Industry Insights:

WHERE IS CHINA'S CCRC INDUSTRY (PART II)?

—LET'S WALK YOU THROUGH THE REALITY

By Joe Christian and Michael Qu

In the year that has passed since we wrote an article entitled "Where is China's CCRC Industry"[1], each of us has been contacted by readers seeking our advice on the development of senior living projects in China. Some have asked us how to localize the U.S. practices into the China context; developers asked us to connect them with overseas operators; and others have expressed their doubt that a CCRC-type community can be successful in China. Our article, however, left open the question of where the product type will go in China. To be frank, at that time (and even now, although to a lesser extent) we have questions about the overall feasibility of the CCRC product type, in that we are not at all certain that Chinese elderly people will want to gather in a congregated community to "enjoy" their life and age in place, as CCRCs are essentially designed to accomplish. That being said, as this article will demonstrate, the "CCRC product type" is anything but monolithic; CCRCs come in all sizes and shapes, which can – and MUST – be adapted to meet the needs and desires of the market in which they are located. Relatively remote, suburban or ex-urban locations will require an entirely different conceptual approach, in terms of number and types of units, services and amenities, to name a few, than in-fill urban locations if they are to have any chance of success.

Our evolving view of CCRCs

Before we get started, again, a brief explanation of CCRCs for those who haven't read our previous article or aren't otherwise familiar with CCRCs. These projects offer residents the opportunity to move into an "independent living" unit in the community when they are active and healthy, needing little or no assistance with the activities of daily living (ADLs) such as getting in and out of bed, dressing and undressing, bathing, using the toilet, eating or taking medications. As the resident grows older, he or she may need assistance with ADLs, and the typical

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--Deal with issues on intellectual property, licensing, general liabilities and employment

[1] http://lawviewer.com/uploads/20140220/5305f12b2303d.pdf

CCRC can provide this in the resident's unit or, if the need is greater, in a separate "assisted living" facility on the same campus as the independent living unit. And if the resident requires round-the-clock nursing care or short-term rehabilitation after surgery, a stroke, a heart attack or other event, the CCRC may provide these services, again on the same campus, in a skilled nursing facility. A memory care unit might also be provided, for dementia or Alzheimer's sufferers. Essentially, what CCRCs offer residents is the opportunity to age in place, without having to relocate as their conditions deteriorate; with the caveat that not all CCRCs will offer the full spectrum of care, but all will offer at least independent living and assisted living, often with nursing staff on duty and doctors on call, allowing the residents some degree of care and assistance as they become more frail.

During last year, we have toured several high profile CCRC-type communities in China, and have represented and advised clients in exploring China's marketplace for development of senior living projects, while researching and writing about the industry have continued to be among our primary interests. We have noted over the last year that the industry is evolving very quickly. Now, if we continue with that question: "where is China's CCRC industry", we can tell you CCRCs are being developed practically everywhere; there is probably one near where you live in China. Does that mean we are less skeptical about the likely acceptability of CCRCs in the marketplace? The answer is, "yes, but….". Our concerns are still there, but they are greatly tempered by what we see as a growing recognition in the market of the need to carefully assess the demand for a product that will meet the needs of the market, and not simply developing a product that fits some pre-conceived notion of what a CCRC is.

As a client and friend of Joe's, whose business before becoming a very successful developer, owner and operator of senior living projects in the U.S. was developing commercial properties, said to him a while ago, it is unique that a developer has such a guaranteed, huge demand for product as in the senior living space in China, due to many factors such as the sheer number of elderly persons, the strains created by the one-child policy, China's rapid urbanization and shifting societal and cultural values, to name a few. The question has been and is how to tap into that demand and, for the private operator/investor, to "do well by doing good." That question applies in spades to the CCRC market, as there are almost infinite possibilities for crafting the "hardware" – i.e., the physical plant, and the "software" – i.e., the services, healthcare and other amenities that the project will provide, all tailored to the location and market conditions in which the CCRC will be located.

