WHERE IS CHINA'S CCRC INDUSTRY?

By: Joseph J. Christian, Asia Fellow, Harvard Kennedy School, Cambridge, Massachusetts
Michael Qu Qin, Lawyer, Co-effort Law LLP, Shanghai, China

Continuing care retirement communities (CCRCs) are a unique senior living product in the U.S. A common definition of CCRCs is that they are age-restricted properties – some times described as "lifestyle" projects - that include a combination of independent living and assisted living and/or skilled nursing services available to residents all on one campus.[1] Memory care units are increasingly being included in the mix as well. The majority of the units typically are not licensed skilled nursing beds.[2] Resident payment plans vary and include refundable, partly refundable and non-refundable entrance fees, condominium and cooperative ownership and rental programs. While industry observers differ in their assessment of whether the market in China will accept a senior living product the same as or even similar to U.S.-style CCRCs, some investors are currently developing or planning a Chinese model of CCRCs that bears great similarity to the U.S. model. We believe that it remains to be seen whether this product type will be accepted in the Chinese market; but we also believe that it is worthwhile to consider the question, as its raises many other interesting questions about the state and direction of the still very new senior living industry in China.

What's happening in the marketplace in China?

Looking at the market, there are early CCRC-type products like Cherish Yearn in Shanghai and Yanda, General's Garden and Sun City in Beijing, and additional similar projects have been announced as under construction or in the planning phase. Many insurance companies, in particular, are moving in this direction. Union Life has been in construction of a large CCRC in Wuhan, and Ping'an last year announced it will invest up to RMB17 billion to construct a comprehensive senior living community of around 1.5 million square meters in the city of Tongxiang in Zhejiang Province (浙江桐乡). Also in Tongxiang Wuzhen (乌镇), YaDa International Holding (雅达国际控股) is planning to invest RMB10 billion in the next five years to build a health ecological park. Projects like these are mostly found in cities that are tourism destinations or are close to affluent populations.

These projects are essentially a type of CCRC. Even in the extremely huge projects like the above in Wuzhen, which is being planned as a healthcare park with mixed uses: a hospital, senior university, senior living, hospitality and commercial center, a very dominant part of the park is a senior living community for both independent and assisted living. The most recent land granting case in Beijing of comprehensive usage of senior care community also reflects this trend. A cooperative bidder founded by Greenland (绿城), Jianyin Investment (建银投资) and Blackstone (黑石) purchased two plots in Beijing Miyun County (密云县) where, according to the master planning, mixed use of properties for the purpose of residential, tourism, nursing home and kindergarten are to be built, consisting of approximately 400,000 square meters. With this initial test case from the capital, other cities are expected to follow suit. The land usage, its size and location, and further preferential policy treatments are important elements to determine where the senior care industry in China will head to in the future—whether it will favor the development of communities much like CCRCs in the U.S., or evolve a type of senior housing unique to China.

At this point in the evolution of the senior housing industry in China, the authors are unsure what direction – or directions – the industry will take. However, we can predict with some confidence that the product will be uniquely Chinese. We can also say that there seems to be a tendency to over-build senior care properties, with some communities as large as 10,000 units.[3] Even though projects of this size can present significant

[1] In U.S. nomenclature, to be considered a CCRC, the community must offer independent living and nursing care. *NIC Investment Guide – Investing in Seniors Housing & Care Properties*, Second Edition 2012.
[2] https://www.seniorshousing.org/filephotos/Classifications_for_Seniors_Housing_Property_Types.pdf
[3] See a previous version of this Newsletter [http://www.lawviewer.com/upload/file/13668882641425.pdf] in which the authors, along with Jim Moore of Moore Diversified Services, discussed at length the wisdom and necessity of commissioning a seasoned

management challenges, the trend in China still seems to be ever larger developments.

Over-building is just one of the risks facing investors and inexperience is definitely another. Many investors have come to appreciate these risks. However, notwithstanding the risks, there are multiple incentives for investors to enter the market at this moment: (a) local governments are supportive due to the real-estate-driven economy – a large portion of many local governments' revenues derives from the sale of land use rights; (b) local governments are also eager to respond to the mandate set forth in the 12th five-year plan to provide comprehensive care to their senior citizens; (c) senior housing is thought to be attractive to consumers as a blend of an aging-in-place solution and a real estate investment; and (d) investors from all fields see a promising future for senior housing in China, for reasons that are by now well-known to the readers of this Newsletter. Therefore, the more land acquisitions are secured by investors now, the greater the chance will be to win in the future competitive market.

