16 August 2019

The Hon. Kevin John Anderson, MP
Retirement Village Exit Entitlement Discussion Paper
Regulatory Policy, Better Regulation Division
Department of Customer Service

By email:

Dear Minister Anderson

Retirement Villages – exit entitlements and recurrent charges cap discussion paper

Thank you for the opportunity to respond to the NSW Government's discussion paper regarding proposed reforms to exit entitlements and recurrent charges under retirement village contracts in NSW (**Discussion Paper**).

By way of introduction, Lendlease is the largest, owner, operator and developer of retirement villages in Australia. We currently own and operate 72 villages which include approximately 12,500 accommodation units and in NSW we own and operate 17 retirement villages and a total of 3,300 accommodation units providing housing to over 4,400 residents.

The retirement living industry has become a major contributor to the housing market in NSW, providing a range of housing products and financing choices for consumers. In particular, retirement villages offer important alternatives to retirees in the lower and middle-income brackets.

In addition, the sector offers many other benefits such as lifestyle, community and companionship, access to care and hospitality services. This reduces pressure on existing social infrastructure and the need for the public sector to meet such needs. With the number of seniors in NSW forecast to double over the next 15 years, it is imperative that the State remains competitive.

Lendlease supports legislative reforms which provide certainty and fairness for our customers. However, we urge the Government to carefully consider the way that the proposed measures are implemented, to ensure the interests of all stakeholders are balanced. We believe that there are adverse consequences for residents, operators and the State Government if this balance is not achieved.

Below I set out a summary of our concerns, followed by responses to some of the specific queries in the Discussion Paper, and finally a proposed alternative approach which we believe will protect residents' interests while also ensuring fairness for other stakeholders.

1. Lendlease's key concerns with the proposed changes

(a) Impact of the changes on viability of the industry

The financial impact of the mandatory buybacks and restriction on recurrent charges recovery cannot be underestimated. Based on our data, in most cases it is not possible to arrange the resale of a unit within a period as short as 6 months.

The proposed timeframes have been based on the 'Fair Trading Model', however, we have concerns regarding the assumptions and data underlying this model. For example, the data used to determine the time between vacant possession and settlement refers to a Property Council submission in Victoria from 2016. Using such data disregards state-based differences in the market and is not appropriate to form the basis for such significant reforms. Nor does it consider fluctuations over the property cycle given the limited timeframe the data has been based on.

The 'Fair Trading Model' assumes that the average time to sell a retirement living dwelling in NSW is 6.6 months in metropolitan areas and 13.1 months in regional areas. Using average figures in this way oversimplifies the data and neglects the distributional effects within the industry. Also, it does not appear that the data used has taken into account residents who may have contractual or statutory buyback arrangements, in order to ensure that the data is not artificially skewed towards a 6-month timeframe. Given that the proposed buyback arrangements relate to registered interest holder contracts in NSW, we question the veracity of the 'Fair Trading Model'.

Lendlease's data over a recent 3-year period indicates that the average time between vacant possession and settlement of a resale for registered interest holders in NSW is approximately 8.3 months. Further, 54% of settlements take over 6 months and 9% take over 18 months. These timeframes would clearly be longer during periods of long-term economic down-turn, which must be factored into the reforms. Given that the NSW property market has been buoyant for such a long period it is difficult to find data in NSW in a depressed market. However, by way of example, Lendlease's data over a recent 3-year period in Western Australia, whilst representing less than 10% of our overall portfolio, indicates that the average time between vacant possession and settlement of a resale for residents who are entitled to capital gain under their contracts is approximately 16.9 months.

Therefore, the effect of the proposed reforms would be that in a good market, operators will need to buyback most units and in a depressed market, such as the current Western Australian market, operators may need to buyback almost all units. This will significantly reduce operators' cash flow and revenue and necessitate a substantial increase in interest bearing debt in an industry that already has low levels of liquidity and cash yield.

The financial burden and contingent liability created by the proposed changes will depreciate the value of operators' investment in the village. It is likely that this will force operators to reduce investment into existing village infrastructure and increase costs to residents. The financial viability of the industry will be considerably compromised and smaller operators may be forced into liquidation.

