Submission to the Review of the *Retirement Villages Act 1986 (Vic)* by:

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Submitted via email: rvreview@justice.vic.gov.au

Dear Consumer Affairs Victoria

The three of us welcome the opportunity to comment on the Issues Paper for the *Retirement Villages Act 1986* (Vic) Review. We have been provided with a copy of the submission from the Consumer Policy Research Centre (CPRC). We agree with much of what is in this submission. As academics, we conducted the research commissioned by the CPRC and the three of us, together with the rest of the steering committee, were involved in the design, deployment and analysis of the results of a substantial survey of Retirement Village residents which informed the CPRC submission.

We agree that the CPRC approach of utilising the "five preconditions of effective consumer engagement" framework for analysing the results makes a great deal of sense.

Regarding the CPRC submission, we agree with all their recommendations. However, we would add to them as follows:

CPRC Recommendation 1:

<u>In our view this should be expanded</u> to tailor information and outreach to meet the needs of those who <u>advise</u> older people about Retirement Villages including lawyers and financial advisors. Consumers need advice on both legal and financial aspects including some of the key risks consumers may be exposed to in Retirement Village contracts. The information needs of those advisors may be different from that of consumers and expressed in different language.

CPRC Recommendation 2:

In our view the information that should be collected and published <u>should also include</u> the capacity of the Retirement Village to pay exit payments within a reasonable time frame, its track record in doing so, the financial condition of the Retirement Village, and what type of entity it is (e.g. public listed company, private company, mutual, charity etc). This information would be useful for those who advise consumers as well as providing data the regulator should have in order to be able to properly regulate the industry. Other information the regulator should consider collecting is demographic information about the age / gender of new entrants to the village, the age / gender distribution of the residents of the village and details of the age / gender / cause of exit for those people who leave the village and the current vacancy rates. We realise this is a "big ask" and industry is likely to object to providing it. In an ideal world it would be good to have this data, as well as data on residents who have already departed (retrospective data) as such data aids in transparency, and it would provide an overview of residents and their changing demographics/needs over time – which would be beneficial for future planning/adjustments to Retirement Village services and also for future changes to the Act

CPRC Recommendation 3:

In our view this is a perfectly sensible suggestion and we support it fully. It would provide consumers with greater assurance and certainty that managers could be relied upon more fully.

CPRC Recommendation 4:

We agree this is a sensible proposal. Implementing it may be complex, however. The details of implementation are subject to several contingencies, some of which are laid out below.

One of the difficulties is that there is both a factsheet and a disclosure statement, both of which do not seem to be functioning as they are intended, as shown by our recent survey results (see the CPRC submission). In addition, Retirement Village costs include entry fees, ongoing fees, sharing of capital gains or losses, so-called "deferred management fees", reinstatement and refurbishment costs etc. Some of these costs are straightforward to present – e.g. the entry fee and the initial amount of the ongoing fees. Other costs are mostly incurred at the time of exit from the village and these are much more distant in time and subject to much more uncertainty. Again, this was clear in our survey results.

The delay in being paid the exit payment is a cost; but quantifying it financially and presenting it is challenging. The overall cost of the Retirement Village deal can be estimated in terms of either an up-front lump sum cost or in terms of a regular pay-as-you-go payment per month over the resident's expected length of stay in the village. Professor Kyng has developed various financial metrics to measure these costs using actuarial and financial methods. A key issue for the potential resident is how long they are likely to be a Retirement Village resident. The average length of stay depends on their age, gender and health. We can estimate it as 'health adjusted life expectancy' using actuarial / demographic methods. We are happy to discuss this with CAV / the Victorian Government.

In addition, the standard growth of real estate prices is used to demonstrate estimated departure entitlements to residents on the last page of disclosure statements. This information is misleading given these prices do not apply to the re-sale/re-lease of units in Retirement Villages as they are not sold on an "open market" as such.

CPRC Recommendation 5:

We agree this is a sensible proposal. There are limits to what disclosure can achieve in terms of consumer protection.

