PROPERTY COUNCIL of Australia

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Dr Elizabeth Lanyon
Director
Policy and Corporate Services
Consumer Affairs Victoria
GPO Box 123, Melbourne Victoria 3001

Via email: cav.consultations@justice.vic.gov.au

Dear Dr. Lanyon,

Re: Regulatory Impact Statement for the Retirement Villages (Contractual Arrangements) Regulations

The Property Council welcomes the opportunity to comment on the proposed changes to the Retirement Villages (Contractual Arrangements) Regulations (the Regulations).

Our major area of interest is the three alternative approaches considered for renewing the aged care rule. In 2016, we took part in extensive discussions and meetings with Consumer Affairs Victoria (CAV) to address the increasing financial stress being incurred by retirement village operators as a result of the aged care rule. As it currently stands, the aged care rule is a growing issue for retirement village operators, and one of the biggest threats to the financial viability of the sector.

The Property Council supports amending the aged care rule so that people moving from independent living retirement village premises to aged care are treated the same as people moving from any other independent living suburban house or strata title retirement village to aged care. This would mean that, where the outgoing resident controls setting the 'selling price' for their retirement village premises, they would be entitled to receive such 'sale' proceeds to finance their transition into an aged care facility, only after their retirement premises is 're-sold' to the next ingoing resident. This principle is already well established and accepted by residents and operators alike where, provided Schedule 1 is incorporated into the contract giving the resident control over the unit selling price, then the operator is not obliged to automatically pay out the resident after six months from vacating the unit. Virtually all operators adopt Schedule 1 in contracts and this principle has been accepted as fair by residents and operators.

Through our discussions with CAV, we have refined our position to allow non-owner retirement village residents who control the sales price and the sales agent to still gain support from the retirement village operator in their move into aged care. This occurs under the circumstances where their retirement village

unit does not sell within six months from vacant possession and the person has already moved into aged care.

Regarding the three options presented in the Regulatory Impact Statement (RIS), our members support an option which replaces the current aged care rule with a DAP rule for new and existing non-owner residents who have entered retirement villages after 31 July 2006 up to 85 per cent of the estimated exist entitlement (Option 3). By comparison, Options 1 and 2 pose a far greater financial burden for the village operator, given the significant capital a RAD based payment represents compared to periodic DAP payments. The RAD burden grows as more residents move into aged care, and as all new contracts (post 2006) are subject to the aged care rule.

The Property Council will address our feedback to the RIS in the following manner:

- We will provide commentary on the proposed options which relate to the aged care rule; and,
- We will also respond to the questions outlined in the RIS.

Proposed Options

Option 1 – DAP or RAD rule

Under Option 1, non-owner residents moving from retirement villages to aged care will have access to a choice of a DAP or RAD based payments to the estimated exit entitlement. The Property Council does not support this option as it places an unsustainable burden on retirement villages and residents.

For retirement village operators, Option 1 places enormous financial stress on village operators who, under the current aged care rule, must provide an early payout to every resident moving to aged care that chooses to pay a RAD to the aged care provider.

As Victoria's population ages, and residents on post 2006 contracts begin to enter aged care[1], retirement village operators face a growing financial burden in the number of residents opting to pay RADs. The number of retirement village residents moving to aged care has grown over recent years to now comprise approximately 60 per cent of residents that leave a retirement village. According to research by Grant Thornton, the number of RADs needing to be paid in 2021 will grow to approximately 1,912, costing the sector $604 million annually.

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[1] Following the Commonwealth's *Living Longer, Living Better* reforms in 2014, residents on post 2006 contracts can choose to pay a RAD for all aged care accommodation. Prior to these changes, the aged care rule only applied to exit entitlements for residents moving to the low level of aged care, as this was the only level of care where a RAD was required.