In the interest of full disclosure, your authors have had a continuing dialogue between them on the topic of whether and to what extent CCRCs will be acceptable in the China market. Joe's view on that has been evolving somewhat over the past year or so, starting with skepticism and moving toward guarded optimism. When he first started to look seriously into the industry in 2009, the conventional wisdom among many or most was that, since the whole concept of privately financed senior living was essentially unknown in the marketplace – until very recently, elderly Chinese whose children were not able or willing to care for them were limited in their choice of living accommodations to nursing homes, which had a deservedly poor reputation, or beds in hospitals – the "need" end of the care spectrum presented a less risky opportunity to focus on than the "choice" end of the spectrum. Not quite a guaranteed demand, due to cultural and societal norms with respect to the provision of care for the elderly, but the approach made sense at the time, and still does. If people are unfamiliar with the independent living product type, which are typically apartments for healthy and active adults over, say, the age of 60, with very few, if any, specialized services, why would they choose to live there if they don't need to? But if they can no longer live at home because of their physical and/or mental frailty or health issues, the thinking was, they would accept living in an assisted living or skilled nursing facility, but only because they need to, not because they want to. Historically, hospitals have provided shelter and care to the elderly in their geriatric wards, but the operating assumption is that standalone facilities, such as those providing rehab and post-acute care, are needed in many locations due to the shortage of geriatric beds, and should be able to do a better job providing these services, in a more welcoming and communal environment.

We have no argument with that reasoning, and we expect that those who do it well – offering the "right" services at the "right" price, will do well. There will always be demand for higher acuity facilities for the elderly who need the level of care that these projects will provide. But we also believe that there is and will be demand in China for other types of senior living developments – and what we currently have in mind are CCRCs, aimed at the middle to high end of the market, in which the fees can presumably be high enough to cover the costs of providing the services and amenities that would make the projects attractive to potential residents – and perhaps even more important, to their children.

Michael's view towards CCRCs, however, has gradually changed over the past couple of years. As do many Chinese practitioners, he has had great concerns about the over-building of overly large-scale senior living communities in China, which he believes is an inevitable but unwanted result from the common industry practice of over-building of residential properties in the course of China's rapid urbanization. Michael thought that CCRCs did not need to exist in the Chinese marketplace—it could

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A practicing attorney for over thirty years, the primary focus of Mr. Christian's practice has been representing institutional investors and developers in commercial real estate transactions across the U.S. and in Asia. A specialty of his practice since 2000 has been the senior housing industry in the U.S., and since 2009, the senior housing industry in China. He lived and worked in Hong Kong from October 2008 to December 2011, where he co-headed the Asia real estate group of a global law firm. He was appointed a fellow at the Harvard Kennedy School in Cambridge, Massachusetts upon his return to the U.S. at the end of 2011.

Michael Qu

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Being a legal professional that has involved in the development of real estate and senior housing for years, Michael can serve for varied investors in the field, providing sound service on the full spectrum of issues in project development which can arising during the site selecting, acquisition, feasibility studying, construction, financing, pre-opening preparation, post-opening operation and disposal of senior care or hospital facilities.

Prior to co-found Law View Partners, Michael has a wide variety of working experiences as in-house counsel in multinational group and private law practice in both domestic and international law offices.

be other forms of product type to provide continuing care in congregate senior living communities. However, the enthusiasm of the authors' contacts and clients toward CCRCs has caused us to re-shape our viewpoint over time. During the last year, we have visited and studied such facilities in the U.S. and China, many of which offer "lifestyle" services and amenities that able-bodied seniors see as an improvement to their circumstances, which may have included living alone or in a neighborhood that may not offer any meaningful social contact, which is widely accepted as contributing to the physical and emotional well-being of elderly persons. Therefore we think that it is time to shift the discussion from whether CCRCs are suitable for China—which was an appropriate topic as the market was just taking off a couple of years ago, to discussing the ways to do it right, exploring how facilities can offer the "right" services and amenities to the "right" potential residents.