CPRC Recommendation 6:

We agree that standardisation of Retirement Village contracts could have the benefit of enabling advice to be given by a broader range of advisors. As we have no legal expertise we cannot comment further on this.

CPRC Recommendation 7:

We agree that providing clear comprehensive information enabling comparison of Retirement Villages with other forms of housing is a desirable objective. We are of the view that this should include provision of information enabling cost comparisons of different contracts for the same Retirement Village dwelling, different contracts for different Retirement Village dwellings, comparison of a Retirement Village contract with the alternative of renting and comparison with the alternative of ownership of a dwelling.

Some online comparison tools are available. The NSW Department of Fair Trading has one and it is available at the URL http://rvcalculator.fairtrading.nsw.gov.au/. This calculator does not provide information on which of two different Retirement Village contracts is cheaper. It also does not enable a valid like-with-like comparison. It ignores the opportunity cost of money paid as a large lump sum entry fee; it ignores the age and gender of the consumer and consequent health adjusted life expectancy. Further, as the standard growth of real estate prices is often not applicable to re-selling/releasing units in Retirement Villages, the NSW calculator makes inappropriate assumptions about the growth of these prices which then feeds into the calculator's estimates of the consumer's exit payment.

We developed an actuarial science-based online comparison tool at Macquarie University. The Macquarie University Retirement Village calculator is available at URL https://rvcalculator.mq.edu.au/#/calculator It is designed to compare different Retirement Village contracts against each other and against the alternative of renting an apartment. It is a free online financial calculator to facilitate comparison shopping and it uses a "comparison rent" metric to enable comparison of different Retirement Village contracts on a like-with-like basis. The comparison rent is the pay-as-you-go monthly rent, payable over the resident's average length of stay in the village, which has the same economic value as the Retirement Village contract's cashflows. It's a complex calculation but the metric, being a rent, is easy for consumers to understand. Macquarie University is independent of government and of industry and we have no financial interest in the decisions consumers make about Retirement Village residency.

From a financial perspective the Retirement Village contract involves the consumer paying a large up-front lump sum payment and receiving, in return, the right to reside in the village while alive and healthy, and the right to receive an exit payment after they leave the village. The amount of the exit payment and its timing have considerable uncertainty built into them. This payment is analogous to an insurance policy claim payment for a complicated real estate-linked insurance policy. Most consumers do not think of it that way however.

We are happy to discuss methods for comparing Retirement Villages against each other and against other accommodation arrangements if CAV / the Victorian Government is interested. We can adapt our Retirement Village calculator to meet the requirements desired.

Other differences between Retirement Village housing and other forms of housing include length of tenure, financial risks involved, relationship between the growth rates of the Retirement Village exit payment and the costs of residential aged care.

CPRC Recommendation 8:

We fully agree and have nothing to add to this recommendation.

We provide additional responses below to each of the questions from the Issues paper.

1. *Should the payment of an in-going contribution be the defining factor in determining whether the RV Act applies to a Retirement Village? If not, what other considerations ought to be appropriate?*
2. *Is the definition of a Retirement Village under the RV Act otherwise appropriate? If not what other changes would you recommend?*
3. *Is the current purpose of the RV Act still appropriate? If not what do you think the legislative purpose of the Act should be?*

Regarding Questions 1, 2 and 3, we do not have a legal background so we leave it to others who do have this expertise to provide their own feedback. However, we consider the following "stylised facts" about the retirement village industry to be very relevant to our comments and recommendations below.

Stylised facts and discussion

Retirement village contracts are generally very complex and it is difficult for consumers to assess them and compare them. It is difficult to get information about these documents compared with other types of real estate.

These contracts are long-term accommodation arrangements and the entry fees are for most residents a substantial proportion of their overall wealth at the time of entry. The entry fee may be lower than the cost of other similar accommodation, but this isn't always the case. When they leave the village the exit payment / refund they receive is likely to constitute a substantial proportion of their remaining wealth.

The right to reside typically terminates when the resident dies, or their health declines and they can't live independently, or they voluntarily relocate to some other accommodation. The vast majority of Retirement Village residents leave due to death or ill health necessitating a transfer to residential aged care. This means the average length of stay in a Retirement Village can be calculated as their 'health adjusted life expectancy'. This calculation depends on their age and gender.

