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# Spending Assets Prudently For Quality Assisted Living

*Most residents in assisted living communities depend on their after-tax annual incomes to pay their bills. Some also rely on contributions from family members. However, new methods of payment must be found if the senior housing industry is to serve more than just the small percentage of seniors who can afford private-pay assisted living on their income alone.*

**By Jim Moore**

*Jim Moore* is President of Moore Diversified Services, Inc., a Fort Worth, Texas-based senior housing and health care consulting firm. He has authored several books on assisted living and senior housing, including ASSISTED LIVING STRATEGIES FOR CHANGING MARKETS.

*Caution: The concepts outlined in this article have not been universally accepted by the industry, personal financial planners, or the consumer marketplace. But we must find new approaches to solving old problems by sometimes stepping outside the box. If you utilize these ideas, do so with extreme caution—perhaps initially on a limited, experimental basis.*

The great majority of the assisted living communities developed in the United States over the last ten years are structured to be on a private-pay basis. Most residents must rely on their Social Security, company pensions, and interest earned on their lifetime savings—in other words, their after-tax annual incomes—to pay their bills. Some may also get help from their adult children or other relatives. But other creative, prudent methods of payment must be found if the senior housing industry is to serve more than just the thirty to thirty-five percent of seniors aged eighty and over who currently can realistically afford to pay privately for assisted living.

In order to have enough money to pay for other discretionary purchases, a senior should ideally spend no more than eighty percent of his or her after-tax income on the assisted living monthly fee. At today's rate, that rules out approximately sixty-five to seventy percent of seniors aged eighty and over.

However, many of those same seniors could afford assisted living if they approached the cost similarly to nursing home or continuing care. That means introducing innovative options such as properly planned spending of assets.

### The Case of Mrs. Barker

Consider Mrs. Barker, an eighty-three year-old widow living alone in a home she has owned for thirty years. A recent heart attack and osteoporosis have taken their toll and left her frail, occasionally forgetful, and in need of assistance with the activities of daily living. She has a modest after-tax income of

Figure 1

MRS. BARKER'S CURRENT SITUATION

83 Year-Old Widow:
- Statistical Life Expectancy: 6 Years

Lives Alone in Her Home of 30 Years:
- Current Home Value: $110,000
- Mortgage paid off

Current Health Condition:
- Recent Heart Attack & Advancing Osteoporosis
- Somewhat Forgetful & Frail
- Needs Assistance With Approximately 3 ADLs
- Considering Moving to an Assisted Living Community

Current After-Tax Income of $1,875/Month, or $22,500/Year:
- Social Security is $900/Month
- Savings Portfolio of $235,000 (earns $975/Month at 5% after-tax savings)

Can Afford to Spend 80% of Her After-Tax Income for Assisted Living:
- $22,500 x .80 = $18,000/Year, or $1,500/Month

Source: Moore Diversified Services, Inc.

$22,500 a year, or $1,875 a month. Figure 1 summarizes Mrs. Barker's situation.

Mrs. Barker and her daughter, Kim, have considered the options. Mrs. Barker could move in with Kim and her husband Bill, or find a more modestly priced residential facility (perhaps with semiprivate accommodations). She could stay in her house (at relatively high risk) while accessing intermittent, marginally effective, and costly home health services. Ultimately, she might end up in a nursing home, spending the assets she and her husband had accumulated over a lifetime. Eventually, she might be a Medicaid recipient.

After considerable homework and soul-searching, Mrs. Barker's daughter concludes that The Gardens at Westridge, an assisted living community, is the most suitable place for her mother; Mrs. Barker reluctantly agrees. But eighty percent of Mrs. Barker's after-tax income is only $1,500 per month, and The Gardens charges $2,500 per month for basic services and a reasonable array of assistance with the activities of daily living. (Approximately forty-five minutes of direct, hands-on care per day.)

### An Analysis of Mrs. Barker's Finances

To be prudent, we can assume that Mrs. Barker's Social Security income of approximately $900 a month will increase at only two percent per year, while the after-tax interest rate on her existing savings portfolio of approximately $235,000 will continue to earn a conservative five percent annually. We can also reasonably assume that The Gardens at Westridge's assisted living service fee ($2,500 per month in 2002) will likely increase at about four percent a year. Figure 2 summarizes the situation.

A most critical assumption is Mrs. Barker's reasonable life expectancy. Based on life expectancy tables for an eighty-three-year-old

Figure 2

MRS. BARKER LIKES
THE GARDENS AT WESTRIDGE

| The Gardens at Westridge | Mrs. Barker's Current Situation |
| --- | --- |
| 2002 Monthly Service Fee (MSF): $2,500/Month[1] | A $1,000/Month income affordability shortfall |
| Annual MSF Escalation: 4% | Only her Social Security has a modest COLA[2] of a modest 2%/year |

Mrs. Barker's Options Appear Limited:

1. Do nothing;
2. Access home health care on a sporadic basis;
3. Try to find less desirable, semi-private assisted living accommodations;
4. Continue to live at home at increased risk;

or...

