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Report to Congressional Requesters

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TAX-EXEMPT BONDS

Retirement Center Bonds Were Risky and Benefited Moderate-Income Elderly

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The Honorable David Pryor
Chairman, Special Committee
on Aging
United States Senate

The Honorable Brian Donnelly
House of Representatives

This report responds to your request that we (1) review the extent to which charitable organizations use tax-exempt bonds for housing the elderly, (2) identify the characteristics of the housing facilities and the residents, and (3) determine the extent to which and reasons why housing facilities default on their tax-exempt bonds.

As arranged with your offices, we are sending copies of this report to interested parties and will make copies available to others upon request.

The major contributors to this report are listed in appendix III. If you have any questions about the report, please call me at (202) 272-7904.

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Executive Summary

Purpose

According to the American Association of Retired Persons, by the year 2030, persons age 65 and older are expected to represent 22 percent of the U.S. population—2 1/2 times that in 1980. Responding to this expected growth, nonprofit charitable organizations have increasingly used tax-exempt bonds to obtain lower interest rates to finance housing for the elderly. This increased use has, in turn, increased Congress' concerns about how the bonds are being used and who is benefiting from the federal subsidy that tax exemption provides. Congress also is concerned about why some of these bonds are going into default.

Congressman Brian Donnelly and Senator David Pryor asked GAO to review the extent to which charitable organizations use tax-exempt bonds for housing the elderly. In addition to determining the volume of bonds, they asked GAO to

- identify the characteristics of the housing facilities, including the type of services provided and related fees and residents' incomes; and
- determine the extent to which and reasons why housing facilities default on their tax-exempt bonds.

Background

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax those nonprofit organizations operated for charitable purposes. Providing for the special needs of the aged has long been recognized as a charitable purpose under federal tax laws.

To be recognized as a tax-exempt provider of housing for the elderly, an organization must meet several requirements set forth in Internal Revenue Service rulings. For example, the home must meet the special health care and financial security needs of the elderly, and residential facilities must meet the specific physical, social, and recreational requirements of the elderly.

State or local governments issue tax-exempt bonds on behalf of charitable organizations to finance housing for the elderly. Under certain conditions, tax-exempt bonds may also be issued on behalf of private, for-profit persons or organizations to finance housing for the elderly. When tax-exempt bonds are used, organizations must make principal and interest payments in accordance with the bond agreements. Failure to make timely payments constitutes a default on the bond.

GAO used a questionnaire to determine the extent to which nonprofit organizations used tax-exempt bonds to finance housing for the elderly.

The questionnaire collected information on the types of living arrangements offered, levels of health care services provided, and entrance and monthly fees charged. To calculate default rates for bonds used to finance housing for the elderly, GAO used information from the Bond Investors Association and the Securities Data Company, Inc. GAO also did case studies of seven defaulted for-profit and nonprofit housing facilities.

Results in Brief

GAO's survey identified 271 tax-exempt bonds totaling $2.8 billion that were issued from 1980 through July 1990 on behalf of charitable organizations to finance 221 housing facilities for the elderly. In about half of the facilities' most recent bond issues, bond proceeds provided 90 percent or more of the total funds used to finance the project. Facilities used the bond proceeds and other related funds primarily to finance construction; expansion; and furniture, fixtures, and equipment.

The facilities GAO identified offered the elderly residents a range of living arrangements, health care and assistance, and amenities. Entrance and monthly fees varied depending on unit size and services offered. The fees must support both the specialized services and the relatively high debt payments these highly debt-financed projects must pay. Accordingly, GAO found that 75 percent of the facilities housed residents with average incomes greater than $15,000—making the facilities affordable primarily to 27 percent of the nation's elderly. Due to the expense of these housing projects for the elderly, it is unrealistic to expect similar projects financed solely by bonds to be available to the vast majority of elderly with incomes below $15,000. Additional subsidies would have to be provided. The bond subsidy however, may still serve a public purpose by encouraging charitable organizations to provide housing for elderly persons who may not be able to afford private, for-profit units.

As of the end of 1989, GAO estimated that the overall default rate for bonds issued for retirement centers between 1980 and 1989 was about 20 percent. In comparison, GAO estimated an overall default rate of about 1 percent for selected revenue bonds such as bonds for industrial development projects and hospitals. GAO's case studies of defaulted projects showed that the facilities were highly debt-financed and the bonds' interest rates were higher than average rates charged on revenue bonds issued during the same period. This weak financial structure combined with the inexperience of some developers and their overestimated market projections of occupancy made the facilities vulnerable to default.

Various industry officials described to GAO potential safeguards against default. However, policies that might reduce the possibility of default, such as requiring a certain level of equity, might also preclude successful projects from being undertaken if the organization does not have resources to provide sufficient equity.

Principal Findings

Multi-Service Facilities Are Costly, Used by Moderate- and Higher-Income Elderly

For those charitable organizations responding to GAO's survey, GAO found that the role of tax-exempt bonds in providing housing for the elderly has increased greatly since 1980, when $52 million in bonds were issued. That figure rose to $614 million by 1989. GAO found that from 1980 through July 1990, 271 tax-exempt bonds totaling about $2.8 billion were issued on behalf of charitable organizations to finance 221 housing facilities for the elderly. For the most recent bonds issued on behalf of individual facilities, the value of bonds ranged from $225,000 to $63 million, averaging about $11 million. About 63 percent of the total funding was used for construction, furniture, fixtures, equipment, and expansion; 31 percent of the total funding was used to refinance prior debt. The bonds were also the major source of financing. For about half of the bonds issued, the face amount represented 90 percent of the total cost of the project. (See pp. 16-20.)

The entrance and monthly fees paid by elderly residents are based on the amount of debt financed; living arrangements; need for health care; and other amenities, which vary among facilities. Of the nonprofit facilities GAO identified, some facilities offered efficiency apartments with no health care, while others offered two-bedroom apartments and intensive full-time nursing care. The average entrance fees for a studio/efficiency unit ranged from $30,416 to $37,080, and the average monthly fees ranged from $884 to $1,007. The average entrance fee for a two-bedroom unit ranged from $70,020 to $102,140, and the average monthly fees ranged from $1,028 to $1,230. Seventy-five percent of the facilities GAO identified housed residents with average annual incomes of $15,000 or more, making them affordable primarily to 27 percent of the elderly population. (See pp. 20-26.)

GAO's survey results suggested that providing housing, health care, and related services for the elderly is expensive. Providing similar specialized housing to lower-income elderly would likely require additional subsidies. This result is consistent with what others have found. The American Association of Homes for the Aging states that it is difficult for facilities or a sponsoring organization to provide further subsidies for low-income residents without access to large endowments or a substantial fundraising capacity. Raising rents of existing residents to subsidize lower-income residents could result in resentment among other residents. A 1990 Department of Housing and Urban Development report concluded that some form of subsidy in addition to tax-exempt financing or low-income housing tax credits would be needed if projects were to serve a range of low-income residents. (See pp. 26-27.)

Facilities Were Prone to Default Due to Weak Financial Structures, Inexperienced Developers, and Overestimated Market Projections

GAO estimated that approximately 20 percent of bonds issued for retirement centers during the 1980s defaulted, compared with a 1-percent default rate for selected types of revenue bonds, such as bonds for industrial development projects and hospitals. During the same period, the default rate for retirement center bonds peaked at 93 percent in 1983 and has dropped below 10 percent since 1986. The average time from issuance to default was about 34 months. (See pp. 30-32.)

In its seven case studies, GAO found that the facilities were highly debt-financed. Five of the projects used bond and bond interest to finance 100 percent of the projects; one financed 95 percent, the other 91 percent. In addition, the interest rates these projects paid were above the market average for other revenue bonds. This weak financial structure made the projects vulnerable to financial difficulties. These projects also were burdened with developers that had no or limited experience in the retirement center industry. Further, the market projections were overestimated. As a result, occupancy rates ended up far below projections. In none of the seven cases was the facility closed due to the default. (See pp. 32-36.)

GAO discussed the case study results with officials from three successful nonprofit facilities. According to the officials, the ability to maintain financial reserves and the involvement of experienced management were keys to avoiding default. Other industry officials suggested a number of possible safeguards against default. For example, one investment banker suggested that requiring credit enhancements such as a letter of credit would bring closer scrutiny to the project's finances prior to development. Public Securities Association officials stated that such a requirement, however, might prevent bonds from being issued for viable small projects if the added cost of the credit enhancement exceeded the net savings obtained. Other suggestions included controlled spending and requiring organizations to provide more equity. (See pp. 36-39.)

Industry Comments

Responsible officials of the American Association of Homes for the Aging and the Public Securities Association reviewed the report and provided informal comments. Overall, the officials generally agreed with the information presented. GAO included the officials' comments in the report where appropriate.

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Abbreviations

AAHA	American Association of Homes for the Aging
HUD	Department of Housing and Urban Development
IRC	Internal Revenue Code
IRS	Internal Revenue Service

Introduction

Background

Long-term health care and housing policy decisions made today can affect how older Americans are housed in the future. The American Association of Retired Persons projects that by 2030 there will be about 66 million people age 65 and over—2 1/2 times their number in 1980. Providing for the special needs of this group has long been recognized as a charitable purpose under the federal income tax code. Nonprofit charitable organizations exempt from federal income tax under Section 501(c)(3) are commonly referred to as 501(c)(3) organizations. The use of tax-exempt bonds is one way these organizations can finance housing for the elderly. This housing is diverse, consisting of varying types of residential units and levels of health care.

As of the end of October 1989, about 5,900 organizations had listed housing or care for the elderly as a charitable activity when they applied to the Internal Revenue Service (IRS) for tax-exempt status. In order to be recognized as a tax-exempt provider of housing for the elderly, an organization must meet several requirements set forth in IRS rulings. The housing must meet the elderly's special needs, such as providing or arranging for health care and providing for the elderly's financial security. To meet elderly persons' financial security needs, the organization must operate the housing at the lowest possible cost and set fees that are affordable to a significant portion of the elderly in the community. In addition, the organization must assist residents who become unable to pay by either maintaining them in residence to the degree the organization is financially able, or finding the resident another place to stay. At the very least, if charitable organizations want to keep their tax-exempt status, they cannot have a policy to evict residents who can no longer afford the fees due to changing economic circumstances. If the housing is not affordable by a significant number of elderly in the community, then its benefit to the community is not broad enough to warrant exemption under Section 501(c)(3).

The Internal Revenue Code (IRC) allows state and local governments to issue bonds that provide investors with interest income that is exempt from federal income tax. This exemption allows governments to issue debt at lower interest rates than they otherwise would have to pay. Tax-exempt bonds are used by state and local governments to finance public-purpose projects, such as schools, roads, or water and sewer facilities.

State and local governments can also provide tax-exempt financing for charitable organizations and private, for-profit persons or organizations if the proceeds are used for certain activities specified in the IRC.[1] For 501(c)(3) organizations providing housing for the elderly, tax-exempt financing allows the organizations to finance all or part of their operations at interest rates lower than conventional financing. According to the American Association of Homes for the Aging (AAHA), tax-exempt bond interest rates are typically 1 to 3 percentage points lower than conventional financing interest rates.

In addition to being classified by the type of entity that uses the proceeds, tax-exempt bonds can also be classified by the source of revenue that backs the issue. For example, revenue bonds, which include bonds issued on behalf of 501(c)(3) organizations to finance housing for the elderly, are backed by proceeds such as rent and service fees from the project being financed.

When bonds are issued, the 501(c)(3) organization is committed to principal and interest payments presented in the bonds' offering statement and agreed to in the bonds' terms of indenture. Failure to pay principal and interest in accordance with the terms of indenture constitutes a default on the bond. Even though a facility may be in default, it could continue operating while its financing is being restructured.

›jectives, Scope, and ›thodology

Congressman Brian Donnelly and Senator David Pryor asked us to obtain information on 501(c)(3) organizations that provide housing for the elderly. In particular, they were interested in knowing the extent to which tax-exempt bonds are used to finance housing for the elderly and who is benefiting from the federal subsidy. They also wanted to know why organizations default on these bonds. As agreed with Congressman Donnelly and Senator Pryor, we reviewed the extent to which 501(c)(3) organizations have used tax-exempt bonds since 1980 for housing the elderly. In addition to determining the volume of bonds, we specifically agreed to (1) determine characteristics of the housing facilities and their residents and (2) determine the extent to which and reasons why some housing facilities default on their tax-exempt bonds.

We used two questionnaires to gather data on the volume of tax-exempt bonds and to identify facility characteristics. The first questionnaire

[1]Tax-exempt bonds may be used by private, for-profit persons to finance residential rental housing for the elderly only if the housing meets low-income tenant occupancy requirements. The Technical and Miscellaneous Revenue Act of 1988 applied low-income tenant occupancy requirements to 501(c)(3) bonds where the property constitutes residential rental property and is acquired rather than constructed or rehabilitated.

identified 501(c)(3) organizations nationwide that provided housing for the elderly and used tax-exempt bonds, while the second questionnaire collected detailed information on the bonds and facilities. Appendix I contains a copy of the second questionnaire and a summary of the organizations' responses.

In developing each questionnaire, we consulted with officials from AAHA. In developing the second, more extensive questionnaire, we consulted AAHA, firms that provide financial services to 501(c)(3) organizations, firms that underwrite tax-exempt bonds, and IRS officials familiar with bond financing. We also pretested the questionnaires before mailing them to the 501(c)(3) organizations and housing facilities.