The contracts usually involve a large fee paid at entry, ongoing recurrent fees and a partial refund of the entry fee paid to the departing resident or their estate when they leave the Village. The partial refund may be adjusted for sharing of capital gains and / or capital losses and for so called "deferred management fees" and various other charges. These "deferred" fees are deducted from the entry fee paid, which were received by the operator at that time. The amount of the deferred fee to be charged is determined based on a formula involving the term of residence, but this is actually paid up front by the resident. Capital gain is usually defined as the *difference* between the entry fee paid by a new resident who replaces a departing resident, and the entry fee paid by that departing resident.

There is considerable uncertainty as to the amount of the refund the departing resident will receive on exit from the village. This is due to uncertainty about the term of residency, about the amount of any capital gains or losses, about the amount of any refurbishment or reinstatement costs and about the time it takes for the Retirement Village operator to pay the amount owing.

There is considerable uncertainty about the length of time it takes for the Retirement Village operator to pay the exit payment after exit has occurred. This may be due to the Retirement Village practice of funding exit payments by re-selling the dwelling to a new entrant. This is a major risk for departing Retirement Village residents who are alive, as they will need access to their money to pay for alternative accommodation. Having to wait for an unspecified amount of time for the release of these funds can limit a resident's choice of accommodation – particularly when deciding which aged care facility to relocate to. For those residents who have died, their estates bear the brunt of waiting for the release of the funds from the Retirement Village.

The resident usually doesn't "own" the unit or apartment they live in, or if they do via strata or company title, their ownership rights are very heavily constrained by the Retirement Village contract.

From a financial perspective, the contract involves the resident paying the large entry fee, committing to pay the ongoing recurrent fees and in return *receiving the right to reside*, *while alive and well.* They also *obtain the right to receive the exit payment on, or some time after, the time of exit from the village.* The *right to reside* is basically the same as what is known as a "life interest" in a property. Typically these are valued using actuarial methods. The *exit payment received after exit* is analogous to an insurance policy payout for a complex real estate-linked insurance contract. The entry fee pays for the right to reside and it pays for the eventual exit payment. In effect, the consumer pays <u>the rent for the right to reside in an up-front lump sum and pays more on top to cover the exit payment</u>.

The combined effect of the fees and charges taken out of the refund paid after departure and the length of time taken to make that payment act as an impediment to leaving a Retirement Village for consumers who are dissatisfied. It is potentially a trap for the unwary.

Given the high complexity of the contract, the large amount of money involved, the high risk and uncertainty involved, the difficulty involved in getting out of the Retirement Village contract, and the vulnerability of the consumer, consumers are not well served or well protected by the current regulatory regime.

4. *What improvements could be made in the register of Retirement Villages?*
5. *What other information should operators be required to include in the register?*

The information held in the register is very limited and of limited usefulness to the consumers or the regulator, or those who advise consumers and other stakeholders.

The regulator should have access to much more information about the industry they are regulating than they currently do. The public has a right to know much more about Retirement Villages and the industry than they currently do. We believe that a lot more financial and demographic information should be included in the information consumers receive. Specifically the register should include information about each retirement village:

- The Retirement Village's financial condition (e.g. Balance Sheet, and Profit and Loss statement, details of assets held) on at least an annual basis for at least the last three years and updated annually. If they can't provide this they should say so. A statement of some kind from Retirement Villages regarding their assets and liabilities should also be provided.
- Whether a Retirement Village typically has to re-sell a departing resident's dwelling to a new incoming resident in order to be able to fund a departing resident's exit payment. It would not be difficult for the Retirement Village to provide this information.

