# Australian Retirement Village Contracts and the need for accurate, impartial advice:

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RVs

- common form of housing for older people.
- “age friendly” accommodation
- for the healthy aged – NOT the same as aged care
- aging of the population => demand for RVs residency is likely to grow.
- average entry age 74 and 67% female.
- It is common to fund the move to RV by selling family home - downsizing

RV contracts are complex - long documents – fifty pages to several hundred pages

can be viewed as a **combination of insurance and financial products**

- life tenancies (for term of **healthy** life)
- life annuities, (for term of **healthy** life)
- death and disability insurance (with decreasing sum insured) and
- real estate options exercisable at the time of exit.

Customer pays

- large up front lump sum
- recurrent “maintenance” fees during tenancy

Customer receives

- right to receive a partial refund of ingoing fee, adjusted up for capital gains, down for capital losses, down for “deferred management fees” (exit fees) and down for various other fees. Often there’s a **<u>substantial delay</u>** in receiving the payment
- right to reside while alive and well – right terminates on death or incapacity for independent living

**Or can be seen as a “loan” to the operator by the resident in return for the “license” (right to reside)**

RVs  controversial in recent times - lot of media unfavourable media attention –
Fairfax media, ABC & others.

State Government Inquiries in Victoria in 2016 and in NSW in 2017.
Inquiry reports quite damning of industry practice
Recommendations include better disclosure and better dispute resolution but not structural reform

Much debate about the “loan / license” contract and the “deferred management fee” feature of contracts.

In recent weeks Lend Lease and others announced they are considering offering consumers at some of their RVs a choice between various different types of RV contract. This involves a tradeoff between the entry fee and the exit fee

We analyse this proposed innovation in contract design and the alternative forms of RV contract that may be on offer by other RV operators

Much variation in RV design features.

- Comparison shopping very difficult. Time consuming – site visits needed.
- Various fees and charges being extracted from the resident's exit payment when they leave.
- When resident leaves it is usually through death or disability and they are older, frailer and poorer, so their capacity to engage in a dispute or litigation with the RV owner is diminished.
- resident in a weak bargaining position relative to the landlord compared with a normal pay-as-you-go rental arrangement.
- The complexity of the contract design may not benefit the consumers very much.

## NEED FOR ACCURATE AND IMPARTIAL ADVICE

We argue that there is a strong need for accurate and impartial financial & legal advice for consumers about these RV contracts, to facilitate understanding of them and comparison between them so as to inform consumers of the costs, benefits and risks involved.

Using a Retirement Village Cost Calculator developed at Macquarie University and funded by a grant from Financial Literacy Australia, we can analyse and compare different retirement village contracts.

This RV calculator is designed to help consumers with comparison shopping and to raise their awareness of the features of RVs they should be wary of and the fees and other features they need to take into account when making a financial decision or choosing between different RV contracts that may be offered to them. The RV calculator may be useful for both consumers and their advisors, including legal practitioners and financial advisors.

We illustrate the use of the RV calculator with a case study comparing several different RV contracts for several different consumers. Our results show that the relative viability of the RV arrangement varies with the age, gender and relationship status (partnered or single) of the resident as well as the RV contract features.

MAIN FEATURES OF RV CONTRACTS

- The ”**ingoing fee**”: pay a large sum of money up front in return for the right to reside in the RV.

- The “**ongoing fee**”: requirement to pay regular smaller payments e.g. weekly, monthly or quarterly.

- **right to reside terminates** when you **die** or **can’t live independently** or **voluntarily relocate**

Upon exit from the village residents receive a **partial refund** of the ingoing fee.

The partial refund is made up of

- The **ingoing fee**,
- **Plus** part of the gain (if any) on resale
- **Less**: part of the loss (if any) on resale

There usually are **outgoing fees** deducted from the refund

## **RV CONTRACT OUTGOING (EXIT) FEES**

SOME RVS DON'T HAVE AN EXIT FEE - SOME HAVE 100% EXIT FEE

LOTS OF VARIATION IN EXIT FEE DESIGN:

- Based on a percentage of either ingoing fee or on resale value or the max of the two
- Typically depends on term of residence at time of exit
- Maximum fee typically around 30%
- simple structure: e.g. 6% per year of residence for a max of 5 years
- More complex: 15% per year for first 1 year then 10% per year for next 2 years
- Yet more complex: 12%, 8%, 4%,3%,2%,1% over years 1,2,3,4,5,6
- One went up, levelled off, then down: +10%,+5%,+2.5%,0%,-2.5%,-5%,-10% over terms of 1,1,5,7,5,1,1 years respectively! Truth is stranger than fiction!