We used the IRS Exempt Organization Master File as of the end of October 1989 to identify the nonprofit organizations that had indicated to IRS that they were providing or planned to provide housing for the elderly. On the basis of the file, we mailed the first questionnaire to about 5,900 501(c)(3) organizations. We received responses on 89 percent of the initial questionnaires, with the respondents identifying 479 facilities that used tax-exempt bond financing to provide housing for the elderly. Industry officials identified 86 other facilities that provide housing for the elderly, bringing the total number of potential facilities that provided housing for the elderly and used tax-exempt bond financing to 565.[2]

To obtain detailed information on the housing facilities, use of bond proceeds, and characteristics of the residents, we mailed the second questionnaire to these 565 facilities. About 75 percent, or 422, of the facilities responded to our questionnaire. We eliminated facilities that provided only nursing home care and those that had bonds issued prior to 1980. This left us with 221 facilities that provided residential housing for the elderly and used one or more tax-exempt bond issues in 1980 or later. We only obtained detailed information on the most recent bond issues.

To the extent possible, we verified facility responses by comparing them with documents mailed to us with the questionnaires. The documents included marketing brochures describing fees charged and services offered, sources and uses of funds, and bond offering statements. Additionally, we called several respondents to obtain more information and to clarify responses.

[2]Sixty-eight of the 86 were facilities sponsored by one 501(c)(3) organization.

Nonetheless, our survey might not have identified all 501(c)(3) organizations that provided housing for the elderly and used tax-exempt bond financing. The IRS Exempt Organization Master File may not have included all organizations providing this housing. Some organizations, such as churches, are not required to file for tax-exempt status. In addition, 669 organizations did not respond to the first questionnaire and 143 organizations did not respond to the second questionnaire. Further, we did not attempt to determine if facilities complied with IRS requirements for tax-exempt status.

To determine why organizations default on their tax-exempt bonds, we first discussed the general nature of the retirement housing industry with industry officials. For example, we talked to underwriters and officials from bond rating agencies such as Standard and Poor's to obtain their views on the use of tax-exempt bond financing for retirement centers and the inherent risks involved in developing such facilities. We also reviewed and developed case studies on the operations and financing of seven facilities that had defaulted on their debt service payments between 1983 and 1989. We selected our case studies from data we obtained from Bond Investors Association, a firm that collects information on corporate and municipal bonds in default. According to industry officials, Bond Investors Association has more bond-default data than any other source. Officials from the firm told us they believe their data contain approximately 90 percent of all bonds in default.

Using Bond Investors Association data, we identified 68 tax-exempt bond issues for retirement centers that defaulted from 1980 through 1989.[3] The defaults included bonds issued on behalf of nonprofit and for-profit organizations to finance retirement centers. We selected our seven case studies—about 10 percent of the 68 defaults—on the basis of a combination of the dollar value of default, status of default, and geographic location. Since the default data base included defaults in only 18 states (the majority of which were in the Southeast), we selected cases to give us the broadest geographical dispersion the data could provide. The facilities were in Florida, Georgia, Indiana, Kentucky, Oklahoma, Tennessee, and Texas. Five of the facilities were nonprofit and two were for-profit facilities. The dollar value of the bonds ranged from $7 million to $53 million.

[3]The 68 issues were in default for failure to pay principal and interest. They were not considered technical defaults such as cases where the facility did not maintain required reserves.

In each case, we reviewed relevant documents such as bond offering statements and bondholder correspondence to obtain information on the bond issue and facility operations. We interviewed officials who were familiar with why the facility defaulted, including the bond trustee, administrator, and the issuing government authority. We also visited six of the facilities that defaulted to view the property and obtain information on the facility operations. We did not visit one facility because it was not occupied prior to default and the facility is now operated as a residential facility not limited to the elderly. We did not do a financial analysis of each case. (See app. II for summaries of the case studies.)

To contrast reasons for default, we selected three successful nonprofit facilities in Florida and Tennessee to obtain reasons for success. Successful facilities were identified by industry officials from underwriting and consulting firms and AAHA. We visited these facilities and interviewed officials, who gave us their opinions on reasons for their success.

To place the number of defaults in perspective, we used bond data from Bond Investors Association and Securities Data Company, Inc., to calculate a default rate for tax-exempt bonds used for retirement centers. The Securities Data Company, Inc., collects information on various securities, including tax-exempt bonds. The company's data base includes information on issues sold on behalf of nonprofit and for-profit organizations for retirement centers. We calculated an overall default rate by dividing the total number of retirement center bond defaults for bonds issued from 1980 through 1989 (using Bond Investors Association data) by the total number of bonds issued for retirement centers for the same period (using Securities Data Company, Inc., data). We also calculated an overall default rate by dividing the dollar value of retirement center bonds in default for bonds issued from 1980 through 1989 by the dollar value of retirement center bonds issued for the same period. In both calculations, we excluded all defaults that occurred for bonds that were not issued during this period.

Our calculated default rate reflects an estimate of the default rate of tax-exempt bonds used to finance housing for the elderly. Bond Investors Association data and Securities Data Company, Inc., data may not have included all defaults and all issues for retirement centers, respectively. However, these were the only available data bases that enabled us to estimate this rate. We could not calculate the default rate using data collected in our questionnaire and the data obtained from Bond

Investors Association because the questionnaire data included only non-profit organizations, whereas the default data included nonprofit and for-profit organizations.

Since bonds for housing the elderly are one type of revenue bond, for the purpose of comparison we also estimated the overall default rate of selected types of revenue bonds. Included in the selection are bonds used for industrial development projects, nursing homes, retirement centers, and other special uses. We obtained the number of defaults of these bonds issued between 1980 and August 1990 from Bond Investors Association. The total number of selected revenue bonds issued between these dates was obtained from the Public Securities Association. According to the Public Securities Association, the total number of issues may be underestimated due to lack of information for issues before 1985. In addition, Bond Investors Association may not have data on all defaults. As a result, the estimate reflects a rate based on the best available data.

We did our review from July 1989 through July 1990 in accordance with generally accepted government auditing standards. We obtained informal comments from AAHA and the Public Securities Association. Their comments have been incorporated in this report where appropriate.

Despite Tax-Exempt Bonds, Housing Is Costly and Serves Primarily Moderate- and Higher-Income Elderly

The role of tax-exempt bonds in providing housing for the elderly has increased greatly since 1980. Housing facilities that provide various specialized services for the elderly tend to be risky ventures. The tax-exempt bonds used to finance these projects reflect this risk. The fees residents pay must be structured to cover the financing costs and the specialized services. Our survey showed that tax-exempt, bond-financed facilities for the elderly varied by living accommodations, health care services provided, and amenities offered. Fees varied greatly depending upon the facilities' living accommodations, health care services, and amenities. On the whole, facilities financed by tax-exempt bonds tended to serve primarily the moderate-income and high-income elderly. Further subsidies would be required if the housing were to be made more affordable to the lower-income elderly.

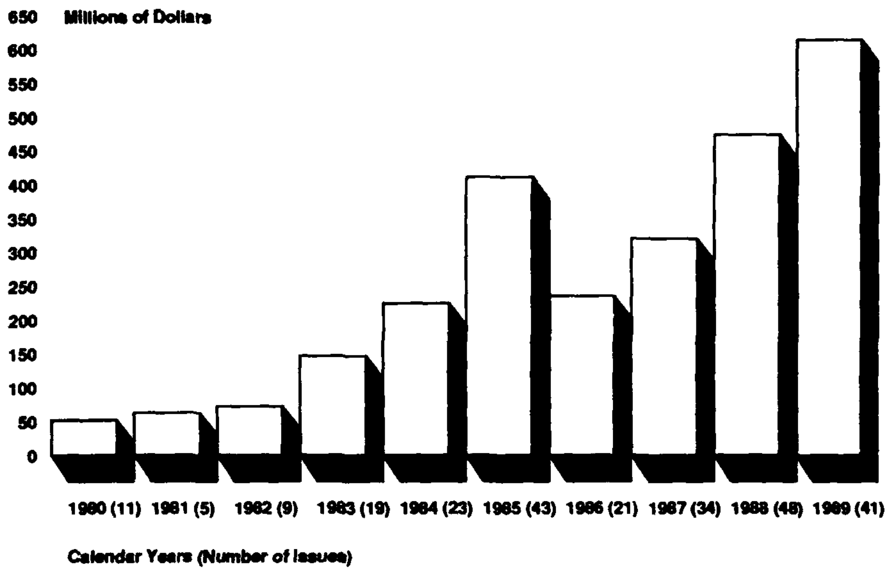
Trends in the Use of Tax-Exempt Bonds to Finance Housing for the Elderly

The number of issues and the dollar value of tax-exempt bonds used to finance housing for the elderly has increased since 1980. The 221 non-profit organizations in our survey identified 271 bonds of which 193 (or 71 percent) were the organizations' most recent issue. In 95 of the most recent issues (about 50 percent), the bond proceeds provided 90 percent or more of the total funds used to finance the facilities, making these projects highly debt-financed. In these 193 most recent bond issues, 63 percent of the total funding was used for construction, furniture, fixtures and equipment, and expansion.

Tax-Exempt Bond Usage Has Increased

Through July 1990, our survey identified 271 tax-exempt bonds valued at about $2.8 billion that were issued since 1980 to house and care for the elderly. The face value of the 193 most recent bonds ranged from $225,000 to $63 million, averaging about $11 million. As shown in figure 2.1, there was a large increase in bonds issued in 1985. This may have been due in part to organizations rushing to market in anticipation of the Tax Reform Act of 1986, which placed a number of new restrictions on the use of tax-exempt bonds.

Figure 2.1: Trend in Tax-Exempt Bonds Issued to Finance Housing for the Elderly



Note: Eleven bonds valued at $162 million have been issued through July 1990. Six additional bonds were issued during the period; however, the specific date of issuance was not identified. This brings the total to issues valued at about $2.8 billion.

There were also regional variations in the use of tax-exempt bonds for housing the elderly. For the 221 facilities included in our survey, the Midwest had 42 percent of the bonds issued since 1980. These issues represented 27 percent of the total face amount of bonds issued. Conversely, the South had fewer issues (32 percent), but the issues represented 45 percent of the total face amount of bond issues. Table 2.1 shows by Census geographic regions differences in the face amount and total number of tax-exempt bonds issued for elderly housing.

Table 2.1: Total Number and Face Value of Bonds by Census Region

Region	Issues	Percent of total issues	Face value in millions of dollars	Percent of total face value
Midwest	115	42	$757	27
South	86	32	1,240	45
Northeast	47	17	558	20
West	23	9	227	8
Total	**271**	**100**	**2,782**	**100**

Most Tax-Exempt Bonds Are Unrated and Projects Are Highly Debt-Financed

Sixty percent of the bonds that 501(c)(3) organizations in our survey identified as the last or most recent issues were not rated. Generally, an organization may choose to have a bond rated by a rating agency such as Fitch Investors Service, Inc. For a fee, the rating agency does a comprehensive review including financial and management evaluations to determine the organization's ability to pay its debt. The greater the ability to pay the debt, the higher the rating and the lower the estimated risk. The lower the risk, the lower the interest rate.

Fitch Investors Service will rate tax-exempt bonds used to finance housing for the elderly. However, Fitch officials stated that a rating categorized as an investment grade rating will not be given to new start-up continuing care facilities, which generally offer their residents a lifetime continuum of health care. Moody's Investors Service officials view the retirement industry as speculative. They stated, however, that if asked, Moody's would rate bonds used to finance housing for the elderly. Standard and Poor's has a policy not to rate bonds used to finance specialized housing for the elderly because, among other reasons, of the difficulties in assessing future health care liability.

There are several risk factors to be considered in developing a bond rating. According to Standard and Poor's, facilities for the elderly have a number of speculative elements. These include estimating the demand for housing, estimating the cost of future health care needs, and structuring the entrance and monthly fees to cover projected expenses. Given these factors, an organization's ability to pay its debt cannot always be predicted accurately. However, some bonds can receive higher ratings if the organization obtains some form of credit enhancement, such as a letter of credit. The letter of credit would be provided by another institution, such as a bank, which would be obliged to pay all or a portion of the debt should the 501(c)(3) organization default. Before providing the letter of credit, the institution would scrutinize the ability of the 501(c)(3) organization to meet its debt obligation. About 70 percent of the most recent bonds in our survey that were rated were based on credit enhancements.

Tax-exempt bond financing was a significant source of funds for nonprofit organizations in our survey to use in providing housing for the elderly. If a high percentage of the cost of developing and constructing housing facilities for the elderly is financed from debt, the debt payments will be a large part of the overall financing costs. Since debt payments tend to be inflexible, to remain solvent the organization must have a predictable cash flow to make timely payments. Of the bonds that facilities said were their most recent issues, 16 percent had face amounts that were 100 percent of the total funds used. For about half of the bonds issued, their face amount represented 90 percent or more of the total funds used. Other sources of funds can include conventional bank loans, endowments, and taxable bonds, or other federal assistance.[1]

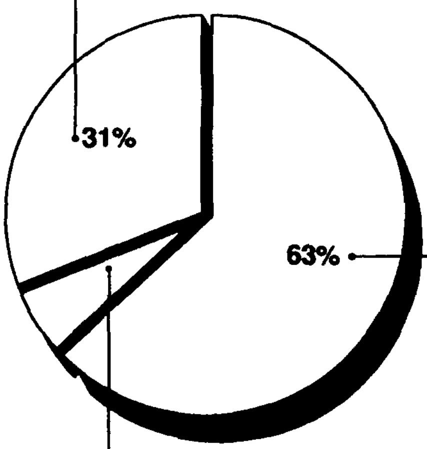
High debt-financing is not necessarily a problem if there is a high degree of certainty that incoming revenues will cover the debt payment or if, at completion, entrance fees are used to retire a large portion of the debt. However, the combination of high debt-financing with uncertain demand for housing and resulting unpredictable revenues would reduce the likelihood of the project's success.

