Elderly Housing

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Overview

Purpose

The senior housing industry has grown substantially since the 1990s with an increase in continuing care communities and the growth of new capital sources for all areas of the industry.

The purpose of this article is to provide an introduction to the senior housing industry. This article will review the provisions limiting and regulating organizations that provide housing for senior citizens, outline the Service's positions, and update previously published articles, 1979 ATRI 234 and 1985 CPE 174, by reviewing current trends and discussing the handling of applications and ruling requests from such organizations.

This article will not deal with entities participating in projects that use the low-income housing tax credit provided in section 42 of the Code. These projects are subject to residency and other requirements beyond the scope of this article.

Background: An Aging Population

A study by the U.S. Department of Health and Human Services' Administration of Aging released in 2002 reports that, by the year 2030, the older population, defined as 65 years or older, of the United States will more than double to 70 million. In 2000, the older population represented 12.4% of the population in the United States, about one in every eight Americans. By 2030, about 20% of the population will be 65 years or older.

- This growth is attributable to the aging of the Baby Boomers and to the advances and improvements in medicine and health care resulting in longer life spans.
- These statistics show why there is a boom in the elderly housing industry. Demand in this area provides a critical role for the nonprofit developer.

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Overview, Continued

In This Article

This article contains the following topics:

Basic Rules on Elderly Housing

History

Prior to the 1970s, the Service did not consider the elderly to be a charitable class, nor the relief of their distress to be a charitable activity. Rather it was the Service's position that charitable exemption was linked to the concept that only those elderly persons unable to provide care for themselves without undue financial stress fell under the definition of charitable class.

Revenue Ruling 72-124: Requirements for a Home for the Aged

By the 1970s, there was a growing belief that senior citizens from whatever socio-economic background face many barriers to their basic supportive needs as they age, ranging from inadequate income to declining health and mobility. In support of this concept, the Service issued guidance with respect to homes for the aged. In Rev. Rul. 72-124, 1972-1 C.B. 145, the Service recognized that the relief of the distress of old age as a charitable purpose was not based on financial considerations alone. Instead, the ruling recognizes that the elderly as a class face forms of distress other than financial, such as need for suitable housing, physical and mental health care, civic, cultural, and recreational activities and an overall environment conducive to dignity and independence. The ruling sets forth the requirements that a residence for the aged must meet in order to qualify for exemption under section 501(c)(3) of the Code.

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Background of the Organization in Revenue Ruling 72-124

Rev. Rul. 72-124 held exempt under section 501(c)(3) of the Code an organization formed under the sponsorship of leaders of a church congregation in a particular community for the purpose of establishing and operating a home for the aged. The board of directors was composed of leaders of the congregation, as well as other civic leaders in the community. It provided housing, limited nursing care, and other services and facilities needed to enable its elderly residents to live safe, useful, and independent lives. Admission to the home was generally limited to persons aged 65 and over.

The organization was self-supporting in that its operating funds were derived principally from fees charged for residence in the home. An entrance fee was charged upon admission, with monthly fees charged thereafter for the life of each resident. Fees varied according to the size of the accommodations furnished. Because the necessity of retiring its indebtedness, the organization ordinarily admitted only those able to pay its established rates. However, once persons were admitted, the organization was committed by established policy to maintaining them as residents, even if they subsequently became unable to pay the monthly charges. The organization did this by using reserves to the extent available, seeking support under local and Federal welfare programs, and soliciting the church congregation and the general public. The organization's charges were set at an amount sufficient to amortize indebtedness, maintain reserves adequate to provide for the life care of its residents, and set aside enough for a limited amount of expansion sufficient to meet the community's needs.

The Service's Position: Rev. Rul. 72-124

The Service reasoned that the elderly are likely to experience other forms of distress, even if they are not poor, and that organizations that serve their special needs (housing, health care, and financial security) provide relief to the distressed even if they do not operate substantially below cost.

Housing needs are satisfied if the housing is specifically designed to meet some combination of the physical, emotional, recreational, social, religious, and similar needs of aged persons.

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The Service's Position: Rev. Rul. 72-124 (continued)

Health care needs are satisfied if the organization either directly provides some form of health care or maintains some continuing arrangement with other organizations or health personnel to maintain the physical, and if necessary, mental well-being of the residents.

The need for financial security is satisfied if:

1. The organization is committed to the established policy, whether written or in actual practice, of maintaining in residence any persons who become unable to pay their regular charges through using its own reserves, seeking funds from local and Federal welfare units, or soliciting funds from its sponsoring organization, its members, or the general public. Note that an organization required by the terms of its financing agreements to house aged people of specified low or moderate income levels may satisfy this condition even though it may not be committed to continuing care of individuals who are no longer able to pay the established rates; and

2. The organization operates so as to provide its services to the aged at the lowest feasible cost, taking into consideration such expenses as the payment of indebtedness, maintenance of adequate reserves sufficient to insure the life care of each resident, and reserves for physical expansion commensurate with the needs of the community and the existing resources of the organization.

Facilities Available to Those of Limited Means

If a question arises as to whether the organization is operating at the lowest feasible cost, the fact that an organization makes some part of its facilities available at rates below its customary charges to persons of more limited means than its regular residents will constitute additional evidence that the organization is attempting to satisfy the need for financial security, provided the organization fulfills the first condition regarding the provision of financial security. The amount of any entrance, life care, founder's, or monthly fee charged is not, per se, determinative of whether an organization is operating at the lowest feasible cost, but rather must be considered in relation to all items of expense, including indebtedness and reserves.