`Whatever the reasons are, the risks cannot be overlooked; but when we look at what happened in the CCRC industry in the U.S. and what can be learned from that experience, we believe that it is possible to predict and avoid these risks.

CCRCs in the U.S.

There are approximately 2,000 CCRCs in the U.S., the oldest dating back over 100 years, many having evolved from nursing homes or homes for the aged. They emerged in the 19th century, as homes for widows and orphans from the American Civil War, which ended in 1865. During the Great Depression in the 1930s, CCRCs were mainly charitable endeavors, in which would-be residents turned over their assets to a charitable institution that operated the old age home in exchange for care for the remainder of their lives. In some ways, the financial model of these 1930s-era facilities has been carried over into modern CCRCs, as we will see below.

The industry has experienced steady growth since the 1960s, as parents of the "baby boom" generation grew older. The first major growth period was in the 1970s and early 80s, but growth slowed as projects faltered, owing in some measure to unsophisticated lending practices and inexperienced developers, factors that are common in a nascent industry like the CCRC industry. CCRCs essentially had to reinvent themselves, and the 1990s through the mid-2000s saw another very substantial growth period, as the capital markets began to understand and accept the product type and developers grew more experienced and sophisticated. But there was a sharp decline in the number of new CCRCs in the aftermath of the global financial crisis (GFC) in 2008. It should be noted, though, that CCRCs survived the financial crisis quite well. There were a few notable bankruptcies of CCRCs, but by all reports, no residents were deprived of their residency or of the services they bargained for when they entered the CCRC.

CCRCs in the U.S. are typically fewer than 300 units, with about one-third of CCRCs having more than 300 units and only about 8% having over 500 units. 150 units is considered the minimum optimal size to achieve operating

Joseph Christian is a fellow at the Harvard Kennedy School in Cambridge, Massachusetts, where he is researching and writing on the senior housing industry in China, with particular focus on the applicability of the U.S. experience in the industry to China's nascent industry.

A practicing attorney for over thirty years, the primary focus of his practice has been real estate, representing institutional investors and developers in large commercial transactions across the U.S. and in Asia. A specialty of his practice has been the senior housing industry in the U.S., where he has represented institutional investors in the sector since 2000. From October 2008 to December 2011, he was based in Hong Kong, where he co-headed the Asia real estate group of DLA Piper. During that time, he worked closely with several U.S.-based operators and investors, as well as Chinese developers and insurance companies, in their exploration of the senior housing market in China.

His professional experience has earned Mr. Christian the reputation as an expert on the senior housing industries in the U.S. and China, and he has chaired, presented and spoken on panels at several senior living conferences in Shanghai and Hong Kong. A speaker and writer on U.S. and Asian real estate issues, Mr. Christian is an Instructor at the Harvard Graduate School of Design's Executive Education program.

Mr. Christian is a member of IAHSA and of the Pacific Council on International Policy, based in California. While in Hong Kong, he was a member of the Asia Pacific Real Estate Association; the Asian Association for Investors in Non-Listed Real Estate Vehicles; the Urban Land Institute – Asia Pacific, where he served on the Executive Committee; and the American Chamber of Commerce, where he served on the Real Estate Committee.

Contact information:

joseph_christian@hks.harvard.edu
joseph.christian@gmail.com

professional team to perform a detailed market feasibility study as part of the planning and development of a senior living project.

efficiencies.[4] CCRCs can be found in urban, suburban and rural locations. Eighty percent of CCRCs in the U.S. are operated as not-for-profit institutions, and half of the CCRCs are affiliated with faith-based organizations.

Fee Structures for CCRCs in the U.S.