Tax-Exempt Bonds Were Used Primarily to Finance Construction

Nonprofit organizations used tax-exempt bond financing for various purposes. Figure 2.2 shows that for the 193 most recent tax-exempt bond issues in our survey, 63 percent of the bond proceeds and other related funds were used to finance construction. We included expansion and items such as furniture, fixtures, and equipment in construction costs. About 31 percent of the total funds were used to refinance prior debt associated with the same facility. The remaining 6 percent of the total funds were used for renovation and acquisition of existing facilities and other purposes.

[1] Of the 221 facilities responding to our survey, 22 percent have used conventional financing, 7 percent have used endowments, and 5 percent have used taxable bonds. Ten percent have used other federal assistance such as Federal Housing Administration mortgage financing.

Figure 2.2: Uses for the Most Recent Bonds Issued—Percent of Total Dollars



Note: Construction includes new construction, furniture, fixtures, equipment, and expansion.

Multi-Service Facilities Are Costly and Geared Toward Moderate- and Higher-Income Elderly

Housing facilities for the elderly financed by tax-exempt bonds offered a variety of living arrangements, health care services, and amenities. Entrance and monthly fees varied depending upon the housing and services offered and financing costs. Providing this housing can be expensive even with tax-exempt bond financing. Because of the expense of these specialized facilities, the facilities are geared toward the moderate- and higher-income elderly.[2] Our survey showed that 75 percent of the facilities housed residents with estimated average annual incomes greater than $15,000. According to Bureau of Census data, most elderly have annual income under this amount. Making this housing more available to the lower-income elderly would require additional subsidies from the facility, a parent organization, or from the government.

[2]There is no generally accepted definition of moderate-income elderly. According to Bureau of Census data, the median income for elderly persons (65 years and older) was $9,087 in 1988. For purposes of this report, we refer to elderly persons with income greater than $15,000 as moderate- and higher-income elderly.

Facilities Offered a Range of Housing, Health Care, and Amenities

Housing for the elderly is diverse. Facilities offered a range of living accommodations depending on the individual's need for health care or other services. Living arrangements for facilities in our survey were classified as either independent living, assisted living, or personal care.

Residents entering independent living units are self-sufficient and require basically no assistance in daily activities. As the resident ages, the facility may offer assisted living or personal care units, where increasing levels of care are provided.[3] These units are generally for residents who require some assistance, such as with meals and housekeeping.

Of the 221 facilities in our survey, 193 (87 percent) offered independent living units. The number of independent living units varied by facility from under 12 to over 400, averaging 168. As shown in table 2.2, 36 percent of the facilities offered assisted living units, and 20 percent offered personal care units.

Table 2.2: Type and Average Number of Living Arrangements Offered

Type of living arrangement	Number of facilities	Percent of facilities	Average number of units offered
Independent living	193	87	168
Assisted living	79	36	46
Personal care	45	20	50

Note: Number of facilities does not equal 221 and percent of facilities does not equal 100 because facilities offer more than one type of living arrangement. Of the 221 facilities, 94 (43 percent) offered two or more types of living arrangements.

In addition to a variety of living arrangements, most facilities in our survey offered different levels of health care services. For example, intermediate nursing care provides residents with some nursing assistance, but 24-hour skilled nursing care is not provided. Skilled nursing care provides residents with intensive full-time care. In our survey, 159 facilities, or 72 percent, provided nursing care. For facilities providing nursing care, the average number of beds was 67 for skilled nursing care and 74 for intermediate nursing care. For the 159 facilities, table 2.3 shows the number of facilities by type of nursing care offered.

[3] We distinguished between assisted living and personal care units in our survey because industry officials told us that facilities may use either term to describe the same higher level of care.

Table 2.3: Type of Nursing Care Offered

Type	Number of facilities	Percent of facilities
Skilled care	65	41
Intermediate care	28	18
Both skilled and intermediate care	44	28
Other specialized care[a]	22	14
Total	**159**	**100**

Note: Percent of facilities does not add to 100 due to rounding.

[a]Includes specialized care such as an Alzheimer's clinic.

Finally, the facilities also may offer other services and amenities. Most of the facilities offered a beauty salon, crafts room and craft programs, cable television, transportation to shopping, a library, and religious/vesper services. Fourteen of the facilities offered golf courses and/or tennis courts. Appendix I contains a summary of amenities offered at the facilities.

Entrance and Monthly Fees Varied Depending on the Type of Housing and Services Offered

The type of housing, services, and the degree of health care available determine residents' fees. Fees at a retirement facility may include an entrance fee, a monthly fee, or both. For example, a facility offering housing and health care services may require an entrance fee and a monthly fee. The entrance fees can be refundable. In our survey 84 percent of the facilities that charged an entrance fee offered refund plans.

The entrance fee can be used for capital financing, to offset operational costs, and to fund current and future health care. For example, a Tennessee facility used the entrance fee to subsidize nursing care fees so that when a resident requires this care, the resident's monthly fee does not increase. Others may use the entrance fee to provide a number of free nursing care days. In some cases residents may pay a fee to purchase a unit such as a condominium. At facilities charging only monthly fees, the fee will include rent and the costs of any additional services provided.

Of the 221 facilities that responded to our survey, 144 facilities (about 65 percent) charged an entrance fee, and virtually all facilities charged a monthly fee. Facilities based entrance fees upon a variety of factors, including unit size. For example, the facilities' average entrance fees for a studio/efficiency ranged from $30,416 to $37,080, whereas for a unit larger than a two-bedroom apartment the average entrance fees ranged from $122,913 to $146,319. The average low and high monthly fees for all facilities ranged from $884 to $1,493. Table 2.4 shows the average low and high entrance and monthly fees charged by type of unit.

Table 2.4: Range of Average Entrance Fees and Monthly Fees by Type of Unit

	Entrance fee		Monthly fee	
Type of unit	Low	High	Low	High
Studio/efficiency	$30,416	$37,080	$884	$1,007
One-bedroom	47,825	61,643	891	1,056
Two-bedroom	70,020	102,140	1,028	1,230
Larger than two-bedroom	122,913	146,319	1,354	1,493

Note: The entrance and monthly fees shown above are for all facilities in our survey regardless of the length of time housing has been provided. Typically, older facilities have lower entrance and monthly fees. Entrance and monthly fees are for one person in a unit regardless of whether independent living, assisted living, or personal care is offered. Monthly rates may be higher for more than one person in a unit.

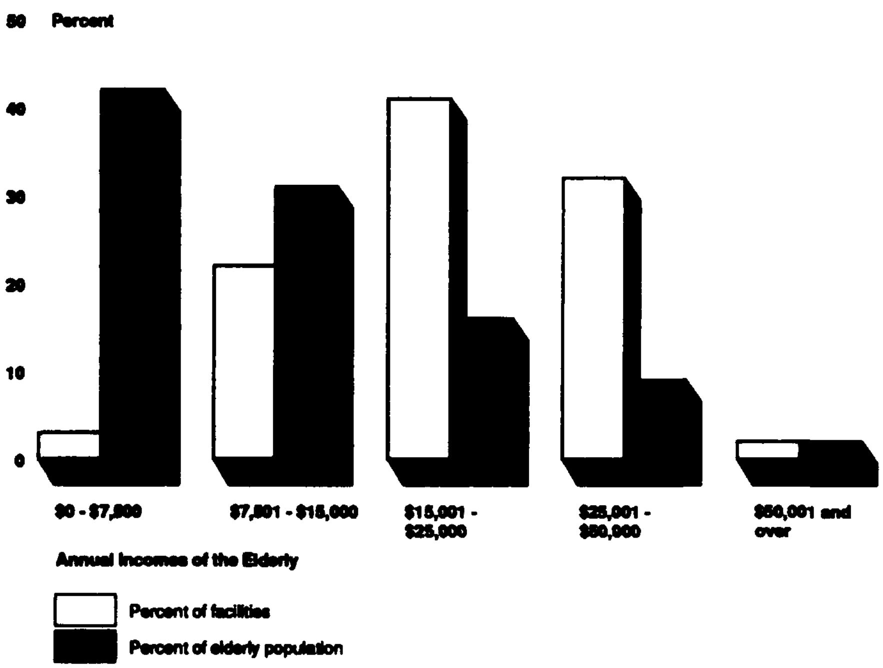
Typically, monthly fees vary with the size of the unit and services offered, such as housekeeping, meals, and the level of care provided. For example, a Texas facility offered a studio/efficiency independent living unit with a monthly fee of $935 to $985 a month. The monthly fee for a two-bedroom independent living unit at the same facility was $1,645. The monthly fees are typically higher when residents require more personalized services such as assisted living. For example, the monthly fee for a studio/efficiency, assisted living apartment at this facility ranged between $1,500 and $1,749 a month, and a two-bedroom assisted living unit was $2,321 a month.

The entrance fees and monthly fees identified in our survey appeared to be similar to fees charged by other housing facilities for the elderly. However, we could not determine if these other facilities offered similar levels of services and living arrangements to those in our survey. In a 1989 survey of 215 for-profit and nonprofit facilities done by a retirement center consulting firm, the median entrance fee for a studio apartment was $35,650. In our survey, the median entrance fee for a studio apartment was $31,500. For a one-bedroom apartment, the 1989 survey found a median entrance fee of $52,000. Our survey found a median entrance fee of $51,250 for a one-bedroom apartment. For entrance fee facilities, the report listed a median monthly fee of $736 for a studio apartment. For rental facilities, the report listed a median of $778 for a studio apartment. Our survey showed a median monthly fee of $822 for all studio apartments.

Most Facilities House Residents With Average Incomes Greater Than $15,000

Consulting firm officials, underwriters, housing administrators, and others in the retirement housing industry told us that, in general, an elderly person needs an annual income of at least $15,000 to $20,000 to afford the monthly fees required by facilities that provide services or health care. Our survey appears to support their observation, as 75 percent of the facilities housed residents with estimated average annual incomes greater than $15,000. In contrast, 1988 Bureau of Census data show that 27 percent of the elderly population have incomes greater than $15,000. Figure 2.3 shows a comparison by income levels between the 1988 elderly income distribution and the average income of residents of the facilities we surveyed.

Figure 2.3: Comparison of 1988 Income Distribution of the Elderly Age 65 Years and Older and Percent of Facilities Housing Residents of Similar Incomes



Source: Percent of facilities from GAO survey of 221 501(c)(3) organizations whose residents' average income falls within each income category. Percent of elderly population from 1988 Census, Money Income publication.

In addition to income required to support monthly fees, residents often require accumulated wealth to cover up-front entrance fees. Although entrance fees may be seen as a barrier to specialized housing for some elderly, the amounts can be within the reach of elderly who have other assets. Residents typically use the proceeds from the sale of their homes to pay entrance fees. The U.S. Census Bureau and Department of Housing and Urban Development's (HUD) American Housing Survey for the U.S. in 1987 states that 75 percent of older persons own their homes. The median value was $58,885.

Generally, IRS does not consider an elderly person's income when determining the charitable status of organizations that provide for his or her special needs. However, according to IRS Revenue Ruling 79-18, nonprofit organizations providing housing for the elderly must ensure the facilities maintain fees that are within reach of a significant portion of the community's elderly. Basically, if the fees charged are so high that only a small portion of the community's elderly can afford them, then IRS believes the benefit to the community is not large enough to warrant tax-exempt status. According to IRS officials, this is a condition that IRS is supposed to examine on a case-by-case basis when an organization files for tax-exempt status or during subsequent audits. We did not evaluate IRS enforcement of this ruling.

Our earlier discussion of the relationship of income and fees was based on nationwide figures; in contrast, IRS considers the appropriateness of fees on a local basis. This results in IRS having a broad definition of serving the community's elderly when making this determination. Thus, for example, fees that might exclude most of the nation's elderly may be appropriate for a higher income community. In practice, IRS may use a market test to determine if a facility is reaching the community's elderly. According to IRS officials, if a facility is fully occupied, IRS may view it as serving the community's elderly.

How Can More Low-Income Elderly Afford Specialized Housing?

Our survey results suggest that providing housing, health care, and related services for the elderly is expensive. This is consistent with what others have found. According to AAHA, such housing for the very poor requires subsidies in amounts greater than those provided by tax-exempt financing. As an illustration of the potential benefits of tax-exempt bond financing over conventional financing, assume an organization needs $10 million to construct a facility. If interest rates are 1 to 3 percentage points lower for tax-exempt bond financing, this would amount to a $100,000 to $300,000 annual savings in interest payments over conventional financing such as bank loans. For a 150-unit facility, this savings amounts to about $670 to $2,000 per unit per year or about $56 to $167 per unit per month. AAHA said that it is difficult for facilities or a sponsoring organization to provide further subsidies for low-income residents without access to large endowments or a substantial fund-raising capacity. Raising rents of existing residents to subsidize lower income residents could result in the displacement of some and resentment among other residents.

A June 1990 report by HUD on housing for the elderly supports the AAHA's position. The HUD report stated that

> "Because of the added facilities needed to provide the support services, congregate housing projects are more expensive to develop and operate than a regular rental project exclusively for the elderly. A congregate rental project targeted to the lower- and very low-income elderly would require subsidies for both the housing and services."[4]

The study concluded that even projects serving a range of low-income tenants would require some form of subsidy in addition to tax-exempt financing or low-income housing tax credits.