For our readers who have already been involved in this industry and might not totally agree with us, or who might have a better understanding of the industry – we are totally fine with that. For us, this article fulfills our mission to give readers an updated picture of what we see has been happening and what might happen in China's senior living industry, and to continue the discussion from here.

Several case studies

Many people see Cherish-yearn as an example of CCRCs in the early years of the industry in China. Michael sees it as a unique project given the particularity of the time when the project was developed. No one will deny at that time (in 2006) it was much easier to build and sell real estate than it is today—if the owners of Cherish-yearn had chosen to build and sell residential units rather than a senior living community, they most likely would have earned more than what they have earned as of today. Of course, as many know, there were land issues to be addressed at that time for Cherish-yearn if it were to be developed as residential houses. In any event, the developers were visionary in choosing a very promising type of real estate (note here that we refer to it as a *real estate* product instead of a *senior care service* product, as that label reflects our understanding of the product type of the project at its infant stage). We also note that the focus of the company has been shifting to operational matters, and that they have adopted the concept of membership cards for their residents, which actually paves the way (although legally it might be challenged on a case-by-case basis) for charging entrance fees in CCRC-type communities, as is common in CCRCs in the U.S. For purposes of this article, we will put aside the seeming success of Cherish-yearn, whether you admit it is successful or not, and put more of our focus on other CCRC communities that emerged in just the past year or two.

The first project we will discuss is Starcastle, which we first visited at the end of 2013, just a few months after it opened. The facility is in the

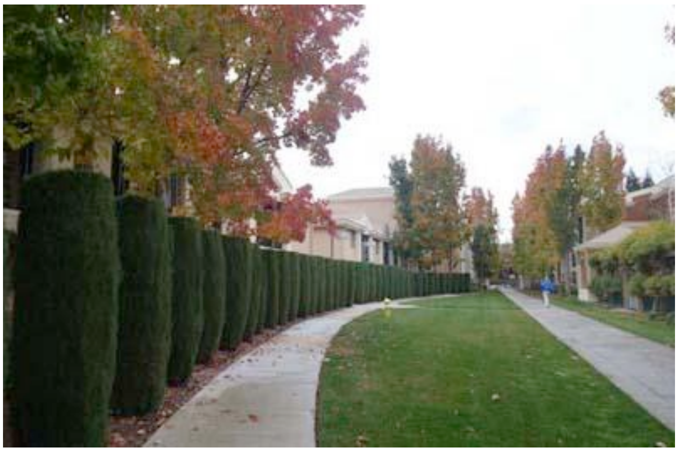
Baoshan district of Shanghai. The developer/operator, Starcastle Senior Living (a joint venture between Fortress Investment Group, a US-based fund, and Fosun Group, a Chinese company), repurposed an existing, thirteen floor office building, eventually building out 190 units of independent living and 20 - 30 assisted living/healthcare beds (depending upon number of beds per room). The facility's visual image was that of a high end serviced apartment, with a spacious and well-appointed lobby that included a concierge desk. Quite attractive, with average monthly rents for independent living units at 11,000 to 12,000 RMB per month, with rental for the largest IL unit being 16,900 RMB per month. Monthly charges for assisted living units average 16,000 RMB. The facility opened in May of 2013, and when we visited in November, it had 60 IL residents and far fewer AL residents. Given our preconceived notions about the likely formula for success in China being to address the "need" end of the spectrum, we (and many other observers of the market) were, frankly, surprised at the high level of occupancy of the IL units. We don't know what the average age of the residents is, but many appeared quite active and independent. Our tour guide mentioned that one of the occupants was a recently retired professor from Fudan University in Shanghai, who chose the project over her apartment in Shanghai in order to be engaged socially and intellectually with her peers in the community, rather than spend her days alone in her apartment, with limited social interaction. As of this writing, occupancy has increased to 185 residents, 170 of whom (92%) live in the IL units, with the remaining 15 residents (8%) living in the AL units. This experience has caused us to think that, with the right business model, a CCRC – in the right location, with the right services and amenities – could very well be successful in China.