Other Significant Rulings

Reinforcing the Principles

Following the holding in Rev. Rul. 72-124, the Service thereafter reinforced these principles with the publication of several revenue rulings that hold that the elderly as a class are proper beneficiaries of charitable activity, regardless of their income or net worth.

Senior Centers

Rev. Rul. 75-198, 1975-1 C.B. 157, holds that senior citizen centers may qualify for exemption under section 501(c)(3) of the Code, where the center offers information, referral, counseling services relating to health, housing, finances, education, and employment, as well as a facility for specialized recreation for a particular community's senior citizens, who need not be members to obtain services or participate in the activities.

Rural Rest Homes

Rev. Rul. 75-385, 1975-2 C.B. 205, holds that an organization that operates a rural rest home to provide, at a nominal charge, two-week vacations for elderly poor people from nearby metropolitan areas qualifies for exemption under section 501(c)(3) of the Code since the vacations are relieving the distress of being poor as well as aged.

Home Delivery of Meals

Rev. Rul. 76-244, 1976-1 C.B. 155, holds that an organization that provides home delivery of meals to elderly and handicapped people by volunteers, for a fee insufficient to cover the cost of operations but approximating the cost of the meals provided, or for a reduced fee or no fee depending on the recipient's ability to pay, is operated for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Transmitting Radio Broadcasts

Rev. Rul. 77-42, 1977-1 C.B. 142, holds that an organization that sets up closed circuit radio transmitting equipment in multiple residence structures such as nursing homes, rest homes, and convalescent homes to provide the elderly residents an opportunity to listen to free, non-commercial and educational broadcasts concerning their special needs such as employment, financial security, health and legal care, as well as cultural and recreational needs. Such service is relieving the burdens of the elderly.

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Other Significant Rulings, Continued

Low Cost Bus Transportation

Rev. Rul. 77-246, 1977-2 C.B. 190, holds that an organization that provides, upon request, low cost bus transportation to senior citizens and handicapped persons in the community where public transportation is unavailable or inadequate qualifies for exemption under section 501(c)(3) of the Code as operated exclusively for charitable purposes.

What Makes an Elderly Housing Project Charitable?

Catering to the Special Needs of Elderly Residents

As our elderly population increases, so does the need for housing that is adequate, low cost, easy to maintain and designed to assist them in avoiding accidents or injuries. Additionally, the housing should allow the senior citizen to continue with an active retirement.

To fall under the criteria of a charitable residence for the elderly, a home, whether it provides health care or simply a residence, must provide services that cater to the special needs of its elderly residents. In 1979, the Service published Rev. Rul. 79-18, 1979-1 C.B. 194 and its counterpart relating to special housing for the physically handicapped, Rev. Rul. 79-19, 1979-1 C.B. 195.

Background of the Organization in Rev. Rul. 79-18

Rev. Rul. 79-18 held exempt under section 501(c)(3) an organization that provided specially designed housing to elderly persons at the lowest feasible cost and maintained in residence those tenants who subsequently became unable to pay its monthly fees. The organization was formed to meet the housing needs of the elderly by building and operating an apartment rental complex designed especially for the elderly. It was formed under the sponsorship of community leaders to meet a community need for such a facility. The board of directors consisted of civic leaders and other individuals with a particular interest in the problems of the elderly.

The complex consisted of apartment units designed, constructed, and equipped to meet the special needs of its elderly residents (e.g. fire-resistant materials, safety features such as grab bars, wide entrance and exit ways, ramps, etc.). The complex employed a person for 24-hour medical emergencies as well as transportation for medical examinations. The resident manager coordinated recreational and social programs for the residents. Admission to the complex was generally limited to persons age 65 or older.

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Background of the Organization in Rev. Rul. 79-18 (continued)

The initial funds for the building and facilities were provided by a grant. Otherwise, the complex was self-supporting, deriving its operating funds principally from the fees charged the residents. Only residents who were able to pay the full rental charges were admitted. However, once persons were admitted to the facility, the organization was committed by established policy to maintain them as residents, to the extent possible, even if the residents subsequently become unable to pay the monthly charges.

The organization used its own reserves as well as soliciting contributions from the public to effectuate this policy. The organization provided services at the lowest feasible cost. Receipts were used in furtherance of the organization's stated purpose, charges were set at an amount sufficient to maintain adequate reserves to pay for the life care of any of its residents and to enable it to set aside earnings for limited amounts of expansion. Net earnings were generally used to improve the facilities.

The Service's Position in Rev. Rul. 79-18

The Service reasoned that the organization relieved forms of distress that the elderly are susceptible to by providing specially designed housing within the financial reach of a significant segment of the local service area, and by committing itself to operating at the lowest feasible cost and maintaining in residence tenants unable to pay monthly fees.

The rulings make clear that an organization can satisfy the relief of distress and community benefit requirements of Rev. Rul. 72-124 by meeting the standards provided in Rev. Rul. 79-18, and as long as the facilities and services are provided at a charge within the financial reach of a significant segment of the community's elderly persons. However, how these standards are defined will determine whether or not a particular housing project is exempt under section 501(c)(3) of the Code. The Service's definition of these standards is discussed in other sections of this article.

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What Makes an Elderly Housing Project Charitable?, Continued

Financial Security of the Resident

An important concept in Rev. Rul. 79-18 is financial security of the residents. More specifically, the community must be committed to an established policy of maintaining in residence any person who becomes unable to pay the regular charges, through the organization's own reserves or funding from private and governmental units or the general public.