The fee structures employed by CCRCs in the U.S. have evolved with the industry, but essentially consist of a combination of entry fees and monthly service fees. The entry fee assures the resident that he or she will be entitled to remain in the CCRC for as long as his or her needs for care do not exceed the ability of the CCRC to provide the care.[5] Depending upon the type of contract between the CCRC and the resident, the entry fee will also assure the resident that the full spectrum of care offered by the CCRC will be made available to the resident for the remainder of his or her life: without any increase in cost – a so-called "life care contract" ("Type A"); without any increase in cost, up to a specified number of days in the assisted living or skilled nursing portions of the CCRC – a "Type B" contract; or with a charge for daily care in the assisted living or skilled nursing portions, at a specified or market rate – a "Type C" contract. Entry fees will vary greatly depending upon the type of contract a resident chooses, and can be quite substantial - particularly if a Type A contract is chosen, so much so that typical residents would need to sell their homes to pay the fee. In 2010, the average entry fee was approximately $145,000, but some high-end projects charge over $1 million.[6] Monthly fees typically cover non-care related expenses, such as debt service, management and maintenance expenses, and similar expenses of operating the property, but may also cover care-related expenses under a life care contract. Needless to say, there are many, many variations in how the fees are structured, not only from CCRC to CCRC, but within a CCRC and even for the same unit in the CCRC.

A Sampling of Issues

CCRCs are very complex projects, in many ways. Here are a few highlights --

From the developer's point of view, designing the fee structure can be quite challenging. The developer needs some degree of certainty that the entry fees and fixed monthly fees will provide sufficient funds to cover the expenses of operating the facility and the expense of the care promised to each resident. In essence, particularly in the case of a "Type A" contract, the CCRC will be providing health and long-term care insurance, not to a very large pool as a commercial insurance company would do – thus spreading the risk across a large pool of insured, but to a small pool consisting of the residents of the CCRC. Luckily, there are actuarial firms that can provide guidance on this, but the risk remains. Refundability of the entry fees also pose a risk to the owner, especially if the refund of the fee is not conditioned upon "resale" of the unit.

Regulatory complexities can also pose difficulties for the operator of the CCRC. As noted above, the arrangement between the CCRC and the residents potentially can be seen as a prepaid health plan, a health maintenance organization, a continuing care arrangement, an insurance contract, or a combination of any or all of these. These multiple layers can create confusion – which regulators have jurisdiction? Some owners may try to structure their programs to avoid a particular kind of licensure, only to find themselves subject to more burdensome regulations. Other owners may enter into joint ventures with license holders, such as a hospital, to avoid the need to be licensed themselves.

Resident contracts are quite complicated. Forms that we have seen in the U.S. are often 40 – 50 pages or more. They address myriad issues, including the terms and conditions of the entry fee and its refundability, services and services fees; but one of the more thorny issues is the transfer of a resident – voluntarily or involuntarily – from one care level to another. While the typical contract covers this issue in great detail, the CCRC operator also needs to be cognizant of federal and state laws, which may be in conflict, that would apply to moving a resident from, say, independent living to assisted living without the resident's consent, which the CCRC operator needs to have the right to do to maintain the integrity of the applicable portion of the project. For example, there could be

[4] *Independent Living and CCRCs,* Jim Moore (2009). Of course, more units may be appropriate, but care must be taken not to overbuild.
[5] As noted above, CCRCs at a minimum provide independent living arrangements and skilled nursing, and may also provide assisted living and/or memory care units.
[6] Entry fees are correlated with housing values in the market area of the CCRC, in recognition of the fact that most seniors will sell their homes to pay the entry fee.

issues under the U.S. Fair Housing Act for moving a resident prematurely, and state law and regulatory issues for not moving the resident soon enough.

Financial Assistance and Tax Deductions

Federal and state government programs, such as Medicare and Medicaid, respectively, may be available to assist a resident to pay the health care portions of the fees charged to the resident. A resident may also have private pay long-term care insurance to help defray the costs of assisted living and the occupancy costs of skilled nursing facilities in the CCRCs, as needed.

Portions of the resident's fees that are allocated to medical care may also be deducted from the resident's federal and state income for taxation purposes. Depending on how the entry fee is structured, a portion of it may be deducted from the resident's income as prepaid health expenses.

Regulation of CCRCs in the U.S.

