STUDY OF FINANCING FOR AFFORDABLE ASSISTED LIVING OPTIONS PURSUANT TO HJR 749

December 15, 1999

VHDA

December 15, 1999

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia 23219

Members of the Virginia General Assembly
General Assembly Building
Richmond, Virginia 23219

Dear Governor Gilmore and Members of the General Assembly:

Pursuant to House Joint Resolution 749, I am pleased to submit the report entitled, "Study of Financing for Affordable Assisted Living Options." Enclosed are copies of the report for you and the members of the General Assembly. I trust that you will find the study report responsive and informative.

I wish to express my appreciation to members of the senior housing industry who participated in VHDA's focus group on assisted living studies for their assistance in producing this report. Their efforts were indispensable in the completion of this report.

Sincerely,

Susan F. Dewey

Susan F. Dewey
Executive Director

SFD:mb

Enclosure

Virginia Housing Development Authority
601 South Belvidere Street • Richmond Virginia 23220-6500 • 804-782-1986 • V/TDD 804-783-6705

Preface

Virginia Housing Study Commission's Two-Year Study of Assisted Living Issues

HJR 749 was one of a number of study resolutions recommended by the Virginia Housing Study Commission in its 1998 Annual Report, following the completion of a two-year comprehensive study of issues related to the availability of affordable assisted living options in the Commonwealth. The recommendations made by the Housing Study Commission addressed a wide gamut of land development, building code, finance, work force, regulatory and resource issues that, together, were intended to create a more favorable environment for the development of affordable assisted living options for frail seniors throughout Virginia.

HJR 749 Study Mandate

One of the issues addressed by the Housing Study Commission was the perceived shortage of mortgage capital available under favorable terms and conditions to developers of affordable assisted living facilities. In particular, the Commission was concerned that the only current state-level loan program in Virginia targeted to assisted living developments—i.e., the Virginia Housing Development Authority's Assisted Living Loan Program—had received no applications since its initiation in March 1998. Therefore, the Commission recommended HJR 749, which directs VHDA to analyze its Assisted Living Loan Program with the goal of increasing loan production. The study resolution further directs VHDA to carry out its analysis with the participation of the Department of Housing and Community Development (DHCD) and the senior housing industry. In conducting the study, the Authority was directed to consider: (1) reasons for the loan program's lack of applicants; (2) methods for program restructuring and marketing to attract applicants; (3) creating an assisted living loan product that would not require HUD mortgage insurance; and (4) providing a more favorable interest rate for assisted living developments.

Scope of Study Report

While the first of the specific study mandates focuses narrowly on VHDA's current assisted living loan program, the latter three broaden the scope to a more general review of VHDA's program options for providing financing for affordable assisted living developments. During the study process, a number of substantive issues arose concerning the adequacy of assisted living subsidies that led VHDA to further broaden the scope of the study to focus on the full set of issues needing to be addressed at the state-level in order for affordable assisted living facilities to become feasible.

Study Process

VHDA's study process incorporated the following four activities.

1. **Focus Group of Senior Housing Industry Representatives**

   VHDA convened a focus group composed of representatives of DHCD and the senior housing industry for the purpose of reviewing VHDA's Assisted Living Loan Program as well as broader issues related to the development of affordable assisted living options. Sixteen individuals representing fifteen organizations, along with VHDA's executive director,

Study Process
(continued)

multifamily director, and a member of VHDA's Board of Commissioners, attended the focus group meeting and participated in the discussion. The group included representatives of the mortgage banking industry, lending institutions, for-profit and nonprofit assisted living operators, assisted living professional organizations and affiliates, and state and federal government housing officials (see Appendix C). A subgroup of the participants agreed to continue to work with VHDA on issues identified in the meeting with continued input from the entire focus group.

2. **Review of activity in Virginia under the HUD Section 232 Program**

   VHDA requires mortgage insurance for its assisted living loans through HUD's Section 232 program. VHDA staff reviewed data on all lending activity in Virginia under the assisted living and "board and care" components of the Section 232 program in order to determine the overall level of market acceptance by developers in the Commonwealth.

3. **Review of studies and reports**

   VHDA staff reviewed numerous studies, reports and presentations on affordable assisted living issues prepared by practitioners and study groups that provided both national and Virginia perspectives. Particular attention was given to the following two research reports prepared under the major multi-year *National Study of Assisted Living for the Frail Elderly* conducted for the Administration on Aging and the National Institute on Aging of the U.S. Department of Health and Human Services.

   - *State Assisted Living Policy: 1998*; Robert Mollica, Ed.D., National Academy for State Health Policy, June 1998—This report is a comprehensive national analysis of state policy and regulatory issues related to assisted living, including a state-by-state summary of current state regulations and policies.

   - *Report on In-Depth Interviews with Developers*, Barbara Manard and Rosemary Cameron, The Lewin Group, Inc., December 1997—This report involved in-depth interviews with 29 developers of assisted living facilities from 21 states to identify current barriers to the development of assisted living facilities and future trends in the industry, as well as the potential for assisted living to serve a larger low-income and Medicaid-eligible population.

4. **Review of assisted living programs in other states**

   VHDA staff reviewed assisted living lending activities of other state housing finance agencies in order to identify program opportunities. Agencies in a number of states offer financing for assisted living facilities, including Illinois, Massachusetts, New Jersey, Oregon, Rhode Island and Washington. Three of those states—Massachusetts, New Jersey and Rhode Island—have significant active lending programs that were looked to for ideas on best practices that could serve as a basis for expanded program offerings by VHDA.

Preface

Structure of Final Study Report

The focus group responses confirmed and reinforced the principal findings of the other research activities undertaken by VHDA staff, all of which surfaced significant issues and debate regarding the following topics that provide the structure of the study report.

- **What Constitutes Assisted Living**—There is still no consensus on a definition of assisted living, including where it begins and ends on the continuum of care. There also continues to be disagreement on appropriate standards for facility design and the level and type of services that should be provided.
- **Major Barriers to Affordable Assisted Living**—There are major cost, market and regulatory barriers—particularly the need for significantly higher levels of public reimbursement through Virginia's Auxiliary Grant and Medicaid waiver programs—that have severely limited the feasibility of affordable assisted living and, thereby, the demand for mortgage financing for residential facilities that address affordable assisted living needs. These same barriers have created substantial development risks that limit the terms and conditions under which mortgage financing can be provided by VHDA and other public and private lenders. These barriers must be addressed in order for affordable assisted living to become a reality.
- **VHDA's Involvement with Assisted Living**—VHDA has been involved in programs and activities to promote the provision of senior residential support services, and the aging-in-place of low-income seniors since the late 1980s. VHDA's decision in early 1998 to provide taxable bond financing for HUD-insured assisted living projects was intended to incrementally supplement earlier activities.
- **Opportunities**—VHDA's lending options are limited by major barriers. Nonetheless, approaches to the development of affordable assisted living are being taken in several states that point to potential opportunities for Virginia. There are a number of actions that VHDA can take to foster the availability of affordable assisted living options.

The focus group concluded that, in the absence of significant additional subsidies, including higher state reimbursement levels, VHDA's provision of financing through the HUD Section 232 program holds limited opportunities for serving affordable assisted living needs. Consequently, the focus group discussed a range of alternative means for promoting affordable assisted living services and made several specific suggestions for consideration. VHDA has conducted an initial review of those suggestions and contacted other state housing finance agencies for information on best practices. Focus group suggestions and alternatives, and the experiences of other states, served as the primary basis for the four specific action items identified in this study.

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Concept of a "Continuum of Care"

Significant changes in the housing needs and demands of seniors have resulted in the concept of a "continuum of care" in which new types of non-institutional residential options are being created to provide varying degrees of assistance with activities of daily living. These new housing options bridge the gap between fully independent living in single-family homes and traditional apartments, and institutional nursing home settings.

The Definition, Regulation and Subsidization of Assisted Living in Virginia is Still Evolving

In Virginia, as in other states, the definition and regulation of assisted living is still evolving from the traditional "board and care" model of generally small facilities providing shared congregate accommodations and limited supervisory custodial services, to a new model that places higher priority on the residential quality of the living environment and focuses on the provision of broader and more intensive services that prolong the independence of individuals not yet in need of ongoing medical services. This is reflected in Virginia's current tiered system of licensure and regulation of adult care facilities.

Virginia has also moved toward a parallel, tiered system of reimbursement to residential care facilities for Supplemental Security Income (SSI) recipients based on the level of services provided. A number of legislative and budgetary recommendations are being made to increase reimbursement rates to better reflect the current cost of service provision, and the issue will continue to be addressed by legislative and gubernatorial commissions.

Lack of Consensus on an Assisted Living Model Impacts the Extent and Means Through Which VHDA Can Address Assisted Living Needs

As Virginia's systems for regulating and subsidizing assisted living continue to evolve, there is still considerable disagreement between proponents of a "social" model of assisted living who place greatest priority on the quality of the residential environment provided to frail seniors, and those who emphasize a "health care" model for whom a primary concern is the need to find less intensive and costly care alternatives to nursing home placement.