In summary, the unintended consequence of operators having to buyback the majority of units are as follows:

- the majority of an operator's capital will be tied up in buying back dwellings, which means there would be a lack of capital to re-invest or maintain the village.
- In an effort to manage capital and banking covenants, operators will be forced to reduce unit prices to sell stock and reduce working capital.
- Unit valuations are based on market evidence. As unit prices reduce for reasons outlined above, this will eventually negatively impact the unit valuations being relied on to agree buyback prices, therefore adversely affecting residents.
- Operators will experience financial hardship or in extreme cases face liquidation, placing extra stress on existing residents due to the economic uncertainty.
- Under the current "partnership model", where operators and residents (on registered interest holder contracts) both benefit from capital growth and working together to maximise prices, the interests of operators and departing residents align in trying to obtain the highest selling price. This relationship will be strained in buyback situations with operator and resident alignment being lost.

Many operators will be required to re-focus their businesses and investments to other States to the detriment of NSW and its retirees. No other State or Territory has such restrictive conditions, with the 18-month buyback regimes in Queensland and South Australia being the closest to what is proposed in the Discussion Paper.

(b) Registered interest holder contracts will no longer be offered

The likely response by the industry (and certainly Lendlease) to the proposed legislative changes would be to cease offering any contracts that provide residents a share of capital gain. With the short buyback timeframes proposed, coupled with the rights that registered interest holders have in relation to price setting and appointing their own agent, it would make no commercial or practical sense for operators to offer residents the option of being registered interest holders and sharing in capital gain in NSW.

This would be an unacceptable outcome based on our experience because:

- Many customers want the ability to share in capital growth to provide funds to meet their future care needs and other expenses when they leave a retirement village.
- The choice to participate in capital growth pays off for most residents. Residents who are registered interest holders have on average received approximately 110% of the money they paid when they moved in, following the resale of their unit. Conversely residents who are non-registered interest holders have on average received approximately 80% of the money they paid when they moved in. This difference in return is primarily capital gain entitlement.

(c) Retirees will have less choice

For the reasons explained in the above paragraph, we believe that the proposed reforms will lead to operators limiting the contract options offered to customers, and stifle innovation in the industry. In short, customers have less choice to retire in the way that suits them financially.

We believe that it is critical, more so now than ever, that the retirement sector focus on increasing the options available to retirees. This is what our extensive market research has highlighted, and the reason why Lendlease has recently invested in bringing the following contract choices to the market:

OPTION 1: Prepaid Plan

New customers can choose to pay an upfront fee (circa 18%) instead of a deferred fee when exiting. Under the prepaid plan, residents retain any capital gain.

OPTION 2: Refundable Contribution

New customers can pay a higher ingoing contribution (circa 30%) upfront but have the certainty of the entire ingoing contribution being refunded when they leave, within 90 days of vacant possession. There is no deferred management fee.

OPTION 3: Deferred Management Fee

The Deferred Management Fee (DMF) contract (e.g. payment of 30% - 35% of the resale price) continues to be offered as it has remained a popular choice. As mentioned above, most existing Lendlease DMF contracts in NSW offer residents the majority of the capital gain at re-sale.

OPTION 4: Pay As You Go

New customers can pay monthly contributions rather than an entry lump sum or deferred management fee.

Providing consumers with the ability to select the contract option that suits them, enables more people to access the support of retirement village living while having the security of knowing they can fund their future costs.

(d) The proposed reforms do not take into account fundamental differences between registered and non-registered interest holders

The existing NSW Retirement Villages Act reflects the important commercial distinction between 'registered interest holders' and non-registered interest holders. The proposed reforms are inconsistent with this framework, and therefore we question their practicality.

Whilst the Discussion Paper contrasts the two arrangements from a legal perspective, it fails to outline the commercial differences. Most registered interest holder residents in NSW hold a long-term (ie. more than 50 years) lease that is registered on title. From a commercial perspective, they receive more than 50% of the capital growth in the unit. Conversely, non-registered interest holders may have licences or leases, but these are not registered on title. They receive less than 50% of the capital growth in the unit, and in most cases no capital growth at all.