This issue (and genuine financial stress for the retirement village operator) is further exacerbated by the fact that the outgoing resident continues to control the setting of the selling price. In Victoria, it has become industry practice to introduce specific clauses into resident contracts providing the non-owner resident with control over the sale of the dwelling. However, the right of control now has implications for the aged care rule as the resident is potentially entitled to receive an early payout (prior to sale) while retaining control of the sale. For outgoing residents who have received all their exit entitlement, this is a disincentive to sell their dwelling in a timely manner. On average, sale times of 12 to 18 months are common, particularly where residents have received an early payment from the village operator to fund a RAD and therefore have no incentive to set realistic market based selling prices for their units. This time frame includes the exiting resident vacating the dwelling, the operator conducting any required refurbishments, finding the buyer for the dwelling, and then receiving the payment. During this time, the retirement village will experience a large outflow of funds which places a strain on operator cash flow.

Payment of the RAD has adverse liquidity impacts for all operators, and in particular smaller operators which represent a large portion of the market. Larger operators may have higher cash balances allowing them to absorb the delay of cash flow, but they may need to re-evaluate their position. For smaller operators, payment of the RAD will result in large lump sum outflows with extended and unknown periods prior to any cash inflows. Where surplus cash is unavailable, villages will need to acquire loans to cover working capital shortages.

The Property Council commissioned Grant Thornton to undertake financial modelling of the impact of the aged care rule on a typical retirement village, for its report *The effect of the Victorian aged care rule on the retirement village sector*. The modelling found that for a 'typical' for-profit retirement village of 200 units with all residents on post 2006 contracts and an average sales time of 9 months, the village operator will need to inject $4.8 million to cover RAD payments to avoid the village becoming unviable. Raising such funds will simply not be possible in many cases.

Retirement Village Overview	
Size of organisation (dwellings)	200
Residents leaving the village annually 15 per cent	30
Residents moving to aged care annually 60 per cent	18

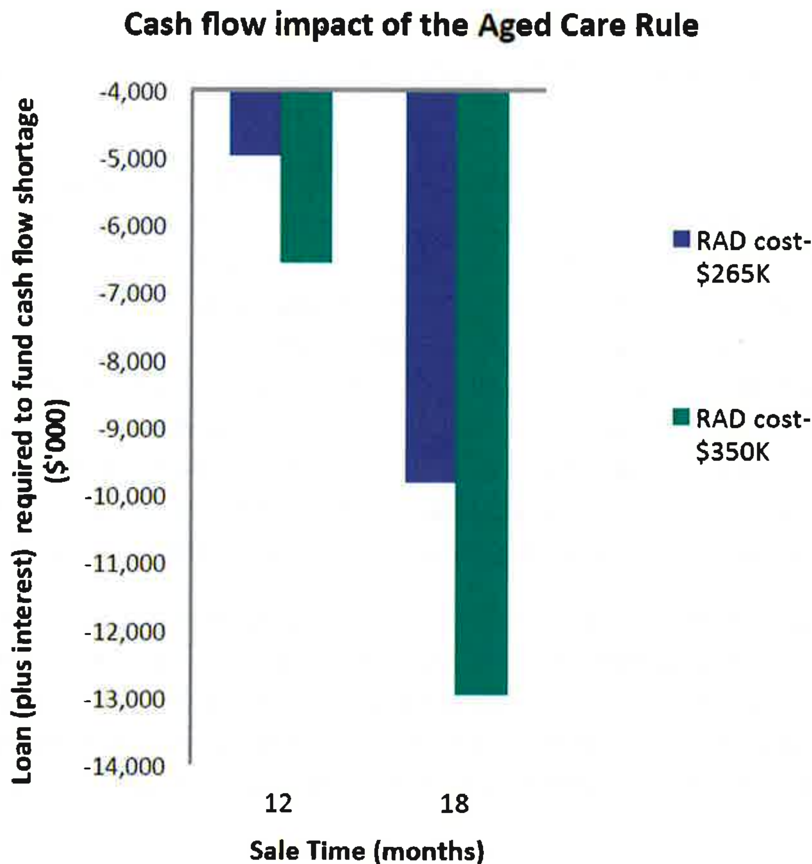
Impact of the Aged Care Rule ($'000)			
Average Sale Time	9 months	12 months	18 months
Loan needed to fund early payout	$4,800	$4,800	$9,600
Interest on loan	-$96	-$192	-$384
Opportunity cost	-$120	-$240	-$480
Operating cash flow in the first financial year	$1,300	-$5,200	-$5,200
Net operating cash flows over the average sale time	$1,300	$900	$400