- The Retirement Village's track record in paying exit payments and a history of how long it took for the payment to be made, for each exit over the past three years, as well as the average time taken. It would not be difficult for the Retirement Village to provide this information as they would know how long it took from their records. This should be measured as the time from vacant possession to when the exit payment was fully paid.
- A history of the ratio of the exit payment received by departing residents to the entry fee they paid, for each exit over the past three years, and the average of this ratio over that period. This would provide the public with information on the overall impact of the effect of deferred management fees, capital gain and loss sharing and other costs on the amount a resident would get back at the end per $1.00 of entry fee paid. This would be a simple metric to calculate and the Retirement Village would have the information to hand to enable them to calculate it.
- The Retirement Village operator's form of business organisation (listed company, unlisted company, charity, mutual etc). This would be easy for Retirement Village to provide.
- Details of the demographics of their residents and so on. This should include the age and gender profile of current residents, the age and gender profile of new entrants over the past three years, and the age / gender / cause of exit for each exit from the Retirement Village resident population over the past three years.

6. *Are the current 21 day 'consideration' period and the 3 day 'cooling off period' under the RV Act effective in achieving their aims? If not, what other or additional measures would be effective and fair?*

The 3 day cooling off period is in our opinion too short and it should be 5 business days instead. In NSW the 90-day settling-in period is a good feature of regulatory regime and it could be adopted in Victoria easily. Given the large amount of money involved and the fact that it is a long-term arrangement that is difficult to get out of, it would be much fairer for consumers to have the 90 day settling in period as part of the regulatory regime.

7. *When advertising the 'price' of a Retirement Village unit, should there be a requirement to include a reference to any deferred management fees and other departure fees and charges?*

Yes definitely. Retirement Villages should be required to disclose:

- the maximum DMF percentage (DMF%)
- number of years of residency required to reach that maximum DMF%
- what the DMF % applies to (e.g. entry price or resale value)
- history of the average amount of any reinstatement or refurbishment costs incurred by departing residents over the past three years
- ratio of the exit payment received to the entry payment made should be calculated for each Retirement Village unit sold over the past three years. This disclosure should consist of the **average**, the **median**, the **25th** and **75th** percentiles of the distribution of this ratio. This information would provide prospective residents with information

about the overall effect of the various departure fees and charges and resident's share of capital gains or losses

- Retirement Villages should also be required to disclose information about the time taken to pay out the exit payment to departing residents. This should include the **average** time, the **median** time, the **25th percentile** and the **75th percentile** of the distribution of the time taken. The delay in receiving the exit payment incurs costs for the departing resident. It should be disclosed.

All information disclosed should be signed off by an auditor.

8. *Has the provision of a Factsheet and Disclosure Statement to prospective residents led to an improved understanding of the financial and contractual arrangements relevant to living in a Retirement Village enabling prospective residents to make an informed decision?*

It is difficult to answer this question as it is framed. A more relevant question would be **how much** have these documents improved understanding, if at all, **and whether this understanding is enough for prospective residents to make an informed decision?** To determine these answers, a study of the comprehension of contracts / disclosure documents with the old and the new disclosure regimes would need to be done. This would be time-consuming and expensive to do and it would need to ascertain more than just self-reported understanding to generate valid results. We note that in the Disclosure Statement the Operator can choose which assumptions to apply about the rate of capital gains used in calculating exit payments. Consequently, they could, in effect, provide overly optimistic growth rates, which do not accurately reflect *actual* growth rates.

9. *What, if any, further improvements could be made to improve prospective residents' understanding of the potential financial and contractual arrangements relevant to living in a Retirement Village?*

We are of the view that:

- CAV could provide consumers with easy access to the Macquarie University Retirement Village Calculator on the CAV website. We would be happy to work with CAV on adapting the RV calculator to meet Victorian requirements, and compute other metrics as required. This would provide prospective residents with better, and more accurate information and, therefore, the ability to compare different Retirement Village deals that may be on offer
- Consumers should be provided with an estimate of their health adjusted life expectancy. This is highly relevant to judging whether a Retirement Village contract delivers value for money to the consumer. CAV could easily provide this information on their website
- Operators could be required to disclose the information suggested in our response to question 7 above
- The risks involved in Retirement Village living could be provided in an online resource, including the potential risk of having to relocate to residential aged care

and the risk of having to wait a long time to receive an exit payment.