Currently, neither Medicare nor Medicaid provides benefits for retirement community living. However, there are some benefits for nursing home care. Medicare provides limited benefits for skilled nursing home care, and no benefits for intermediate or custodial care. Medicaid, which provides health benefits to qualified low-income people, covers the cost of skilled nursing home care. States also extend Medicaid coverage to intermediate nursing care.[5] These programs would not cover the costs of residential units and may not fully cover the cost of health care, depending on the intensity of care, the state of residence, and the income level of the individual.

HUD provides subsidies for new construction and rehabilitation of existing housing, as well as housing subsidies to low-income residents under a number of programs. In its June 1990 report, HUD states that these programs, along with public housing programs, provide housing assistance to a number of low-income elderly. The report also states that it appears the relatively more important gap is not in the provision of housing to low-income elderly, but in the provision of support services.

[4]Congregate housing provides a living arrangement that integrates housing and services for those older persons who are frail, chronically ill, or socially isolated but who do not need 24-hour supervision.

[5]In October 1990, the distinction between skilled nursing care facilities and intermediate nursing care facilities was eliminated and all nursing facilities participating in Medicaid now have to meet a single set of quality standards for services, residents' rights, and administration.

Conclusion

Since 1980, charitable organizations have increasingly used tax-exempt bonds to finance housing for the elderly. In our survey of 501(c)(3) organizations, we identified 271 bond issues, totaling about $2.8 billion, that were issued during the last 10 years on behalf of these organizations to finance 221 housing facilities. The bond proceeds were a significant source of funds for these organizations. For the organizations' most recent bond issues, the bond proceeds were used primarily to finance construction, furniture, fixtures, equipment, and expansion.

Housing for the elderly is diverse and costs vary depending on the level of health care provided and amenities offered. Our survey showed a range of living accommodations, health care, and amenities, and a range of entrance fees and monthly fees. Entrance fees ranged from about $30,000 to over $140,000. Monthly fees ranged from an average of about $900 to over $1,400. Given these fees, 75 percent of the facilities housed residents with average incomes greater than $15,000.

IRS classifies activities that provide for the special needs of the elderly as charitable. This classification is generally made without regard to the elderly person's income. However, IRS requires nonprofit organizations that provide housing for the elderly to ensure that the fees are within the reach of a significant portion of the community's elderly. As our results showed, it is not surprising, given the fees charged, that without additional subsidies the majority of the nation's elderly do not have the income to live in a high percentage of specialized retirement facilities financed with tax-exempt bonds. The value of the exemption alone is clearly not sufficient to bring fees for facilities such as those in our survey within reach of most elderly people.

In an attempt to target more of the benefit to lower-income elderly, IRS could narrowly define its revenue ruling definition of serving the needs of the elderly. In all likelihood, though, this alone would not ensure more units for the lower-income group. In fact, a more narrow definition could have an unintended result of curtailing the supply of housing provided by charitable organizations using tax-exempt bonds. Increasing the availability of specialized housing to the majority of the elderly with lower incomes would require additional subsidies above and beyond that provided by tax-exempt bond financing.

Even if a tax-exempt bond subsidy did not reduce costs enough to lower fees so that they were within the reach of most lower-income elderly, it could still serve a public purpose by increasing the supply of specialized housing for the elderly above that provided by the private sector alone.

Our review was not designed to determine whether housing provided by nonprofit organizations would have been supplied through the market. However, it is possible that combining the tax-exempt bond subsidy and the nonprofit organizations' authority to provide housing for the elderly as a charitable activity might increase the supply of specialized housing for the elderly. Due to their charitable mission, tax-exempt organizations may in some cases provide housing for lower-income individuals unable to afford market-based fees. At the very least, if they want to maintain their tax-exempt status, charitable organizations cannot make it a policy to evict residents who can no longer afford the fees because of their changing economic circumstances.

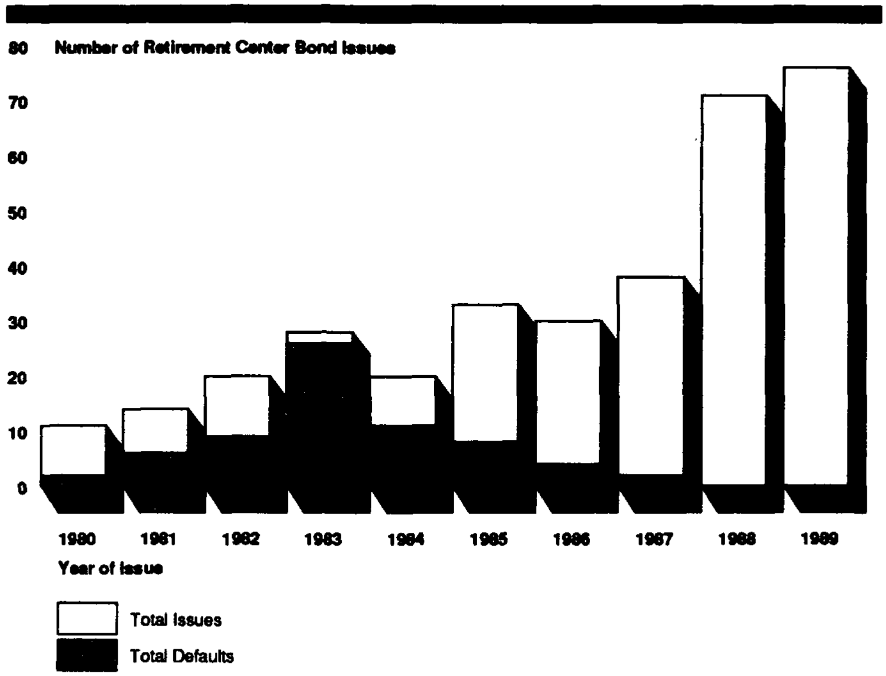
Weak Financial Structure, Inexperienced Developers, and Overestimated Market Projections Increase Risk of Default

As of the end of 1989, nonprofit and for-profit facilities providing housing for the elderly had an estimated default rate of 20 percent for bonds issued from 1980 through 1989. In the seven case studies we reviewed, each facility suffered because the projects were highly debt-financed at interest rates above the market average, exposing them to financial risks. Also, inexperienced developers and overestimated marketing projections made the projects particularly vulnerable to default. On the other hand, officials at three successful projects credited their achievements to having financial backing and experienced management. Various industry officials identified other strategies for avoiding default, such as requiring organizations and individuals to contribute more equity to the development of the facility.

Profile of Defaults

Using Bond Investors Association data, we identified 68 defaults of bonds issued for retirement centers between 1980 and 1989. Of the 68 defaults, 35 were for bonds issued on behalf of nonprofit organizations and 26 for bonds issued for for-profit organizations. We were unable to determine the status for the remaining seven defaults. On an annual basis, the default rate was the highest for bonds issued in 1983. Twenty-six out of 28, or 93 percent, of the bonds issued that year defaulted (see fig. 3.1). We did not identify any bonds issued in 1988 or 1989 that defaulted. However, given that we found the average amount of time from issuance of the bond to default was about 34 months, bonds issued in those years may default later.

Figure 3.1: Retirement Center Bond Default Trends



Source: Total issues were obtained from Securities Data Company. Total defaults were obtained from Bond Investors Association.

We estimate that, as of the end of 1989, the default rate for retirement center bond issues was about 20 percent for bonds issued from 1980 through 1989.[1] To ensure that the rate was not overly influenced by extreme values, we also calculated the default rate by excluding 1983, which had the highest default rate and 1989, which had the lowest number of defaults (as of the end of 1989). Excluding these two years the default rate was about 18 percent. This compares to our estimate of an overall default rate of about 1 percent for selected revenue bonds.[2] Calculating the default rate in terms of dollars versus number of issues, the default rate for retirement center bond issues was about 18 percent.

[1]Our calculation is an estimate based on the best available information. The Bond Investors Association and Securities Data Company, Inc., data may not have included all defaults and all issues for retirement centers, respectively. Public Securities Association officials stated that although most defaults are likely included in our calculation, the number of bonds issued (particularly in the years 1980 through 1984) for retirement centers may be understated.

[2]Included in the selection are bonds used for industrial development projects, nursing homes, hospitals, retirement centers, ports, airports, housing, and other special uses.

Excluding the 1983 and 1989 issues, the default rate was about 15 percent.

Industry officials believe defaults for retirement center issues have declined in part because interest rates, which were high in the early 1980s, reflecting inflation and tight credit, have moderated. Also, AAHA officials attributed the lower default rates to the retirement center industry's increased experience over the last decade. Public Securities Association officials also stated that the retirement center industry has matured. The officials stated that the estimated default rates may not appear to be so high if the rate is compared with the failure rate of new small businesses.

The amount bondholders receive when a facility defaults on its bond issue can vary greatly, depending on the plan worked out after default, according to a Bond Investors Association official. The official estimated that bondholders who invested in retirement centers that defaulted receive on average 60 cents for each dollar invested. This compares to about 75 cents on the dollar that investors receive for defaults of all types of bonds. The official stated that the lower amount for retirement center bonds may be due to the liquidation of facilities. Liquidation represents the lowest payout for bondholders.

Profile of Seven Case Studies

To establish why organizations defaulted, we did case reviews of seven facilities that defaulted.[3] The facilities in our case studies were vulnerable to default because of the facilities' weak financial structure. The facilities were heavily debt-financed and the bonds were issued during a period of high interest rates. Further, much of the bond proceeds were spent on non-income-producing items. In addition to the weak financial structure, inexperienced developers and poor marketing projections were further contributing factors to the facilities' vulnerability to default. Our review of the seven bond offering statements showed that the risks to the investor were disclosed. In none of the cases was the facility closed due to the default.

Weak Financial Structure

Facilities typically combine other funding sources with the bonds to finance a project. For example, a facility can invest the bond proceeds and earn a limited amount of interest, which would contribute to the total funds needed to build the facility. In addition, organizations can

[3] App. II contains a summary of each case study.

apply equity (funds or land) toward financing the project.[4] However, in five of the seven defaults we reviewed, the tax-exempt bonds and the interest earned on the bond proceeds provided 100 percent of financing for the facilities; that figure was 91 percent and 95 percent in the two others. Not only were the facilities heavily debt-financed, their interest rates were higher than average rates charged on revenue bonds issued during the same time period (see table 3.1). This can be expected given that these projects are generally riskier than other types of projects financed with tax-exempt bonds.

Table 3.1: Interest Rates of Defaulted Bonds Compared with the Interest Index at Time of Issue

Interest in percent

Default case number	Date of bond issue	Defaulted bonds interest rate	Interest index[b]
1	Jan. 1987	9	7
2	Oct. 1982	15[a]	10
3	Jun. 1983	13[a]	10
4	Feb. 1983	14	10
5	Dec. 1985	12[a]	9
6	Sep. 1980	13[a]	10
7	Jun. 1983	12	10

[a]The project financing consisted of short-term and long-term revenue bonds. The interest rate shown is for revenue bonds maturing in 30 years.

[b]The interest index is the average interest rate for 25 various revenue bonds that mature in 30 years. This information came from the Bond Buyer Indexes 1980-87, Revenue Bonds. The rates represent the interest rate corresponding to the month, week, and year the case study bonds were issued.

Further, the facilities spent a substantial portion of their funds on "soft costs," which are non-income-producing items, such as development, architecture and engineering, underwriter, and legal fees. In each case, less than 60 percent of the funds were spent on "hard costs"—income-producing items such as construction, furniture, fixtures, equipment, and land.[5] Table 3.2 shows the use of funds for the seven case studies.

[4]In our survey, we found that for 60 percent of the facilities the equity contribution was 11 percent or less.

[5]As a result of our questionnaire, we found that nonprofit organizations spent about 62 percent of the total funds available (not including funds used for refinancing prior debt) on hard costs.

Table 3.2: Use of Total Funds Available by Type of Cost

Cost in percent

Default case number	Hard-cost items	Soft-cost items
1	0	100[a]
2	45	55
3	40	60
4	59	41
5	58	42
6	48	52
7	39	61

[a]All funds were used to refinance a prior bond issue.

Industry officials told us that in general no more than 30 percent of the project funds should be used for soft costs. Spending on soft costs means there are fewer funds available for income-producing items. It is important, however, to review these costs on a case-by-case basis, since not all soft costs are avoidable. Some soft costs such as capitalized interest are justified and should be adequately funded to make the project viable. This funding allows the organization to make payments on the debt during the construction phase when there is no cash flow.

Inexperienced Developers and Marketing Companies

Inexperienced developers and marketing companies contributed to default in all seven cases we studied. According to Retirement Housing: A Step-by-Step Approach,[6] successful developers of retirement housing must be knowledgeable about retirement housing and be well informed about all aspects of development and marketing. The developer may perform the development and marketing tasks or may form or select companies to perform these tasks. AAHA officials generally viewed inexperienced developers and poor feasibility studies as primary reasons for default. This inexperience, when combined with heavy debt and high interest rates, makes the facilities more vulnerable to default.

We found that in all seven case studies, the developer or company selected to develop the facility had no or limited experience in developing retirement centers. In four of the cases, the developers generally had experience in developing commercial property but had never developed retirement centers. In two cases, the developers were bankers with no experience in the retirement industry. In one case, a company was selected that had provided consulting services in developing retirement

[6]James L. Laughlin and S. Kelley Moseley, Retirement Housing: A Step-by-Step Approach (New York: John Wiley & Sons, 1989).

and nursing centers but had limited experience in actually developing a retirement facility.

In all seven cases we found that developers formed or selected companies to market the facilities that had no or limited experience in marketing retirement facilities. In one case, the developer formed a company with no experience in marketing retirement facilities. In three other cases, the developers selected companies without experience in the retirement industry to market the facilities. In three cases, the company selected to market the facility had limited experience.

