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Comment on Donald L. Redfoot's "Long-Term Care Reform and the Role of Housing Finance"

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At this writing, the Clinton administration's proposal for reforming the nation's health care system has just been released. The proposal includes an optional state-federal program that provides some coverage for long-term care, including home and community-based care for disabled persons. But there is no mention of housing. This iteration in the development of long-term care policy is only the latest in a long history of academic studies of the long-term care system and congressional proposals to reform it. Housing has essentially always been excluded.

One must recognize this history of neglect to fully appreciate the significance of Don Redfoot's article, "Long-Term Care Reform and the Role of Housing Finance." The article joins what is unfortunately only a handful of writings that have addressed the link between housing and broader social welfare issues—in this case, long-term care (e.g., Cohen 1969; Newman 1990; Newman and Schnare 1992; Noelker 1982; Sussman 1979). Redfoot's effort and publication of his article in *Housing Policy Debate* certainly increase the odds that at least the housing sector may begin to pay serious attention to the need to conceptualize the role of housing in long-term care. For this alone, Don Redfoot and Fannie Mae deserve much credit.

Redfoot reviews a litany of ills associated with the current system of long-term care and, particularly, nursing homes: high costs that have grown faster than the general inflation rate; inappropriate placement in nursing homes of many elderly who do not require the level or intensity of services provided; the requirement that elderly persons pauperize themselves to qualify for Medicaid coverage of nursing home costs; and discrimination against nursing home applicants whose disability levels generate unacceptable cost-reimbursement ratios. His preferred solution to these problems is universal coverage for long-term care services—a much more extensive program than the optional capped block grant for home and community-based

care included in the Clinton proposal. Largely because availability of such coverage would represent a *guaranteed* source of reimbursement, dramatic effects could be expected on the supply of home and community-based services, on the one hand, and residential options, on the other. In this new system, consumers could access the type and amount of care they need and receive this care in the setting of their choice—home, a special supportive residential setting, or a nursing home. Under a generous universal long-term care benefit, according to Redfoot, the housing problems of the long-term care population can be solved within the limits of the current housing market and government housing subsidy programs. Financing for the health and related services component of long-term care can be separated from financing for the housing component. Virtually all that will be needed in addition, in his view, is a program to subsidize housing repairs.

Redfoot's proposal leaves me with two major questions. Is providing a long-term care service benefit that frees up other resources for housing the key to an open and accessible long-term care system? And if the separation of financing mechanisms has the projected effect, will reliance on private resources, current programs, and modest tinkering with the housing finance component be sufficient? In the remainder of this comment, I make a rough first cut at addressing each of these questions.

Separating services from housing

Separating the service component of long-term care from the housing component, other things being equal, has two primary benefits.[1] First, consumers' decisions about *where* to live can be independent of decisions about care needs. The present system, by contrast, packages the housing and service components together. For example, most nursing homes are financed heavily by Medicaid, the health insurance program for the poor; Medicaid reimbursements cover both nursing service costs and nursing home capital costs. Similarly, board-and-care homes that serve roughly 500,000 poor people are funded largely by state supplements to the supplemental security income program; these subsidies usually cover room, board, and some protective oversight. Even for the affluent, the need for long-term care

[1] A third possible benefit is political feasibility. The public may be more willing to fund health-related services than residential options that have the potential to be extravagant. Historically, charges of extravagance have been leveled at particular housing assistance programs.

assistance often can be satisfied only by moving to a particular residential setting. Thus, consumers who require types of assistance that are provided only in a particular setting have no choice, be they rich or poor, but to move to that setting. This system can lead to inappropriate institutionalization of persons who need a particular service that is offered only in nursing homes but is not inherently restricted to that setting.

The second benefit of separation is that services can be tailor-made to individual needs, rather than conforming to the one-size-fits-all approach typical in today's nursing homes (Kane and Kane 1991), which leads to overserving. Extending this second benefit to housing should result in settings whose environmental features are set by consumers' tastes and preferences rather than their need for services. Providers who meet consumer demand will stay in business; those who do not will fail.