When a resident is a non-registered interest holder, the operator is required to repay their exit entitlement within the 6-months after they have permanently vacated the premises, if not re-sold prior. For non-registered interest holders, recurrent charges also cease to be charged 42 days after they permanently vacate their premises. We support this position as the resident does not benefit from any capital growth in the unit (or their share in capital growth is minimal). In this instance the risk and reward between the operator and the resident is reasonably balanced.

If, on the other hand, residents who are registered interest holders become entitled to either a 6- month or 12-month buyback, the risk and reward profile becomes disproportionate. This creates a situation where (not unlike owners of typical residential real estate) they:

- Benefit from the capital growth of the unit.
- Have the right to set the price.
- Have the right to appoint their own estate agent to procure offers for their unit.
- Have the right to a guaranteed buyback

The cost to operators would be a significant and unfair burden which could threaten business viability, particularly in the case of smaller operators. It would also be a strong deterrent to potential investors in the NSW industry. Further, any retrospective application of this proposed buy-back period would give rise to a particularly untenable situation where registered interest holder residents retain the same opportunities, but the operator takes on significantly more risk.

Lendlease believes a reasonable middle ground would be the introduction of an 18-month statutory buyback for registered interest holders together with a requirement to offer a non-registered interest holder contract in all villages. This would be offered to all new residents at all non-strata titled villages, giving them the freedom to choose. If they prefer the certainty of repayment within 6 months of vacant possession, they would select the non-registered interest holder contract with the knowledge that they will not benefit from capital gain. If, on the other hand, they would prefer to benefit from capital gain in the future, they would select the registered interest holder option, but still have the certainty of an 18-month buyback guarantee.

The proposal to give registered interest holders similar rights to non-registered interest holders by providing for a 6 or 12 month buyback, and cessation of service fees after 42 days, disregards the involvement and benefits registered interest holders have in the resale of their home.

(e) Transition to Residential Aged Care

In his pre-election announcement, The Hon. Matthew Kean, the New South Wales Minister for Energy and Environment, stated that "Retirement village residents across NSW will save thousands of dollars and be able to transition into aged care more easily under new laws that will require villages to pay exit entitlements and stop charging fees sooner". The Discussion Paper's definition of the issue, in the section headed "The problem defined", suggests that residents wishing to move to another village or to aged care are particularly disadvantaged as they often rely on their exit entitlement proceeds to pay for their new accommodation.

We agree that the transition from a retirement village to either another retirement village or a residential aged care facility is something that requires particular focus. As referenced in the Discussion Paper, assistance is provided by retirement living operators to residents in Victoria and South Australia when they transition to aged care, to assist them with the aged care accommodation funding.

I would like to provide some important background that is absent from the Discussion Paper and is important context for consideration of this matter. The Living Longer Living Better reforms in the Aged Care sector commenced on 26 June 2013. The aim of these changes was to protect the savings of aged care residents, ensure the continued availability of capital funding for aged care infrastructure and promote public confidence in the aged care system. Whether intentional or not, three of the changes have had unintentional negative impacts on the Retirement Village industry, being:

1. Removal of the distinction between low and high care in residential aged care.
2. Allowing providers to require lump sum accommodation payments from people with high care needs.
3. Introduction of means testing on income and assets in residential care.

To elaborate, prior to the reforms, aged care residents requiring low care services could be asked to pay a lump sum payment in the form of an accommodation bond (agreed between the resident and the provider), as a contribution towards the capital costs of the facility. Conversely, residents requiring high care could not be asked to pay lump sums, instead paying a daily accommodation charge.

Most retirement village residents who transition into aged care move into what was previously classified as high care. Prior to the reforms this meant that in many cases they were not required to pay a lump sum bond. The introduction of these reforms in the Aged Care sector means that in all cases retirement village residents are now required to pay a RAD (bond) or DAP (daily accommodation payment), which significantly increases the financial pressure on them or their families. Furthermore, the impact of means testing has had the effect of increasing aged care accommodation payments significantly.

Whilst Lendlease is supportive of providing assistance to retirement village residents transitioning into aged care, we believe a mandatory 6-month or 12-month buyback requirement for all residents goes too far. Assistance should be aligned with other States and focused on residents transitioning to residential aged care, as is the case with the regimes in Victoria and South Australia without the additional imposition of buyback obligations for all registered interest holders in NSW.