Regulation of CCRCs occurs on two levels: the assisted living and skilled nursing components are required to be licensed as any assisted living or skilled nursing facility would be; and the CCRCs themselves are subject to regulation. Each state imposes its own regulatory scheme – there is no uniform set of regulations across the states. A primary reason – political factors aside - for the lack of uniformity is that circumstances differ from state to state - what might be an appropriate set of regulations for, say, California would not be right for Mississippi. While assisted living and skilled nursing facilities are required to be licensed in every state, not all states regulate CCRCs.[7]

CCRC regulations typically address several aspects of the operation of a CCRC:

- As discussed in the "Fee Structures" section above, most CCRCs promise in their contracts with residents to furnish health care or assisted living services for the life of the resident, in exchange for an entry fee, a fixed periodic fee, or both. This promise is in many ways similar to a prepaid health plan, a health maintenance organization, a continuing care arrangement, an insurance contract or a combination of any or all of these, each of which is regulated, and subjects the CCRC to regulation in most states.
- **Virtually all** states require that a number of disclosures be made to prospective residents, and often to the state regulatory authority as well, as part of the entry documentation and payment of the entry fee. These disclosures may include: information about the business entity that will operate the CCRC and its owners; audited financial statements; budgets with actuarial analysis; a feasibility study for the CCRC; marketing projections; forms of resident agreements; and advertising copy.[8] These disclosures are intended to protect the resident, who, as noted above, may be about to deposit the equity in his or her home with the CCRC operator with the expectation that the operator will make good on its promise to provide the resident with appropriate levels of care for the remainder of the resident's life. The resident needs to be assured that the CCRC will open for business as

Michael Qu Qin is a PRC-qualified lawyer in Co-effort Law LLP based in Shanghai, China, where he practices in the areas of real estate, foreign investment and mergers and acquisitions. He has extensive experience as a lawyer for over ten years. Since 2010, he has specialized in the senior housing industry, representing foreign and domestic investors in the sector. Prior to joining Co-effort Law LLP, he was in-house counsel in METRO Group China. Prior to that, he had been practicing in another law firm since 2002. In his practice, Michael has successfully represented investors in the real estate, senior housing, asset management, retail and hospitality sectors in dealing with commercial transactions and disputes.

Michael is active in the senior care industry, and he regularly publishes the China Senior Housing and Care Newsletter, a legal publication that provides valuable insight into the development of the China senior housing and care industry and helps investors doing business in China. He is a frequent speaker at real estate and senior care seminars.

A legal professional who has been involved in the emergence of the senior care industry for years, Michael is now focusing primarily on assisting private investment in the field, providing counsel regarding company and capital formation, project development and acquisitions, regulatory issues on operation, corporate finance, and related issues.

Contact information:

quqin@co-effort.com
quqin@lawviewer.com

[7] As of 2010, twelve states had no CCRC-specific regulations.
[8] *Seniors' Housing and Care Facilities,* Paul A. Gordon, Urban Land Institute

projected and have the wherewithal to maintain itself as a going concern, which depends in part on the CCRC's ability to sell memberships to other potential residents in accordance with its marketing plan.

- The regulatory effort often takes the form of requiring a certificate of authority or obtaining a license before the CCRC may enter into a resident contract, collecting fees, advertising or beginning construction. The application fee for the license or certificate is nominal in most states, but some states charge a fee based on a percentage of the total cost of the facility to pay for the costs of engaging consultants to review the feasibility of the project. Some states also require evidence that licenses to operate the assisted living and skilled nursing (as applicable) portions of the project have been applied for.

- States also regulate the handling of residents' deposits, often requiring that they be escrowed or some times requiring a surety bond. The CCRC developer typically is permitted to use the deposits to retire construction debt or to pay part of the construction costs of the facility. Deposits are important not only in that they provide funds to the operator to pay development costs, but they also indicate a potential buyer's interest. Consequently, all or a portion of the deposit may be non-refundable, as long as the CCRC operator performs its obligations.

- States may place conditions on the release of the deposits to the developer. For example, regulations may require that potential residents have made deposits for a certain percentage of units before any deposits can be released; and as the percentage of units increases, more of the deposit can be released. The goal of conditions like these, of course, is to provide assurance of the completion and viability of the project before funds are released to the developer. Some states require that long-term financing be in place before deposits can be released. Reserve requirements are also common.