How the competing "social" and "health care" models are ultimately reconciled in Virginia will have a significant impact on the type, design and funding of facilities developed to provide assisted living care. In turn, it will impact the extent and means through which "housing" agencies such as VHDA, with access to resources and subsidies that are constrained to serve primarily "residential" purposes, will be able to address assisted living needs.

Major Barriers to Affordable Assisted Living

There Are Four Major Barriers to Facility Feasibility

There are four major barriers that have severely limited the development affordable assisted living facilities:

1. Insufficient level of operations/service subsidies
2. Rising acuity levels
3. Obstacles to use of primary federal housing subsidies
4. High development risks

Major Barriers to Affordable Assisted Living (continued)

Barrier #1 —

Insufficient Level of Operations/Service Subsidies

First and foremost, the lack of sufficient state subsidies to support facility operations and care services has rendered most attempts by developers to structure affordable projects infeasible before the issue of mortgage financing even becomes a consideration. The deficiency in reimbursement levels has been sufficiently large that, even where debt service costs have been eliminated through outright capital grants, there has still been a gap between the monthly fees that owners must charge and the income (including subsidy assistance) of low-income seniors. Therefore, developers have avoided serving low-income seniors even though they comprise a substantial share of the population in need of assisting living.

Barrier #2 —

Rising Acuity Levels

There has been a steady rise in the average acuity level (i.e., acuteness of need) of assisted living residents. This is undermining assumptions underlying the financing and operations of assisted living and forcing facilities to choose between terminating occupancy and providing more intensive levels of service at a correspondingly higher cost. This change blurs the distinction between the social and health care models of assisted living, and raises difficult long-term issues regarding the use of programs and resources (e.g., Low-Income Housing Tax Credits) intended to serve primarily residential needs. In mixed-income facilities, rising acuity levels are also creating problems of asset spend-down among non-Medicaid residents.

Barrier #3 —

Obstacles to Use of Primary Federal Housing Subsidies

Currently, tax-exempt bonds and Low-Income Housing Tax Credits are the two primary subsidies that VHDA can use to reduce the cost of developing assisted living facilities. Bricks and mortar costs represent only about 20% of total facility expenses. So, even if use of these subsidies results in a 50% reduction in development costs, the total reduction in monthly fees will be just 10%. The monthly cost of private-pay assisted living is sufficiently high relative to the low-income occupancy requirements imposed under federal regulations, so that even a 10% reduction in costs results in only a very narrow window of affordability for seniors being served. In addition, these subsidies entail federal regulatory requirements that impose offsetting costs on assisted living facilities—particular in regard to the way in which services can be provided—that dilute the benefits otherwise achieved.

Barrier #4 —

High Development Risks

Assisted living is a relatively new industry that is changing rapidly as developers respond to shifting market, regulatory and subsidy environments. The lack of long-term experience with development and operation of assisted living facilities, high costs relative to the income of seniors, and difficulty in measuring levels of need and effective demand, are increasing the risk of facility failure. Developers are finding the concept of assisted living more difficult to execute than they have thought. Some markets may already be saturated with private-pay facilities. Consequently, industry shakeouts are anticipated.

Executive Summary

VHDA's Involvement with Assisted Living

VHDA's Activities to Date

Since the mid 1970s, VHDA has provided financing for the development of 87 senior housing facilities providing over 10,000 affordable senior dwelling units throughout Virginia. VHDA has worked with the owners of these predominantly independent living developments to encourage the provision of supportive services as their senior residents have "aged in place." In addition, VHDA has financed a number of senior developments intended to provide congregate/ assisted living services. Finally, VHDA--in recognition of the desire of most seniors to age in place in homes they own—became a national pioneer in the development and promotion of reverse mortgage options that can be used by very low-income seniors to afford the cost of in-home services.

VHDA's Section 232 Assisted Living Loan Program

In 1998, VHDA began offering financing for assisted living facilities as an incremental expansion of its existing senior housing programs. This was done to accommodate the desire of for-profit developers for alternative sources of financing for the new larger types of private-pay facilities being developed. VHDA chose to provide loans from bond proceeds rather than from the Virginia Housing Fund, because the Fund is restricted to small loans (i.e., $1 million or less) in recognition of the limited total amount available annually for all types of multifamily lending (approximately $14 million).

VHDA's lack of underwriting experience with facilities providing more intensive levels of supportive services, together with the difficult experiences of VHDA, HUD and private lenders in financing "congregate care" facilities during the late 1980's, necessitated the use of external credit enhancement in order to raise bond funds at favorable interest rates. The best source of credit enhancement available to VHDA is HUD Section 232 mortgage insurance. That program has engendered developer resistance due to its perceived "red tape," but remains one of the few cost-effective options for affordable developments.

To date, only taxable bond financing has been offered. Use of tax-exempt bonds and federal Low-Income Housing Tax Credits to reduce development costs have largely been precluded in Virginia due to the low levels of state reimbursement provided under the Auxiliary Grant and Medicaid waiver programs. Current reimbursement levels are insufficient to meet the needs of the low-income seniors whom the tax-exempt bond and tax credit programs are required to serve. Even where debt service costs are completely eliminated through the provision of capital grants, there is still a significant gap between the income of most low-income seniors (including state subsidy payments) and the fee needed to cover the cost of facility operations and individual care. There may be greater opportunities to use tax-exempt 501c3 bonds, which are less constrained by federal income limits. These opportunities will be explored.

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Opportunities

New Directions in Affordable Assisted Living in Other States

States have begun to respond to the rapidly growing demand for affordable assisted living by addressing fundamental subsidy and regulatory issues. The most successful efforts have depended on increases in state reimbursement rates for Supplemental Security Income (SSI) recipients living in residential care facilities, in order to provide subsidies fully commensurate with the cost of reasonable minimum levels of quality care. Often, increased reimbursement rates in these states are double current rates in Virginia. Another key element of initiatives in these states are broad Medicaid waivers that expand eligibility for assistance to a much wider range of incomes. Model state housing finance agency lending programs have been made possible by the subsidies provided through their state's Medicaid plans.

These same states have also made changes in licensure and regulatory policies that have facilitated the development of affordable assisted living options. New Jersey has gone farthest by actively facilitating and promoting the provision of assisted living services within federally assisted senior housing through separate licensure and regulatory requirements and a special Medicaid waiver, which reflect the unique circumstances of these housing developments.

Opportunities VHDA Can Pursue

VHDA's lending options have been limited by the identified major barriers. Nonetheless, there remain steps that VHDA can take to foster the development of affordable assisted living. These opportunities may expand to the extent that the General Assembly increases state reimbursement levels for assisted living care and takes further steps to create flexibility in state licensure and regulation.

VHDA will take the following actions to pursue current opportunities.

Action Item #1—*VHDA will seek assistance from HUD and key senior housing industry organizations in order to develop a pro forma for a prototype affordable assisted living facility in order to document the current level of state subsidies needed to stimulate development of affordable assisted living facilities. Upon completion, VHDA will share this pro forma with legislative and gubernatorial commissions studying long-term care issues.*

Action Item #2—*VHDA will offer assistance to legislative and gubernatorial commissions studying long-term care issues in: (1) determining the desirability and feasibility of a pilot affordable assisted living program; and (2) if warranted, developing guidelines for such a program.*

Action Item #3—*VHDA will work with DHCD and senior housing industry groups to identify and disseminate information on innovative means for reducing the cost of developing and operating assisted living facilities.*

Action Item #4—*VHDA will work with other state housing finance agencies and senior housing industry groups to: (1) identify and disseminate information on creative means for using 501c3 bonds to finance affordable assisted living facilities; and (2) publicize the availability of 501c3 financing through VHDA.*

Part I — What Constitutes Assisted Living

Concept of a "Continuum of Care"

Changes in Senior Housing Needs

Over the past two decades, a number of factors have contributed to significant changes in the housing needs and demands of seniors. These changes are the result of several factors.

- Extended life expectancies are creating a rapidly growing population of frail, elderly people age 75 and older.
- Changing patterns of familial relationships and care giving are increasing the proportion of frail, elderly people who need to access services that assist them with one or more activities of daily living.
- The rapidly rising public cost of institutional care has caused federal and state governments to seek less expensive alternatives to nursing homes as a place of residence for frail, elderly people.
- High rates of homeownership among the current generation of seniors and their increased financial resources compared to earlier generations have increased demand for home-like, non-institutional care alternatives.

These changes have resulted in the concept of a "continuum of care" for seniors in which new types of non-institutional residential options are being created to provide varying degrees of assistance with activities of daily living. These new housing options bridge the gap between fully independent living in single-family homes and traditional apartments, and institutional nursing home settings.

Traditional "Board and Care" Facilities

In the past, there was limited effective demand for residential settings providing non-medical assistance with activities of daily living. People with low levels of acuity (i.e., less acute needs) were usually provided assistance by family caregivers. More acute needs for assistance in activities of daily living were addressed in one of two ways. Private-pay services were provided by in-home care providers or in the relatively limited stock of nonprofit retirement homes. Public-pay services were provided through a network of small state-licensed proprietary "board and care" facilities that generally offered shared congregate accommodations and supervisory custodial services. The term "board and care" arose from the stereotypical small boarding home which, in the past, predominated this level of residential care.