## MUCH VARIATION IN CAPITAL GAIN / LOSS SHARING

- No capital gain or loss sharing
- Rv gets 100% of the gain but resident gets 100% of the loss
- Rv and resident share 50% of both gain and loss

Definition of capital gains can lead to unforeseen problems - interaction with refurbishment costs – resident pays to refurbish apartment but the rv operator gets the increase in value that results

- Capital gain / loss highly uncertain
- Capital gain = new entry fee (new resident) less old entry fee paid by old resident
- Operator can offer different deal to new resident (e.g. higher dmf / lower entry fee) so affecting the capital gain

**Other fees / features may include**

- Requirement to pay for **refurbishment / reinstatement** at time of exit

- Requirement to pay for **agent's fees** / **selling expenses**
- Requirement to pay **RV operators legal expenses**

- Requirement to pay "Capital Maintenance Fund Contribution"

- Possible **lengthy delay in receiving the exit payment** / refund from the RV after leaving

**Overall <u>variation in RV contracts is HUGE</u> -** Many different possible combinations of

- entry/ingoing fee,
- ongoing / maintenance fee,
- exit fee,
- sharing of gain / loss
- extra fees / features & delay in getting the exit payment
-

## <u>Mandatory Disclosure - NSW</u>

NSW requires disclosure form provided by RV to consumer including “standard fees and charges” form. This includes the following information to be used in the NSW Dept of Fair Trading Online RV Calculator

- Entry / ingoing fee
- Type of title
- Ongoing fee
- Capital gains / capital loss sharing
- Exit fees – whether based on entry fee / resale price
- Exit fees – fee percentage per year of residence / period from year A to year B

NSW disclosure document does not require disclosure of:

- Requirement to **pay for reinstatement / refurbishment costs** at end
- The **delay** in being paid the refund when a resident leaves the village
- Details of any “capital maintenance fee” (rate, # years)
- Details of any expenses incurred in selling the RV unit (e.g. agent’s commission)

**<u>This is intended for use with the NSW Government RV calculator</u>**

The RV calculator does a projection / forecast of

- Total recurrent fees payable over a period
- Amount of refund payable at the end of the period
- Breakdown of that refund into components for entry fee, exit fees, capital gains / losses etc

Can do it for 7 years, then either 5, 10 or 15 years

Assumes optimistic growth rate of real estate prices
Claims to assume delay of nearly 1 year for refund but this not included in the calculation
Claims to use the “best available assumptions”

- Not useful for comparing RV deals – e.g. what if the contract has no exit fee?
- ignores inflation of recurrent fees
- Ignores the issue age / gender / health & the **<u>length of stay</u>** in the RV
- Ignores the **<u>time value of money / opportunity cost</u>**
- Too many numbers to compare - information overload for consumers

Note that the minimum term is 5 years – but the most costly deals are those for short term of stay

## Mandatory disclosure: Victoria

Vic requires all the above information to be disclosed in a “Facts Sheet” including the items not required by NSW

Victoria does not have a RV calculator as far as we are aware but their facts sheet requires the RV operator to **provide estimates of the exit payment** a departing resident

would get after terms of 1 year, 2 years, 5 years and 10 years.

- It explicitly takes account of capital gains / losses, departure / exit fees, reinstatement / renovation costs, long term maintenance fund contribution and sale costs.
- This still ignores the **time value of money** and the **expected term of residence** but it is better than the NSW calculator in that it covers the scenarios of short terms of stay and the items NSW ignores.

Neither the NSW and Victorian disclosure documents provide disclosure of the delay in receiving the exit payment. This delay is a significant risk for consumers and does impact on the true cost of the RV arrangement. There have been documented cases where the delay is several years.

Some industry PR claims the rv operators profit comes only from the so called “deferred management fee” and not from the maintenance fee.

The “deferred” fee is actually paid up front – the operator has the use of the money from the start – misleading to call it “deferred”

But many RVs offering contracts with no DMF (but higher entry fee). On these contracts the profit can’t be coming from the “deferred fee” so it must be coming from either the “maintenance fee” or from having the use of the resident’s entry fee money

Just looking at the entry fee, exit fees, exit payment and recurrent fees not sufficient to enable comparisons between deals

What is needed is a way to measure the cost of the RV deal that can take account of the fee structure, the likely length of stay in the village, the time value of money, the capital gains / losses, the possible delay in receiving the exit payment and the extra costs that may happen at the end of tenancy.