Unfortunately, simply separating services and housing is not sufficient to achieve these benefits, except for the affluent. For most long-term care clients, two additional features must also be in place.

The first essential is long-term care service coverage generous enough to induce an adequate housing supply response and to provide real market power to consumers and their families. In fact, separation in the absence of adequate coverage could actually have deleterious effects, since there would be a shortage of necessary services and no place of last resort. The generosity of the long-term care service benefit is, therefore, crucial if separating service from housing is to improve the housing choices of long-term care clients.

The second essential is that consumers must have a viable, ongoing source of payment explicitly earmarked for the housing component. Certainly the infusion of new resources to cover the costs of long-term care would free up other resources to pay for housing. But, again, the size of this effect depends on the generosity of the service subsidy. Furthermore, even a generous service subsidy that covers all their service needs will not empower those who cannot afford the cost associated with the housing component. Consumers who cannot pay the housing costs associated with the expanded array of settings will not reap the benefits of greater choice.

For these reasons, a separable long-term care service subsidy is likely to have the greatest impact in government-assisted housing, where concerns about ability to continue to pay rent do not

exist. Currently, the more than 100,000 residents of assisted housing who need personal assistance with activities of daily living[2] must rely primarily on the home and community-based services that may be available in their communities. Because of the restrictive reimbursement for these services,[3] many communities cannot offer a full array of services and cannot meet the growing demand for the services that are provided. If the services required to maintain a person at home are not available, the person risks eviction. The type of long-term care benefit system Redfoot advocates would go a long way toward remedying the problems of the long-term care population in assisted housing.

The housing component of long-term care reform

In a reconfigured long-term care system that subsidizes service costs but not housing costs, consumers must be able to pay for their housing from private resources. According to Redfoot, for some unstated proportion of the long-term care population, the freedom from long-term care expenses would be enough to make the housing costs of the expanded array of residential options affordable. Homeowners who wish to remain in their homes but have an affordability problem would rely on home equity conversion instruments, such as reverse annuity mortgages, through which they could unlock their home equity and use it to defray current expenses, including those for housing. Growth in the supply of supportive residential settings, such as assisted living developments, would be spurred by federal mortgage insurance. How reasonable are these assumptions?

Affordability of supportive housing

Presumably, whatever its many benefits, the availability of long-term care insurance will have no effect on the basic development and operating costs of housing. Therefore, a simple test of the

[2] This figure is derived by adding the estimated number of elderly persons needing personal assistance with at least one activity of daily living cited in Struyk et al. (1988) and the estimated number of persons with severe mental illness living in assisted housing cited in Newman (1993). Since no data are available on the number of persons with physical impairments who live in assisted housing and need some assistance, the estimate provided here is a lower bound.

[3] Medicaid offers almost no coverage for home care, Medicare limits the number of days of care, and both Title III of the Older Americans Act and the Social Service Block Grant are nonentitlement programs.

affordability of the expected new supportive residential settings is to compare the current rents for new efficiency and one-bedroom units—the types of units typically found in assisted living and other supportive housing developments—with the current incomes of the elderly. For this exercise, it is assumed that the unit is developed in the Washington metropolitan area, that it has a loan insured by the Federal Housing Administration (FHA), and that elderly owners and renters have incomes at the national median: $17,351 and $9,675, respectively (U.S. Bureau of the Census 1993). The affordability standard is set at 40 percent rather than the typical 30 percent to account for the generous long-term care benefit. The results are summarized below.[4]

	Efficiency	*One-Bedroom*
Development cost	$65,000	$70,000
Annual operating costs per unit	$ 4,000	$ 4,000
Total monthly rent	$ 822	$ 858
Annual income required for 40 percent housing cost−income ratio	$24,659	$25,728

This simple example demonstrates that the sheer housing costs associated with supportive housing, stripped of any long-term care service costs, are not within reach of many elderly. Renters are in the worst shape; not only are their incomes less than half that required to support the rental costs of a unit in such a development, but they also have no property they can sell and turn into a supplementary income stream. While median owners come closer to being able to afford one of these new units, they, too, face an affordability gap. If a median owner 65 years old who owns a home valued at the median, $70,418, sells this home and invests the proceeds in a certificate of deposit paying 5 percent—higher than the 3 percent currently being paid—that owner can expect about $6,500 a year in each of his or her 17 years of remaining life. This raises the owner's income to $23,851—still short of the mark. Although this annuitized value is higher if the stream is begun at an older age (since there are fewer remaining years of life), the decline in income at older ages more than compensates for this increase.