Notes for Impact of the Aged Care Rule table:

- The model assumes that all residents leave on the first day of the financial year. Although the timing of the exit becomes less significant as the time to sell increases.
- The loan is taken out after six months of the dwelling being on the market as this is when the RAD payment is due.

Source: Property Council of Australia (2014) *The effect of the Victorian aged care rule on the retirement village sector*

Moreover, there is the potential for greater downside if market conditions worsen. An increase in the RAD costs, sale time or combination of these would further deteriorate the financial position of a retirement village operator. The following chart shows the increase of both sales time and RAD payments on the above illustrative example. In the event that the sale time increases to 18 months, the loan required to fund the village's cash flow shortage will double to $9.6 million.



Source: Property Council of Australia (2014) *The effect of the Victorian aged care rule on the retirement village sector*

Growth of the RAD burden on retirement village operators will have a profoundly negative impost on the financial and operational health of the sector. As such, it is our view that the adoption of Option 1 will not be sustainable for industry's ongoing viability.

Option 2 – DAP or RAD rule with RAD grandfathering provisions

CAV's preferred option involves replacing the current aged care rule to be a DAP rule for all residents who entered retirement villages after 31 July 2006 with an optional (grandfathered) RAD rule for residents who are already living in retirement villages.

In the alternative to our submission set out below in relation to Option 3, we submit that the following changes should be made to the proposed Regulations in relation to Option 2:

1. It should only be in circumstances where there is a material breach of an operator's obligations in relation to the clauses set out in Schedule 1 that the resident is entitled to recover the refundable ingoing contribution. The words "committed a material breach of" should replace the word "breached" in proposed new Regulation 6(1)(b).

2. The proposed new Regulation 7 does not address the interaction between the aged care rule, which under the new Regulation will require the operator to pay the lesser of the RAD and the unpaid refundable in-going contribution if requested by a resident who entered into a residence contract before the date the Regulations commence, and the right of the resident to set the resale price of the unit pursuant to the clauses set out in Schedule 1 of the new Regulations. A resident who has the benefit of the operator funding payment of the RAD to the aged care provider, should not also have the right to set the resale price of the unit, as this leads to residents placing unrealistic prices on units and delaying sales, as the resident has no incentive to set a realistic market price. The proposed new Regulation 7(7), (8), (9) and (10) only addresses the value of the amount to be funded by the operator to the resident for the move to aged care. It does not address the value of the resale price for the unit to be offered for sale on the market.

The Property Council proposes that if a resident's RAD is funded by the operator (pursuant to proposed new Regulation 7(2)) then the parties should be required, if they cannot agree on the resale price, to appoint a valuer to determine the fair market value of the unit in similar terms to that set out in proposed new Regulation 7(7), (8),(9) and (10). Further, if the unit cannot be sold at that price after a set period (of three months) either party should be entitled to obtain an updated valuation which should be binding on the parties.

The proxy amount defined in paragraph 3 of Schedule 3 should be "the current market value of the residence right as agreed between the resident and the owner, and failing agreement as determined by an independent valuation...."

We further recommend that Regulation 7 should also include a clause that makes it clear that any RAD or DAP payment made by the retirement village operator will be deducted from the exit entitlement payable to the resident.

Option 3 – DAP rule

Option 3 replaces the current aged care rule with a DAP rule for new and existing non-owner residents who have entered retirement villages after 31 July 2006. This is the preferred option of The Property Council.

Rather than one lump sum payment of the RAD at six months, periodic payments of the DAP would be made (up to 85 per cent of the value of the exit entitlement). These would be made to the aged care facility until the dwelling is sold, and the resident is repaid their exit entitlement, at which point the resident can decide their own future payment method.