Initial Expansion of Care Options

Since the mid 1980s, there has been a dramatic expansion of the range of residential alternatives between independent living and nursing home care in response to burgeoning consumer demand for more varied housing choices. Initially, this occurred through the development of two differing models of care.

Part I — What Constitutes Assisted Living

Concept of a "Continuum of Care" (continued)

Health Care Model

The need to control escalating Medicare and Medicaid costs led to the tightening of federal and state requirements for nursing home occupancy. This, in turn, resulted in hospital and nursing home operators developing new residential alternatives that generally followed a "health care model" but provided less intensive services than found in a nursing home environment. This approach is typified at the federal level through the expansion of HUD's Section 232 mortgage insurance program for nursing homes to include first "board and care" and, then later, "assisted living" facilities.

Social Model

HUD responded to the rapid aging of the resident population of federally subsidized senior independent living developments by promoting the new concept of a "congregate care" facility that provides meals, housekeeping and other low-intensity services to still generally independent seniors in order to enhance their ability to age in place. HUD's efforts included both promoting the provision of congregate care services in existing HUD-funded independent living developments as well as financing new free-standing congregate care facilities through an expansion of the Section 221d4 multifamily housing mortgage insurance program.

VHDA responded to the need for services among residents of traditional housing in a similar manner to HUD by: (1) financing three congregate care facilities with tax-exempt bonds; and (2) participating in a demonstration program funded by the Robert Wood Johnson Foundation through which owners of VHDA-financed Section 8 senior independent living developments were encouraged to make available a range of supportive services to their increasingly frail, elderly occupants.

Limitations of Initial Efforts to Expand Options

Each of these initial efforts to expand residential service options has met with marketing and/or regulatory limitations.

Marketing Limitations. New facilities developed to provide assistance with daily living services following a health care model have often met with consumer resistance from seniors desiring more home-like surroundings. Likewise, developers of residential "congregate care" facilities have found that demand is relatively shallow for the level of services they provide. Typically, seniors needing only limited assistance with activities of daily living resist moving out of their homes until driven to do so by a more intense level of need. Frequently, seniors do not view "congregate care" facilities as providing sufficient value relative to the high rents that must be charged in order to cover the costs associated with the installation of a commercial kitchen and the high staffing costs associated with the provision of supportive services. Substantial defaults by borrowers in HUD's Section 221d4 congregate housing program led Congress to terminate funding in the early 1990's. Similarly, the long-lease up

Concept of a "Continuum of Care" (continued)

Limitations of Initial Efforts to Expand Options (continued)

periods experienced by VHDA's initial congregate projects caused the Authority to discontinue funding of that type of development.

Regulatory Limitations. As the low-income population of publicly assisted senior housing has become older and frailer, owners have begun to make services available to enable their residents to age in place. However, some owners have found it difficult to offer an array of services that fully meet the needs of their residents without triggering adult care residence (ACR) licensure and regulatory requirements. Such requirements can impose costs on a low-income housing development designed and operated principally for independent living that are difficult to absorb. Risk of incurring licensure and regulatory requirements has been a problem for some owners even when the services to be offered would be made available on an optional basis by an outside service provider.

New Concept of Assisted Living

"Assisted living" is a relatively new residential concept that attempts to more fully bridge the gap between independent living and nursing home care. Assisted living combines a home-like residential setting with the provision of a fuller array of assistance with daily living services than is found in congregate care residences in order to enable frail, elderly people to maintain a level of independence not generally found in institutional facilities. Unlike congregate care, demand for which has proven to be primarily driven by consumer preferences, "assisted living" is predominately "need driven"—i.e., seniors seeking an assisted living residence do so because they are no longer able to remain in a fully independent living setting.

Definition and Regulation of Assisted Living in Virginia

Definition of an Assisted Living Facility

The Virginia Housing Study Commission, in its two-year study of assisted living issues, found that while assisted living services may be provided in one's home,

> *"...an assisted living facility is generally defined as a residential setting where appropriate personal care services, 24-hour supervision, and assistance are provided in an environment which fosters maximum independence and promotes individual dignity."*

Regulation of Adult Care Residences

In Virginia, assisted living facilities are licensed by the Department of Social Services and are defined as adult care residences (ACRs). Under Section 63.1-172 of the Code of Virginia, an ACR is defined as:

> *"…any place, establishment, or institution, public or private, operated or maintained for the maintenance or care of four or more adults who are aged, infirm, or disabled and who are cared for in a primarily residential setting..."*

Part I — What Constitutes Assisted Living

Definition and Regulation of Assisted Living in Virginia (continued)

Two-Tier ACR Licensure Structure

As of February 1996, Virginia adopted a two-tier licensure structure for ACRs to differentiate "residential living" and "assisted living" care.

- **Residential Living.** "Residential living" is a level of service provided to individuals who may have physical and mental impairment and require only minimal assistance with activities of daily living (ADLs)—i.e., generally dependence in only one ADL.
- **Assisted Living.** In contrast, "assisted living" is a level of service provided to individuals who may have physical or mental impairments and require at least moderate assistance with activities of daily living—i.e., dependence in at least two or more ADLs.

"Regular" and "Intensive" Levels of Assisted Living

Within assisted living, Virginia has established two payment levels for recipients of state Auxiliary Grant assistance: "regular assisted living", and "intensive assisted living."

- **Regular Assisted Living.** Regular assisted living services are provided to individuals who are dependent in two or three activities of daily living (ADLs) or behavior patterns.
- **Intensive Assisted Living.** Intensive assisted living services are provided to individuals who are dependent in four or more ADLs or a combination of ADLs and cognitive or behavior patterns and who meet the criteria for home and community-based Medicaid waiver services (i.e., are at risk of nursing home placement). Additional state licensure requirements are placed on facilities providing intensive services.

Assisted living ACRs can be freestanding facilities or sections of facilities that offer other residential options—i.e., a wing of a continuing care retirement community (CCRC) or a floor of an independent living building. In Virginia, ACRs may offer either single rooms or multiple occupancy rooms.

Lack of Consensus on an Assisted Living Model

States Continue to Define and Regulate Assisted Living in Very Different Ways

Despite some general consensus around the concept of "assisted living," there continues to be wide divergence in the use of the term among state regulatory bodies and within the senior housing industry. In some states and among some industry groups, "assisted living" and "board and care" are used synonymously. In other states and segments of the industry, "assisted living" and "board and care" facilities are considered to represent distinctly different residential models. These differences in terminology are reflected in state law and regulations and are the basis for differences in the residential options available to seniors from state to state. They are also manifestations of an industry that is rapidly changing to reflect and serve the evolving needs and wants of the growing frail, elderly population.

Part I — What Constitutes Assisted Living

Lack of Consensus on an Assisted Living Model (continued)

Social Model versus Health Care Model

A key area of disagreement involves defining where assisted living begins and ends on the continuum of care, particularly the extent to which assisted living should provide medical services including the direct dispensing of medications.

Social Model. Proponents of the "social" model of assisted living, place high priority on the residential quality of the living environment and generally emphasize services which prolong the independence of individuals not yet in need of ongoing medical services. Under the social model, a high priority is usually placed on individual living accommodations (e.g., studio, one-bedroom and two-bedroom apartments) rather than shared living quarters, because private space is viewed as providing a more "normal" and less institutional living environment.

Health Care Model. Proponents of a "health care model" of assisted living typically view assisted living as serving individuals with higher acuity levels which include some level of ongoing medical assistance needs. Typically, the emphasis of this model is to move people currently residing in nursing home settings, or at risk of nursing home placement, but who do not require skilled nursing care, into more residential type settings with lower intensity services. Residential facilities developed under this model are more likely to provide shared living space.

The distinctions between these two models have lessened as, on the one hand, average acuity levels (acuteness of need) have continued to rise while, on the other hand, consumer demand for more home-like accommodations has intensified. However, as the differences have blurred, confusion has grown over what distinguishes "residential" from "health care" facilities and services. Regulatory and program structures that fit one model have become more difficult to effectively implement as the lines dividing different levels of care become less clear.

"Facility-Based" versus "Service-Based" Definitions

Disagreement has also grown among state regulatory bodies and within the senior housing industry over whether assisted living should be defined as a type of residential development or as a residential services philosophy. These two differing approaches to regulation have far-reaching impacts on the manner in which residential options for seniors are designed, funded and operated.

- **Facility-Based Definition.** Regulatory and financing programs that adopt a facility-based approach assume that all residents of an assisted living facility will need or desire similar levels of assisted living services.
- **Service-Based Definition.** In contrast, a services-based approach focuses on providing the appropriate level of assisted living services to seniors in their current residential location—be that a single-family home or traditional apartment development—and regulating and licensing the service provider rather than the residential facility.