The formation or selection of companies with little or no experience in marketing retirement centers contributed to the facilities' inability to achieve projected occupancy rates. For example, according to officials involved in two facilities, the company hired to market the facilities used nursing home instead of retirement center techniques to attract prospective residents. Industry officials said that developers who market retirement facilities should approach elderly people as potential residents, not as potential nursing home patients. In another case, a local government issuing authority official said the facility's marketing plan was not set up for the convenience of prospective tenants. Hours for inspecting the facility were limited to weekday working hours; these were not conducive to the elderly, who might want a family member along to help in assessing the facility. As a result, the government official said, the facility did not attract residents and had a high vacancy rate.

Overestimated Market Projections

Market projections are typically based on market feasibility studies. Essentially, the market feasibility study identifies the potential market and projects how many individuals are likely to use the facility. According to industry officials, flaws in market feasibility studies can lead to overestimating occupancy projections.

According to individuals associated with six of the seven facilities, market projections of the number of potential residents were overestimated because the studies used unrealistic market areas. For example, in two studies the primary market area—where 65 to 80 percent of the residents are expected to come from—exceeded the generally accepted 5- to 25-mile radius from the facility. In these cases, the secondary market area included potential residents who lived more than the generally accepted 10- to 50-mile radius from the facility. The studies also used a "target" resident age of 65, while the industry recognizes a target age of 75.[7] This, too, resulted in overestimating the potential market.

As a result of unrealistic market projections, occupancy was overestimated. At five facilities we studied, actual occupancy rates were substantially less than projected. In none of the cases were the facilities forced to close due to the default. Table 3.3 shows the projected and actual occupancy rates.

Table 3.3: Comparison of Projected and Actual Occupancy Rates at the Time of Default

Projected and actual in percent

Default case number	Projected[a]	Actual
1	96	77.0
2	75	.2
3	26	6.0
4	79	19.0
5	50	8.0
6	80	73.0
7	96	29.0

[a]The expected occupancy rates for the year in which the project defaulted.

Five of the seven facilities defaulted on their bond issues in less than 2 1/2 years from the bond issue date. One facility operated for about 6 years after opening but never reached the projected occupancy level. Overall, the time before default ranged from 14 to 78 months after the bonds were issued for the seven default case studies.

Default Prevention Strategies

Successful housing facilities for the elderly seem to have avoided the problems identified in our case studies. The three successful facilities we visited have their own reasons why they have avoided default. Strategies for success also come from others in the retirement housing industry—such as investment bankers and issuing authorities.

Success Stories

According to industry officials, additional sources of funds and experienced management help facilities avoid default. Since it often takes time to get the occupancy rate up and to keep it at a level sufficient to cover costs, it is very helpful if the facility has a financial safety net. Available equity or a sponsoring organization such as a religious or fraternal organization with alternative sources of funds are two ways to provide

[7]Our survey respondents said that 83 percent of their residents were age 75 or older.

that cushion. Experienced management is better able to keep costs under control and also is better able to ensure sooner rather than later that the facility is running smoothly. This helps to reduce turnover and thus keeps occupancy rates up.

At a Tennessee facility, a sponsor provided financial backing and played a key role. The facility had not yet been accepted by the community, and occupancy rates were low. To increase occupancy, management expanded its marketing efforts to other states, in the hope of attracting additional occupants. The administrator said the sponsor was able to cover the debt payments until occupancy rates increased. The facility would have defaulted without the sponsor's backing, according to the official.

The sponsor of a facility in Florida keeps a common reserve fund in case the facility has financial trouble. The facility is also managed by a company with over 20 years' experience in developing and operating retirement centers. The administrator said that experienced management is better able to market a facility and control costs.

Would Greater Restrictions Reduce the Default Rate?

As our earlier calculations showed, defaults for housing projects for the elderly have declined in recent years. Industry officials said that, among other factors, this appears to reflect growing experience and sophistication regarding this type of project on the part of those who put the projects together, as well as those who purchase the bonds. Even so, the default rate for these bonds is still above that of other types of revenue bonds.

There are a number of safeguards that could be used to reduce the likelihood of default. For example, according to AAHA officials, the Continuing Care Accreditation Commission accredits existing retirement centers with an emphasis on examining the financial soundness of facilities. The officials stated that the Commission may pursue an accreditation program for facilities in development, which would provide further safeguards. Industry officials suggested a number of other conditions or restrictions that could also reduce the likelihood of default. However, each of the constraints discussed below also involves costs that may keep certain viable projects from taking place.

One investment banker suggested that facilities be required to provide credit enhancements such as a letter of credit. The organization providing the credit enhancement typically will scrutinize the project prior to development and may keep informed of the facility's operation. However, officials from the Public Securities Association stated that obtaining credit enhancements or insurance raises the cost of issuing the bonds. The organization would have to weigh the benefit of the credit enhancements against the cost of obtaining it. If the cost of the enhancement does not result in a net savings to the organization, then it would add to the overall cost of the project. Other industry officials said that while such enhancements might increase the financial viability of projects receiving them, such a requirement could prevent bonds from being issued for viable small projects because of the added cost.

A related restriction would be to require that bonds used to finance housing facilities for the elderly be rated by an independent agency. Many of the bonds identified in our survey were unrated. We asked industry officials if requiring a rating would help reduce defaults. Generally, to be beneficial, the additional audience that a good rating (assuming it was good) would provide along with the potential for lower interest costs would have to outweigh the additional cost associated with obtaining a rating. Officials told us that retirement center bond issues, if rated, will typically receive low ratings. This reflects the inexperience of the organizations running the facilities and the uncertainty involved in the occupancy and revenue projections underlying the income estimates of the facility. One additional consideration is that the purchasers of these bonds tend to be sophisticated institutions with diversified portfolios. Such investors have the capability to investigate the financial viability of a project without the aid of a rating agency.

An official from a local housing authority for the elderly focused on controlled spending as a safeguard. He said that requiring more of the bond proceeds to be spent on hard costs for income-producing items would increase the likelihood of success.

However, an AAHA official said that there can be legitimate reasons for higher expenditures on soft costs in some cases. For example, an architect's fees would be higher than normal if he had to redesign a building to meet the particular needs of the elderly.

Consulting firm officials stated that requiring more equity might prevent defaults in the retirement home industry. The officials believe that organizations and individuals contributing equity to the development of a facility would be more committed to ensuring that the facility succeeds, since their own funds would be at stake. In addition, equity might provide a financial cushion to get the facility through developmental stages when occupancy is low and rental income is insufficient to cover debt payments. However, the officials said that many organizations do not have enough resources to contribute sufficient equity. In such cases, requiring the contribution of a predetermined amount of equity would prevent such organizations from developing a facility, even though the facility could succeed with a greater proportion of debt financing.

Conclusion

The overall default rate for bonds used to finance retirement centers was about 20 percent for bonds issued between 1980 and 1989. This compares to an overall default rate of 1 percent for selected revenue bonds. The default rate of housing facilities has been declining since it peaked at 93 percent in 1983. Although we did not find any bonds issued in 1988 or 1989 that defaulted, it may be too early to tell whether the bonds will eventually default, since we found the average amount of time from issuance of the bond to default was about 34 months. The defaults of the projects in our seven case studies were partly due to the projects' being heavily debt-financed at high interest rates. Also, inexperienced developers and overestimated market projections made the projects more vulnerable to default.

On the other hand, the successful projects we reviewed showed that having a financial sponsor and experienced developer can help avoid default. Some industry officials suggested other strategies for avoiding default, such as requiring credit enhancements, setting limits on spending for soft-cost items, or requiring a certain level of equity from developers up front. While these ideas might reduce the vulnerabilities to default, other industry officials feel such requirements would reduce the number of financially viable projects undertaken.

Questionnaire Summary Responses

U.S. GENERAL ACCOUNTING OFFICE
Washington, D.C. 20548

SURVEY OF USERS OF TAX-EXEMPT BONDS FOR ELDERLY HOUSING

INTRODUCTION

The U.S. General Accounting Office, an agency of Congress, is studying tax-exempt bonds used to finance housing for the elderly. Specifically, Congress has requested GAO to study the use of these bonds to acquire, construct, or rehabilitate property for housing the elderly by organizations eligible under Section 501(c)(3) of the Internal Revenue Code.

In an initial questionnaire sent to 501(c)(3) organizations, you indicated that your organization provides housing for the elderly and used tax-exempt bonds as a financing method. The purpose of the attached second questionnaire is to obtain basic financial information concerning the bond issue(s) and to obtain more specific information concerning the facility itself.

Your responses should be made only for the facility where housing for the elderly is offered and tax-exempt bonds were used. If you are a sponsoring organization or a management company filling out the questionnaire on behalf of the facility where the housing is offered, please respond to the questions only for the facility where the housing is offered.

Please note that if your facility is currently under construction (new or expansion/rehabilitation), you should answer the questions concerning facility characteristics according to what the facility will offer upon completion.

Please feel free to draw upon the expertise of those individuals in your organization who are familiar with the bond issue(s) as well as those who are familiar with the facility's characteristics.

The questionnaire is numbered only to aid us in our follow-up efforts and should take less than one hour to complete. Your responses will be treated confidentially, combined with those of others, and reported only in summary form. If you have any questions, please call Lorelei Hill at (404) 331-6900.

Please return the completed questionnaire in the enclosed pre-addressed envelope within five days of receipt. Your timely response wil. help reduce future follow-up efforts. In the event the envelope is misplaced, the address is:

U.S. GENERAL ACCOUNTING OFFICE
Atlanta Regional Office
Ms. Lorelei Hill
Suite 2000
101 Marietta Tower
Atlanta, GA 30323

Thank you for your assistance.

Please enter the following information.

Name of person completing questionnaire: ____________________

Title: ____________________

Telephone Number: (______) ____________

PROJECT IDENTIFICATION DATA -- Facility name,address, and Employer Identification Number (EIN):

N = Total number of respondents responding to item.

All responses represent percentages except where noted.

-1-

1. For the facility or Employer Identification Number (EIN) listed on page 1, were tax-exempt bonds used to finance housing for the elderly? (CHECK ONE.)

N = 413

93% Yes → (CONTINUE WITH QUESTION 2.)

7 No → (YOU DO NOT NEED TO COMPLETE ANY OTHER QUESTIONS. PLEASE RETURN THE QUESTIONNAIRE IN THE ENCLOSED ENVELOPE.)

2. Is the residential housing for the elderly offered under this EIN located at the address listed on page 1? (CHECK ONE.)

N = 383

70% Yes, residential housing offered under this EIN is located at the address listed on page

30 No, residential housing is <u>not</u> located at the address on page 1, but is offered under the EIN.

Please provide the name and address of the facility where the residential housing is located.

Name of facility: ____________________

Address: ____________________

____________________ ZIP __________

ANSWER THE FOLLOWING QUESTIONS ONLY FOR THE FACILITY OFFERING HOUSING FOR THE ELDERLY LISTED ON PAGE 1 <u>OR</u> THAT YOU INDICATED DIRECTLY ABOVE.

3. Does this facility offer <u>only</u> nursing home care? (CHECK ONE.)

N = 383

25% Yes --> (YOU DO NOT NEED TO COMPLETE ANY OTHER QUESTIONS. PLEASE RETURN THE QUESTIONNAIRE IN THE ENCLOSED ENVELOPE.)

75 No (CONTINUE WITH QUESTION 4.)

4. Is this facility currently under construction, expansion, or rehabilitation? (CHECK ONE.)

N = 287

23% Yes
77 No

5. Was your most recent bond issued prior to 1980 or in 1980 or later? (CHECK ONE.)

N = 287

23% Prior to 1980 → (YOU DO NOT NEED TO COMPLETE ANY OTHER QUESTIONS. PLEASE RETURN THE QUESTIONNAIRE IN THE ENCLOSED ENVELOPE.)

77 1980 or later → (CONTINUE WITH QUESTION 6.)

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FINANCIAL INFORMATION

6. How has this facility been financed/refinanced since becoming operational or since construction, expansion or rehabilitation began?
(CHECK ALL THAT APPLY, INDICATE THE APPROXIMATE TOTAL DOLLAR AMOUNT OF EACH, AND INCLUDE ANY FINANCING FOR CONSTRUCTION, EXPANSION, OR REHABILITATION.)

		MEAN	MEDIAN	RANGE
N=218	Tax-exempt bonds	$12,172,361	$6,100,000	$150,000 - 81,000,000
N=11	Taxable bonds	4,285,345	1,763,800	350,000 - 20,000,000
N=10	HUD financing .... (Do not include HUD guarantee or insurance programs in this category.)	1,902,438	1,333,500	86,000 - 5,100,000
N=8	FHA mortgage financing	2,947,683	1,916,100	400,000 - 8,672,600
N=2	FmHA financing (Farmers Home Administration)	2,312,500	2,312,500	600,000 - 4,025,000
N=48	Conventional financing (Such as bank loans.)	3,642,955	1,700,000	14,850 - 26,500,000
N=3	Other federal financing ...	238,947	250,000	166,840 - 300,000
N=6	State and/or local government financing	2,634,974	582,310	405,750 - 11,000,000
N=15	Endowments	7,879,424	3,000,000	114,914 - 36,000,000
N=57	Any other form of financing			
	Type I Identified	3,743,911	800,000	8,200 - 38,781,000
	Type II Identified	1,784,432	675,000	10,000 - 8,829,000

7. If in question 6 you indicated that this facility used HUD financing, please indicate the applicable HUD section designation or block grant type and the amount of each.

	HUD SECTION/BLOCK GRANT TYPE	AMOUNT		
		MEAN	MEDIAN	RANGE
N=13	Type Identified	$3,889,262	$971,500	$17,000 - 20,670,000

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8. Does this facility plan to use tax-exempt bonds as a financing method in the future? (CHECK ONE.)