2. Responses to specific questions in the Discussion Paper

(a) Is the description of the 'Sydney Metropolitan Area' appropriate? If not, why not, and what areas should be included or excluded?

Lendlease is supportive of the Central Coast being excluded from the definition of 'metropolitan area'. The impacts of a six-month buyback would have significant financial impacts in an area where there is a large amount of stock but with a slower selling market then Sydney.

We also consider that the City of Blue Mountains or Wollondilly should be excluded from this definition for the purposes of the proposed buyback reforms. The outer metropolitan regions do not have the same market conditions as more central Sydney regions, and it would therefore be financially damaging to the operators in these areas.

(b) Calculating fair property values

A mechanism to appoint an independent valuer is appropriate where an operator and a resident cannot agree on a sales price. However, the valuer should be required to have expertise in retirement villages, to ensure that valuations are accurate and reflect the particularities of the industry.

If the proposed buyback provisions are implemented, it will be important to ensure that registered interest holders would not be entitled to appoint a third-party selling agent, or set the price for the sale of their home

(c) What information should the operator be required to provide to the resident when the exit entitlement has been determined?

Lendlease is supportive of measures to improve transparency regarding calculations at the time of exit. Operators should be required to provide residents with a calculation of their departure entitlements, including references to contractual provisions and assumptions relevant to the calculations. We would recommend that any provisions not be overly prescriptive or detailed, to ensure that residents are not overwhelmed with excessive information.

(d) Opt out provisions – Exit entitlements

If a compulsory buyback regime for registered interest holders is implemented in NSW, such residents should have the ability to opt-out of the buyback upon written request (with a reasonable amount of notice to the operator) should they wish to wait for the property to sell on the open market.

Once a registered interest holder resident has opted-out of the buyback provisions, they should only be entitled to opt back into the regime if: a sale price has been agreed between the resident and the operator; and the unit is ready for sale. Furthermore, to ensure that there is not an undue burden on operators, any buyback period would need to recommence from the date the resident decided to opt back into the regime.

(e) NSW Civil and Administrative Tribunal – Undue hardship provisions

Given the significant financial burden of the proposed reforms, it will be essential to include undue hardship provisions. Such provisions must take into account the fact that many operators will be reluctant to apply for hardship due to reputational risk. For example, the application should be kept private and confidential to the extent possible.

(f) **The trigger point - Are there any other factors that could affect the setting of a 'trigger point'? Do you think any of the 'triggers' listed would be suitable to start the 6 and 12 month periods?**

If the proposed amendments are introduced, the 'trigger point' for buyback timeframes will be critical to ensuring that the proposed reforms are as reasonable and realistic as possible.

The length of time between a resident deciding to leave the village, and the sale of a unit is dependent on a range of factors. There are also several steps which need to occur before a unit is placed on the market, many of which require the cooperation of the operator and resident (or their family) and therefore can be beyond the operator's control. Broadly speaking, these steps are:

(i) resident serving a notice to vacate;

(ii) appointing an agent and setting the sale price for the unit;

(iii) the resident moving out of the unit, clearing out all belongings and returning keys to the operator (i.e. vacant possession); and

(iv) determining, agreeing and completing reinstatement work.

At the time of exit, residents and their families are going through a major life change to move to higher care or, in the event of death, families are going through the grieving process. This is why, as referenced above the average sale period is well above 6 months and why it is important that operators can be as flexible with outgoing residents as possible.

It is important to note that the above steps (and others we have not listed) may not take place in the same order. For this reason, the only logical trigger for the buyback period is the completion of all of the above steps. At that point the unit is ready to be placed on the market, and the onus is on the operator to manage this process expeditiously.