This is possible using the MQU RV calculator https://rvcalculator.mq.edu.au/#/

The RV calculator aims to

- make comparison shopping between retirement villages easier and
- promote awareness of the information needed for decision making.

It does this by converting the fees charged under the contract into a simple "**comparison rent**" **payable monthly during the stay in the RV.**

Most RVs have a fee structure that includes

- a large **entry fee** (**ingoing fee**)
- regular **recurrent fees** (**ongoing fees**)
- a partial **refund of your entry fee** possibly adjusted for capital gains / losses and other items
- an **exit fee** (**outgoing fee**) This exit fee is taken out of your refund / exit payment
- possibly extra fees and features that impact at the time of exit

**<u>Three hypothetical RV contract examples</u>**:

The UBB retirement village offers consumers a choice of 3 different RV contracts all for the same 2 BR unit.

- Option 1 has a high entry fee of $1.5m, a monthly maintenance fee of $600 and charges no exit fee. The refund at the end is the whole entry fee of $1.5m

- Option 2 has a medium entry fee of $1.0m, a monthly maintenance fee of $600 and charges an exit fee of 6% of the entry fee for each year of residence up to a maximum of 5 years. If you stayed 5 or more years your refund at the end would be $700,000

- Option 3 has a low entry fee of $500,000, a monthly maintenance fee of $600 and charges an exit fee of 100% of the entry fee regardless of how long you stay in the RV. So when you leave your refund is $0

**<u>Question:</u>** Which of these is the best deal for you given that all of them give you the right to live in the same 2 bedroom unit?

**<u>Answer:</u> it depends on the fee structure and your age and gender**

**For option 3**,

- If you are male and aged 91 you may only be in the RV for 4 years. You pay $500,000 and get nothing back when you leave. It has cost you $125,000 per year plus the $7,200 in monthly maintenance fees. **In total this is 11,000 per month**

- If you are a female aged 68 you may live in the RV for 20 years. The cost per month for you would be **<u>$2,700 per month</u>**. (75% cheaper than for the male aged 91!)

In these calculations for option 3 we've ignored the interest income the RV can earn on the entry fee you paid. If we take the interest rate into account that makes the monthly cost slightly higher than shown above.

**For option 1**

We should take account of the interest the RV could earn on the money during your stay in the village. They have the use of your money from when you move in to when you move out. If this sum could earn interest at say 4% p.a. then that generates income of $60,000 per year. Combined with the $7,200 yearly recurrent fees this costs $67,200 annually or **$5,600 monthly**.

**Which is better?**

For the 91 year old male this is cheaper than option 3, so he should prefer option 1 to 3.

For the 68 year old female this is dearer than option 3 so she should prefer option 3 to 1.

**Most RV contracts are more similar to option 2 than to options 1 or 3.**

**<u>Option 2</u>** has an entry fee and an exit fee structure that is intermediate between options 1 and 3

To estimate the true cost per month with option 2 we need to

(i) Calculate the financially equivalent entry fee for a contract with no refund paid at the end.
(ii) Convert that equivalent entry fee to a cost per month paid monthly over the term of the resident's stay in the village. (the comparison rent)

This requires us to use a suitable **interest rate** and **term** for the calculation.

Using actuarial methods we can estimate the term of residence based on age and gender.

We then compute the financially equivalent pay as you go monthly rent based on the assumed term, interest rate and fee structure. This is what we call the "**<u>comparison rent</u>**" and it allows consumers to compare different retirement village contracts on a like with like basis.

Just looking at the entry fee and / or the exit fee is not enough for a valid comparison.

For the 91 year old male we get a comparison rent / cost of $8,500 monthly over a 4 year term

- For the 68 year old female we get a comparison rent / cost of $4,800 monthly over a 20 year term

This comparison rent is not the amount a resident actually pays monthly over the term. It is a comparison figure to help choose between different RV contracts.

A decision about which RV to choose is more than just a financial one. However the comparison rent gives consumers more information about the true cost of the deal and how to choose between different deals on offer. Even if one is more expensive than another it might be worth paying more. Our calculator helps quantify how much more.

CONSIDER THE FOLLOWING 3 RETIREMENT VILLAGE CONTRACTS

| | RV1 | RV2 | RV3 |
|---|---|---|---|
| ingoing fee | $487,500 | $1,120,000 | $1,627,200 |
| ongoing fee per month | $628 | $672 | $672 |
| outgoing fee per year | 25% | 6% | 0% |
| maximum # years | 4 | 5 | 0 |
| maximum exit fee | 100% | 30% | 0% |

These are all offered over the same RV apartment.