[4] Specific assumptions are available from the author.

One potentially important omission here is the value of non-housing assets held by the elderly that could make these units affordable for a greater proportion. Data from the 1988 Survey of Income and Program Participation indicate that the median value of these assets is roughly $20,000 for the population 65 and older and declines with increasing age (Eargle 1990, 6). The combination of the annuitized value of these assets, the annuitized value of the sold home, and current income barely meets the monthly rent on efficiency units for owners at the median but falls short of the one-bedroom rent. For renters, even if they all held assets at the median (which is highly unlikely), the monthly payout plus income would still fall short of the required rent. The general conclusion remains that the housing costs of these units are likely to be unaffordable to many elderly, both owners and renters.

This example also raises a basic question about Redfoot's assumption that a generous long-term care benefit will, through market competition, lower the price for the *housing* component of the supportive housing setting. The numbers given above reflect the new construction cost of basic multifamily housing, a sector characterized by substantial competition. Why should competition in the supportive housing market result in development and operating costs *lower* than those for general multifamily housing in an already competitive market?

Even so, greater supply is still associated with the benefit of more options for those who can afford them. Redfoot's main strategy to increase supply is federal mortgage insurance, which has recently become available for supportive housing.[5] Will federal mortgage insurance increase supply? The answer appears to be "Yes, but . . . ."

Federal mortgage insurance

Financing for private sector supportive housing has been in flux for more than 10 years. A snapshot of the financing of current developments would probably reveal that about half are relying on conventional financing, about 40 percent are using tax-exempt bonds, and the remaining 10 percent are structured as equity or limited partnerships. But the *new* entrant into this market faces dramatically different options. Under the 1986 tax

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[5] Such housing is currently referred to as "board-and-care" in the regulations, but some observers expect a separate designation for "assisted living" as early as 1994.

reform, tax-exempt bond financing has been substantially reduced because state bond capacity has been cut back and restrictions have been placed on the use, and users, of this financing source. Tax reform has also eliminated the tax incentives driving many limited partnerships, since private investors can no longer deduct losses against other wage and portfolio income. Thus, limited partnerships must be motivated by income and potential property appreciation rather than tax incentives. Finally, conventional sources of finance have also become scarcer for two reasons: past defaults in the industry, which have made many lenders cautious, and the savings and loan crisis, which has had spin-off effects on all development financing. Knowledgeable observers of the industry indicate that most of the development in this sector in the past several years has been by companies with a track record and a long-term relationship with one or more lenders (referred to as "relationship lending"). It is also estimated that as few as 100 lending institutions are currently involved in the long-term care market, with the majority focusing on nursing homes.

In this environment, introduction of federal mortgage insurance is most likely to interest two types of developers: those who have already developed supportive housing without federal mortgage insurance (since it was not available) and those who have not developed supportive housing but have used federal mortgage insurance in other types of housing development. In the first case, while it is unclear how much effect the addition of federal mortgage insurance will have on obtaining financing above and beyond the developer's track record and relationship to the lender, the presence of this credit enhancement is undoubtedly positive, although not without some practical problems. If the developer continues to work with the same lender, some potential limiting factors are whether the lender has worked with the U.S. Department of Housing and Urban Development (HUD) before, is certified by HUD to work with federal mortgage insurance, and is willing to work with a government program. On the other hand, the developer may seek out an FHA-certified mortgage banking company and attempt to build a relationship with this new lender.

