Friday, 16th August 2019

The Hon. Kevin Anderson MP
Minister for Better Regulation and Innovation

C/- Retirement Village Exit Entitlements Discussion Paper
Regulatory Policy, Better Regulation Division
Department of Customer Service
2-24 Rawson Place
HAYMARKET NSW 2000

By email:

Dear Minister,

Re: Feedback on the discussion paper, *Retirement villages – exit entitlements and recurrent charges cap*

Thank you for the opportunity to provide feedback on the discussion paper, *Retirement villages – exit entitlements and recurrent charges cap,* dated July 2019.

By way of background, AEH Retirement Living is a smaller, privately-owned operator in New South Wales. We have been active in the sector for more than 15 years, which builds on more than half a century of our group providing expertise to the residential housing sectors. Within our boutique group we have significant skills and expertise in designing, developing, building and operating retirement villages, along with other forms of housing.

As a group and as individuals we are passionate about our customers and about our product. The author of this letter has a particular passion for housing, seniors' housing and innovative ways to provide accommodation to the current and next generation of senior Australians, with an emphasis on quality, service and affordability. We have a keen interest in the planning, legislative, finance, design and operational solutions required to meet that demand.

We are also actively involved with the Retirement Living Council and the Property Council of Australia and have provided separate input into their submission, which we also endorse. This letter is provided in an individual capacity as an owner and operator, with a particular focus on the implications on smaller operators. We almost exclusively focus on the question of mandatory, time-limited exit entitlements, which in this letter we refer to as "buy-backs". Since these comments are more of a general nature, they address the question on Page 26, "Can you think of any other benefits or costs of this reform? What are they?"

The primacy of the customer, whose wellbeing is threatened by the proposal

We understand that the wellbeing of customers – the residents – is of pre-eminent importance to operators. Customers are at the centre of an operator's business and without customers an operator would not exist. It is important for us to say this because the comments that we make in this letter sit within that context. We are seeking an outcome on these reforms that ensures a vibrant long-term future for the sector for the benefit of our customers.

The discussion paper has acknowledged that it is derived from the findings of the *Greiner Inquiry* and in particular, Recommendation No. 5. The Inquiry drew upon the 867 "unique views" (expressed by post, email, online submission or through attendance at a forum). Supported by several industry-wide surveys, the vast majority of the 66,000 village residents in New South Wales enjoy their lives in their chosen community. These residents have freely chosen to move into their respective retirement villages, usually after careful and often lengthy consideration and advice.

We have serious concerns that, although the intention of the proposed buy-back reform is to improve the wellbeing of the customer / resident, it will ultimately have the <u>opposite effect</u> in several important ways. We are concerned that the proposed changes will not improve the lives of residents, but rather lead to an escalation of disputes, (particularly around values and valuations), depress property prices to the detriment of all stakeholders, reduce customer choice, and lead to a diminished and less vibrant sector. This is at a time when government should be supporting growth and innovation in the sector as the country faces significant demographic changes and an escalating need to provide specialised and diverse housing options that support the needs of senior Australians.

Innovation and employment growth provided by smaller operators (small business) is endangered

Smaller operators have played a critical role in the development of the seniors living sector over many decades. Indeed, along with not-for-profit operators, they have been largely responsible for building the sector; some smaller operators have become medium-sized operators, and the portfolios of the large operators are invariably derived from the consolidation of the work of those founders. As with all parts of the economy, small business, (including the smaller operator), is of critical importance to both innovation and long-term employment growth.

The enormous demographic changes and the significant supply required to meet those changes depend upon the confidence of the private sector to make the required investment. This is nowhere more important than in the retirement living sector which is almost entirely funded without government support. This includes investment from smaller operators.

In our view the proposed changes to buybacks in their current form endanger the viability of small and medium-sized operators, and also the long-term vibrancy of the industry.

Residents have enjoyed choice, but there is a likely narrowing of the product on offer

Today, prospective residents can choose from wide variety of financial models. The current legislation caters for a 6-month mandated buy-back option for those who have chosen to have non registered interest holdings. Retirees are also free to *not* move into any village, and remain in their family home, or chose to down-size to strata apartments or many other forms of accommodation.

Some residents have chosen (and continue to choose) to move into a retirement village where they have a registered interest holding and share in the capital gain when the home is re-sold. From experience, those residents view the purchase of their home as a combination of *both* a lifestyle choice and a property/housing choice. They have elected to move into such a village understanding the nature of the contract, including the benefits of a flexible non-binding commitments at the purchase stage. Along with the benefit of sharing capital gain, our view is that customers understand that this is ultimately determined by the market in both time and quantum. They have chosen that form of accommodation.

We have a serious concern that the proposed reforms (regarding buy-backs) will limit the products on offer to future residents. Specifically, if an operator has a 6-month obligation to buy back an ILU, along with the complications and potential disputes of having an independent valuation mechanism, why would any operator offer a diversity of models? In recent years customers have demanded more choice and operators have responded, including through voluntary time-limited buy-back models.

Our view is the proposed changes will drive the industry toward a non registered interest holder model with no capital gains sharing to residents. This is *not* what customers have said they want. With fewer choices for customers, we believe that this will lead to a diminished sector.

Future mis-alignment of the interests of operators and residents, more disputes, depressed prices

Operators and outgoing residents are generally aligned in the current sales process, in a sense that both want to achieve the best possible result in the fastest possible timeframe. Our concern is that the proposed buy-back changes, along with the required valuation mechanism, will cause a misalignment of the interests of operators and residents and lead to a rise in complaints and disputes. For several years the industry, with its peak bodies, has worked hard to provide better and speedier complaint-handling and dispute resolution. In our view, the proposed changes could unwind the benefits of these reforms, and lead to a rise in complaints and disputes.