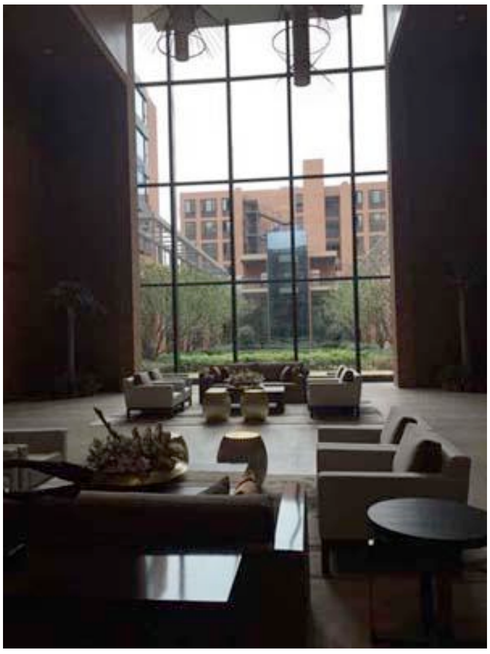
The Starcastle project is definitely worth studying in that (a) the size of the project is close, albeit somewhat smaller, to that of a typical CCRC in the U.S., compared with many other much larger projects being developed now in China; and thus may serve as an experiment as to whether the U.S. experience can be applied in China, a question that all of us are eager to see answered; (b) the operator has a dynamic view on how to optimize the development of the project -- e.g., they have reacted to the unanticipated demand for the IL units, based, we feel, on the lifestyle being offered at the facility, and have increased the originally planned number of IL units from 150 to 190, while reducing the number of AL units; and (c) we understand that the turn-over rate of the facility is low, meaning, of course, that residents and their families are content with the facility and the services it offers. The performance of the project may change over time, but at the moment, we are more optimistic about its chances of success than we might have been a year or so ago, as the project defied the conventional wisdom about what would be accepted in the market. Starcastle's view of the product type is evident in its plans to develop a CCRC nearby with 800 units, several times the size of its first project.

The second project we toured, last August, has recently broken ground. It is Taikang's project in Shanghai's Songjiang district. Like those of other insurance companies, Taikang's project is quite large—it consists of over 2,400 units, sizable community service areas and a 400-bed tier-two rehab hospital. According to Taikang's strategy (again, like many other insurance companies' plans), similar projects are under construction in other cities such as Beijing, Guangzhou and Sanya. Taikang plans to invest nearly RMB100 billion in constructing a chain of 10 to 15 senior living communities. Readers who are familiar with CCRCs should know that CCRCs, in many States of U.S., are regulated by the insurance authorities given that the contractual arrangement and fee model are akin to an insurance policy that provides a residency, health insurance and economic package to make sure residents can age in place and receive the health benefits, in particular, that the operator promises in the contracts. By paying an entry fee to reserve a right to stay, and monthly fee for services to be charged during residency, CCRCs seem to be a perfect choice for insurance companies, don't they? We will have more discussion on this below.

The third project, which is also typical of projects being developed by big real estate companies, is

Vanke's Hangzhou project. The project is part of a large mixed-use community that Vanke is developing in the outskirts of Hangzhou. It consists of 615 independent living units, all of which Vanke intends to sell, on a usufruct basis (because the nature of the land use right is tourism, selling strata title of the units is restricted). Because target customers of the project are independent seniors at lower ages than that at which most CCRCs will admit residents, healthcare components within the community are not very "typical" of those a CCRC would offer. Basic healthcare and amenities will be provided by Vanke's service force through its 24/7 on-call services and a well equipped club-house of 4,500m^2—all these can be enjoyed by paying a RMB 15,000/m^2 purchase price and 2,000~3,000 monthly fee. Within the project, and the whole community as well, there will be a day care center, a nursing home and a hospital to be managed by a third party to meet residents' healthcare needs. Vanke doesn't call the community a CCRC; however, we feel it reflects a developer's attitude to "Continuing Care"—it doesn't have to provide all of IL, AL, skilled nursing and memory care to have a community defined as a CCRC; it could be a carefully orchestrated combination of service components under the Chinese context, as long as they can serve the need of seniors in the community when their needs increase over time. In the absence of CCRC regulations in China, developers have the opportunity to figure out alternatives that can be accepted in the marketplace. We haven't seen its sales and occupancy performance, so it's too early to say if it is a smart move for Vanke, but testing the waters for the demand for independent living units might be a good start in this endeavor.