Part II — Major Barriers to Affordable Assisted Living

There Are Four Major Barriers to Facility Feasibility

There are four major barriers to developing affordable assisted living facilities:

1. Insufficient level of operations/service subsidies
2. Rising acuity levels
3. Obstacles to the use of primary federal housing subsidies
4. High development risks

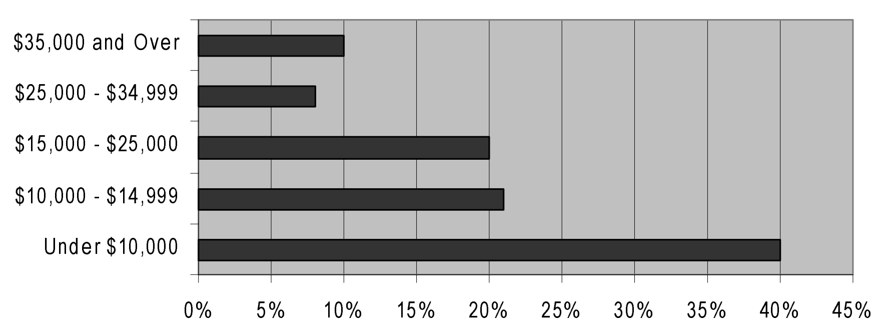
These barriers have significantly limited the feasibility of affordable assisted living facilities and, thereby, the demand for mortgage financing for such facilities. To the extent that demand is demonstrated, these same barriers have heightened lending risks, thereby hindering the ability of lenders, both public and private, to provide financing under favorable terms and conditions.

Barrier #1 — Insufficient Level of Operations/Service Subsidies

Substantial Subsidies are Needed in Order to Make Assisted Living Affordable

Nationally, combined room, board and service fees in the private assisted living market generally range from $1,500 to $3,500 a month ($18,000 to $42,000 annually). Although higher and lower fees are found, most facilities charge fees within this range. VHDA's focus group participants agreed that, on average in Virginia, a reasonable minimal level of quality care requires a combined monthly fee of at least $1,500 ($18,000 annually). Even such low-end fees equal or exceed the incomes of low-income seniors and are considered affordable to only about 25% of the senior population. Therefore, substantial subsidies are needed in order to provide affordable assisted living.

Percent Distribution by Income of Persons Age 65+: 1996



Based on data from the Current Population Survey conducted by the U.S. Bureau of the Census

The Greatest Share of Subsidy Need is to Support the Costs of Operations and Individual Care

Industry experience has been that, generally, 80 percent of monthly assisted living fees are to cover costs related to individual care and facility operations, with the amortized cost of bricks and mortar representing only about 20% of total fee charges. This reality has long been recognized and is reflected in the provision by states of reimbursement grants and Medicaid waiver payments that augment the limited federal Supplemental Security Income available to very low-income seniors ($494 a month in Virginia) in order to assist them in paying the cost of room, board and care.

Part II — Major Barriers to Affordable Assisted Living

Barrier #1 — Insufficient Level of Operations/Service Subsidies (continued)

Current State Auxiliary Grant and Medicaid Waiver Payment Levels

Presently in Virginia, Supplemental Security Income (SSI) recipients who are residing in licensed Adult Care Residences (ACRs) are eligible to receive an Auxiliary Grant that raises their monthly benefit to a maximum of $775 per month ($891 in Planning District 8). Virginia also has a Home and Community-Based Services Medicaid Waiver Program which further assists ACR residents who receive assisted living services. They may qualify for an additional monthly supplement of up to $90 (regular assisted living) or $180 (intensive assisted living) in order to defray the higher costs associated with their care. The Auxiliary Grant is funded from state and local revenues.* The Medicaid waiver for regular assisted living is state funded, while the Medicaid waiver for intensive assisted living combines state and federal funds.

Auxiliary Grant and Medicaid Waiver Payments are Insufficient to Cover the Full Cost of Assisted Living

Auxiliary Grant subsidies in Virginia, like similar SSI supplements in other states, grew out of the traditional "board and care" model that has relied heavily on shared living accommodations and very limited custodial services. As a result, payment levels have been set at a rate well below the cost of new residential care facilities that provide more intensive assistance with activities of daily living and provide separate studio, one-bedroom and even two-bedroom living units. Although Virginia currently provides assisted living supplement payments to qualifying seniors to reflect the higher cost of providing assisted living services, those supplements are relatively modest and still do not reflect the very different cost structures found in the new assisted living industry compared to the traditional board and care industry. In addition, trade associations representing the board and care industry have maintained for some time that state reimbursement levels are inadequate to support even the more limited levels of care provided in non-assisted living care facilities. That assertion was borne out in the 1997 study by JLARC of adult care residences serving people with mental disabilities and again in the 1998 study of long-term care issues by the Joint Commission on Health Care.

Even with No Debt Service, the Cost of Operations and Care Cannot Readily be Covered by Current Levels of Payment

The lack of adequate state subsidies to support facility operations and individual care have rendered most attempts by developers to structure affordable projects infeasible before the issue of mortgage financing has even become a consideration. The deficiency in reimbursement levels is sufficiently large that, even where debt service costs are eliminated through outright capital grants, there is still a gap between the monthly fees that owners must charge and the income (including subsidy assistance) of low-income seniors. For this reason, developers have avoided serving low-income seniors even though they comprise a substantial share of the population in need of assisted living services.

*Eighty percent of the cost of Auxiliary Grants is funded with state general revenues; twenty percent is funded by localities

Barrier #1 — Insufficient Level of Operations/Service Subsidies (continued)

Example of Subsidy Shortfall

As an example, Culpeper Gardens—a nonprofit federally assisted low-income senior housing development in Arlington County—has just constructed a new assisted living addition using a capital grant provided through HUD's Section 202 senior low-income housing program. Despite a debt-free building, the $1,585 monthly charge (low by Northern Virginia standards) is unaffordable to many low-income persons and exceeds the combined maximum Auxiliary Grant/Medicaid waiver supplement available in Northern Virginia by from $514 (intensive assisted living) to $604 (regular assisted living). As a consequence, the nonprofit owner of this development is soliciting charitable contributions to support a subsidy fund to assist very low-income residents. This is a practice that most nonprofit sponsors of assisted living facilities have found is necessary to carry out in light of inadequate state levels of reimbursement.

Barrier #2 — Rising Acuity Levels

Acuity Level of Residents is an Important Factor in Project Design and Feasibility

The acuity level of residents (i.e., the acuteness of their impairment/need for services) is a major factor impacting the design and operations of assisted living developments. Facilities serving individuals with greater impairments have higher staffing needs (which represent a very substantial percentage of overall costs) and may also require more specialized design features that also add to costs. Therefore, such facilities must charge higher fees. The differential in costs related to differing acuity levels is reflected in typical fee structures that vary by level of service need. Many assisted living facilities—particularly those designed on a social model, and those attempting to provide affordable assisted living services to non-Medicaid-eligible individuals—have consciously targeted the healthier, less impaired segment of the population in need of assisted living services as a means of controlling costs and maintaining a predominantly residential environment.

Average Acuity Levels are Rising Throughout the Industry

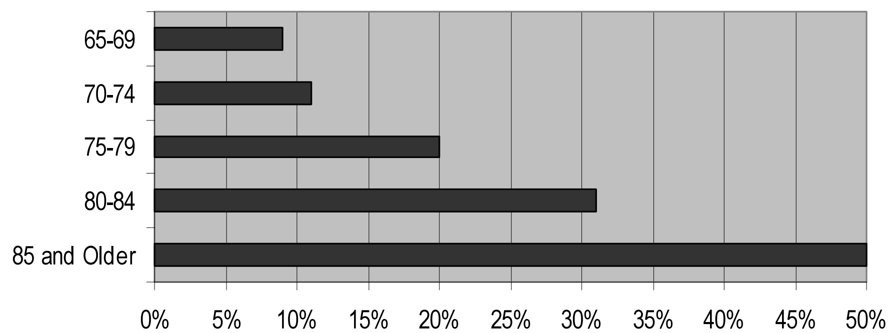
The average age of residents in assisted living facilities has risen steadily in recent years. Whereas it was once common to find residents in their seventies, today residents are typically in their middle eighties. Parallel to this change in the age of occupants has been a steady rise in their acuity level (i.e., level of acuteness of need). While many facilities—particularly those adhering to a strict social model of assisted living—are able to attract younger, less impaired seniors during initial lease-up, many of these same facilities are experiencing resident populations that are becoming impaired at an unexpectedly rapid rate. As subsequent turnover occurs in these facilities, it becomes more difficult to continue attracting younger, less impaired residents. This contributes further to rising average ages and acuity levels.

Part II — Major Barriers to Affordable Assisted Living

Barrier #2 — Rising Acuity Levels (continued)

Average Acuity Levels are Rising Throughout the Industry (continued)

Percent of Elderly Persons Needing Assistance With Everyday Activities by Age: 1991 (Civilian noninstitutional population)



Source: U.S. Bureau of the Census

Rising Acuity Levels are Undermining the Assumptions on Which Some Models are Based

A result of rising acuity levels is the gradual "medicalization" of some assisted living facilities. This increases costs through the need to provide more intensive services and maintain higher staffing levels. The shift to more intensive assisted living services may also result in additional state regulatory and licensure requirements that contribute further to higher costs. Unless rising acuity levels are adequately anticipated and planned for in financial models, they can have far-reaching impacts on facility operations and profitability.