While there is a requirement that the policy be established, it may or may not be advertised to the residents or potential residents. Additionally, there is no guidance on how the reserve fund should be established or how it should be funded. Some states do require funded reserves for senior communities. For example, California requires communities to have funded reserves in order to advertise as a "life care" community.

Housing Options for the Elderly

Background

Many people assume that a traditional nursing home is the only option for parents or older persons who can no longer live alone in their own homes. However, there are many housing alternatives available.

Many seniors are choosing the "Aging in Place" option, which generally refers to active seniors, moving down, not in size, but in their home maintenance. As seniors remain in their homes until they are in their late 70's or 80's, when they do relocate, they want to stay close to their home of many years. Long distance moves occur when seniors want to be closer to adult children, siblings, or other close relatives, or go back to where they grew up or once lived. Relocating seniors find satisfaction in their new location if they have common interests with other residents or neighbors and can have friendly, helpful people around them.

Since the 1960s, the trend has been to for seniors to move from cities to rural or suburban settings with warmer climate and recreational opportunities. This has lead to the development of active senior communities, apartments and complexes offering medical care components. Communities such as these offer seniors the opportunities to move to nearby metro or suburban locations, which offer the appropriate lifestyle without sacrificing the proximity to friends or the familiar.

"Seniors Only" Complexes

Apartment complexes, condominiums, cooperatives and other such retirement communities, offer private, separate residences designed for the independent senior. These types of communities do not provide medical services but instead provide seniors with maintenance-free living, recreational facilities as well as ownership or in the case of rental units, the opportunity for seniors to free up equity to supplement income.

Modular Home Communities

Modular Home Communities, also known as mobile home communities, have full-time residents or part-year residents, "snowbirds" who reside in the community during particular times of the year. The lots and the mobile units, which are usually not mobile, are leased to, or owned by, the residents.

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ECHO Housing

Elderly Cottage Housing Opportunity (ECHO), Accessory Units, or Granny Flats are housing where seniors occupy a second family living unit or apartment with a separate entrance, on a single-family lot, with another family.

The homes are usually complete, portable, small homes installed in the back or side yards of single family house lots to provide safe, affordable housing for someone who is largely self-sufficient. Generally they are permitted by the jurisdiction to foster affordable housing, or aid families with elderly parents unable to live completely alone. The owner of the home and lot may be a senior, or the "renting" party may be a senior.

Shared Housing

Organizations may set up shared housing networks where seniors can share their home, or share the home of another. The roommate need not also be a senior. Professional organizations that specialize in these types of arrangements match the two parties based on needs on one side and abilities to provide on the other side. They screen before matching and follow up afterwards to help the match work out.

Assisted Living

Assisted living offers help with non-medical aspects of daily activities in an atmosphere of separate, private living units. It can be likened to congregate living for residents less able to function independently in all aspects of their daily lives. In some states licensing is required.

Continuing Care Retirement Communities

A Continuing Care Retirement Community (CCRC) offers seniors a facility that combines housing, services and health care, allowing seniors to enjoy a private residential lifestyle with the opportunity of independence and the assurances of long-term health care. CCRCs are discussed in detail in a separate section of this article.

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Skilled Nursing Facilities

Skilled nursing facilities (commonly referred to as nursing homes) offer the most intensive level of care on the residential care continuum. Skilled nursing facilities (SNFs) are equipped to handle individuals with 24-hour nursing needs, post-operative recuperation, or complex medical care demands, as well as chronically-ill individuals who can no longer live independently. SNFs must be licensed by the state to meet standards of safety, staffing, and care procedures. Such facilities may be freestanding or part of a senior community. SNFs may specialize in short-term or acute nursing care, intermediate or long-term skilled nursing care.

Alzheimer's Facilities

Early stage Alzheimer's patients may be accommodated in a congregate or independent wing of a multi-level campus. Many assisted living communities will accept and successfully house early stage residents. As the disease progresses, patients develop argumentative behavior, "sundowning" and wandering habits. Generally the communities best equipped to deal effectively with this middle stage patient are Alzheimer's Communities.

Senior Day Care Centers

The types of service will vary from "custodial care" with programs for stimulation and rehabilitation to day care providing medical care and procedures.

Senior Short-Term Vacation Housing

Senior short-term vacation housing offers a "try before you buy" option, which allows one to take advantage of a senior community in a distant location. People too frail for the rigors of hotels and restaurants for multiple days can vacation at a slower pace with needed care available to them.

When Would these Various Types of Housing be Exempt?

The foregoing describes several types of senior housing organizations that might apply for exemption under section 501(c)(3) of the Code pursuant to Rev. Ruls. 72-124 and 79-18. In such cases, the basic criteria discussed below must be satisfied.

However, not all housing applicants will request exemption as elderly housing organizations. Instead, a community that caters to the elderly may apply as a something other than an elderly housing project. For example, a project may apply as low-income housing (Rev. Proc. 96-32, 1996-1 C.B. 717), assisting the physically handicapped (Rev. Rul. 79-19, 1979-1 C.B. 195), or a hospice-type facility (Rev. Rul. 79-17, 1979-1 C.B. 193).

Focusing on the Continuing Care Retirement Community

Introduction

Continuing Care/Life Care Retirement Communities (CCRCs) have a long history. CCRCs' roots were originally in religious and fraternal organizations that provided care in institutional settings, where residents often had to pay over all of their assets in return for lifetime health care, hence the term "life care." Today, CCRCs are reinventing senior living by providing social and cultural opportunities in addition to life care and its related services and amenities.