(g) **Other timing considerations for the transfer of payments**

As noted above, we have concerns regarding the data underlying the assumptions in the Discussion Paper and urge the Government to review the Fair Trading Model which forms the basis of the proposed timeframes in the reforms. We highlight the following:

- The Fair Trading Model does not appear to differentiate between registered interest holder contracts and non-registered interest holder contracts. This means the data may be unfairly skewed by data were residents already had a buyback provision of less than 6 months, and most likely did not share in capital gains.
- The 'duration between vacancy and settlement' is based on data taken from Victoria, which is a potentially inaccurate for assessing reforms for the NSW market.
- Residents generally enter into a retirement village contract which is subject to the sale of their existing home. In 20% to 30% of cases, purchasers may change their mind due to health changes, inability to sell their home or other circumstances. This conditional sale process adds time to the settlement period of a retirement village sale.

We are also concerned that mandatory buybacks that occur too early may lead to a distortion of market prices (downwards), as sufficient time has not been allowed to appropriately test the market over the medium- to long- term.

(h) Proposed reforms regarding recurrent charges

We consider that the proposal to cease all registered interest holders' liability for recurrent charges for general services after 42 days generally places an unreasonable and significant financial burden on operators.

Recurrent charges fund expenses relating to the maintenance and operation of the village on a cost recovery basis. Operators must continue to provide general services, which include the upkeep of the residents' property and maintenance of the common property of the village. Residents who have departed the village therefore continue to receive a benefit from these services by ensuring that their property is in a desirable condition for sale. This is particularly true for registered interest holders, who will generally benefit from any capital gain achieved on resale.

There are very few cases where the time from vacant possession to settlement would be less than 42 days. In turn, the proposed reform will require operators to fund recurrent charges for almost all departing residents. As noted above, there are several steps in a sale process which must be completed before settlement, many of which are beyond the operator's control. It is therefore unreasonable for operators to bear the full burden of these costs until a new resident commences occupation.

Operators may seek to recover additional costs of the proposed reform by increasing recurrent charges, charging higher departure fees and implementing other lump sum fees in order to off-set such costs. Such an outcome would be detrimental to residents and the competitiveness of the market generally. We believe that the existing provisions, which apportion liability for recurrent charges after 42 days according to the resident's capital gain entitlement, balances the burden for these costs more fairly and sensibly.

We believe a reasonable compromise to balance the interests of residents and operators would be for:

- registered interest holder residents moving to aged care, recurrent charges would cease at 42 days after vacant possession; and
- all other registered interest holders, recurrent charges would cease at 6 months after vacant possession.

(i) Commencement options for both reforms

Our view is that the two proposed reforms should commence together, and both need to be grandfathered. Each of the proposed reforms are significant, and therefore, it would be unreasonably onerous for the changes to apply to contracts that had been entered into in a different legal framework. We expect that applying the reforms to existing contracts would impose an extreme financial impact on operators, one which may be passed on in some way by operators to present and future residents.

3. An alternative model

Lendlease proposes the following to ensure a fair and sustainable outcome for all stakeholders:

(a) Future residents should have the choice between the certainty of a 6month buyback as a non-registered interest holder, and the opportunity to participate in capital growth by becoming a registered interest holder. To ensure this choice remains available, it is recommended the amendments be changed to require operators to offer a non-registered interest holder contract with a 6-month buyback period, whilst providing registered interest holder residents a safety net of a longer 18-month buyback period. Retirees must have freedom to match their arrangements to their personal and financial circumstances, including the possibility of future options in the market to meet people's needs as they evolve. The buy-back requirements should not apply retrospectively and will only apply to residents who are non-strata title holders.

(b) The exception would be registered interest holder residents moving to residential aged care, who would receive advances from the operator to fund their daily accommodation payments (DAP) when due to the aged care provider, up to a total of 85% of the estimated exit entitlement payable to the resident. The total amount advanced by the operator will be deducted from the exit entitlement paid to the resident. This position reflects the current position in Victoria and similar position in South Australia.

(c) The trigger date for the mandatory buyback period to commence would be the later of:
- The 'termination date' (within the meaning of the Act);
- the date the resident (or their Estate) gives vacant possession of the unit;
- the date the resale value is agreed between the operator and the former resident (or failing agreement, an independent valuation is obtained that determines the resale value at which the unit is able to be marketed); and
- the date any reinstatement and/or renovation works to the unit are completed.

(d) For registered interest holder residents moving to aged care, recurrent charges would cease at 42 days after vacant possession and for all other registered interest holders, recurrent charges should cease at 6 months after vacant possession.

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