GET CREATIVE!

[1]With reasonable allowance for assistance with Activities of Daily Living (ADLs).
[2]COLA = Cost of Living Adjustment

Source: Moore Diversified Services, Inc.

female, and her personal physician's assessment of her current health, Mrs. Barker's estimated life expectancy is six years. Of course, she could outlive her statistical life expectancy, so spending of assets must be conservative. In any case, Mrs. Barker wants to leave what she can to her children.

### Putting Home Equity to Work Prudently

Fortunately, Mrs. Barker owns her home free and clear. Its market value is approximately $110,000; thus, upon sale, she would net approximately $100,000 after selling costs. (See Figure 3.)

Through carefully planned spending of the proceeds of her house—the liquidated home equity—she can fill the "affordability gap" in her income and pay for her residence at The Gardens. Her existing $235,000 savings portfolio remains intact to serve as her final estate or act as a financial buffer in the event of a very long life or unanticipated expenses.

Figures 4 and 5 illustrate Mrs. Barker's asset spending profile. If net proceeds from her home sale were $100,000, that would last for eight years—beyond her life expectancy of six years. If her home netted $150,000, the spending profile would last for about eleven years.

Figure 3

MRS. BARKER AND HER DAUGHTER GET CREATIVE

1. The Plan: (in round numbers)

| | |
|---|---|
| Sell Home | $110,000 |
| Selling Costs @ 9% - Approx. | (10,000) |
| Net Sales Proceeds | $100,000 |

2. Set up a "Declining Balance Fund" to Cover the Gap Between:

   a. 80% of Her Current After-Tax Income ($1,500/Month); and,

   b. The 2002 Assisted Living MSF of $2,500 (This Fund covers the 2002 Gap of $1,000/month)

3. Some Other Variables to Consider:

   Fund Earnings: 5% (After-Tax)
   MSF Annual Increase: 4%

Source: Moore Diversified Services, Inc.

Figure 4

A PRUDENT SPENDING PROFILE CAN BE STRUCTURED TO EXCEED A SENIOR'S EXPECTED LIFE

| Required to Cover a $2,500 MSF[1] | | Maximum Term of Senior's Spending Using Only Liquidated Net Home Equity of:[2] | | |
|---|---|---|---|---|
| Payment From Current Income | Spending Assets Per Month[3] | $100,000 | $125,000 | $150,000 |
| $2,000/mo | $500/mo | 11 Years | 13 Years | 15 Years |
| 1,750 | 750 | 9 | 11 | 12 |
| 1,500 | 1,000 | 8 | 9 | 11 |

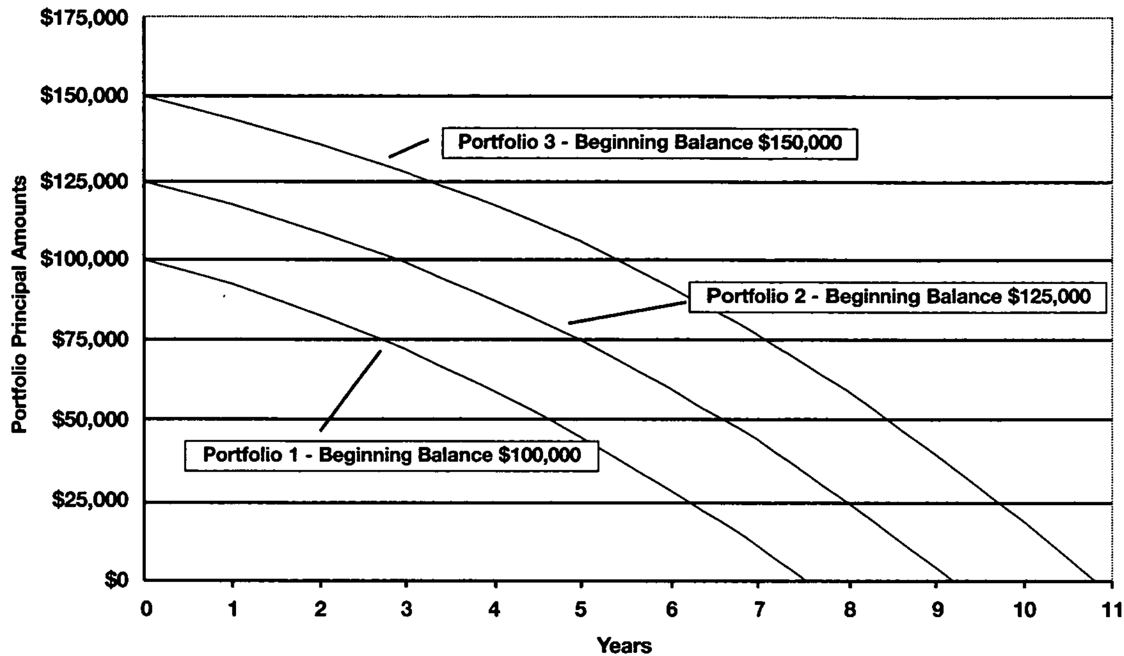
*Prudent and individually planned assisted living asset spending models can deliver affordability with time spans that will likely exceed the statistical life expectancy of many seniors.*