N = 219

7%	Definitely yes
33	Probably yes
48	Would depend on the specific situation
10	Probably no
1	Definitely no

If you answered "Definitely no" please write in the primary reason why.

N = 2

9. Was your most recent tax-exempt bond issued on behalf of your facility only, or did you receive a portion of a bond that was issued on behalf of a sponsoring organization? (CHECK ONE.)

N = 219

87% Issued on behalf of this facility only --> (CONTINUE WITH QUESTION 10a.)

13 Received a portion of a bond issued on behalf of a sponsoring organization -> (Please provide the organization name and person most knowledgeable about how the bond proceeds were distributed between facilities.)

Organization name: ______________________

Knowledgeable person: ______________________

Telephone number: (   ) ______________

(SKIP TO QUESTION 22 ON PAGE 10.)

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10a. In order to obtain a composite nationwide picture of tax-exempt bonds that were used for housing projects for the elderly, we need to obtain some basic financial information concerning the facility's most recent tax-exempt bond issue.

[Examples of sources for this information are the official closing memorandum(s), IRS Form 8038 (Information Return for Tax-Exempt Private Activity Bond Issues), trustee, bond counsel or the Bond Offering Statement. Feel free to draw from the expertise of others knowledgeable about the bond issue.]

Please provide the following information for the most recent bond issue and answer only for the facility where residential housing for the elderly is offered and tax-exempt bonds were used.

If this bond issue has a fixed and a variable interest rate, enter the information for the fixed rate in the first column and the variable rate information in the second column.

MOST RECENT ISSUE	RANGE FIXED RATE BOND	RANGE VARIABLE RATE BOND
Initial Bond Issue Date	1-12/1980-1990 N(Month)=128 N(Year)=129	1-12/1981-1990 N(Month/Year)=75
Final Bond Maturity Date	1-12/1982-2029 N(Month)=127 N(Year)=129	1-12/1985-2021 N(Month)=72 N(Year)=75
Maximum Permissible Term of Bonds	Mean=26 Yrs Median=30 Yrs Range = 2-42 Yrs N=130	Mean=20 Yrs Median=20 Yrs Range = 9-35 Yrs N=74
Yield to Maturity Rate at Time of Issue............	Mean=8.72% Median=8.5% Range=6.25%-14.25% N=101	Mean=6.12% Median=7.5% Range=4.69%-13.13% N=51
Name of Bond Underwriter	______________	______________
Name of Bond Counsel	______________	______________
Name of Issuing Authority	______________	______________

10b. For the bond issue above, what was the issue price? (Initial offering price offered to the public less any accrued interest to the day of delivery.)

Mean = $11,287,471 Median = $6,425,625

Range = $225,000 - $62,950,000 N = 156

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11. Often in the financing or refinancing of a project, other funds are used in conjunction with a tax-exempt bond issue.

Please provide all sources and uses of funds used in conjunction with your most recent tax-exempt bond issue as indicated in question 10a and 10b.

Examples of sources for this information are the official closing memorandum(s), IRS Form 8038 (Information Return for Tax-Exempt Private Activity Bond Issues), trustee, bond counsel, or the Bond Offering Statement. Feel free to draw upon the expertise of others knowledgeable about the sources and uses of funds.

Please indicate the amount of each source and use of funds as listed below. If a source or use of funds indicated was not used, please place a zero in the appropriate space.

NOTE: Total sources of funds on page 6 should equal total uses of funds on page 7.

	SOURCE OF FUNDS*	TOTAL**	MEAN	MEDIAN
		(In millions of dollars)		
N=192	Face value of tax-exempt bond	$2,060.9	$10.7	$6.0
N=9	Face value of taxable bond	37.0	4.1	2.0
N=26	Other loans	65.0	2.5	.6
N=89	Equity	109.9	1.2	.4
N=83	Interest earned on bond proceeds during construction	58.7	.7	.2
N=44	Accrued interest to the day of delivery	3.2	.1	.03
	Other (Please describe.)			
N=71	Other Source - Type I	188.6	2.7	.6
N=19	Other Source - Type II	14.0	.7	.3
N=193	TOTAL - SOURCE OF FUNDS	$2,537.3	$13.1	$7.0

CONTINUED ON NEXT PAGE

* N values, Totals, Mean, and Median values include only those respondents who indicated a dollar value.

** Reflects actual dollars respondents provided. Total source of funds is the sum of the individual sources of total funds as listed above. The total source and total use of funds do not equal because some respondents did not provide values that allowed the totals to match.

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QUESTION 11 (CONTINUED)

	USE OF FUNDS*	TOTAL**	MEAN	MEDIAN
		(In millions of dollars)		
N=172	Tax-exempt bond issuance cost	$92.7	$.5	$.2
N=8	Taxable bond issuance cost	2.4	.3	.2
N=31	Proceeds used to pay for enhancement	11.1	.4	.1
N=120	Debt service reserve fund	131.2	1.1	.6
N=29	Other reserves	44.7	1.5	.3
N=76	Refinancing of existing debt	644.7	8.5	4.8
N=148	Hard construction costs such as building construction, site preparation, construction supervision, etc.	1,040.8	7.0	3.4
N=108	Furniture, fixtures and equipment	77.4	.7	.3
N=64	Land	55.5	.9	.4
N=109	Capitalized or funded interest ...	157.4	1.4	.4
N=33	Working capital	24.5	.7	.4
N=100	Other costs such as developers' fees, architects' fees, contingency fees, etc.	104.6	1.0	.3
	Any other costs (Please describe.)			
N=80	Other Costs - Type I	86.6	1.1	.2
N=32	Other Costs - Type II	45.0	1.4	.3
N=193	TOTAL - USE OF FUNDS	$2,518.6	$13.1	$7.4

NOTE: Total sources of funds on page 6 should equal total uses of funds on page 7.

* N values, Totals, Mean, and Median values include only those respondents who indicated a dollar value.

** Reflects actual dollars respondents provided. Total use of funds is the sum of the individual uses of total funds as listed above. The total source and total use of funds do not equal because some respondents did not provide values that allowed the totals to match.

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12. Was the tax-exempt bond listed in question 10a and 10b rated? (CHECK ONE.)
N = 185

28% Yes, through a credit enhancement feature
12 Yes, but without a credit enhancement feature
60 No

13. For the bond issue listed in question 10a and 10b, have you drawn <u>at any time</u> from the principal amount of the debt service reserve fund? (CHECK ONE.)
N = 188

9% Yes
64 No
27 Not applicable

14. For the bond issue listed in question 10a and 10b, is the debt service reserve fund current according to the indenture terms of agreement? (CHECK ONE.)
N = 187

70% Yes
3 No
27 Not applicable

15. For the bond issue listed in question 10a and 10b, was it a privately placed or a publicly placed issue? (CHECK ONE.)
N = 186

32% Privately placed issue
53 Publicly placed issue
8 Both privately and publicly
7 Unsure

16. Were the tax-exempt bond proceeds used for a particular section or part of your facility such as additional residential units or a skilled nursing section? (CHECK ONE.)
N = 190

43% Yes → Please describe: ______________________

57 No

17. To complete our composite picture, we also need to know the purpose of the tax-exempt bond financing.

Please indicate the approximate percents of the bond issue that were used for each of the categories listed below.
N = 191

Purpose of bond issue:

a. Construction of new building(s) .... 57 Percent

b. Furniture, fixtures, and equipment .... 2 Percent

c. Expansion on existing facility .... 5 Percent

d. Renovation of existing building(s) .... 2 Percent

e. Acquisition of existing building(s) .... 4 Percent

f. Refinancing of a prior tax-exempt bond issue .... 20 Percent

g. Refinancing or repayment of a prior debt .... 11 Percent

h. Other uses (Please specify.)

______________________ ... 0 Percent

______________________ ... 0 Percent

TOTAL 100 PERCENT*

* Percent does not equal 100 due to rounding.

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18. Other than your most recent bond issue, have you previously used tax-exempt bond financing at the facility identified on page 1 or as identified in question 2? (CHECK ONE.)

N = 193

30% Yes (CONTINUE WITH QUESTION 19.)

70 No (SKIP TO QUESTION 21.)

19. Please provide the following information regarding the previous tax-exempt bond issue(s).

	PRIOR TO MOST RECENT ISSUE	NEXT TO PRIOR MOST RECENT ISSUE
Total bond face value at maturity	Sum = $564,358,879 Mean = 10,261,071 Median = 5,500,000 N = 55	Sum = $209,460,000 Mean = 27,675,069 Median = 22,645,000 N = 12
Issue Price .... (Initial offering price offered to the public less any accrued interest to the day of delivery.)	Sum = $406,405,474 Mean = 10,160,137 Median = 5,808,126 N = 42	Sum = $203,559,080 Mean = 18,756,310 Median = 12,895,000 N = 12
Initial Issue Date	Range = 1972-1989 N = 49	Range = 1979-1986 N = 11

20. What was the purpose of the previous tax-exempt bond(s) financing? (Please indicate the percent of bond proceeds that were used for each of the categories listed below.)

	PRIOR TO MOST RECENT ISSUE	NEXT TO PRIOR MOST RECENT ISSUE
	N = 55	N = 14
a. Construction of new buildings	59 Percent	75 Percent
b. Furniture, fixtures, and equipment	2 Percent	3 Percent
c. Expansion of existing facility	3 Percent	0 Percent
d. Renovation of existing building(s)	3 Percent	0 Percent
e. Acquisition of existing building(s) ...	2 Percent	0 Percent
f. Refinancing of a prior tax-exempt bond issue	27 Percent	15 Percent
g. Refinancing or repayment of a prior debt	3 Percent	1 Percent
h. Other uses (Please specify.)		
Other Use I	1 Percent	4 Percent
Other Use II	0 Percent	2 Percent
TOTAL	100 Percent	100 Percent

21. Is this facility currently operating as a 501(c)(3) organization? (CHECK ONE.)

N = 192

100% Yes

0 No ⟶ Please describe the type of organization.

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FACILITY CHARACTERISTICS

22. How long has this facility offered housing for the elderly? (Answer only for the facility identified on page 1 or as identified in question 2 of this questionnaire.) (CHECK ONE.)

N = 220

7%	Facility currently under construction
6	Less than 1 year
30	1 to 5 years
15	6 to 10 years
9	11 to 15 years
5	16 to 20 years
18	21 to 50 years
10	Over 50 years

23. Is the facility listed on page 1 or as identified in question 2 controlled, operated, associated with, or sponsored by a larger organization? (CHECK ONE.)

N = 221

57%	Yes (CONTINUE WITH QUESTION 24.)
43	No (SKIP TO QUESTION 25.)

24. How long has this larger organization indicated in question 23 been in operation? (CHECK ONE.)

N = 126

1%	Less than 1 year
8	1 to 5 years
5	6 to 10 years
17	11 to 15 years
5	16 to 20 years
30	21 to 50 years
35	Over 50 years

25. What types of living arrangements and how many units does the facility listed on page 1 or as identified in question 2 currently offer or will it offer when completed? (CHECK ALL THAT APPLY.)

Independent living units (Please enter number of units. ____)	Mean = 168 Units N = 193
Assisted living units (Please enter number of units where residents currently or will receive this type of care. _____)	Mean = 46 Units N = 79
Personal care units (Please enter number of units where residents currently or will receive this type of care. _____)	Mean = 50 Units N = 45
Other (Please describe and enter the number of units.) ______________________ - # of units _______	Mean = 39 Units N = 9

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26. What type of nursing care does the facility currently offer or plan to offer when completed? (CHECK ALL THAT APPLY.)

Intermediate care (Enter number of beds. _______) Mean = 74 Beds N = 74

Skilled care (Enter the number of beds. _______) Mean = 67 Beds N = 120

Other care (Please describe.)

_________________ - # of beds _______ Mean = 43 Beds N = 20

_________________ - # of beds _______ Mean = 26 Beds N = 3

N = 36 No nursing care currently offered at this facility, but arrangements have been made for receipt of care at a nursing care facility.

N = 25 No nursing care currently offered at this facility, and no arrangements have been made for receipt of care at a nursing care facility.

→ (SKIP TO QUESTION 28.)

27. If you indicated a level of nursing care in question 26, please indicate the average (mean) cost per day for intermediate beds and for skilled beds.

AVERAGE COST PER DAY

Intermediate beds .. $ _______.00 Mean = $68 Median = $67 Range = $26-125 N=78

Skilled beds .... $ _______.00 Mean = $85 Median = $84 Range = $28-170 N=113

28. What types of buildings does this facility currently have, or, if you are currently under construction, what types of buildings are planned? (CHECK ALL THAT APPLY.)

N = 221

N Selecting the category	
57	Duplex(es) or townhouses
89	One- or two-story building with apartments
108	Mid-rise - 3 to 5 floors
47	High-rise - 6 or more floors (Please indicate number of floors. _______)
36	Separate villas or cottages, similar to a single-family house
30	Other (Please describe.) _______________

Mean number of floors for high-rise = 10 floors Range = 6-20 floors N=221

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29. Of the total units in this facility, excluding nursing care beds, what is the range of square footage and, regardless of square footage, how many units are currently occupied and how many are currently vacant? (PLEASE ANSWER, EVEN IF UNDER CONSTRUCTION.)