RV1 has a low entry fee but charges a 100% exit fee (25% per year for 4 years)

RV2 has a medium size entry fee and a 30% exit fee (6% per year for 5 years)

RV3 has a high entry fee but 0% exit fee

All have no sharing of capital gain or loss, no other exit costs

Q: Which of these is the best deal? A: It depends!

We argue that a sensible way to compare like with like in deciding which RV contract is best is to compute the **cost per month of stay in the village**. We show this in the table below

This will depend on the total cost and the duration of residence in the RV.

For a male aged 90 this may be 3.6 years.

For a male aged 60 it may be 21.2 years

| | RV1 | RV2 | RV3 |
|---|---|---|---|
| term / length of stay | | | |
| Male aged 90: 3.6 years | **$11,406** | $9,591 | $6,361 |
| Male aged 60: 21.2 years | $3,084 | $4,741 | **$5,605** |
| | | | |
| 2 | $11,911 | $9,914 | $6,447 |
| 5 | $9,270 | $9,336 | $6,293 |
| 10 | $5,214 | $6,426 | $6,056 |
| 20 | $3,201 | $4,843 | $5,650 |

RV3 has no exit fee but the highest entry fee and for the 60 y/o male it is the dearest

RV1 has the lowest entry fee but the highest exit fee, and for the 90 y/o male is the dearest

**<u>Hypothetical example – effect of downsizing into a RV on old age pension</u>**

Shirley - single female aged 80 sells her $1m home and downsizes into a RV apartment.

Entry Fee = $680K,  Exit fee = 5% p.a. for a max of 7 years applied to entry fee

Ongoing (recurrent) fee = $450 per month, No sharing of capital gain / loss

Comparison Rent is $4373 per month over expected term of 7.9 years

Other assets $130,000 in shares / cash. Shirley's assets (for means testing) after downsizing are worth **$450,000** and the interest on this is **$13500** per year @ 3% p.a. Assume 0% inflation.

This generates a reduction in the pension **from 907.60** per fortnight **to $310.39** per fortnight but adding in the interest income we get a fortnightly income of $829.63.

The decision to downsize by moving into a RV has **reduced her income by $2,027.34** per year.

Add to this the cost of RV living ($4373 per month) then **the cost goes to $54,503.34** per year

Before downsizing she owned her home, had the full pension plus interest on $130K for a total annual income of $27,500. Downsizing means going backwards in this scenario.

## NEED FOR CONSUMER FINANCIAL ADVICE

This example illustrates the need for consumer financial advice at / before the point of entry to a RV.

Many consumers may need advice about what happens at / before the point of exit from a RV. There is the possibility of having to an aged care facility. In the above example a resident departing after 5 years may receive an exit payment of $476,000. This may not be enough to pay for entry to an aged care facility, or there may be a long delay in getting the money.

Advice may be needed about

- The cost of entry to a suitable aged care facility and the financing options
- Whether the RV exit payment will be sufficient to cover it
- How to deal with a situation where there is a delay in getting the money from the RV to finance the move to aged care
- Planning for it in advance

Apart from the above scenarios there is the need for consumers to get advice about which of several different RV contracts to choose, the pros and cons of downsizing into an RV etc.

**Consumers need legal advice** about

- the features of the contract,
- the fee structure,
- the rules and regulations they must comply with and in particular about
- issues that may lead to disputes with the RV operator
- remedies available to them in the event that they are in dispute with the RV operator.

Some contracts contain “nasties” that impose risk and cost on consumers. Many of these are likely to happen at the end of the term of the contract when the resident is older, poorer, sicker and less capable of engaging in a dispute with the RV operator.

**Refurbishment**

The contract may require the resident to pay for "refurbishment" of their apartment and give the RV operator control over how much money it may cost the resident. The cost of refurbishment may not benefit the resident if the increase in price of the unit is less than the amount spent or is shared with the RV operator as part of the gain.

**Delays in getting the exit payment**

There may be delays in getting paid the exit payment so consumers need to know what remedies if any are available for dealing with this. Engaging in litigation over such issues may be very time consuming and expensive.

There have been various inquiries into the RV industry and State Governments have made changes to the regulations to improve disclosure and dispute resolution. Much more could be done to reform the industry.

Consumers do need appropriate advice on RV contracts. The need for advice is likely to increase over time as the aging of the population increases demand for RV accommodation.