As Average Acuity Rises, So Too Does the Spend-Down Rate of Resident Assets

Differential pricing by level of care can help protect against the cost creep associated with rising resident acuity levels. However, such pricing can have a significant impact on low- and moderate-income seniors. For such individuals, increases in impairment can result in unanticipated higher fee charges that, in turn, lead to the rapid spend-down of their limited assets. This can leave some seniors unable to continue paying for care even though their frailty is not yet sufficient to warrant nursing home placement. Such individuals have no public safety net on which to rely in order to continue receiving services if Auxiliary Grant and Medicaid waiver reimbursements are—as has usually been the case—insufficient to cover their higher fees.

Rapid Spend-Down Can Be a Particular Problem for Affordable Assisted Living Facilities

Private-pay facilities that specifically target low-income seniors are most impacted by resident spend-down of assets. For mixed-income developments with skewed rent structures, spend-down of assets by market-rate residents can create difficult management and marketing problems as the facility struggles to maintain a feasible balance of incomes and fees. For private-pay facilities targeting an exclusively low-income population, rapid rates of spend-down may create serious occupancy problems unless strategies can be developed to subsidize care. A "scholarship fund" is a tactic employed by many nonprofit providers, but relies on either an ability to tap into a substantial base of charitable giving or development of other means of ongoing capitalization.

Part II — Major Barriers to Affordable Assisted Living

Barrier #3 — Obstacles to Use of Primary Federal Housing Subsidies

Tax-Exempt Bonds and Low-Income Housing Tax Credits Can Only Serve a Narrow Private-Pay Market

Currently, there are two primary federal housing subsidies that VHDA can use to reduce the cost of developing assisted living facilities: tax-exempt bonds and Low-Income Housing Tax Credits. The use of tax-exempt bonds enables VHDA to reduce the interest rate charged to borrowers, thereby lowering facility debt service costs. Of far greater significance, are federal Low-Income Housing Tax Credits through which developers are able to raise equity to substantially reduce the amount of debt that they must incur. Both programs require developers to set aside either 20% of units for occupancy by households with income of 50% or less of area median, or 40% of units for occupancy by households with income of 60% or less of area median.

Below is the range of maximum income levels for low-income single individuals across housing markets in Virginia.

	Maximum Income at 50% of Median Threshold	Maximum Income at 60% of Median Threshold
Lowest Income Areas (rural counties)	**$13,400** ($1,117 per month)	**$16,080** ($1,340 per month)
Highest Income Area (Northern Virginia)	**$27,550** ($2,296 per month)	**$33,060** ($2,755 per month)
Statewide Average	**$18,970** ($1,580 per month)	**$22,800** ($1,900 per month)

Comparing these incomes to the range of monthly fees charged by private-pay assisted living facilities, it is apparent that seniors who are at the uppermost level of the income-qualification range to reside in facilities funded with tax-exempt bonds and/or Low-Income Housing Tax Credits can just barely afford private-pay rates at the lower end of the prevailing market range.

As discussed earlier, debt service costs generally account for only 20% of total facility expenses. Therefore, a 50% reduction in capital costs by using tax-exempt bonds and tax credits would lower total facility expenses by approximately 10%. This reduction, while significant for individual residents, creates a relatively narrow range of income eligibility for the required set-aside of low-income units under federal housing program regulations.

At present, the potential opportunity for use of tax-exempt bonds and Low-Income Housing Tax Credits to fund affordable assisted living facilities appears to be greatest in Northern Virginia where both development costs and qualifying low-income limits are high. Opportunities appear to be most restricted in rural areas in light of limited incomes relative to costs, and the low absolute level of demand in more sparsely populated rural areas that makes it necessary for private-pay facilities to serve a broader band of income. At the present time, there is no area of the state where there appears to be other than limited opportunity for use of tax-exempt bonds and Low-Income Housing Tax Credits.

Barrier #3 — Obstacles to Use of Primary Federal Housing Subsidies (continued)

Federal Tax-Exempt Bond and Low-Income Housing Tax Credit Requirements Impose Off-Setting Costs	Use of tax-exempt bonds and Low-Income Housing Tax Credits are generally restricted to housing developments that provide separate individual living accommodations with full residential facilities (e.g., private baths and full kitchens). This requirement is consistent with the social model of assisted living. Nevertheless, it imposes design standards that can limit the achievement of the economies needed in order to sufficiently reduce facility costs to a level affordable to low-income seniors. In addition, use of Low-Income Housing Tax Credits is limited to housing developments that: (1) do not require receipt of facility-provided care services as a condition of occupancy; and (2) set rents consistent with federal rent standards, which do not reflect the cost of supportive services. These requirements impose operational diseconomies that can make efficient and cost-effective marketing and delivery of services very difficult, particularly when the level of services is sufficient to trigger state licensure regulations. In addition, these requirements cause developers with significant unsubsidized private-pay operations to design a wholly different mode of service delivery and operation in order to make use of tax credits. That is something many developers are unwilling to do. None of these requirements have proven to be insurmountable for the use of tax-exempt bonds and Low-Income Housing Tax Credits in the development of affordable assisted living facilities. Nevertheless, together the requirements create design and operational diseconomies that can offset a significant portion of the reduction in total facility costs that might otherwise be achieved. This is particularly true in Virginia, given the narrow income band that tax-exempt bond and Low-Income Housing Tax Credit facilities must serve, and explains the lack of developer interest in the use of these subsidy programs in Virginia for affordable assisted living.
Rising Acuity Levels Pose Additional Challenges to the Use of Low-Income Housing Tax Credits and Tax-Exempt Bonds	Use of tax-exempt bonds and Low-Income Housing Tax Credits are also limited to facilities that provide predominately residential services (e.g., are not a health care facility). In recent years, IRS letter rulings have relieved much of the initial investor fear over the manner in which the distinction between residential and health care facilities would be made. Nevertheless, rising acuity levels raise serious long-term issues regarding the use of tax-exempt bonds, Low-Income Housing Tax Credits and other housing subsidies intended and required to be used in facilities that are primarily residential in nature. To the extent that rising acuity levels gradually eliminate the distinction between assisted living facilities developed on a social model and those following a health care model, then the long-term ability to comply with federal use restrictions and regulations prohibiting mandatory services could become problematic.

Part II — Major Barriers to Affordable Assisted Living

Barrier #4 — High Development Risks

Lack of Effective Service Subsidies Restrict Developer Activity to Limited Private-Pay Markets—Some of Which May Already be Saturated

The effective demand for unsubsidized (i.e., private-pay) assisted living represents a small share of total assisted living need (variously estimated at approximately 25 to 30 percent of all seniors needing this type of assistance). Therefore, overbuilding is a much more serious risk for private-pay assisted living facilities than for senior independent living developments or the multifamily housing market at large. Even for more experienced assisted living developers, the risks are increasing as production of new private-pay facilities in some markets is catching up with or beginning to exceed market demand.

Risks Associated with Long Initial Lease-Up Periods Can Be Exacerbated by Weak Markets and High Rates of Unit Turnover

In addition, assisted living facilities have generally experienced very slow initial lease-up rates due to ongoing marketing difficulties in convincing seniors in need of this type of residential care to move from an independent living setting—usually a home they have owned for a considerable number of years—and the lengthy logistical requirements of their doing so.

Slow lease-up periods require significant up-front project reserves to cover the high fixed costs associated with assisted living facilities. Any significant lengthening of lease-up periods resulting from weaker market demand can seriously undermine project viability. In some facilities, this issue is being exacerbated by unexpectedly high rates of unit turnover (in some cases as much as 30 to 35 percent annually). These high turnover rates are resulting from increased levels of resident acuity.

Industry Shakeouts are Anticipated

The in-depth interviews with developers conducted as part of the national study of assisted living issues found that the concept of assisted living is proving more difficult to execute successfully than many developers had thought. Developers have identified and attempted to serve a growing range of separate niches in demand for specific types of assisted living settings and services in order to increase market penetration. However, demand for individual niches has proven extremely difficult to quantify. Demand for some niche products has proven to be elusive as the choices available to consumers have grown and as rising acuity rates have led to rapid shifts in the scope of services needed and demanded by residents. Consequently, the risk of failure is rising. Many now anticipate industry shakeouts similar to those experienced in the congregate care industry a decade ago.

Part III — VHDA's Involvement with Assisted Living

VHDA Activities to Date

Financing of Senior Housing Developments

To date, VHDA has provided financing for 87 senior housing developments containing over 10,000 affordable dwelling units. The vast majority of that housing has been financed with federal subsidies that ensure its continued affordability to low-income seniors. Nearly two-thirds (57 developments containing 6,864 units) were financed between the mid 1970s and mid 1980s with federal Section 8 project-based rent subsidies. A quarter (22 developments containing 2,317) have been financed since the early 1990s using federal Low-Income Housing Tax Credits. Much of this housing was designed with common areas and facilities and can continue to provide appropriate accommodations for seniors over time as they age in place.