If the resident does exercise control over the sale (as is the case for most residents in Victoria), the DAPs plus a token interest rate (i.e. Reserve Bank rate) should be deducted from the exit entitlement. This interest will assist in paying the funding costs of the retirement village operator who pays the DAP on behalf of the resident.

Periodic payment of DAPs will reduce the cash strain on individual retirement villages as the upfront payment is reduced from a large lump sum to smaller monthly payments, which is more manageable than paying the RAD in full. The incentive to hold on to the dwelling is also reduced as DAPs are not refundable by the aged care facility, compared to the RAD which is largely refunded.

Of the three options presented in the RIS, the Property Council believes that this is the only option which does not create undue financial pressure on retirement village operators. We note that a similar view was expressed by the Legal and Social Issues Committee as part of the Inquiry into the retirement housing sector, in noting that "it is reasonable to give retirement village operators the option of paying the DAP on behalf of a departing resident until the resident's unit is sold"[2].

As previously noted, Regulation 7 should also include a clause that makes it clear that any RAD or DAP payment made by the retirement village operator will be deducted from the exit entitlement payable to the resident.

Consultation Questions

Question: Have the changes to contract requirements made in 2014 been effective in improving the fairness of contracts for residents (i.e. residents' understanding of their financial commitments and contractual rights and obligations)?

Feedback from our members suggests that some aspects of the 2014 contractual requirements have been positive. The consistent level of disclosure now required in the form of Fact Sheets and worked examples of outgoing payments to residents have improved disclosure for new residents.

However, the prescribed contract terms and prescribed contract format and headings have caused the residence and management contracts to become significantly longer and more complex documents, making them harder for residents to read and understand. Typically, residence and management contracts are now close to double the length they were prior to the 2014 requirements. Furthermore, the key information that residents need to understand from the contracts is often now required to be in multiple locations in the document.

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[2] Parliament of Victoria – Legal and Social Issues Committee, Inquiry into the retirement housing sector, March 2017

The Property Council of Australia's Retirement Living Council with the help of village operators has developed the 'National Guide to Creating Simple and Effective Retirement Living Contracts', which sets out key elements of a good residence and management contract. A copy of the Guide has been included with this submission for the CAV's reference. We would recommend a rationalisation of the required contractual structure, and would be pleased to provide assistance on best practice contracts. We would also be pleased to support our position by meeting with CAV to discuss detailed improvements.

Question: Is the proposed 85 per cent cap on early exit entitlements (for Option 2) appropriate? What alternative cap would you suggest and why?

Yes, the Property Council believes that payments should be capped to 85 per cent on early exit entitlements to account for potential deterioration of the property market.

Question: Are there any other substantial costs of compliance related to the six month rule exemption, the calculation of early exit entitlements and the other contractual controls?

The Property Council considers the regulatory burden of undertaking an independent valuation for the calculation of in-going contribution refunds to be onerous, particularly when there is already usually good evidence of fair market price available from recent unit resales in the same village. Moreover, all retirement village operators have an excellent idea of the value of their units, which is based on sales data that is historically collected and documented, as well as the fact that the majority of operators usually have an independent annual valuation of their villages which identifies the value of each unit. Therefore, we recommend that the requirement to seek an independent valuation should only apply when the resident and the village operator fail to agree on the value of the unit.

We further recommend that, if a unit remains unsold after 3 months, then the resident and operator should have the ability to initiate a further agreement as to a revised price or, failing such an agreement, appoint an independent qualified person to determine the fair market price at which the unit should be offered for sale. This approach to price setting should be re-applied every 3 months that the unit remains unsold. The cost of independent assessments of value should be shared equally by the resident and the operator.

Should you have any queries about our comments above, please contact Sandra Qian, Senior Policy Advisor on 03 9650 8300.

Yours Sincerely,

Sally Capp
Victorian Executive Director
Property Council of Australia