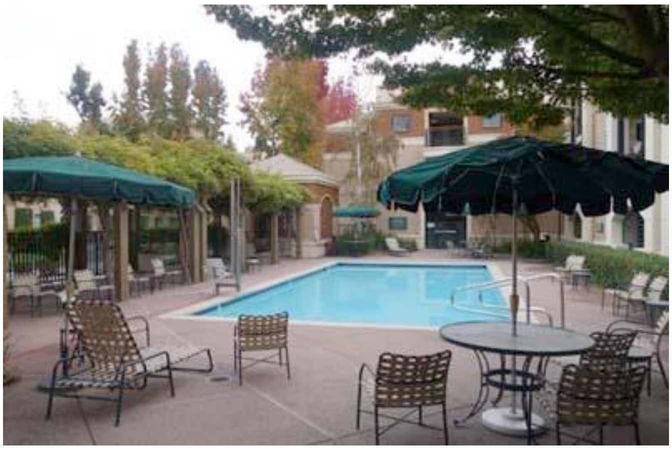
Everyone has a chance to be successful

Why did we choose these three examples? Because each case represents a mainstream player that is developing CCRC-type communities in China; and in the aggregate, they represent the current state of what we see in the marketplace. Starcastle, developed by a joint venture operator, is closer to the CCRC product type we see in the U.S., judging by the size of its project and service types. With proper adaptation and a dedicated team in place, the chance to be successful for such project is significant, in our view, as we described above. We haven't been able to acquire any numbers on the profitability of Starcastle at this moment, but it would be common for sophisticated operators not to expect a high of profitability in the early years of operation; instead, they will be patient and well prepared with capital input and market adaptation.

However, for a listed real estate companies, such as Vanke, the strategic move into senior housing will need more evidence of potential profitability in order to please their shareholders. We have found Vanke has tried different approaches to develop senior living communities. The Hangzhou project seems to be the biggest one; it has also opened a community-based healthcare center in Shanghai in one of its residential communities with the capacity to accommodate 40 day-care adult and 30 short-term boarding residents; a more moderate experimentation by other subsidiaries of Vanke is to build standalone senior care facilities in or close to a community to meet the need of their customers who have bought Vanke's houses for the long term and the health condition of elderly members of their family has become frail. For developers like Vanke, the concern of "if we build it, will they come?" doesn't even exist—actually it is to their advantage. Vanke, as property manager, by the end of year 2014, serves 350 residential communities across China with around 450,000 families[2]. If one out of three families can create healthcare needs from its senior family member, which can contribute RMB 1,000 per month, it is a nearly 2 billion annual revenue business—and, that is only the tip of the iceberg. For big developers, the answer to providing "Continuing Care" is either to provide the right service to the residents within existing communities, or to find the best practices to put in senior living components in new communities.

From insurance companies' perspective, given that senior houses developed by insurance companies are required to be self-held (i.e., not for-sale product) property, insurance companies see that senior housing's value lies not so much in the operating profit that the investment might generate, which is not expected to be substantial or achievable in the short term, but in the appreciation of the land value resulting from development of their projects, which they will reflect on their balance sheets. In addition, insurance companies anticipate that their senior housing investments will provide steady, long-term cash flow and a reasonable operating return, which provide a good match with the insurance companies' liabilities. Senior housing residents also provide a ready-made, captive audience for an array of products offered by the insurance companies. In light of the investment appetite and business nature, there are reasons to believe CCRCs are an optimal choice for insurance companies. However, to address the "if we build it, will they come?" concern, insurance companies should not only count on their marketing force for selling insurance policies, they will need to involve in the planning process an experienced operator/consultant, who could provide valuable assistance in designing a facility that will operate efficiently, and this could mean the difference between the ultimate success or failure of the development. As far as we see, most of the insurance companies are keen to find such expertise from operators, overseas or domestic, as we will elaborate a bit below.