Provision of Services in Senior Independent Living Developments

By the late 1980s, the population of many of the Section 8 senior housing developments financed by VHDA had aged and grown considerably frailer than when the housing was first developed. VHDA was one of a small group of state housing finance agencies that participated in a multi-year program of the Robert Wood Johnson Foundation to encourage the owners of these developments to make supportive services available to their residents in order to facilitate their aging in place. Through this program, VHDA gained an initial understanding of the supportive service needs of very low-income frail seniors and creative ways in which a variety of resources can be drawn upon to offer them affordable services. The experience garnered in working with owners of Section 8 senior housing developments has been used to guide VHDA's financing of senior housing through the Low-Income Housing Tax Credit program to ensure that newly developed independent senior housing is able to adapt to the needs of its residents as they age in place.

Bond Financing of Congregate Care Developments

During the mid-1980s, between the termination of the Section 8 new construction/substantial rehabilitation program and the initiation of the Low-Income Housing Tax Credit program, VHDA sought alternative means of addressing senior housing needs. VHDA financed three senior congregate care facilities with tax-exempt bonds on an uninsured basis under the Authority's "conventional" multifamily loan program. These facilities were based on the congregate care model initiated by HUD and provided traditional senior apartments with services that included one meal a day, housekeeping and other low-intensity supports. The facilities include a central dining room and a great deal of common space. All three facilities have ultimately succeeded, but two experienced considerable lease-up periods that required some loan restructuring by VHDA. In response to market weakness, they have expanded their service packages to include more intensive services including the conversion of some units to assisted living. HUD's experience was far worse and involved considerable loan losses. Based on these experiences with weak market demand, VHDA terminated its congregate care lending program at about the same time that Congress terminated HUD's program.

Part III — VHDA's Involvement with Assisted Living

VHDA Activities to Date (continued)

Virginia Housing Fund Financing for Adult Care Residences

The Virginia Housing Fund is a special loan pool capitalized with funds that constitute part of VHDA's reserves. The Virginia Housing Fund is a vehicle for investing reserve monies in affordable housing programs that address VHDA's mission. The current capitalization of the Fund is over $150 million, most of which is already invested in low-interest mortgage loans. Currently, VHDA is able to provide approximately $20 million annually in new lending capital to the Virginia Housing Fund, one third of which is being allocated to affordable multifamily housing programs. Those new monies, together with repayments from earlier loans and carryover of funds, are providing a total of approximately $14 million annually for special low-interest multifamily loan programs.

The Virginia Housing Fund is intended to address the housing needs of very low-income families and special-need populations, including seniors. To date, a variety of small affordable senior housing developments have been financed with Virginia Housing Fund assistance, including one senior adult care residence. Due to the relatively limited annual funding, Virginia Housing Fund multifamily loans are limited in size (generally no more than $750,000 to $1,000,000). This limit means that Virginia Housing Fund financing is best suited to small senior independent living developments and adult care facilities. Developer experience with assisted living has shown that significant diseconomies begin to impact facility operations when development size drops below 30 units. Therefore, the Virginia Housing Fund does not provide a good vehicle for stand-alone funding of assisted living facilities. However, it can help reduce the finance costs of large facilities when blended with other funds.

Financing of Reverse Mortgages

VHDA was one of the pioneers in developing the concept and market for reverse mortgage loans to assist senior homeowners to age in place. In 1989, VHDA developed the first line-of-credit reverse mortgage program in the country—the Virginia Senior Home Equity Account—through which seniors could draw down home equity on a flexible basis to meet a wide variety of needs including the cost of home health care and in-home assisted living services. That program—including an extensive consumer counseling program developed in partnership with staff of the American Association of Retired Persons (AARP)—became one of the principal models on which HUD's Home Equity Conversion Mortgage (HECM) program was based.

Following the initiation of the HUD HECM program, VHDA actively worked with Fannie Mae and private lenders to promote its use in Virginia. In FY 99, VHDA determined that private lender acceptance and use of the HUD program had grown sufficiently so that VHDA's involvement was no longer needed. Nevertheless, VHDA continues to view reverse mortgages as a key component of Virginia's overall efforts to ensure that seniors are able to access affordable assisted living services in whatever setting most appropriately suits their needs and wants.

Part III — VHDA's Involvement with Assisted Living

VHDA's Section 232 Assisted Living Loan Program

Purpose in Offering Program

VHDA began offering taxable bond financing for assisted living facilities in the spring of 1998 in response to requests from developers for such a program. Discussions with the development community in 1997 had surfaced interest in a lending program to serve the new types of private-pay assisted living facilities that were beginning to be brought to market in significant numbers. These facilities typically contain 70 to 100 units and are built to design standards that generally follow the social model of assisted living. The development community was looking for both an additional source of development financing as well as a funding source that could potentially lower costs in order to enable projects to serve a broader range of incomes.

Rationale for Use of Taxable Bonds for Program Funding

VHDA chose to design a program using taxable bonds for several reasons.

First, due to typical project size, the identified borrowing needs could not be served through the Virginia Housing Fund because of the dollar limits set on loans (generally, $750,00 to $1,000,000). VHDA has restricted the size of VHF multifamily loans because of the limited amount of funds available. VHDA's five-year business plan calls for annual allocations of $12 to $14 million to the Virginia Housing Fund for multifamily housing loans. Just two to three loans for typical new assisted living facilities would fully subscribe those funds. Designing a program for small projects is not attractive because of the assisted living industry's experience with economies of scale. Generally, other state housing finance agencies that are providing funding for assisted living facilities (other than small congregate facilities) are requiring projects to have at least 30 units because diseconomies of scale become significant below that threshold.

Second, VHDA chose not to use tax-exempt bonds and federal Low-Income Housing Tax Credits in light of the barriers identified in Part II to their effective use for assisted living, and the high level of demand for those resources by developers serving other low-income housing needs.

VHDA recognized that a program using taxable bonds would have to serve a moderate-income population of seniors. Nevertheless, VHDA chose to offer such loans in light of the relatively limited financing choices available to most developers in the private marketplace.

Underwriting of Assisted Living Loans Requires Unique Experience and Skills

Assisted living lending has less in common with traditional multifamily mortgage lending than it does with other sectors of commercial lending where analysis of the financial capacity, business operations and experience of the facility's operating entity take on greater importance in underwriting than an analysis of market demand for units at particular levels of rent. Adequate loan underwriting requires knowledge and understanding of the assisted living business and the ability to adequately assess the organizational and business competency of the borrowing entity. Such experience and skills are especially important in light of the substantial development risks that assisted living facilities entail.

VHDA's Section 232 Assisted Living Loan Program (continued)

Limited VHDA Experience with Assisted Living Requires Use of Credit Enhancement for Bond-Funded Developments

Lenders such as VHDA that lack skill and experience with assisted living lending and that wish to raise assisted living mortgage funds in the capital markets at favorable interest rates must compensate for a lack of in-house skills in order to satisfy credit analysts of their ability to adequately manage risk. This can be done in a number of ways such as relying on third party underwriting services, use of external credit enhancements, and adoption of more conservative underwriting standards.

Rationale for Use of HUD Section 232 Mortgage Insurance

Most state housing finance agencies that are offering assisted living loans are providing credit enhancement through HUD's risk sharing mortgage insurance program. This program, while requiring some risk participation, delegates loan processing and underwriting to the state housing finance agency. This allows for greater program flexibility that makes the risk sharing program more attractive to developers than standard HUD mortgage insurance programs.

VHDA, unlike many other state housing finance agencies, does not participate in HUD's risk sharing program because the Authority has sufficient financial strength to achieve favorable interest rates in the credit markets for most types of multifamily financing on an uninsured basis. Participation in the risk sharing program just for the purpose of financing assisted living facilities would not be practical in light of the relatively low level and unpredictability of demand for such funding.* Consequently, VHDA has chosen to require credit enhancement for taxable bond funded assisted living loans through HUD's Section 232 mortgage insurance program, which has specific assisted living and board and care components. This alternative likely limits potential demand because of developer resistance to use of direct HUD insurance programs. However, use of the Section 232 program is less costly than reliance on expensive letters of credit, which is an important consideration for facilities targeting affordability.

Program Limitations

VHDA has chosen to rely on underwriting by HUD to compensate for limited in-house assisted living experience and skills and to eliminate dual loan processing by VHDA and HUD which would add to red tape and further discourage program use. For this reason, and because VHDA is unable to provide a below-market interest rate with taxable bonds, VHDA's program guidelines mirror those provided for in HUD's program regulations (see Appendix B for a summary of program guidelines).

As a consequence, mortgage bankers have little, if any, reason to choose to place Section 232 loans through VHDA for financing rather than directly through HUD, unless they are submitting a financing package that also includes use of other state funding programs. This is not likely to change until such time as developers are able to overcome more of the barriers to use of Low-Income Housing Tax Credits and tax-exempt bonds.

*Risk sharing authority is appropriated annually by Congress and is geographically allocated to participating lenders based on level of use and need.

Part III — VHDA's Involvement with Assisted Living

VHDA's Section 232 Assisted Living Loan Program (continued)

One Area of Opportunity May Involve Use of 501c3 Bonds

One exception is for nonprofit developers seeking financing through the issuance of tax-exempt 501c3 bonds. Such bonds are issued subject to more limited and flexible requirements than other tax-exempt multifamily housing bonds. Of particular significance for assisted living facilities is the lack of specific low-income targeting requirements, although the nonprofit organization must still demonstrate to the IRS that it is serving a legitimate public purpose.