Note: At the end of the time span indicated above, Mrs. Barker still has the original principal value of her existing savings portfolio (reference Figure 1).

[1]MSF = Monthly Service Fee
[2]Reflects annuity model that considers the time value of money (interest earned).
[3]Spending funding shortfall v. required base MSF of $2,500/month.

Source: Moore Diversified Services, Inc.

**FIGURE 5**
**MRS. BARKERS'S ASSISTED LIVING SPENDING PROFILE**




## What Has Mrs. Barker Accomplished?

To summarize Mrs. Barker's future prospects:

- Mrs. Barker optimizes the quality of life for her remaining years with dignity, proper care, and optimum independence in a setting of her choice;
- Her family lives free of guilt about her need for care, with reasonable peace of mind;
- A previously untapped asset, home equity, is put to work prudently, creatively, and cost-effectively; and,
- Mrs. Barker still retains her original $235,000 savings portfolio for her estate or an emergency fund.

Of course, there is yet another option: financial help from her family. This could be brought into play if Mrs. Barker encounters financial difficulty.

## Is Spending Assets "Financial Voodoo" Or a Dominant Trend?

How much of this kind of spending is going on? It's hard to know, and evidence is difficult to obtain. Many assisted living owners/operators are engaging in "Don't ask, don't tell." That is, rather than ask about income and asset qualifications, they simply inform seniors and their families what it costs to live in their communities and then let them decide whether they can afford it.

Spending savings and assets has occurred in other senior housing settings for many years. It is universally accepted in nursing homes, where the government provides Medicaid coverage only if a resident becomes impoverished. About seventy percent of the 1.6 million nursing beds are funded by Medicaid.

Residents of continuing care retirement communities (CCRCs) also spend savings in paying their nonrefundable entry fees. Communities that charge entry fees may offer only partial or no refund when a resident dies or moves out. Many retain a certain percentage of the entry fee every month until reaching a refundability floor (usually fifty to eighty percent). For example, if the entry fee for a particular unit in a CCRC is $100,000 and the non-refundability rate is two percent per month, residents are essentially spending $2,000 of their assets every month until reaching a typical guaranteed refund-

ability floor of fifty to eighty percent. Some CCRCs allow residents to spend the remainder of their entry fees to make up the difference if rising monthly fees exceed their current incomes. Formulas depend upon state regulatory requirements as well as contract terms.

Another way to look at this situation is to observe the effective monthly service fee. If a CCRC is charging $1,800 for a conventional monthly service fee, we can add to that the $2,000/month nonrefundable portion of the entry fee (spending), for a total effective fee of $3,800 a month! (Of course, the CCRC resident need not keep funds for the types of care promised in the CCRC contract, particularly nursing home care.) Figures 6 and 7 compare typical CCRC spending with planned assisted living spending.

### The Complexities of Qualifying Incomes

Seniors who don't want to spend down their assets should pay only about eighty percent of their after-tax income for assisted living, leaving the rest for other discretionary purchases. This modest discretionary income pool can be used initially for modest lifestyle expenditures in the early stages of a senior's residence in assisted living. Later, as their lifestyle becomes more limited, these available funds can be shifted to pay for advanced levels of tiered pricing as additional assistance with ADLs is provided.

Applying these tax and discretionary income factors yields the following calculations:

| | Monthly | Annually |
|---|---|---|
| Required Monthly Service Fee | $2,500 | $30,000 |
| Adjust for 20 percent discretionary income | $3,125 | $37,500 |
| Adjust for required *pre-tax* gross income: | | |
| - 10 percent average tax bracket | $3,475 | $41,700 |
| - 15 percent average tax bracket | $3,675 | $44,115 |

Figure 6

COMPARISON OF ASSISTED LIVING SPENDING RATE VS. TYPICAL CCRC ENTRY FEE NON-REFUNDABILITY RATE

| Assisted Living Spending/Month[1] | Assisted Living Rate of Monthly Spending[1] | | |
|---|---|---|---|
| | $100,000 | $125,000 | $150,000 |
| $500/mo | 0.5%/mo | 0.4%/mo | 0.3%/mo |
| $750 | 0.8 | 0.6 | 0.5 |
| $1,000 | 1.0 | 0.8 | 0.7 |

Versus...