[2] Please refer to http://www.cdvanke.cn/index.php?m=content&c=index&a=show&catid=18&id=16

Time to re-define "service"

Even though there is so much potential demand for senior housing in China, the adage, "if we build it, they will come" is certainly not universally true. It will depend to a large extent on what the "it" is. As long as the products are properly designed to meet the needs of their targeted market, performance, good or bad, is primarily a matter of technique of marketing and sales. However, service is the prime factor that convinces elderly people to enter a facility in the first place and, more important, to stay—and that is what CCRCs are all about, isn't it? Being "served" – starting with "have you eaten?" – is undoubtedly key to retaining elderly residents, but the service element of the facility and the quality of the food, which early experience in the market show to be far more important than the physical plant, should be stressed in the marketing and sales of the project in order to convince the potential residents of the desirability of living there. Our observation is that many developers are doing a good job in attracting the ultimate buyers (children or the seniors themselves) to the facility based upon its physical appeal, but are too often less focused on the service side. Many hope that an outsourced hospital can meet all higher acuity care needs; others believe a foreign operator can deal with all of what a community needs for care services.

In the U.S. market, services are usually well defined, and residents see them clearly when they tour the community. They probably have their financial consultant advising on their ability to afford to pay for the care/medical expenses in the future. In short, all services and corresponding expenses are fairly predictable. (If you are not familiar with the contract type and fee structure in the US, there is brief introduction in our previous article here.) In China, our concern is that developers might over-promise their services, or even worse, they don't really know what they are capable of providing at the beginning. This issue can be seen from two perspectives—one is whether the fee structure has been designed to provide enough funds for the developer to afford the service expenses down the road; the other is who (the operator) will provide services and whether the services have been localized to fit the Chinese circumstances. All these argue for a clear definition of the service or product types in a CCRC community.

The way Taikang deals with their lack of service experience may shed some light on what project investors could do. At the planning stage, Taikang found a CCRC operator, the American Baptist Homes of the West (ABHOW, the Cornerstone Affiliate), from the U.S., which is a nonprofit senior housing and care developer and provider. Understanding that staff training is the very first step to start a CCRC development, Taikang engaged ABHOW to provide a training program and management consultancy on a regular basis at the pre-opening stage. Throughout the process, ABHOW periodically sent experts to train staff members for Taikang, and Taikang sent senior managers to ABHOW's community, The Terraces of Los Gatos in California, to gain "real" practice experience. The main purpose of this endeavor has been to enable Taikang to establish its own service standards that they hope to learn and localize from ABHOW's standards, which ABHOW took almost 5 years to learn and develop from Ritz Carlton, a renowned luxury five-star hotel brand. When Michael and his colleagues had a chance to tour the Los Gatos Community last November, its executive director, Alex Candalla, who has participated in the program, told us that feedback from both sides was very positive—Taikang has gained operational knowledge from a U.S. leading CCRC developer; and ABHOW, through the process, also expanded its expertise in the Chinese market.

If the collaboration of Taikang and ABHOW is proven to be a good example of importing the service know-how that a developer will need in operation, then the question will be "does the participation of a U.S. operator in a CCRC project, add significantly to the chance of the project to be successful?"—a question only time will tell after CCRC projects have demonstrated themselves to be a success or a failure. We believe that the answer is "yes."

A possible conclusion, again?

With over 200 million Chinese now over the age of 60 (a number that is projected to be almost 450 million in 2050, roughly the size of the entire population of the U.S. in that year), China presents a huge and growing market for the senior housing industry. Even if the market is for only 3% of that number (the government's policy target for seniors living in senior housing), that still equates to roughly 6 million elderly to be living in senior housing. By comparison, this is twice the number of residents currently living in senior facilities in the U.S., where the market penetration is over 7% (compared to the 3% target in China). Assuming that the number of units in an average-sized facility is 300, which is probably on the small side for China, that would be 20,000 senior housing facilities.[3] That should keep a number of us busy for a while!