In recent years, the number of determination applications from CCRCs has increased. Consequently, we will focus on CCRCs as we review key concepts and issues that may arise in any type of elderly housing development. Below is a detailed discussion of the basic structure and operations of a CCRC.

A Life Care Campus

CCRCs are designed to offer active seniors an independent lifestyle and a private home. The community offers varying levels of care in the same building or the same campus. A CCRC may encompass everything from independent living in multiple and single-family residences, to assisted living, to skilled nursing care. Usually designed for persons with substantial financial resources, these communities enable residents to remain as their care needs change over time.

This type of community is sometimes referred to as "life care" because of the opportunity for a continuum of care provided by or within the community. CCRCs may require buy-in, or an up-front annuity purchase followed by monthly payments covering services, amenities and needed medical care. The buy-in may be refundable in part, or not at all. The cost of a continuing care community can be high. The entrance fee can range from $50,000 to $450,000 (which may or may not be refundable), and a monthly fee is required.

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Focusing on the Continuing Care Retirement Community,
Continued

Types of Care Offered

Unlike other types of housing, a CCRC provides a commitment to take care of residents regardless of any changes in their health, for as long as they reside in the community. Within the CCRC, there are three types of care available, providing a phased approach to elderly living accommodations:

1. Independent living, in which the person lives on their own in an apartment or cottage-style housing;
2. Assisted-living offering some level of assistance for residents; and
3. Skilled nursing care, for residents whose health is deteriorating.

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Focusing on the Continuing Care Retirement Community,
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How Does a CCRC Differ From Other Retirement Housing?

A CCRC differs from other retirement housing and healthcare alternatives for the elderly, such as stand-alone assisted living and nursing home facilities, because it offers the full range of housing, healthcare, and support services all in one location. These services are typically guaranteed for a resident's lifetime through a contract signed at the time of move-in. In addition to the amenities mentioned above, CCRCs also provide such services as weekly housekeeping, local transportation, wellness and social programs, and other support services. In return for a one-time "entrance fee" and ongoing monthly fees, the resident is insured that he or she will be taken care of as he or she grows older and more infirm and will not be forced to move again.

- As residents age and need more support, they receive assistance with the activities of daily living and, if required, care in the on-site skilled nursing facility.
- CCRCs not only take the worry out of growing old, but they also offer a great sense of community for those in their retirement years.
- Potential residents are offered a contract stating that the community will offer a private residence, social activities, a list of services and amenities, and access to on-site levels of health care.
- Potential residents are asked to pay a one-time entrance fee ("purchase price" or "annuity") and a monthly service fee for the maintenance and management of the facilities.
- The continuing care contracts provide residents with long-term security and a life long assurance for care.

Next is a discussion of the financial risk arrangements; long-term care services as well as the ownership issues in CCRCs.

These financial considerations are important in assessing not only whether the community caters to the needs of the elderly, but also the feasibility and affordability of the community to those in the population that require the services.

CCRC Risk Arrangements for Long-Term Care Costs

Entrance Fee Contracts

A CCRC assumes different levels of financial risk for the cost of residents' long-term care services (assisted living services and nursing home care). These services are provided in combination with housing, residential services and other related services. A CCRC's financial risk for residents' care is defined in lifetime contracts between the CCRC and the individual residents.

For further information on the types of risk arrangements discussed, please see Scanlon, W. and B.D. Layton (1997) *Report to Congressional Requesters: How Continuing Care Retirement Communities Manage Services for the Elderly*, Washington D.C.: U.S. General Accounting Office.

Full Risk or Type A Contracts

A CCRC may be at full financial risk for the cost of long-term care services. Full Risk or Extensive Agreements provide residents with housing, residential services, amenities and unlimited, specific health-related services without an increase in monthly service due to usage of health-related services.

- This type of agreement typically requires that residents pay an entrance fee and a monthly fee that includes prepayment for long-term care costs, similar to an insurance arrangement.
- The monthly fee may increase based on changes in operating costs and inflation adjustments.
- However, this type of contract means that the CCRC must pay all health costs except those that may be reimbursed by third parties such as Medicare.
- Also known as a life care agreement or an extensive or Type A contract.

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CCRC Risk Arrangements for Long-Term Care Costs, Continued

Partial Risk or Type B

Some CCRCs are at partial financial risk for the costs of long-term care services. Modified Agreements offer the same access to health care as extensive agreements. However, residents pay for care only as it is needed. The CCRC pays some but not all of the costs of long-term care services for residents beyond those reimbursed by third parties such as Medicare.

- Financial risk is limited by a cap on the amount of long-term care services for which the CCRC will pay. For example, for each resident, a CCRC may pay for a maximum of 30 or 60 days of nursing home care per year, whatever limit is specified in the resident's contract.

- Residents pay an entry and monthly fee, which are generally lower than the Type A contract arrangements. The monthly service fee increases as levels of care increase, although residents may receive a discounted rate for the care and a specified number of days of long-term nursing care at no additional cost.

- However, once the resident has reached the contract cap, the resident is at full risk for the cost of additional long-term care services.

- Also known as a modified, limited service or Type B contract.

No Risk or Type C or D

Some CCRCs are not at risk for the cost of long-term care services. They provide a Fee For Service Agreement where residents are responsible for all costs of additional health care if they are needed, without the benefit of resident discounts or any free long-term care days.