(VACANCIES INCLUDE ONLY THOSE UNITS THAT ARE CURRENTLY AVAILABLE FOR RESIDENT OCCUPANCY AND/OR UNDER CONTRACT FOR OCCUPANCY. EXCLUDE MODEL UNITS OR OTHER MANAGEMENT UNITS. ENTER THE RANGE OF SQUARE FOOTAGE OF EACH TYPE OF UNIT AND THE QUANTITY OF OCCUPIED AND VACANT UNITS. IF SQUARE FOOTAGE IS A SINGLE AMOUNT, USE THE FIRST COLUMN.)

TYPE OF UNIT	RANGE OF SQUARE FOOTAGE	TOTAL OCCUPIED UNITS	TOTAL VACANT UNITS
	MEAN RANGES	MEAN UNITS	MEAN UNITS
Efficiency	336 - 388 N=71	33 N=63	12 N=43
Studio	397 - 443 N=101	40 N=94	13 N=65
One bedroom	576 - 720 N=188	66 N=177	26 N=124
Two bedroom	858 - 1,053 N=175	54 N=160	16 N=102
Larger than two bedroom	1,293 - 1,462 N=54	13 N=48	8 N=21
Other (Please specify.)			
Other Type I	645 - 768 N=64	48 N=56	15 N=36
Other Type II	605 - 907 N=10	37 N=9	7 N=6
Other Type III	583 - 804 N=3	28 N=3	36 N=3

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30. Did you indicate above any vacant units in this facility? (CHECK ONE.)

N = 221

80% Yes (CONTINUE WITH QUESTION 31.)

20 No (SKIP TO QUESTION 32.)

31. For a variety of reasons, some units may not be occupied. How much of a contributing factor are the following reasons for vacancies in this facility? (ENTER THE NUMBER OF THE RESPONSES IN THE SPACES PROVIDED.)

RESPONSE SCALE

1 = VERY MAJOR REASON FOR VACANCIES
2 = MAJOR REASON FOR VACANCIES
3 = MODERATE REASON FOR VACANCIES
4 = MINOR REASON FOR VACANCIES
5 = VERY MINOR REASON FOR VACANCIES

	Percent Responding 1 or 2 on Scale	(Total N Responding to Item)
a. Location of facility	4	N=114
b. Facility (or parts of facility) still under construction	36	N=103
c. Low demand for certain types of units	32	N=125
d. Competition from other facilities for the elderly	24	N=124
e. Lack of professional marketing efforts	10	N=116
f. Normal turnover in units	53	N=146
g. Lack of services offered	5	N=104
h. Lack of long-term health care services	2	N=93
i. Entrance fees/monthly fees too high	9	N=115
j. Poor original market research	10	N=106
k. Other reason(s) Please specify:		
Other Reason I	N/A	
Other Reason II	N/A	

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32. Please check amenities currently offered, or if under construction, amenities you plan to offer at your facility. (CHECK ALL THAT APPLY.)

N=221

Percent of Facilities Offering Amenities

77	Activities Director - apartment residents	49	Hiking or walking trails
70	Activities Director - health care center	83	Library
14	Alzheimer's or related disease special unit	11	Opthalmologist office/ services on premises
49	Auditorium	22	Pharmacy
36	Bank	34	Physician(s) office on site
75	Barber shop	5	Playground for visiting children
89	Beauty salon	44	Podiatry services on site
86	Cable television	64	Postal service (Stamps, packages, etc.)
56	Carports or garages	74	Private dining room/catering
62	Chapel	81	Religious or vesper services
58	Chaplain	80	Resident association
39	Coffee shop/snack bar	33	Sauna/spa/whirlpool
87	Crafts room and programs	67	Storage (outside of unit)
18	Dentist's office on site	58	Store for gifts, food, or sundries
74	Exercise room and program	26	Swimming pool (indoor or outdoor)
9	Fireplaces in individual units	5	Tennis courts
73	Game room	86	Transportation to shopping, etc.
63	Garden plots	33	Washer/dryer in units
3	Golf course	81	Washer/dryer in each building or each floor
18	Greenhouse	50	Woodworking or metal shop
64	Guest accommodations	19	Other (Specify) ______________

33. Does (will) your facility charge an entrance fee? (CHECK ONE.)

N = 221

65% Yes (CONTINUE WITH QUESTION 34.)

35 No (SKIP TO QUESTION 37.)

34. To what degree is (will) this entrance fee (be) refundable? (CHECK ALL OPTIONS AVAILABLE TO RESIDENTS.)

N = 144

Number of Respondents	
13	Fully refundable, conditional
4	Fully refundable, unconditional
58	Partially refundable
85	Declining refundable to zero
23	Nonrefundable

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35. Please indicate the entrance fee or range of entrance fees for one person for each type of unit and living arrangement listed below. Also, please indicate the minimum income requirement for each type of unit and living arrangement. (ENTER DOLLAR AMOUNTS. IF ENTRANCE FEE IS A SINGLE AMOUNT, USE THE FIRST COLUMN. IF NO MINIMUM INCOME REQUIREMENT, ENTER ZEROS.)

TYPE OF UNIT	RANGE OF ENTRANCE FEES FOR ONE PERSON * MEAN RANGES		MINIMUM RESIDENT INCOME REQUIREMENT MEAN	
a. Studio/Efficiency				
Independent living ...	$34,227 - 41,950	N=91	$21,664	N=45
Assisted living	20,291 - 26,134	N=25/26	32,634	N=7
Personal care	20,563 - 27,169	N=16	16,267	N=3
b. One Bedroom				
Independent living ...	52,115 - 67,754	N=125/126	27,002	N=56
Assisted living	23,080 - 28,867	N=15	41,442	N=6
Personal care	29,478 - 30,716	N=9	103,123	N=3
c. Two Bedroom				
Independent living ...	71,900 - 104,966	N=122	33,236	N=54
Assisted living	13,933 - 24,459	N=4	25,000	N=1
Personal care	65,000 - 68,000	N=1	86,800	N=3
d. Larger than Two Bedroom				
Independent living ...	122,913 - 146,319	N=46/45	37,955	N=19
Assisted living	N/A	N=0	N/A	N=0
Personal care	N/A	N=0	N/A	N=0
e. Other type of unit (if any) Please describe: ________				
Independent living ...	66,619 - 87,881	N=32	31,298	N=14
Assisted living	6,688 - 8,583	N=4/3	2,000	N=1
Personal care	8,112 - 15,975	N=5/4	N/A	N=0

* Where two N values are provided, the first N value represents the number of respondents who provided a value only for the low end of the range, and the second N value represents the number of respondents who provided a value only for the high end of the range.

36. For what reason(s) do you charge entrance fees, and overall, approximately what percent of all entrance fees go toward the following?
(CHECK ALL REASONS THAT APPLY AND ENTER PERCENTS.) N = 129

Capital financing	39 Percent
Life care	19 Percent
To offset monthly fees	8 Percent
To offset operational costs	24 Percent
Other (Specify.) ________	8 Percent
________	.4 Percent
TOTAL	100 PERCENT*

* Computation of percent does not equal 100 because some respondents' totals were less than 100 percent.

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37. Does your facility charge monthly fees? (CHECK ONE.)

N = 221

99% Yes (CONTINUE WITH QUESTION 38.)

1 No (SKIP TO QUESTION 40.)

38. Please provide the monthly fee or range of monthly fees for one person for each type of unit or living arrangement listed below. (ENTER DOLLAR AMOUNT. IF MONTHLY FEE IS A SINGLE AMOUNT, USE THE FIRST COLUMN.)

TYPE OF UNIT	RANGE OF MONTHLY FEES FOR ONE PERSON* MEAN RANGES	
a. Studio/Efficiency		
Independent living ...	$717 - 809	N = 118/119
Assisted living	1,089 - 1,214	N = 49/48
Personal care	1,241 - 1,494	N = 27/28
b. One Bedroom		
Independent living ...	783 - 949	N = 180/179
Assisted living	1,158 - 1,306	N = 35
Personal care	1,368 - 1,525	N = 21/22
c. Two Bedroom		
Independent living ...	971 - 1,182	N = 165/166
Assisted living	1,606 - 1,761	N = 13/12
Personal care	1,406 - 1,539	N = 5
d. Larger than Two Bedroom		
Independent living ...	1,344 - 1,487	N = 52
Assisted living	1,618 - 1,668	N = 2
Personal care	N/A	N = 0
e. Other type of unit (if any) Please describe: ____		
Independent living ...	923 - 1,105	N = 42
Assisted living	903 - 1,030	N = 9
Personal care	1,122 - 1,502	N = 8

* Where two N values are provided, the first N value represents the number of respondents who provided a value only for the low end of the range, and the second N value represents the number of respondents who provided a value only for the high end of the range.

39. Please describe, in general, what services are included in your monthly fees for each category below.

Independent living: N = 177 ____

Assisted living: N = 75 ____

Personal care: N = 47 ____

Other: (Please describe: N = 6 ____) ____

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40. What is your policy on <u>accepting</u> residents who are unable to pay either an entrance fee, a monthly fee, or both?

N = 207

41. What is your policy concerning residents who <u>once admitted</u> become unable to pay a monthly fee?

N = 213

42. How does the facility cover the costs of residents who cannot pay the entrance fee and/or the monthly fee or, after entering, become unable to pay the monthly fee? (CHECK ALL THAT APPLY.)

N = 211

Number of Respondents	
8	HUD certificate/vouchers
76	Medicaid/Medicare
24	Rental assistance payments
92	Annual fund raising
35	Entrance fees
6	Application fees
106	Unrestricted or Restricted Endowments
91	Other (Specify.)

43. During the last 12 months, for approximately what percent of the residents in this facility do you provide assistance in covering health care fees and housing fees? (CHECK ONE UNDER "HEALTH CARE FEES" AND "HOUSING FEES".)

N = 219

PERCENTS

	HEALTH CARE FEES		HOUSING FEES
23	Cannot be determined	23	Cannot be determined
22	0 percent	26	0 percent
22	1 to 10 percent	37	1 to 10 percent
13	11 to 25 percent	9	11 to 25 percent
15	26 to 50 percent	2	26 to 50 percent
5	More than 50 percent	3	More than 50 percent

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RESIDENT DEMOGRAPHICS

44. How many residents are currently living in your facility? (CHECK ONE.)

N = 220

5%	Currently not occupied
13	1 to 50
17	51 to 100
24	101 to 200
16	201 to 300
25	Over 300

45. Does (will) this facility have a minimum age requirement? (CHECK ONE.)

N = 219

11% No

89 Yes → Minimum age = _____ YEARS Mean = 61 Years Median = 62 Years
Range = 50 - 69 Years

Please describe any exceptions to the minimum age requirement, if any.

N = 106

NOTE: IF THIS FACILITY CURRENTLY HAS NO OCCUPANTS, PLEASE CHECK THIS BOX [__]
AND GO TO QUESTION 50 ON PAGE 19. 6 respondents out of 221 checked box

46. What is the estimated average (mean) annual income of your residents? (CHECK ONE.)

N = 176

3%	$0 to $7,500
22	$7,501 to $15,000
41	$15,001 to $25,000
32	$25,001 to $50,000
2	Over $50,000

47. What percent of the residents in this facility fall into the following age categories? (ENTER PERCENTS.)

N = 201

Below 65 years of age	2	Percent
65 to 69 years of age	4	Percent
70 to 74 years of age	12	Percent
75 to 79 years of age	21	Percent
80 to 85 years of age	33	Percent
Over 85 years of age	29	Percent
TOTAL	100	PERCENT*

* Percent does not equal 100 due to rounding.

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48. Of the total residents of this facility, what is the estimated percent of each racial/ethnic group listed below? (ENTER PERCENTS.)

	MEAN	
a. White	95 Percent	N = 199
b. Black	1 Percent	N = 200
c. Asian/Pacific Islander	< 1 Percent	N = 200
d. Native American	< 1 Percent	N = 200
e. Other	< 1 Percent	N = 200

49. Approximately what percentage of the residents of this facility are of Hispanic origin? (ENTER PERCENT.)

Mean = 1 Percent   N = 199

50. Please send the following information, and any other information you feel may be useful, when you return the questionnaire.

1. Marketing brochures
2. Sample contract/lease agreements
3. Photocopy of IRS Form 8038 for each bond issue (Information Return for Tax-Exempt Private Activity Bond Issues)
4. Photocopy of "Sources and Uses of Funds" from your most recent Bond Offering Statement for the bond issue indicated in question 10a and 10b

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51. If you have any comments on any aspect of your use of tax-exempt bonds to provide housing for the elderly, please use the space below. You may attach additional sheets if necessary.

N = 33

THANK YOU FOR YOUR ASSISTANCE.
PLEASE RETURN YOUR QUESTIONNAIRE IN THE PRE-ADDRESSED ENVELOPE.

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Case Study Summaries

Case Study Project Number 1

Case study project number 1 was a nonprofit corporation formed in August 1981, primarily to provide residential units for the elderly. The corporation had tax-exempt bonds issued in January 1987, totalling $14.5 million at a fixed interest rate of 8.75 percent. The purpose of the bond issue was to refinance a prior bond issue at a lower interest rate. Therefore, all funds were considered soft costs. The bond proceeds provided 95 percent of financing for the project. The remaining 5 percent came from the reserve fund for the previous bond issue and cash.

Description of Facility

The corporation built 206 residential units in 4 buildings located on a 5.6-acre site. Collectively, the four buildings had approximately 205,785 square feet of floor space. Included within the facility was a clinic with a four-bed infirmary. The facility did not have any skilled nursing care on site.

Fees Charged

At the time of default, the project offered various entrance fee plans and a rental fee plan. The entrance fee plans varied in terms of refunds. Depending on the refund plan and the size of the unit, entrance fees varied from $38,800 to $113,900. In addition to entrance fees, residents paid a monthly service fee based on the size of the residential unit and number of occupants. The monthly fees varied from $435 to $1,157. Rental fees varied from $800 to $1,900.