Demand for VHDA Issuance of 501c3 Bonds is Likely to Be Low

VHDA is willing to issue 501c3 bonds, but demand is likely to be low for a number of reasons. First, the nonprofit sector has chosen to focus much of its retirement housing investment in the development of continuing care retirement communities and facilities providing multiple levels of care, including nursing services. Nonprofit facilities represent a relatively small share of new free-standing assisted living facilities. Second, many nonprofits lack the resources, experience and capability to develop assisted living facilities except in partnership with for-profit developers. The greatest demand is likely to come from large, experienced national and regional nonprofits involved in the retirement housing industry. However, such entities have access to a range of alternative "pass-through" conduits that can issue 501c3 bonds. In contrast to VHDA, "pass-through" conduits assume no risk in issuing bonds and, therefore, may be able to charge more limited fees. Accordingly, there may be little to no benefit to a nonprofit in requesting VHDA to issue 501c3 bonds.

HUD Section 232 Program Production in Virginia

To date, production in Virginia under HUD's Section 232 program is in keeping with the relative need and demand for assisted living in Virginia compared to the nation as a whole. Nevertheless, there has been limited program production in both the assisted living and board and care components of the Section 232 program in comparison to overall development activity in the industry. This reflects developer dissatisfaction, as expressed in national surveys and interviews, and in VHDA's focus group, with the perceived "red tape" and lengthy processing times associated with the Section 232 program. HUD has expedited processing of applications in response to developer complaints but, so far, there is no significant documented increase in loan production. Initial loan endorsements in Virginia have remained steady at approximately one loan per year under both components of the program.

HUD Sec. 232 Program Federal FYs 94—99		Initial Loan Endorsements		Virginia's Share	
		Virginia	U.S.	Sec. 232 Loans	Persons Age 85+
Assisted Living	# Projects	5	146	3.1%	2.1%
	# Units	345	12,047	2.9%	
	Mortgage	$33 million	$826 million	4.0%	
Board & Care	# Projects	4	129	3.1%	2.1%
	# Units	310	11,171	2.8%	
	Mortgage	$16 million	$607 million	2.7%	

Part IV — Opportunities

New Directions in Affordable Assisted Living in Other States

States in the Northeast and Great Lakes Are Taking the Lead in Looking for Alternatives

States have begun to respond to rapidly increasing demand for assisted living options by addressing the underlying regulatory and subsidy issues which are fundamental to the provision of affordable assisted living. This trend is most evident in Northeastern and Great Lakes states with large urban populations where both the absolute and relative numbers of people age 85 and older are highest. The substantial impact of Medicaid costs in these states is forcing this need to a high level of priority. In other parts of the country, less change from traditional state regulatory structures and subsidy levels has occurred. Nonetheless, most states are actively reviewing their policies and funding programs in order to identify feasible alternatives.

Increased Payment Levels Under State Subsidy Programs are Essential for Successful State Initiatives

All successful state efforts to encourage the provision of affordable assisted living have depended on increased levels of SSI supplements and/or Medicaid payments that provide subsidies fully commensurate with the cost of providing a reasonable minimum level of quality care. Increased levels of funding by states have begun to establish the fundamental precondition for feasibility upon which broader affordable assisted living initiatives can be built.

Medicaid Waivers Are Being Used to Bridge the Gap Between the Private-Pay and Traditional Medicaid-Eligible Populations

At the core of many state initiatives are broad Medicaid waivers which not only provide increased levels of funding to qualified individuals for assisted living services but also expand eligibility to a much wider range of incomes. Under federal regulations, states are able to serve persons through their Medicaid waiver programs with incomes up to three times the normal eligibility limits for Medicaid and SSI. This exception is made to enable states to develop alternative means of providing care that avoid the spend-down of individual income and assets to the Medicaid eligibility level. Currently, the maximum income that can be served through Medicaid waivers is approximately $17,800 versus the $9,948 maximum eligible income for Auxiliary Grant assistance in Virginia ($11,340 in Planning District 8). That income level is just high enough to afford the lowest rung of the private-pay fee scale in many markets. The Medicaid waiver program thereby enables states to develop a subsidy program that can meet a wide range of assistance needs, and opens the door to the development of successful state housing initiatives targeting the full range of income groups unable to afford private-pay care.

Model Housing Agency Lending Initiatives Are Made Possible by State Medicaid Waiver Programs

State housing finance agencies (HFAs) in Massachusetts, New Jersey, and Rhode Island have each developed affordable assisted living loan programs that are made possible by state Medicaid plans* that allow for maximum aggregate reimbursement rates for new facilities (i.e., state SSI supplements plus Medicaid payments) at levels that range from 50% higher to more than double the amounts presently provided in Virginia.

*Massachusetts uses Medicaid's Group Adult Foster Care (GAFC) which is a service under the "state plan" rather than a Medicaid waiver.

New Directions in Affordable Assisted Living in Other States (continued)

Model Housing Agency Lending Initiatives Are Made Possible by State Medicaid Waiver Programs (continued)

The housing finance agencies in these states provide loans funded primarily with taxable bonds in which 20% of the units are set-aside for seniors with incomes of 50% or less of area median.* Most low-income residents of the facilities developed through these HFA programs are eligible to receive Medicaid funds to cover the cost of their care. (Medicaid funds cannot be used to pay for bricks and mortar costs in assisted living facilities.)

The affordable assisted living mortgage programs in Massachusetts and New Jersey grew out of comprehensive revisions to state regulation and funding of assisted living, which resulted in the development of broad statewide means for using Medicaid funds to pay for assisted living services. New Jersey uses the federal exception income eligibility limit in its Medicaid waiver program, which significantly broadens the range of incomes that can be served by low-income set-aside units in the facilities funded by the state's housing finance agency.

In contrast, the Rhode Island state housing finance agency, in partnership with the state's health and human services and elder affairs departments, used the Massachusetts and New Jersey models to lobby the legislature for funding for a limited pilot program. The approved program directly links funding under a special targeted Medicaid waiver to new affordable assisted living facilities to be funded by the housing finance agency. This is intended to stimulate the development of additional affordable assisted living facilities providing quality care, while limiting the budgetary impact on the state.

Fostering of Aging in Place

New Jersey has created a special licensure and regulatory classification for subsidized senior independent living developments whose owners are providing support services to residents in order to assist them in aging in place. This special regulatory classification recognizes the unique needs and circumstances of these developments, in particular the federal regulatory restrictions under which they must operate. A special Medicaid waiver is linked to these subsidized housing developments that provides reimbursement of up to $1,200 per month to cover the cost of a resident's assisted living services.

Use of Tax-Exempt Bonds and Low-Income Housing Tax Credits

The housing finance agencies in Rhode Island, Massachusetts, and New Jersey permit the use of tax-exempt bonds and Low-Income Housing Tax Credits in their affordable assisted living loan programs. In each case, state subsidy levels are high enough to make such projects feasible. In New Jersey, facilities funded with Low-Income Housing Tax Credits are licensed and regulated under the state's special classification for subsidized residential facilities and are eligible for reimbursement under the special Medicaid waiver designed for that class of properties. Nevertheless, only a small number of facilities funded in Massachusetts and New Jersey have used those federal subsidies due to limitations on their availability under federal volume caps, and the factors creating diseconomies that are cited in Part II.

*In some cases, an alternative of renting 40% of units to individuals with income of less than 60% of area median is allowed.

Part IV — Opportunities

Opportunities VHDA Can Pursue

VHDA Can Help to Develop a Model State Program to Stimulate the Development of Affordable Assisted Living Facilities

Focus group participants strongly endorsed the development of a state pilot program, supported by higher state reimbursement rates, to stimulate the development of affordable assisted living facilities. In their view, the first step in the development of such a pilot should be a determination of a typical affordable assisted living facility's level of need for state subsidies. Focus group participants agreed that this could be demonstrated through the preparation of a detailed pro forma for a prototype project around which consensus could be built (Action Item #1). HUD and other key senior housing industry organizations have sufficient databases on actual project costs to make such a task feasible. Upon completion, the pro forma would be used in determining the desirability and feasibility of a pilot program. Depending on the outcome of that review, proposed program guidelines would be developed and submitted to an appropriate state-level body for review and recommendation to the General Assembly (Action Item #2).

New Jersey provides another model worthy of exploration—i.e., the provision of assisted living services within the existing stock of federally subsidized senior housing. This model avoids the costly provision of bricks and mortar subsidies for wholly new residential care facilities; although, in some cases, funding may be needed for the construction of additional common areas and facilities. For other federally subsidized senior housing, such as Culpeper Gardens, the addition of an assisted living wing that can share overhead costs with a large existing development may make sense. A number of state housing finance agencies, including VHDA, have already taken steps to encourage the provision of services in the senior housing they have financed. New Jersey provides an example of how—with a coordinated state approach to regulation, the provision of subsidies, and financing—this opportunity can be more actively addressed (Action Item #2).