- These types of arrangements require residents to pay for services they use through a combination of an entry fee and a monthly fee (Type C) or a monthly fee alone (Type D).

- Monthly fees in either payment arrangement can increase based on operating costs, inflation adjustments, and the use of long-term care services.

- Residents are at risk for all long-term care service costs not reimbursed by third parties such as Medicare.

- Under either Type C or D, residents typically pay a lower fee than those under Type A or B contracts unless long-term care services are needed.

CCRC Equity Ownership and Refunds

Equity Ownership

In some CCRCs, equity or ownership is an option. With this type of payment plan, the purchase process is similar to purchasing a condominium, cooperative or membership.

- However, the sale and resale usually are limited to those who meet the community's entrance eligibility criteria.
- CCRC may share in the financial appreciation of the unit.
- An owner's association usually governs the residential services and health care.

However, not every transaction described as a sale actually offers an equity interest.

Refunds

Depending on the particular CCRC, the entrance fee may be refundable under certain conditions (i.e. resident leaving the community, transferring to assisted living facilities or death). The most common types of refunds are described below.

Declining Scale Refunds

Under this type of refund (also known as amortizing), the agreement specifies a period of time in which the entry fee will be refundable to the resident on a declining basis. For example, an entrance fee under this arrangement declines at the rate of one percent each month. For example, after six months, ninety-four percent of the entrance fee is refundable.

Partially Refundable

Partially refundable entrance fees guarantee a specific percentage of the refund that will be returned within a certain period of time. For example, fifty percent of the entrance fee is refundable, but only within the first twenty-four months of the contract.

Fully Refundable

Full refunds offer just that, a full refund of the entrance fee. A fixed charge may be deducted before the refund is made, and the agreement generally states how long the refund is valid and under what conditions a refund is due. Entrance fees that offer full refunds are typically more expensive than those without refunds or those that are partially refundable or on a declining basis.

Issues in Elderly Housing Applications

Types of Issues Faced by Nonprofit Organizations

Nonprofit organizations that undertake housing development projects face serious issues of accountability, as well as legal and fiscal responsibilities. Consequently, a thorough review of the structure and operation of the CCRC is required. Additionally, the roles of the Board of Directors and the management staff must be delineated, with clear lines of communication and accountability.

The following section discusses various issues and concepts in the context of CCRCs. Note that the issues are not limited to CCRCs but will also include other elderly housing organizations.

Accreditation

It is important to note that CCRCs are highly regulated in some states, but no federal agency oversees retirement communities or their activities. In their applications, organizations providing elderly housing will often state that they are "accredited," "seeking accreditation," or are "guided by the standards of excellence set by" the accreditation commission.

The Continuing Care Accreditation Commission (CCAC) is a private nonprofit organization that accredits elderly housing communities. The CCAC's mission is to offer the public, especially older persons, a means for identifying organizations successful in providing excellence in aging services. CCAC has set standards and provides educational tools for CCRCs.

The CCAC process is voluntary, and it may take up to 15 months for a decision from the accreditation commission. In order to eligible for accreditation, several factors must be present including that the organization must be in operation. A newly developed community must maintain a 90-percent occupancy rate in its independent living units for at least one year or demonstrate stable, non-declining occupancy at all levels of care and generation of sufficient cash flow.

CCAC works with the community, reviewing its finances, governance and administration, resident health and wellness, and resident life.

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Age Requirement

Exempt and non-exempt senior communities may be restricted by age. Generally, these are restricted to people aged 55 or over, or 62 and over. The restrictions are usually established when the community is created and funded. In 55-and-over communities, restrictions require that at least one of the residents be at least 55, while other residents may be younger than the minimum age. In a 62-and-over community, usually all residents must meet the age requirement.

Retirement Communities such as these are generally oriented towards an active lifestyle and may offer golf, tennis, swimming pool and spa, exercise rooms and a variety of clubs and interest groups. However, there is no ruling or regulation that specifically states that tax-exempt elderly housing projects are restricted to only those aged 65 or older or 62 or older, etc.

Rev. Ruls. 72-124, 75-198, and 79-18 directly ruled that the elderly constitute a charitable class with special needs. The organizations in these rulings provided for senior citizens primarily aged 65 and older in a particular community.

The age restrictions in these rulings were based on various public policies, which cite age 60-65 as elderly, see e.g., National Housing Act (12 U.S.C. 1701q(k)(1), 1715z-1(i)(4)), Social Security Act (42 U.S.C. 402(a)(2)), Older Americans Act (42 U.S.C. 3027(a)(11)), Fair Housing Act (42 U.S.C. 3607(b)) and Medicare (42 U.S.C. 426(a)(1)).

For example, the Older Americans Act was passed in response to the growing number of older people and their diverse needs. The targeted assistance is to persons with the "greatest social or economic need."

Applicability to Tax Exemption

It is important to distinguish not only the age restrictions found in the various statutes but also the applicability of those restrictions in tax-exempt housing projects geared towards the elderly.

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Issues in Elderly Housing Applications, Continued

Fair Housing Act

The Fair Housing Act prohibits discrimination in housing because of:

- Race or color
- National origin
- Religion
- Sex
- Familial status
- Handicap

The Act exempts owner-occupied buildings with no more than four units, single-family housing sold or rented without the use of a broker, and housing operated by organizations and private clubs that limit occupancy to members.