Payment of the entrance fee entitled the resident to a lifetime use of the unit and the project's facilities. In addition, the resident received up to 30 days of nursing care annually at an outside nursing facility at the same monthly fee. There was an additional charge for meals.

Payment of the monthly service and the monthly rental fees entitled residents to receive one meal a day, laundry service, housecleaning service, all utilities (except telephone and cable television), 24-hour security, free parking, special diets, transportation, and facility maintenance services. Optional services offered for additional fees included use of the beauty salon, barber shop, sundries store, and additional meals.

Reasons for Default and Resolution

The facility defaulted on its bonds in 1989, 29 months after the bonds were issued, and declared bankruptcy shortly after. The reasons for the default, according to the issuing authority, bond trustee, and other officials associated with the bond issue, were the inability of the facility to compete with other local retirement facilities, overestimated market projections, and a developer that had no prior experience in retirement housing management. The occupancy rate at the time of default was about 77 percent. The default was settled through a reorganization plan that restructured the debt of the facility. The facility is currently operating as a nonprofit facility.

Case Study Project Number 2

Case study project number 2 was a nonprofit organization formed in 1982. The organization planned to provide housing and a continuum of health care for its residents. However, the facility was never completed.

The corporation had unrated tax-exempt bonds issued in October 1982 in the amount of $53,170,000. The issue was composed of short-term and long-term bonds with interest rates ranging from 12.75 percent to 15.25 percent. The bonds and interest earned on the bond proceeds provided 100 percent of financing for the project. Overall, 45 percent of the financing was used for hard-cost items and 55 percent was used for soft-cost items. The financing was used to (1) acquire an existing 460-unit apartment complex, (2) convert the apartment complex to residential units for the elderly, and (3) construct an adjoining two-story community building. However, the corporation converted about 330 of the 460 units.

Description of Facility

The facility was located on approximately 31 acres. The apartment complex and support facilities totalled approximately 525,000 square feet and included parking for approximately 750 vehicles. The facility was also to include a nursing facility offering intermediate and skilled nursing care.

Fees Charged

Residents were to pay an entrance fee that ranged from $42,000 to $97,000, depending on the size of the unit, for the lifetime right to occupy a residential unit as long as they were capable of caring for themselves. When they were no longer capable of caring for themselves, residents were to be entitled to occupy a bed in the nursing care facility. In addition to the entrance fee, residents were to pay a monthly service fee based on the size of the residential unit and the number of occupants. The monthly service fees were to entitle residents to receive one meal each day, laundry service, maid service, all utilities (except electricity, telephone, and cable television), 24-hour security, free parking, scheduled local transportation service, use of the private dining room, and maintenance of the facility. The monthly service fees ranged from

$480 to $1,135 based on the size of the residential unit and the number of occupants. Additional fees were to be charged for services such as the use of the beauty salon, barber shop, sundries store, and additional meals.

Residents were to be entitled to receive personal, skilled, and intermediate care at the nursing care facility on a temporary basis for an additional charge. Residents of the nursing care facility would have been charged separately for additional meals, laundry, medicines and therapy treatments, and the services of a physician or dentist.

Reasons for Default and Resolution

In December 1983 the bond trustee officially declared the facility in default, approximately 14 months after the bonds were issued. The occupancy rate at the time of default was .2 percent.

According to the bond trustee, the facility defaulted on its bond issue because the construction fund was insufficient to pay for remaining work that could have made the facility marketable. Incomplete construction hampered marketing efforts because the residential units could not be marketed as originally planned. The bond trustee also questioned the existence of a market for this type of facility.

In 1985 the community center portion of the project was sold to a local hospital for $1.8 million. The apartment complex was sold for $10.4 million for residential use. Bondholders received about 52 cents of each dollar invested.

Case Study Project Number 3

Case study project number 3 was a nonprofit corporation formed in November 1981 to develop, own, and operate a retirement center. The corporation had unrated tax-exempt bonds issued to finance the project for $18,230,000. The bond issue was composed of short-term and long-term bonds issued in June 1983 with interest rates ranging from 10.5 percent to 13 percent. The bonds and interest earned on the bonds proceeds provided 100 percent of financing for the project. Overall, 40 percent of the funding was used for hard-cost items and 60 percent was used for soft-cost items. The financing was primarily used to acquire, construct, and equip the retirement center. The facility did not offer a nursing facility but did have an assistance-in-living program that offered seven levels of care.

Description of Facility

The retirement facility is on a 16.25-acre site and consists of 175 apartments situated within one three-story building containing approximately 208,320 square feet.

Fees Charged

According to the bond offering statement, residents were to pay an entrance fee from $29,900 to $89,000 for lifetime use of the facilities, depending on the size of the unit and if the unit was sold before or after the bond closing. Residents who selected the assisted living program paid additional fees. Residents also were to pay a monthly service fee that ranged from $653 to $1,388 depending on the size of the unit and the number of occupants. The monthly service included one meal per day, housekeeping, maintenance, utilities, laundry, and other services.

Reasons for Default and Resolution

In July 1985 the facility defaulted on its bonds, about 26 months after the bonds were issued. When the default occurred, its occupancy rate was about 6 percent.

According to the bond trustee, the reason for default was inaccurate feasibility studies. The lack of residential sales created shortfalls in operating funds, and interest payments could not be made. The project's Board of Directors filed for bankruptcy in December 1986. In August 1987 the facility was sold for $6,025,000 to a health care firm experienced in owning and operating retirement centers. Bond holders received about 52 cents on each dollar invested, according to the bond trustee. The facility is currently operating as a nonprofit rental retirement center.

Case Study Project Number 4

Case study project number 4 is a for-profit limited partnership formed to develop a retirement center for the elderly who do not need the type of institutional care provided by a nursing home. The partnership had unrated tax-exempt bonds valued at $7,200,000 issued to finance the construction of the project. The bonds were issued in February 1983 and were composed of term bonds with interest rates ranging from 10.50 percent to 14.25 percent. The bonds and the interest earned on the bond proceeds provided 100 percent of financing for the project. Overall, 59 percent of the funding was used for hard-cost items and 41 percent was used for soft-cost items.

Project Description

The facility is located on approximately 4.95 acres of land and consists of 132 residential care units in a five-story building containing approximately 90,000 square feet. The facility also contains a library, general store, hobby and crafts room, barber and beauty shop, spa, and other amenities. Limited nursing care is offered on-site; however, a nursing facility is adjacent to the facility.

Fees Charged

Each resident is charged an entrance fee that varied from $6,000 to $7,750, based on the unit type. Residents also paid a monthly fee that ranged from $625 to $1,600 depending on whether residents selected meals as an option. The monthly fee covers the cost of meals if selected; housekeeping; maid service; utilities; 24-hour staffing of social workers; and scheduled leisure, social, and recreational programs.

Reasons for Default and Resolution

The project defaulted on its bonds in February 1985, 24 months after the bonds were issued. When the default occurred, its occupancy rate was about 19 percent. According to the bond trustee and an issuing authority official, the reasons the project defaulted on its bonds were (1) the use of a marketing company that had no prior experience in marketing a retirement center, (2) the use of nursing home marketing techniques, (3) high interest rates, and (4) low occupancy rates. As a result, the project lacked sufficient funds to pay its monthly interest payments.

In April 1986 the bond trustee, together with three individual bondholders, filed for bankruptcy, which was settled through debt restructuring. New bonds were issued and bondholders were paid dollar for dollar invested. The bondholders will also receive 6 percent interest plus 10 percent of the project's net income for the life of the project. As of December 1989, the facility was still operating as a for-profit facility.

Case Study Project Number 5

Case study project number 5 was formed as a for-profit corporation in June 1985 to develop and operate a rental retirement center. In December 1985 unrated tax-exempt bonds were issued in the amount of $10,370,000 with interest rates ranging from 8 percent to 12 percent. The bond and interest earned on the bond proceeds provided 91 percent of financing for the project. The remaining 9 percent of the financing was equity. The bonds were used primarily to buy land and construct and equip a new facility. Overall, 58 percent of the funding was used for hard-cost items and 42 percent was for soft-cost items.

Description of Facility

The facility is located on 6 acres of land and consists of a three-story, 132,500 square-foot building containing 133 residential rental units. The facility offered an assistance program which provided health care and support services.

Fees Charged

An entrance fee was not charged, but each resident was charged a monthly fee that varied from $1,160 to $1,795 depending on the size of the unit. The monthly fee was to cover expenses for one meal a day, maid and linen services, utilities (except for telephone service and cable television), a 24-hour emergency call system, maintenance, scheduled transportation to and from shopping areas, and other services.

Reasons for Default and Resolution

In June 1987 the facility defaulted on its bonds, 18 months after the bonds were issued. The occupancy rate at default was about 8 percent.

According to officials associated with the bond issue, the facility defaulted on its bonds because the developer used nursing home marketing techniques rather than retirement center techniques, a depressed regional economy, and construction cost overruns. The developer of the project had no prior experience in constructing or maintaining a retirement center. The marketing company also had no prior experience in marketing a retirement center.

In August 1987 the facility filed for bankruptcy and a court trustee was appointed. As of March 1990, the occupancy rate had increased to about 65 percent and the trustee was trying to sell the facility.

Case Study Project Number 6

Case study project number six was formed as a nonprofit corporation in March 1978 to provide housing and nursing care for the elderly. Unrated tax-exempt term bonds were issued on September 1, 1980, in the amount of $12,245,000 at interest rates ranging from 8.5 percent to 13 percent. Interest rates were a combination of fixed and variable rates. The bonds and the interest earned on bond proceeds provided 100 percent of financing for the project. The bond proceeds were primarily used to acquire, construct, and equip the facility. Overall, 48 percent of the funding was used for hard-cost items and 52 percent was used for soft-cost items.

Description of Facility

The facility is on a 15-acre site and consists of a four-story, 130,000-square-foot building incorporating 160 independent living apartments. Nursing care is offered in a 15,500-square-foot, one-story building containing 39 skilled and intermediate nursing care beds and 20 residential beds.

Fees Charged

Prior to October 1985, residents paid an entrance fee that ranged from $5,750 to $60,060, depending on the size of the unit. The entrance fee covered limited use of the apartments, health care center, community center, and all related properties at the facility. The monthly fee ranged from $860 to $1,645 depending on the size of unit and the number of occupants. The fee covered the cost of food, certain medical services, housekeeping, maintenance, utilities, and other operating costs. According to the facility administrator, in October 1985 the facility was directed by the state to change from an entrance-fee facility to a rental facility as a result of its poor financial performance. According to a state official, this was done primarily to protect prospective entrants to the facility. This action also protected existing residents. The residents became eligible for a state guarantee that would allow them to recover entrance fees if the facility defaulted.

Reasons for Default and Resolution

The facility defaulted on its bonds in March 1987, approximately 79 months after the bonds were issued. According to the facility administrator, the occupancy rate was 73 percent at the time of default.

According to officials associated with the bond issue, the facility defaulted on its bonds because of high interest rates on the bonds, market competition, inadequate cash flow, poor feasibility projections, higher than expected health care costs, and poor planning. In addition, the marketing company had never marketed a retirement center.

In December 1988, a Superior Court ruled in favor of the bond trustee to foreclose on the facility. In October 1989 the facility was sold to a for-profit organization at a public auction for $5.8 million. The bondholders received about 56 cents on each dollar they invested. As of March 1990, the facility was operating as a for-profit retirement center. Its occupancy rate had increased to 81 percent.

Case Study Project Number 7

Case study project number 7 was formed as a nonprofit corporation in April 1982 for the purpose of providing housing and personal care for elderly persons. Unrated tax-exempt bonds were issued in June 1983 in the amount of $20,500,000 at a fixed interest rate of 12 percent. The bonds and interest earned on the bond proceeds provided 100 percent of financing for the project. The bond proceeds were used to acquire and construct the facility. Some of the proceeds were also used to buy United States Treasury bonds in the principal amount of the bonds to secure payment of the principal at maturity. Overall, 39 percent of the funding was used for hard-cost items and 61 percent was used for soft-cost items.

Description of Facility

The retirement center is on approximately 34 acres of land, of which about 11 acres are undeveloped. The retirement center consists of 114 residential units in three-story adjoining buildings. The facility also has 56 courtyard homes in duplex, triplex, and quadraplex design. The facility also has an 86-bed private health care center currently licensed for 78 nursing beds and 8 personal care beds.

Fees Charged

At the time of default, each resident paid an entrance fee and a monthly service fee. The entrance fee ranged from $29,000 to $96,000, depending on the size of the unit. The monthly service fee ranged from $435 to $913 depending on the size of the unit and the number of occupants. The entrance fee covered the resident's lifetime use of a living unit and the facility. The monthly fee included one meal per day, laundry facilities, housekeeping, all utilities (except telephone and cable television), staff on duty at all times, and other related services.

Reasons for Default and Resolution

The project defaulted on its bonds in December 1985, approximately 30 months after the bonds were issued. At the time of the default its occupancy rate was about 28 percent. The reasons for default, according to officials associated with the bond issue, were an inaccurate feasibility study and the use of a marketing company with limited prior experience in marketing a retirement center.

To resolve the default, the 501(c)(3) organization filed a proposed reorganization plan for the project concurrently with filing bankruptcy. The reorganization plan, according to the bond trustee, involved restructuring the debt by issuing new bonds at a total of $14.35 million. The bondholders received an unrated bond valued at $3,500 per each $5,000 in original bonds, non-interest-bearing registered notes, and a cash distribution. The project is currently operating as a nonprofit retirement center, and its occupancy rate is 94 percent.

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