Action Item #1—*VHDA will seek assistance from HUD and key senior housing industry organizations in order to develop a pro forma for a prototype affordable assisted living facility in order to document the current level of state subsidies needed to stimulate the development of affordable assisted living facilities. Upon completion, VHDA will share this pro forma with legislative and gubernatorial commissions studying long-term care issues.*

Action Item #2—*VHDA will offer assistance to legislative and gubernatorial commissions studying long-term care issues in: (1) determining the desirability and feasibility of a pilot affordable assisted living program; and (2) if warranted, developing guidelines for such a program.*

Part IV — Opportunities

Opportunities VHDA Can Pursue (continued)

VHDA Can Work with DHCD and Senior Housing Industry Groups to Identify and Disseminate Information on Innovative Means for Reducing Facility Costs

The Culpeper Gardens case example points to the degree of creativity that must be employed by developers of assisted living facilities in order to achieve affordability. VHDA concurs with the finding of the Virginia Housing Study Commission's 1998 report on assisted living issues that more can be done at the state level to identify and disseminate information on innovative means for reducing facility costs—particularly the significant costs of facility operations and individual care.

Action Item #3—*VHDA will work with DHCD and senior housing industry groups to identify and disseminate information on innovative means for reducing the cost of developing and operating assisted living facilities.*

VHDA Can Explore with Other State HFAs and Industry Groups the Creative Use of 501c3 Bonds

Tax-exempt bonds issued on behalf of nonprofit organizations can be structured on a more flexible basis than other tax-exempt multifamily housing bonds. This is particularly true of income limits where, absent higher levels of state reimbursement payments, flexibility is needed in order to address overall affordability issues as well as unique issues related to increases in resident acuity. VHDA can explore with other HFAs and senior housing industry groups ways in which 501c3 bonds can be creatively used to achieve affordable assisted living projects. VHDA can then work with senior housing industry groups to disseminate such information, including publicizing the availability of 501c3 bond financing through VHDA, in order to generate affordable assisted living activity.

Action Item #4—*VHDA will work with other state housing finance agencies and senior housing industry groups to identify and disseminate information on creative means for using 501c3 bonds to finance affordable assisted living facilities and publicize the availability of 501c3 financing through VHDA.*

Appendix A — House Joint Resolution 749

HOUSE JOINT RESOLUTION NO. 749
Offered January 21, 1999

Requesting the Virginia Housing Development Authority to analyze its Assisted Living Loan Program with the goal of increasing loan production in such program.

Patrons-- Diamonstein, Almand and Hall; Senator: Woods

Referred to Committee on General Laws

WHEREAS, nationally and in the Commonwealth, the concept of assisted living has emerged in recent years as an important link in the continuum of care for the elderly; and

WHEREAS, although numerous assisted living facilities are operating in the Commonwealth (particularly in urban areas) and many more are in the planning and construction phases, the cost of residency in most such facilities is beyond the reach of a majority of seniors; and

WHEREAS, the number of seniors in the Commonwealth is rising significantly; and

WHEREAS, the Virginia Housing Study Commission, in December 1998, concluded a two-year study of affordable assisted living options for seniors; and

WHEREAS, such Commission study identified the need for additional affordable assisted living options for seniors in the Commonwealth together with the interest of the Commonwealth in fostering the development of such options; and

WHEREAS, the development and operation of such facilities in the Commonwealth is extremely challenging, given the complexity of financing restraints, revenue concerns, staffing recruitment and retention needs, and regulatory issues; and

WHEREAS, the Virginia Housing Development Authority, with its myriad dynamic and acclaimed single family and multifamily loan products, is widely recognized as the leading state housing finance authority in the nation; and

WHEREAS, the Authority announced its creation of an Assisted Living Loan Program in March 1998 but to date has received no applications for loans under such program; and

WHEREAS, the Authority's program requires that program loans be insured by the Section 232 Mortgage Insurance Program of the U.S. Department of Housing and Urban Development (HUD), the relative complexity of which insurance may serve as a disincentive to potential program applicants; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Virginia Housing Development Authority, with participation from the Department of Housing and Community Development and, by invitation, the senior housing industry, be requested to analyze its Assisted Living Loan Program with the goal of increasing loan production in such program.

Appendix A — House Joint Resolution 749

In conducting its study, the Authority shall (i) focus not only on reasons for the program's lack of applicants, but also on methods for program re-structuring and marketing to attract applicants; (ii) consider creating an assisted living loan product that would not require HUD mortgage insurance; and (iii) consider a more favorable interest rate for the financing or rehabilitation of housing units for use as assisted living facilities.

All agencies of the Commonwealth shall provide assistance to the Virginia Housing Development Authority for this study, upon request.

The Authority shall complete its work in time to submit its findings and report on its progress to the Governor and the 2000 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Appendix B — Summary of VHDA's Assisted Living Loan Program

Definition of Assisted Living	An assisted living development is defined as a residential setting where appropriate personal care services, 24-hour supervision, and assistance are provided in an environment which fosters maximum independence and promotes individual dignity.
Taxable Bond Financing	VHDA intends to fund most assisted living loans with taxable bonds. **Target market:** Persons with income at or below 100% of area median **Income Restrictions:** Resident income cannot exceed 150% of area median **VHDA Pricing Policy for Taxable Bond Loans:** • Permanent loan/Immediate delivery: 30-year Treasury yield plus 180 basis points • Permanent loan/15-month delivery: 30-year Treasury yield plus 215 basis points • Construction-Permanent Loan: 30-year Treasury yield plus 250 basis points [**Note:** The above rates and points represent VHDA's normal pricing for taxable bond loans. Under the HUD Section 232 program, the interest rate used in underwriting is set by HUD. Lenders may add points, as necessary, to fit the lender's pricing policy.]
Virginia Housing Funds Loans	In some instances, developments may qualify for funding from the Virginia Housing Fund—a special loan pool through which VHDA invests a portion of its reserves in low-interest mortgages serving a variety of low-income populations. **Target Market:** Persons with income at or below 60% of area median **Income Restrictions:** Resident income cannot exceed 150% of area median **Interest Rate:** 5% (as of 12/99) **Program Priorities:** Loans in rural and inner-city areas and loans to minority developers **Loan size:** Generally, no more than $750,000 **Interest Rate:** 5%
HUD Section 232 Mortgage Insurance	All loans must be insured under the assisted living component of HUD's Section 232 Mortgage Insurance Program.
Loan Origination	Borrowers make application using HUD's Section 232 loan application (HUD-92013-NHICF). All loan applications must be submitted to VHDA through a VHDA/HUD-approved mortgage banker.
Reliance on HUD Underwriting and Program Guidelines	All loan applications are processed and underwritten by HUD following HUD's Section 232 program guidelines. Currently, these include: **Eligible Development Activities:** • New construction/substantial rehabilitation of assisted living facilities • Purchase/refinance of existing facilities with or without repairs and improvements

Appendix B — Summary of VHDA's Assisted Living Loan Program

Reliance on HUD Underwriting and Program Guidelines (continued)	**Maximum Loan Term:** • 40 years for new construction/substantial rehabilitation of facilities • 35 years for existing facilities **Maximum Loan-to-Value Ratio:** • 90% (95% for nonprofits) for new construction/substantial rehabilitation of facilities • 85% (90% for nonprofits) for existing facilities **Minimum Debt Service Coverage Ratio:** 110% **Mortgage Insurance Premium:** 0.5% of mortgage amount **Site Appraisal and Market Analysis, Application and Commitment Fees:** $3 per $1,000 of mortgage amount **Inspection Fee:** Up to $5 per $1,000 of mortgage amount (up to 1% of the total cost of repairs)
Questions	Please direct any questions about the loan product to: • a VHDA/HUD-approved mortgage banker **or** • any VHDA Development Officer at (804) 783-6740

Appendix C — Assisted Living Focus Group Participants

External Participants

Name and Title	Organization
Nancy M. Ambler, Esquire, Executive Director	Virginia Housing Study Commission
Lyn Boyer-Haines, Executive Director	Elder Homes, Corp.
Jo Ann Clipp	Reznick, Fedder & Silverman
Anne Ewald	GMAC
Charlie Famuliner, Director of Multifamily Housing	U.S. Dept. of Housing and Urban Development
Wilda M. Ferguson, Director of Canterbury Club	Canterbury Club, Westminster-Canterbury
Larry Goldman	Mayfair Management, Inc.
Robert Gould	Reilly Mortgage Group
Hammond Hunt	Hunt Assisted Living
Marcia A Melton, Vice President for Public Policy	Virginia Association of Nonprofit Homes for the Aging
Michael Osorio, Executive Director	Virginia Adult Home Association
Richard Ross, Community Planner	Virginia Department of Housing and Community Development
Thomas Runquist	First Centrum
Jacquelin Smedley	First Centrum
Beverly Soble, Vice President, Regulatory Affairs	Virginia Health Care Association
Ronald Sweeney	Highland Mortgage

VHDA Participants

Name and Title	Organization
Tracey S. DeBoissiere, Member, VHDA Board of Commissioners	Northern Virginia Apartment Association
Susan F. Dewey, Executive Director	Virginia Housing Development Authority
Larkin Goshorn, Director of Multifamily	Virginia Housing Development Authority