The effect in the second case—the new supportive housing developer who has worked with FHA insurance products before—should also be positive. Because many housing developers work with mortgage banking companies that are well versed in FHA insurance programs, start-up time for getting certified by HUD and learning to work with HUD programs should be shorter. And since FHA programs are a key part of the mortgage banking

business, these lenders should be anxious to start using this new insurance product. In fact, mortgage banking companies often solicit proposals from developers when new housing products are introduced to the market. An important implication here is that introduction of federal mortgage insurance should make a stream of capital available that typically has not been used in supportive housing development—namely, funds secured by mortgage banking companies that use the FHA multifamily insurance programs. While all these effects are positive, they are also insufficient to get projects built. Here, too, there are practical obstacles. In this second case, the main hurdle facing the developer is learning the supportive housing business and putting together a sound proposal—something mortgage insurance cannot help.

For both types of developers and their lenders, however, a key determinant of the usefulness of mortgage insurance will be the rules and regulations attached to the program: for example, requirements governing the loan-to-value ratio, debt coverage ratios, income-to-expenses ratios, whether the loan is nonrecourse, and the amount of cash and letters of credit required up front. If the rules are too restrictive and burdensome and the processing time too long, the insurance product will be avoided. Historically, whenever a new FHA insurance product is introduced, it takes several years for the industry and HUD to work out a reasonable set of regulations that protect the public interest while allowing the market to operate. There is no reason to expect a different pattern in the present case. In fact, the learning curve may be flatter because FHA is moving into new and uncharted territory. This conclusion is borne out by the current reluctance of some of the major HUD area offices, such as the one in Chicago, even to entertain mortgage insurance proposals for assisted living facilities.

Federal mortgage insurance is likely to have a less positive effect on the new entrant to the supportive housing market who has neither a track record nor a relationship with a lending source. Mortgage insurance has no effect on the legislative changes over the past seven years that have restricted options for developers. And although mortgage insurance represents a credit enhancement that increases the attractiveness of the loan package by reducing the lender's risk, there is little reason to expect that insurance alone has enough heft to reverse the current conservatism of financial institutions. Therefore, even if new entrants into this market are able to develop a sound proposal demonstrating the ability of the project to produce cash flow, tax benefits, or appreciation in some combination that is attractive to lenders and investors—and this should be easier because of the

guaranteed source of service funding—it is still likely that they will have difficulty raising the funds required.

Home equity conversion

For homeowners who wish to remain in place but are experiencing cash flow problems, Redfoot's main strategy is home equity conversion mortgage instruments (HECMs), including lines of credit, lump-sum payments, reverse annuity mortgages, and sale leasebacks. Despite recent growth in these instruments, empirical evidence accumulated over the past decade suggests that their overall effect on housing affordability is likely to be modest.

HECMs make financial sense for only a minority of the elderly—those who own their homes, whose house value is high enough to generate a good monthly income stream, and whose current income is low. Data on the number of elderly who fit into these three categories are not readily available, but the published data that are available indicate that only about 10 percent of those who own homes worth $60,000 or more have incomes below $10,000, and about 25 percent have incomes below $20,000.[6] The target group would fall even lower—to about 4 percent of elderly homeowners—if the characteristics of participants conformed to those Redfoot describes for the typical participant in current programs, namely, incomes of $7,600 or less and house values of roughly $103,000. In short, because of the relationship between house value and income, the elderly who need assistance the most are those for whom HECMs do the least.

But there may be an even more important problem. Experience with HECMs over the past 10 or more years suggests that there is no great demand for these instruments. For example, in the early 1980s, the Buffalo Home Equity Loan Program had a difficult time recruiting participants despite vigorous marketing and outreach efforts. Response improved only when the program added a single lump-sum payment as an alternative to the annuity option. Roughly 10 years later—and again despite strong outreach, marketing, and substantial flexibility in the form of the HECM (e.g., line of credit, lump-sum payment, or annuitized monthly payment)—the rate of application to HUD's HECM Insurance Demonstration Program since 1989 is described as "slow but steady" (Sandy Krems, personal communication, October 1993). Although Congress has authorized

[6] Based on the national American Housing Survey, 1991 (U.S. Bureau of the Census 1993).

funding for up to 25,000 insured loans through September 1995, only 5,000 loans have been written to date. In contrast to most HUD programs, there has been no need to maintain a waiting list.