Depressed prices may arise from the need of operators to quickly re-sell stock that has been bought back. If an operator is required to buy back by legislation (and outside of their previous business planning), it would be a logical economic outcome that they would need to re-sell that stock as quickly as possible, and economics would determine that an increase in supply (with an urgent timeframe) will depress prices for the village. The beneficiaries of the first round of buy-backs (assuming 10% being the approximate re-sale in one year) would fare well, but the other 90%+ would suffer. This outcome is not in the best interests of customers and not in the best interests of operators.

Short-term cashflow impact, slowing future investment and lack of competition

The financial impact of buy-backs exists for all operators, but it is of critical important to smaller operators who, like all small businesses, depend upon careful management of their cashflow. What is of the highest financial importance to any small business is not revenue, or accounting income, but cashflow.

Putting aside development activities, for a completed operating village, the primary source of available cashflow is from the DMF and capital gain derived from the re-sale of ILU's. By way of example, let us assume that a particular village of 100 ILU's will re-sell 10 ILU's in a year. Let us also assume an average re-sale value of $500,000. That is, the gross turnover would be $5 million. If the average receipt of the operator (through the DMF and capital gain) is 25% of the gross proceeds, this implies that the obligation to the outgoing resident would be 75% of proceeds (ignoring other transaction costs for the purpose of this example). The gross cashflow, therefore, received by the operator would be approximately $1.25M. The operator must then meet all other business and financial obligations – interest costs, tax, and all business operating costs, etc – from that cashflow receipt. The free cashflow would therefore be significantly less than the gross cashflow (and that is before shareholders who have provided the funds to the business receive any dividends).

The methodology and numbers adopted in the discussion paper seem to adopt a mean re-sale timeframe. Assuming that the mean also equates to the median timeframe, this implies that 50% of all stock would be bought back by the operator in a year. In our worked example the operator's obligation in this first year would be approximately $1.875 million. In other words, the obligation far exceeds the available free cash in any normal year. There is no magical pool of money that small business keeps in order to accommodate the sort of financial impact that the changes contemplate.

This simple economic reality provides an immediate existential threat to many operators.

Regulatory settings are important to long-term viability

The appetite of equity investors and other finance providers to support the industry is a heavily influenced by the regulatory settings of the day. Under the current legislation, the unique characteristics of non-binding pre-sales (expressions of interest), for example, is the single largest difficulty for banks to provide finance to the retirement village sector on comparable terms to the normal residential market. The constraints in the supply of capital can only constrain the supply of the product. In our view, the changes in their current form will further deter, rather than encourage, investment.

This sector is substantially privately funded, and it is presumed that government does not have the appetite to step in where the private sector withdraws. In our view it is of critical importance for the government to set policy that promotes growth and innovation in the sector. If private (including purpose-based) investment in the sector is too difficult, if it becomes too difficult for smaller operators to raise capital for future projects, capital will simply go elsewhere and not necessarily to servicing the needs of older Australians.

Less investment, and fewer operators could lead to reduced competition. Ultimately, the customer will be the loser.

The basis of timeframes requires careful re-consideration

We would like to better understand the basis of data used to form the timeframes adopted in the discussion paper. Firstly, when considering buy-back arrangements for registered interest holders, all non registered interest holder data should be excluded. Secondly, the distribution of the data should be considered, and we believe that two standard deviations from the mean (90-95%) is the appropriate basis and *not* the mean / median which will likely mean 50% of stock would need to be bought back.

Not retrospective – provide a 6 month *option* prospectively

In respect of buy-backs, we are of the view that any model should only apply <u>prospectively</u>, and <u>not retrospectively,</u> and furthermore <u>be only one of many options</u>. Customers and operators (along with their financiers and investors) have entered into past contractual agreements based on the known legislation, that is, where the ground rules on this critical issue are known in advance. We think it is unreasonable, unwise and unfair to override existing contractual arrangements with these proposed amendments which significantly change the ground rules.

It is reasonable, however, that moving forward, operators offer the equivalent of a six-month buy-back contract as *one* of the options (but not the only option) for future customers. This allows operators to plan for changes, provides economic stability for the sector, and continues to provide choice to customers which is what they want.

Aged-care rule

Finally, in our view there is merit in supporting residents through the progressive payment of their DAP should a need arise for that resident to move to residential aged care, providing: there is a demonstrable inability of the outgoing resident to fund the DAP until their ILU is sold; that this support is progressive and capped; and that it is set-off against the ultimate sale of the ILU.

Conclusion

To summarise, it is our view that the legislative reforms in their current proposed form (concerning buy-backs and their operation) will significantly threaten the viability of many smaller and medium-sized operators, reduce the choice of product that is on offer to customers, stifle innovation and limit growth in the sector. This is at a time when NSW and the country as a whole need to stimulate and encourage investment in the sector – investment that produces homes, communities and services that meet the needs of an exponentially growing cohort of seniors.

We urge the government to carefully consider how this policy is developed and implemented, and we ask that the Minister accepts this view of an operator who is passionate about the sector, our customers and who seeks to provide quality products and services that meet current and future demand. Changes to these delicate and complex regulatory levers will have lasting impact on not only the first group of resident to re-sell, but the vast majority who currently live in retirement villages, and the enormous cohort of seniors who require a vibrant, innovative and growing sector that can provide choice in specialised housing and services.

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