Housing for Older Persons Act of 1995 (HOPA)

The Housing for Older Persons Act of 1995 (HOPA) amended the Fair Housing Act by providing an exemption for housing for older persons from the Fair Housing Act's prohibition of discrimination against families with children in two categories:

- 100% of occupants must be 62 years of age or older; or
- 80% of the occupied units must be occupied by at least one person who is 55 years or older.

HOPA requires that a facility or community seeking to claim the 55-and-older exemption show the following two factors: (1) that the housing be intended and operated for persons 55 years of age or older; and (2) the housing facility or community publish and adhere to policies and procedures that demonstrate its intent to qualify for the exemption. The housing facility or community must also comply with rules issued by HUD for the verification of occupancy.

Applicability of Fair Housing and HOPA to Tax Exemption

While it is possible for a facility that satisfies the Fair Housing Act and HOPA to be a tax-exempt elderly housing community, it is important to distinguish that HOPA and the Fair Housing Act deal with discrimination in housing and not whether a charitable class is being served. An organization that only satisfies HOPA and the Fair Housing Act will not necessarily qualify for exemption under section 501(c)(3).

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Issues in Elderly Housing Applications, Continued

National Housing Act

Section 1701q of the National Housing Act discusses supportive housing for the elderly. The purpose of this section is to enable elderly persons to live with dignity and independence by expanding the supply of supportive housing designed to accommodate the special needs of elderly persons and provide a range of services tailored to the needs of elderly persons occupying such housing. Under this section, the Secretary of Housing and Urban Development is authorized to provide assistance to private nonprofit organizations and consumer cooperatives to expand the supply of supportive housing for the elderly.

Subsection (k) of section 1701q defines the term "elderly person" as meaning a household composed of one or more persons at least one of whom is 62 years of age or more at the time of initial occupancy.

Applicability to Tax Exemption

Under the National Housing Act and related legislation, “elderly” is defined as age 62 or older. The term "supportive housing for the elderly" means housing that is designed (A) to meet the special physical needs of elderly persons and (B) to accommodate the provision of supportive services that are expected to be needed, either initially or over the useful life of the housing, by the category or categories of elderly persons that the housing is intended to serve.

Tax Exemption Under Section 501(c)(3)

It is important to understand that the underlying reason for tax exemption for an elderly housing organization is that the “elderly” are a charitable class, requiring that the organization provide tailored accommodations and services to accommodate their special needs.

Consequently, any application from an organization providing benefits to those younger than 62 would have to be developed extensively to insure that the primary beneficiaries are age 62 or older and to satisfy the criteria under section 501(c)(3) for an elderly housing community such as charitable class, specially designed housing, health and financial security.

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Recent Developments

On September 16, 2003, the Ways and Means Committee of the House of Representatives issued its committee report accompanying H.R 7, 108th Cong., 1st Sess. (2003). The bill, known as the Charitable Giving Act of 2003 would amend the Internal Revenue Code of 1986 to provide incentives for charitable contributions by individuals and businesses.

Section 113 of the proposed act provides an exemption for qualified 501(c)(3) bonds for nursing homes from the federal guarantee prohibition. Subsection (d) of this section provides a definition of a “continuing care retirement community.” Under the proposal, a CCRC is defined as “a community that provides, on the same campus, a continuum of residential living options and support services to persons sixty (60) years of age or older under a written agreement. The residential living options shall include independent living units, nursing home beds, and either assisted living units or personal care beds.”

On September 17, 2003, H.R. 7 passed the House and was received in the Senate. A similar bill, the CARE Act of 2003, S. 272, 108th Cong., 1st Sess. (2003), was passed by the Senate. No further movement on either bill has occurred to date. Updates on the status of both bills will be provided at a later date.

Feasibility versus Affordability

Introduction

Another concept linked to the retention policy is feasibility. The housing project must operate to provide its services to the elderly at the lowest feasible cost. Rev. Rul. 79-18 stated that an elderly housing organization must provide housing “that is within the financial reach of a significant segment of the community’s elderly persons.” By operating at the lowest feasible cost, it is expected that residence in such a home will be available to a significant segment of the community’s elderly persons. CCRCs are generally not affordable to the average elderly individual. But how do you judge “lowest feasible cost,” and what does it mean to be “affordable”?

What Does Lowest Feasible Cost Mean?

The "lowest feasible cost" requirement is not one that can be neatly defined. It is a relative condition, which will vary from case to case, as it is based on the location of the housing project. See Rev. Rul. 79-18.

However, this requirement generally means that a housing project must offer its services to the elderly persons of the community for the least possible expense. It is important to note that the analysis of affordability does not encompass the entire nation. Rather, the affordability analysis looks at the local community and the affordability to those in the area.

Often, a “feasibility” study is conducted regarding an elderly housing project. The study provides insight into whether a housing project is affordable to a significant segment of the elderly population of the community to be served by the development.

The Two Sides of Feasibility

“Feasibility” can be viewed as project feasibility and financial feasibility. Project feasibility refers simply to whether a concept or project can reach fruition by looking at the project as a whole. This generally depends on a variety of factors.

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Feasibility versus Affordability, Continued

Project Feasibility

Unfortunately, not all projects are feasible due to excessive cost or other issues. Project feasibility generally depends on the following:

- Extent of rehabilitation needed
- Physical characteristics, including access, utilities, frontage, drainage, soil characteristics, size and shape
- Legal or regulatory constraints, such as zoning and ordinances, title encumbrances, deed restrictions, or encroachments
- Environmental considerations: both protected environmental features and hazardous substances on site
- Social/political factors
- Market conditions
- Financial or cost factors
- Availability and requirements of funding/subsidy dollars

Although project feasibility is one factor in reviewing an exemption application, the Service's focus is on financial feasibility.

