, some or all of which can then be dedicated to serving economically disadvantaged seniors.

Government Involvement—Medicaid Waivers

Experimental Medicaid waivers that essentially transfer nursing entitlements to assisted living have received much publicity in recent years. But let's look at the facts as recently published in STATE ASSISTED LIVING POLICY: JULY, 2000, from the National Academy for State Health Policy. This definitive study reported there are approximately 58,500 participants in various state Medicaid waiver programs. Some 18,500 participants were in North Carolina, 7,900 in Missouri and 4,400 in Michigan. This leaves approximately 27,700 spread across the remaining thirty-five participating states. That reflected an average of 790 low-income seniors per participating state served via waivers. It's a start, but current waiver initiatives meet only about two percent of the total potential assisted living affordability need.

Some expect that assisted living Medicaid waivers will grow significantly. But can the Medicaid program, which is being scrutinized to hold down costs, really afford to provide universal funding for a whole new type of long-term care—one that caters to many seniors who don't qualify for nursing home care today? If a major public entitlement program for assisted living were implemented, would seniors currently ineligible for today's nursing entitlements (because of lower acuity) literally come out of the woodwork to benefit from this expanded entitlement program? Finally, will Medicaid provide sufficient, consistent, and predictable *multi-year* funding to cover assisted living costs?

Assisted Living as a Medical Tax Deduction

It is highly likely that, for seniors receiving help with two or more activities of daily living, the *total* assisted living monthly service fee may be deductible. This, of course, would be subject to total medical expense deductions that exceed seven and one-half percent of a senior's adjusted gross income.

Unfortunately, this initiative does not help low-income seniors with little or no tax obligations. But it does represent about a twelve to twenty percent discount for income qualified, market rate seniors.

The Public Sector Dilemma

When I ask prognosticators how public-sector involvement in affordable assisted living really works, they typically respond that "policies that *could* be put into place *might* work," or, "the state *could* realize that assisted living is more cost-effective than nursing and therefore they *might* allocate more money." True, the public sector *could* do these things, but it probably won't. Doing so would mean investing a considerable amount in the short term on the chance of realizing savings in the long run. No responsible state government makes policy that way; it would be political suicide!

In the end, if we are to meet the affordability challenge, we must rethink our approaches to funding long-term care through entitlement programs. Families with sufficient financial means must be motivated to pay their fair share for long-term care services, perhaps with appropriate income tax incentives. Private-pay residents should not have to directly subsidize others through blended rent rolls, or other inequitable cost-shifting initiatives.

Life Is Full of Trade-Offs

There is one market dynamic that can assist greatly in developing Gap Income Group assisted living affordability strategies. A consumer's level of discretion, selectivity, and sensitivity regarding the acceptance of available senior living options decreases as a function of decreasing income. Simply stated, there is no free lunch.

As with us all, senior consumers of varying economic status must accept trade-offs on the basis of their relative affordability. This in no way makes low-to-moderate income seniors second-class citizens. Rather, it is the economic reality of the marketplace that these seniors can be effectively served with selected trade-offs that might not otherwise be acceptable to higher-income seniors who can afford a more upscale community. This situation goes on daily in the broad consumer marketplace.

A Look to the Future: Stepping Outside the Box

In this new millennium, we must completely rethink both existing and new approaches to affordability. Some of the future changes will be painful, but necessary. Here are seven provocative ideas:

1. **Stop Asset-Shifting Exclusively for Nursing Home Care.** We have to stop the well-intended, but financially devastating, asset-shifting by seniors in order to qualify for Medicaid nursing entitlements. However, there are other forms of asset strategies that should be considered.

2. **Pay Our Fair Share.** Those of us with the financial means (both seniors and our immediate families) must pay our fair share of either necessary nursing costs, or seek out other viable alternatives, such as assisted living.

3. **Putting Over $1 Trillion of Assets to Work.** Seniors' pent-up equity exceeds $1 trillion (that's with a T!). We should develop financial models that strike a delicate balance between optimizing a senior's autumn years and leaving a reasonable legacy to their children or heirs.

4. **Eliminate Unfair Subsidies.** Private-pay patients or residents should not have to directly or indirectly subsidize the care or sheltered living of others through blended rent rolls, or other inequitable cost-shifting initiatives.

5. **Children Must Help Seniors.** Adult children who have the means must be financial participants. There should be reasonable, financially responsible tax incentives for families who supplement the cost of care for their parents. This would be the most effective next step in the "privatization" of the health care system. How about repeal of the seven and one-half percent medical tax deduction exclusion for families helping seniors?

6. **Create Innovative Sponsor Financial Incentives.** Possibly through the dollar-matching challenges with families and operating profit tax incentives, for-profit operators could have more impact on individual consumer affordability than through tax credits associated exclusively with debt service and capital costs.

7. **Offer Financially Responsible Tax Incentives.** Seniors and their families should receive tax incentives to pay directly for the efficient delivery of health care and living options. Formal and official recognition should be given to the tax deduction of *all* assisted living monthly service fee (for service at two ADLs and above). Ideally, these deductions should not be subject to the seven and one-half percent of adjusted gross income exclusion.

We are making progress, but we must attack difficult affordability issues with pragmatic, hard-nosed strategies rather than wishful rhetoric.