- Retirement Villages could provide historic data on how their Retirement Village exit payments compare with the cost of entry (RAD) into residential aged care over, say, the last three years.

10. Are the current timeframes for provision of a Factsheet and Disclosure Statement to prospective residents appropriate?

No, they are not. There is no reason why these documents could not be supplied *immediately* to those consumers who make an online enquiry.

11. Has the form and content requirements for Retirement Village contracts introduced in 2014 improved residents' understanding of the contractual arrangements they have entered into?

It is difficult to provide concrete evidence for this. However, our survey results (see the CPRC submission) show that only 37.7% of respondents have been satisfied with the overall package of entry fees, ongoing fees, exit costs, capital gains/loss sharing etc. This indicates the necessity to revise and improve the current form and content requirements for Retirement Village contracts.

12. To what extent do Retirement Village contracts remain unnecessarily complex?

This is true to a very considerable extent. The DMF model of Retirement Village contracts is inherently complex for consumers and exposes them to various risks and to a **power imbalance** relative to the operator of the RV. Other features such as capital gain and loss sharing add to this complexity. The complexity generally benefits the operator more than the consumer. The industry practice of paying exit entitlements only after the departing resident's dwelling is re sold to a new resident is one of the main reasons for delays in paying exit entitlements. It is **akin to Ponzi scheme** in this respect. Real estate is illiquid relative to other asset classes, Retirement Village real estate is generally more so. The other features of the contract add to its complexity and risk for consumers in particular the extras that apply at the time of exit or thereafter.

The industry claims that the DMF model allows them to offer consumers a cheaper entry fee and that it's cheaper than the alternative of buying an equivalent dwelling. But this is not a valid comparison as the RV consumer doesn't own the RV dwelling, instead they buy the right to reside in it while alive and well and this is of lower value than the rights attached to ownership. However the RV consumer is entitled to eventually receive the exit payment. It's very debatable that the RV deal is cheaper than buying a place to live in when you properly account for what it is that is being bought.

A combination of the effects of the exit fees levied, other costs incurred around the time of exit and the delay in getting paid an exit payment make it difficult for RV residents to move out and find alternative accommodation without access to their money. This generates a power imbalance between the RV residents and the RV operator. In effect the RV deal is a long term rental arrangement with some extra life-style features added but one where a consumer pays the rent in advance for the rest of their healthy lifespan. This is very different from a normal pay as you go rental arrangement in terms of the bargaining power of the parties.

13. *What further improvements could be made to contractual requirements under the RV Act?*

We leave it to others with legal expertise to comment on this.

14. *Should Retirement Village operators be required to disclose ingoing prices for entering a Retirement Village with and without deferred management fees? If so, what form should this take? If not, why not?*

Yes, we agree. This should take the form of a single lump sum payment by the resident to the operator in return for the right to reside (as per a normal contract) and the right to receive the entry fee back *in full* on exit from the village. However, operators can make the 'no DMF' contract option unattractive to consumers by making it too expensive.

An alternative option is to require Retirement Villages to **also** quote (and provide) a rental contract with monthly rental payments instead of the standard contract. **With the rental option there would be no capital gain or loss sharing and no exit fee** charged to the consumer**.**

15. *Should deferred management fees be calculated on a pro rata basis? If so why? If not why not?*

Yes, a pro rata per diem would be more fair than the alternative of the dmf being based on each completed year or part of a year.

16. *When should Retirement Village operators be required to provide a resident with an estimate of their departure fees and what are your reasons?*

Whenever a resident requests this information. It should be relatively easy for a village to comply and they have to do this when a resident leaves, so they already have the capacity to provide such information.

17. *What do you consider to be the benefits and costs of introducing a form of mandatory accreditation for Retirement Villages?*

18. *What do you consider to be the necessary elements of any mandatory accreditation scheme?*

We leave it to others with more expertise in legal matters to comment on these matters.

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We would like to thank Consumer Affairs Victoria for the opportunity to put our views forward on these important matters.

Yours sincerely,

Tim Kyng, Sue Malta, Maho Omori