...A Conventional CCRC Entry Fee's Non-Refundability (Effective Spending) Rate of 1.5% to 2.0%/mo.[2]

[1]Typical source is liquidated home equity. (See Figures 4 and 5).
[2]In some situations, the non-refundable portion of the EF is purchasing limited life care benefits.

Source: Moore Diversified Services, Inc.

Figure 7

IS SPENDING SAVINGS REALLY A NEW CONCEPT?

*Spending Has Been Taking Place in For-Profit and Not-For-Profit CCRCs for Years*

Comparison of CCRC Entry Fee
Non-Refundability vs. Assisted Living Spending

CCRC Entry Fee (EF): $100,000 (Typical Minimum EF)
Refundability Typically Declines at 2% per Month or $2,000[1]

| | Guaranteed EF (Floor) Refundability Levels | | |
|---|---|---|---|
| | 80% | 50% | 0% |
| CCRC EF Spending Characteristics . . . | | | |
| Non-Refundable Portion of EF | $20,000 | $50,000 | $100,000 |
| No. of Months of Spending @ $2,000/mo | 10 months | 25 months | 50 months |
| | | Versus Assisted Living Spending Characteristics | |
| Equivalent No. of Months @ $1,000/ month (Using MDS = Spending Model)[3] | 36 months | 52 months | 84 months |

[1]In some situations, the non-refundable portion of the EF is purchasing limited life care benefits.
[2]Average length of stay in assisted living: 24 months.
[3]Refer to Figure 4.

Source: Moore Diversified Services, Inc.

Thus, someone who must pay $2,500 per month, or $30,000 per year in after-tax dollars for assisted living service fees and still have twenty percent for discretionary purchases (without spending down assets) would actually need $37,500 in annual after-tax disposable income. That comes to about $42,000 to $44,000 in pre-tax income, depending on their individual tax situations. The economics of prudent spending are summarized in Figure 8.

### Increased Savings Portfolio: Another Option

Instead of spending down her $100,000, Mrs. Barker could add it to her current savings portfolio. Assuming that it earned five percent interest, it would produce an additional after-tax income of approximately $5,000 a year, or $417 a month.

Added to her $1,500 budget, this additional income would allow her to spend approximately $1,917 per month for The Gardens at Westridge. Obviously, this would still leave her short of the necessary $2,500 by $583 per month.

### Approach Assisted Living Savings and Asset Spending With Extreme Caution

The concept of spending in assisted living needs cautious, extensive market testing. The prudent approach would be to implement spending of the liquidated home equity, but not a senior's existing savings portfolio. Significant safety margins

Figure 8

THE ECONOMICS OF PRUDENT ASSISTED LIVING SPENDING

(How a Senior Consumer Can Cover a Shortfall Involving a $2,500 Base Monthly Service Fee)

| Monthly Payment From *Current* Income | Amount of *Spending* Per Month | Base MSF | After-Tax Requirements Available With 20% Discretionary Income | *Pre-Tax* Income Discretionary Income @ 20% Annual | Monthly | Required Before Spending[1] |
|---|---|---|---|---|---|---|
| $2,500/mo | - 0 - | $30,000 per year | $37,500 per year | $7,500 per year | $625 monthly | $44,115 per year[2] |
| $2,000 | $500 | $24,000 | $30,000 | $6,000 | $500 | $35,300[2] |
| $1,750 | $750 | $21,000 | $26,250 | $3,700 | $310 | $29,165[3] |
| $1,500 | $1,000 | $18,000 | $22,500 | $3,175 | $265 | $25,000[3] |

MSF = Monthly Service Fee

[1]Using a prudent spend-down model, annual pre-tax income requirements are significantly reduced by as much as $20,000...increasing the potential market.

[2]Using an *average* tax bracket of 15%.

[3]Using an *average* tax bracket of 10%.

Source: Moore Diversified Services, Inc.

should be deployed. These concepts are not without challenges, but their potential to expand the market for assisted living is significant and worth exploring.

Is spending a significant factor in assisted living today? Probably not. But it will likely become much more common over the next few years.

### A Final Word of Caution

To a casual observer, the Barkers' story might seem an ideal solution for a family. However, experienced assisted living professionals know it's rarely—if ever—that simple.

Spending savings is universally accepted and works in nursing homes because the government can be counted on to step in with Medicaid coverage once a resident becomes impoverished. This is often not the case in assisted living. Medicaid waivers for assisted living are limited in number, and most owner/operators consider Medicaid reimbursement rates to be too low.