Financial Feasibility

Financial feasibility is established through different types of budget projections. An initial budget helps determine the preliminary feasibility of the project. Generally, applications for exempt status will include only initial budgets since projects are usually in the planning stage.

A preliminary budget should generally include estimates for all sources and uses of funds including site costs, and rehabilitation/construction estimates. For example, budgets should list expenses for acquisition, site improvement (e.g. site, abatement, and construction), soft costs (e.g. market study, attorney, architect, permits and fees), construction period costs (e.g. construction loan interest, construction period expenses such as taxes), financing fees, prefunded reserves, development fees, property taxes, and operational budget.

These various factors provide the basis of whether the community operates at the lowest feasible cost and thereby is affordable to the elderly citizens in the community.

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Feasibility versus Affordability, Continued

How Does Feasibility Play Into Affordability?

Housing developments are generally expensive to produce and difficult to finance. The projected or initial budgets are usually amorphous, updated throughout the planning and development stages. But these budgets are critical to establishing not only whether the project is feasible but also whether the housing development will be available to a significant segment of the elderly population the community is to serve.

What Does it Mean to be "Affordable"?

"Affordable" housing is generally defined by housing costs (mortgage, interest, taxes and insurance). An affordability analysis should encompass the service area as a whole rather than select locations within the community or a myriad of other similar facilities in other parts of the country. Additionally, an affordability analysis should include:

- The number of households' aged 62 and above
- Definition of the "community" or "local market"
- The number of owner-occupied housing units
- The percentage of the elderly citizens within the defined community that are to be served by the housing project and can afford the units at the project.

Defining the "Community"

So how does one define the community or local market area? The common dictionary definition is that community means "a social group of any size whose members reside in a specific locality, share government, and have a cultural and historical heritage."

There is no precedential guidance addressing this issue in detail. Each case is resolved on the basis of the facts and circumstances, and on a community-by-community basis.

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Feasibility versus Affordability, Continued

How Important is Affordability?

Consequently, a feasibility or affordability analysis should include an analysis of the persons that can be reasonably expected to occupy the residences. For example, a feasibility study discusses the affordability of the community located in State X. It includes an extensive discussion of affordability for residents of State Y but a limited discussion of the affordability for the residents of State X. The study also shows that only a small percentage of community residents are expected to be from State Y, but the majority will be from State X. The inclusion of areas of the country that residents are not reasonably expected to move from would not be much help in studying the affordability of the community for the potential residents.

However, a study that discusses the local population, the number of elderly, income levels, and elderly residences in relation to the location of the community provides far more information and insight into whether the housing is affordable.

Finally, it is important to understand that availability to moderate or low-income individuals is not a necessary condition in satisfying the “lowest feasible cost” or “affordability” requirements. Rather it is only a factor, which would aid in the determination of feasibility and affordability.

Financing the Property

Introduction

Operating at the lowest feasible cost is also tied heavily with how the housing project is financed. Housing projects utilize several different types of financing to develop their communities. No matter what type of financing is utilized, most loan applications will require a management plan and signed commitments from the various service providers.

In all financing situations, it is important to review the terms of the financing, especially the interest rates charged. Unreasonably high interest rates need to be closely looked at.

Equity Financing

Equity is what an owner contributes, in the form of cash, land or buildings (less any debt on the subject properties). Most lenders require a minimum amount of owner contribution, establishing the loan-to-value (LTV) ratio. The LTV determines how much the lender is willing to risk. Generally, the lender's underwriting criteria will set the loan amount as no more than a certain percentage of the appraised value of the property. The owner is required to contribute the difference.

Acquisition Financing

Acquisition Financing is used to purchase property and may be in the form of a short or long-term loan. Unlike other types of financing, there are no assurances at the time of the loan that development or permanent financing can be obtained.

Construction Financing

Generally, a short-term (12-18 months) loan funds the construction or rehabilitation of a project. Generally used for "hard" construction costs such as materials and labor, construction financing may also be used for the "soft costs" associated with construction, including fees, permits, licenses, and surveys.

Construction financing is typically advanced in phases, based upon achievement of construction goals. The project manager, with approval of the nonprofit, will requisition draws for the funds. Generally, permanent financing is arranged to pay off the construction loan at the completion of construction. In elder housing cases, construction financing may be found where there are pre-sales of units. In such situations, a careful review of the financing is required.

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Financing the Property, Continued

Permanent Financing

Usually there is a long-term loan that pays off the acquisition and/or construction loans. It is repaid with the operating revenue of the community. Repayment is usually over a period of 15-30 years, although longer repayment periods are not uncommon. The property serves as collateral for the loan.

Management – Who Has Ultimate Oversight?

Defining Management

Management of the community, like feasibility, can be broken down into two concepts: asset management and property management.

- Asset management refers to how the organization owns and operates the property as related to its mission and long-term goals, i.e. the big picture.
- In contrast, property management is concerned with the everyday operations of the property, focusing on the annual operating budget.
- It is common for nonprofit organizations to use this type of split management approach, with a nonprofit overseeing asset management and a for-profit overseeing property management.

Management Contracts

Rev. Proc. 97-13, 1997-1 C.B. 632, sets forth conditions under which a management contract does not result in private business use under section 141(b) of the Code. Contracts must provide for reasonable compensation for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the facility. Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation.