- Pre-sales are very important to the success of a project, and they are a significant indicator of the likelihood of its success. Accordingly, some states require a certain level of pre-sales before permitting construction to commence or accepting an application for approval of the project.

Accreditation of CCRCs

As can be seen from the discussion above, regulations addressing CCRCs tend to be focused more on consumer protection, primarily at the outset of the relationship between the prospective resident and the CCRC, and less on the quality of the operation of the CCRC and of the services provided. To address the latter set of issues, the American Association of Homes and Services for the Aged has established an independent Continuing Care Accreditation Commission to develop and implement a comprehensive accreditation program that includes a self-evaluation process in the areas of governance and administration, finance, health care and resident protections. The process includes a review by a visiting team and evaluation by an accreditation committee.

To be eligible for the accreditation process, a CCRC must have been open for business for at least one year and have achieved stabilization – or be able to demonstrate financial viability. Compliance with state regulations is also reviewed during the process. The process is repeated annually, and the CCRC must maintain its status to remain accredited.[9]

Accreditation focuses on quality and results[10] and essentially supplements and augments state regulations. In doing so, it also provides valuable guidance to consumers choosing a CCRC; and presumably, being accredited gives a CCRC a marketing advantage over its non-accredited competition. However, accreditation is voluntary and is not universal. Only 15% or so of CCRCs in the U.S. are accredited.

The Verdict on CCRCs in the U.S.

In summary:

- CCRCs in the U.S. have a long history and are well-established as a senior living product type. However, while the CCRC industry is well-developed and quite mature in the U.S., it is fair to say that it is always

[9] *Seniors' Housing and Care Facilities,* Paul A. Gordon, Urban Land Institute
[10] See http://www.carf.org/home/.

evolving and changing, to meet the changing needs and desires of the target population. Today's seniors have very different attitudes about lifestyles and expectations for their retirement years than did their parents; and the senior living industry constantly takes these differences into account in developing and operating senior living facilities of all types including, of course, CCRCs.

- CCRCs that offer the full spectrum of care provide seniors with the comfort that they can live out their years in one community, without having to move as their needs for assistance and health care increase; and, depending on the type of contract they enter into, without ever having to pay more than a level monthly fee. If the entry fee is of the refundable type, the resident's children or other heirs would be able to inherit it, just as they would inherit their parents' home.

- Many of the CCRCs in the U.S. are so-called "lifestyle" communities, offering residents a variety of social and recreational activities to keep them socially engaged and occupied, as well as dining options, housekeeping, transportation and, of course, health care services, all in one community. While this model has been quite successful in the past, the current trend has been for seniors to enter senior housing in general at higher levels of acuity; most seniors will not enter a community until they have had a health event that awakens them to the need to plan for a future that may require ever more intensive care, with activities of daily living – as offered in assisted living, or skilled nursing.

- Regulations provide a good level of protection to the residents, mostly from a financial and consumer protection point of view, as they are focused primarily on disclosures and financial viability. The accreditation process provides comfort with respect to quality and results.

- Federal welfare programs will reimburse the portions of the entry and monthly service fees that are allocated to health care costs. Private pay insurance programs may cover the occupancy costs of assisted living and nursing homes. A portion of the resident's medical expenses may be deducted from the resident's income for tax purposes.

- CCRCs have experienced annual turnover rates far lower than that of other senior living products, primarily because residents do not need to move out when their need for care increases – they simply move to another portion of the CCRC.

- An important development in the senior housing industry occurred in 2005 with the introduction by the National Investment Center for the Seniors Housing & Care Industry of a map database that accurately measures performance and communicates that performance to key stakeholders in the industry, such as institutional investors. The database covers the largest 100 metropolitan statistical areas in the U.S., which collectively account for approximately 67% of the U.S. population. Reporting performance of properties greatly improved transparency, which in turn has led to increased liquidity in the senior housing market.

- Finally, CCRCs, like other senior housing product types, fared relatively well in the financial crisis. There were a few notable bankruptcy filings in the sector, resulting from potential residents' inability to sell their homes and to pay the entry fees upon which CCRCs rely. From all reports, however, no residents were forced to leave the affected CCRCs, and all received the care that they bargained for and expected.

The verdict? CCRCs in the U.S., when conceptualized, developed and operated by experienced and professional developers and operators, can be a very attractive living arrangement to a large segment of the senior population. And they can be very attractive investment opportunities.