Time will tell what product types will be accepted in the marketplace; and, no doubt, that will differ from market to market. But from what we have witnessed so far, a well thought-out CCRC model, providing the "right" mix of unit types, services and amenities to meet the demand in the local market, has been surprisingly – to us, at least – well-received, and we expect that the product type will be well-represented in the China market, as long as developers keep in mind that not one size of CCRC fits all. We admit that the sample of up and running CCRCs is a small one, but we nevertheless think that our conclusion is valid, due to the early successes of the model.

Here are a few takeaways for our readers:

- We have been wondering if the CCRC model may be developing something of a competitive advantage by being early movers in the senior housing industry, in that CCRCs – those operating now, in development or being planned – currently appear to far outnumber other senior living product types. It has been noted by many that one of the obstacles to developing robust demand for senior housing is the lack of familiarity with the senior housing products. The numerical lead of CCRCs may result in acceptability of the product type before other models catch up, simply because markets will become familiar with them sooner.

- Compared to the situation currently in the U.S. where residents have been moving in at an older and frailer age, CCRCs in China seem to be attracting seniors at a wider range of ages. It is usually what a market at its early stage will be, as economic and cultural perspectives and product awareness of customers are varied. According to experts in the U.S., including Jim Moore of Moore Diversified Services, with whom we co-authored an article discussing market and

[3] We acknowledge that China currently has approximately 4 million beds for seniors in nursing homes across the country, but those homes are widely held to be undesirable and substandard.

feasibility studies,[4] people move into CCRCs when they or their partners have a "life event", such as a heart attack or a stroke. It gets them thinking about want might be down the road. Reasons for seniors to move into CCRCs can be a "life-style" choice, or based on a real estate investment, among others. Again, what works in the U.S. won't always work in the Chinese context without proper adaptation.

- Also because the product concept of CCRCs is new, operators want to sell to almost every possible customer, whatever their health condition and financial situation is. As a result, it makes the operational side of the business even harder. For example, it is common that seniors in CCRCs dine together, which is encouraged by many operators, but it could be problematic, if an IL resident is dining with a possible memory care resident, perhaps in his/her mid-eighties. Before fairly sophisticated mechanisms (e.g., health assessment, accreditation, staff training programs) for CCRCs can be developed over time, it is really challenging for operators of CCRCs to manage their risks.

- Because CCRCs require large investments in brick-and-mortar, many senior care operators have been found branching out into the home health care segment. Some take it as a strategic move, to test the water; but many take this as an important complement to their service capacity—a "feeder" for their senior housing project. Although, as far as we know, no (or very few) home health care operators have been successful in China, it appears to be a business worth trying for CCRC operators. The home health care operation basically acquires a client base that the operator hopes will move into the CCRC when they can no longer be taken care of in their homes. Also, it gives the operator the opportunity to familiarize its clients with the operator's organization and the CCRC, and perhaps some seniors will choose to move in before they "need" to, if they get confortable with the operator. On top of that, it makes a lot of sense for an operator to start with home care as it caters very much to the government's "90-7-3" target[5].

Admittedly these are merely our conclusions, but food for thought as move forward with our initiative to discuss the CCRC product type. Of course, other well-conceived and well-implemented projects will succeed as well – there is room in this market for many different kinds of developments, as long as they are designed with a knowledgeable and astute eye toward providing the kinds of services and amenities that the market needs and wants.■

[4] Please refer to P7~P13 of the Journal Selection 2013 of China Senior Housing and Care. http://lawviewer.com/uploads/20140222/53089c6d7ad28.pdf

[5] Under the so-called "90-7-3" target, the government intends that ninety percent of seniors will be cared for in their homes, and seven percent will be cared for in community centers, leaving only three percent as the target/prediction for care in housing institutions.