Some economic analyses of the housing behavior of the elderly are consistent with these observations. The body of work by Feinstein and McFadden (1989) and Venti and Wise (1989, 1990) finds little evidence that liquidity constraints affect the housing conditions of the elderly, or that HECMs increase consumption by the low-income elderly significantly. These analysts conclude that many elderly are not interested in either liquefying or annuitizing their housing. Many may have a strong desire to leave a bequest (Poterba 1989).

Other analysts, however, emphasize supply-side constraints on HECMs. Chinloy and Megbolugbe (forthcoming), for example, point to incomplete markets for resale, securitization, and derivative instruments, which are widely available for conventional mortgages. Whether remedies for these structural inadequacies would substantially increase participation in HECMs is an open question.

Enhancing home repair programs

The main part of Redfoot's housing strategy that addresses the low-income elderly directly is the enhancement of current home repair programs. Beyond concerns for the safety of occupants, home repair assistance might make the home more suitable for in-home long-term care services. Unfortunately, very little is known about how housing attributes affect access to, or the effectiveness of, in-home and community-based long-term care services. But what limited evidence exists suggests that as many as 17 percent of the elderly may live in dwellings and neighborhoods that either impede the efficient delivery of these services or preclude their delivery altogether (Newman 1985). This empirical research based on national data is consistent with the perceptions of home care workers in New York City, as reported in Scharer et al. (1990, 518): "Providers are increasingly concerned about their ability to deliver good quality care in unsafe neighborhoods and deteriorating home environments." Greater access to home repair assistance moves in the right direction. But is simply expanding current programs, even with heavier emphasis on dwelling modifications (e.g., grab bars, handrails), the right approach? To answer this question, we need more information on such fundamental questions as the housing

deficiencies of those requiring home care, the deterrent effects of these deficiencies on service access and effectiveness, how to organize home repair programs to meet these deficiencies, and the comparative costs of such programs.

Even if the data are encouraging, improving dwelling conditions is only one component of a strategy for making the residential environments of those in need of long-term care suitable for that care. The other component, which is far more difficult to address, is neighborhood conditions. According to Scharer et al. (1990), some home care providers have arranged to have escorts from security services accompany home care workers visiting unsafe neighborhoods. Maintaining 24-hour, on-call services is much more difficult under these circumstances. Although most communities rely on local law enforcement to ensure safety, crime continues to be a major problem, particularly in big cities. According to the 1991 American Housing Survey (U.S. Bureau of the Census 1993), nearly 40 percent of the elderly live in the central cities of metropolitan areas. To the extent that lack of resources plays a role, President Clinton's proposed anticrime bill moves in the right direction by supporting 50,000 additional police officers around the country. But an even more fundamental problem is uncertainty regarding the most effective strategies for preventing neighborhood crime. Several approaches are being tried, such as voluntary neighborhood watch teams and the reintroduction of community policing and neighborhood beat and foot patrols. Incentives for continuous experimentation with multiple approaches are warranted.

Conclusions

If the beneficial effects on housing are modest even under the highly unrealistic assumption of universal coverage for long-term care services, they are likely to be even smaller under proposals now being considered. On the supply side, developers of long-term care settings and their lenders are looking for a reliable source of income, whether it be fees paid by affluent residents or government reimbursements such as Medicaid. An optional, capped block grant to the states, even if generously funded, is unlikely to meet this standard. On the demand side, a substantial fraction of the elderly—the single largest group of consumers of long-term care services—have housing affordability problems that are not solved by the separation of housing and service funding, by a universal long-term care service benefit anywhere near the plausible range, by HECMs, or by FHA mortgage insurance programs for supportive housing settings. Those

who live in deteriorated houses may be helped by home repair programs, although many questions exist about this type of intervention. Addressing problems of the deteriorating neighborhoods where many of the elderly in need of long-term care live is at least as important—and even less well understood.

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