Will U.S.-style CCRCs Flourish in China?

We think that at this stage in the development of the senior housing industry in China, it is nearly impossible to predict what product type or types will succeed in the marketplace. We expect that the type of projects that will meet with greatest acceptance in the near future will be those that are need-based – that is, residents move in because they have to, not necessarily because they want to. Will this lead to acceptance of U.S.-style CCRCs? Perhaps if it can be positioned not as a purely "lifestyle" project, but one that stresses that it offers peace of mind to Chinese elders, knowing that they will be able to remain in their community for the rest of their lives, with guaranteed access to the assistance and health care that they need. CCRCs may also have an advantage over rental models, as are typical in assisted living projects, in that the entry fee provides a kind of "ownership" of the resident's unit, which would likely be attractive to Chinese elders – as the refundable entry fee would be inheritable by their children.

That being said, it is hard to imagine that the U.S.-style CCRC would be "adopted" wholesale by the Chinese marketplace. The projects we mention at the beginning of this article do seem like typical U.S. CCRCs, regardless of whether the developers or operators admit they are in fact copying the model. But if this is what they were planning—actually we have found many projects in construction are also holding themselves out as "China's CCRCs"—they must have adopted many features from the U.S.'s practice.

However, what cannot be learned and adopted from the U.S. are those essential elements that help developers to foster the whole industry: the highly regulated environment in most states, the well-established internal discipline and external overseeing mechanisms to ensure consumer protection, the acceptance and incentives for seniors to move into senior housing, and others as we discuss in the above article. It is important to note that all of these attributes of the industry were not built in one day, not even in a decade.

In China, while many are concerned about the quality of service in those CCRC-type communities (they are right to be concerned, but we anticipate that as more foreign operators stretch their arms into the Chinese market, the burden and worry will lessen gradually), we believe it is more important not to overlook the disconnects in fee structuring in those communities, in that many developers are choosing fee models based on the nature of land use right, rather than on financial soundness.[11] From those choices in fee model, the membership (entry fee) model is the most popular one, thanks to its flexibility by nature. But such a "flexible model" in a less regulated market[12] is not an optimal solution by any means. While more projects are emerging into the market, many issues that the U.S. has encountered will undoubtedly occur in China as well. Standing on the giant's shoulder and making fewer mistakes is what this article aims to provide. We expect that certain best practices in the U.S. industry, many of which were discussed above, will be adopted by CCRCs in China, but ultimately, if CCRCs do catch on in China, they will be CCRCs "with Chinese characteristics," to borrow a phrase from Deng Xiaoping. ■

Resources:
American Seniors Housing Association
Independent Living and CCRCs, Jim Moore (2009)
Seniors' Housing and Care Facilities, Paul A. Gordon, Urban Land Institute
American Association of Homes and Services for the Aged
Carf International

If you want to know more about this subject, please contact:
Michael Qu Qin **Lawyer, Co-effort Law Office /Chief Editor of China Senior Housing and Care**
Tel: 86-021-68866151*152 86-13817878607
E-mail: quqin@co-effort.com or quqin@lawviewer.com

11 We note that most developers are trying to sell more and get as much upfront return as they can, but with some restriction in developing different types of land use right, they have to resort to various fee structures. For example, houses and facilities built on allocated or collective-owned land are not allowed to be sold—not even for leasing without prior approval in some cases. So developers will figure out ways to charge in terms of entry or membership fee. And in some other cases, houses built on granted state-owned land, where the owner possesses 40 to 70 years' right to use, are also restricted from being sold in separate set if the usage of such land is, for example, infrastructure or tourism. It is unlike the fee structures in the U.S. where developers put financial soundness in priority.

12 As understood by the authors, currently in China, activities in developing a CCRC-style community are mostly regulated by real estate regulations, which do not address the selling of membership cards. Only facilities within the community that intend to provide nursing care or rehabilitation or medical services will fall into some regulatory administration from the Ministry of Civil Affair and Ministry of Health, where supervision of the selling of memberships is hard to find as well. We do note, however, that some cities have been taking a hard look at memberships/entry fees, with an eye toward minimizing the risks that they potentially pose to the elderly residents of CCRCs.