Net profits arrangements do not include:

(1) compensation based on a percentage of gross revenue (or adjusted gross revenue) of a facility or a percentage of expenses from a facility, but not both;

(2) a capitation fee; or

(3) a per unit fee.

Permissible arrangements include:

(1) 15-year contract with 95 percent periodic fixed fee;

(2) 10-year contract with 80 percent periodic fixed fee;

(3) 5-year contract with 50 percent periodic fixed fee;

(4) 3-year contract with a per unit fee arrangement; and

(5) 2-year contract with a percentage of revenue or expense fee arrangements.

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Management – Who Has Ultimate Oversight?, Continued

Asset Management

Asset management is concerned with the long-range financial picture of the community, *including* property management. Generally, ownership of the property is compatible with the mission and capacity of the organization and is a large part of the exempt organization's overall financial and strategic planning. How assets fit into the long range plans and help achieve the goals and mission of the organization is an important aspect of whether an organization is exempt.

Property Management

Property management is a complex activity, especially managing subsidized property that has complex compliance, recordkeeping, and reporting requirements. In some cases, it is entirely appropriate that a nonprofit contract for management services rather than fulfill this role on its own.

The division between the two roles allows owners and managers to enforce rules and advocate for changes without a problem. On the other hand, when a nonprofit manages its own properties, it provides for close involvement with the community's residents, allows the organization to directly implement its concept of property management, and management fees may be diverted to support its goals and missions rather than a management team.

Ultimate Oversight by Nonprofit

As discussed above, there are two types of management that will be found when reviewing an organization. Unfortunately, asset management as a concept is generally ignored in favor of property management since property management is a day-to-day oversight. But as property management is a subset of asset management, it is essential that the nonprofit continue to have ultimate oversight.

Community-Based Board of Directors

Ideally, asset management and oversight should lie in the hands of a "disinterested" board of directors, meaning persons who are not financially linked to the exempt organization. Generally, such a board of directors is composed of community and civic leaders or other persons within the community where the housing project is located. This concept plays into private benefit and inurement discussed below.

Related Parties and Private Benefit

Introduction

The relationships between parties can lead to private benefit issues. Prior to construction even beginning, the major players in an elderly housing development will come together to sort out their various roles and duties. As already discussed, it is essential for the nonprofit to have ultimate oversight of the housing project.

Defining the Nonprofit's Role

In many situations, the nonprofit acts as the developer of the project with such responsibilities as:

- Defining the project concept, and finding and securing the community site and may also be involved in the hiring and oversight of other entities involved in the development such as the contractor.
- Obtaining appraisals and market studies as well as all permits.
- Creating development and operating budgets, prepares financing applications, negotiates terms of financing, and manages the budget.
- Oversight of the project and professionals, handling requisitions (periodic construction loan disbursements), managing bookkeeping and development costs, updating the budget, handling change orders, hiring management, and marketing the project.
- Monitoring property management (marketing, tenant selection, occupancy status), finances (operating budget, bookkeeping, operating costs), preparing annual financial statements, and arranging for an audit.

Delegating Responsibility

When a building is ready for occupancy, the nonprofit sometimes delegates property management to the management staff responsible for the day-to-day operations of the facilities, including all compliance, accounting, and reporting requirements. While there is nothing inherently wrong with delegating responsibility such as this to outside parties, oversight must continue to lie with the nonprofit and its board members.

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Related Parties and Private Benefit, Continued

Developer Driven Deals

In some cases, the housing project is driven by a for-profit developer and not a nonprofit. These types of transactions are known as "turnkey."

Simply defined, a turnkey contract is a contract between two or more parties where the contract is awarded to one of the parties to perform all stages from the initial to the final stage, inclusive of consultancy, managerial, technical and other services, until the contractual project is ready for immediate commercial production or final use.

Examples

Below are examples of turnkey contracts that one may encounter during review of an application. The purpose of the examples is to illustrate the different circumstances where a turnkey contract may exist. Whether a turnkey contract will affect a project will depend on the facts and circumstances.

An arrangement that is more along the lines of true turnkey contract would involve for example A, a nonprofit, and B, a for-profit developer. They have a development arrangement whereby B retains ownership and risk of loss throughout the construction phase of the community. This places the financial risk on B. B is required by contract to complete all stages of the construction and other contracted services before A assumes the project.

In contrast, C, a nonprofit, and D have a similar arrangement as A and B, except that D, the developer, is not obligated to complete construction or follow the site plan. As noted from the basic definition of a turnkey, this is not a turnkey arrangement, which requires performance of all stages of the project.

Another example is E, a nonprofit, and F have a similar arrangement to C and D, with the additional fact that E has a lease with an option to purchase the property. In this type of arrangement, the parties do not transfer ownership or financial risk.

Since arrangements can be very complicated, all documents related to the project should be carefully reviewed during the determination process.

Conclusion: So What Have We Learned?

Concluding Thoughts

An organization sponsoring housing facilities for the aged will be deemed "charitable" if it meets the special needs of the elderly such as the need for health care, financial security, and residential facilities designed to meet specific physical, social, and recreational requirements. Obviously, the organization must also meet the other requirements for an exempt organization.

As we have discussed, all of the factors that play into the determination of what is charitable are subjective. An elderly housing project in Beverly Hills, California, cannot be compared using the exact same criteria as an elderly housing project in Knob Noster, Missouri. The criteria, including affordability and feasibility of the project, will vary depending upon location of the community.
