

Why retirement village contracts need to be regulated like insurance

Written by The Conversation

While you may think signing a retirement village contract is similar to buying a house or apartment, it isn't. Retirement village contracts resemble insurance contracts more than purchase agreements, only they aren't regulated like insurance products.

The lack of regulation increases the risk for retirees. They face considerable delays in receiving their payments when they leave, costs due to the delay, and the potential loss of all payment from companies that don't need to meet the financial standards of an insurance company.

Most retirement village contracts provide the consumer with a combination of the right to reside in the retirement village (until death, incapacity for independent living, or voluntarily relocation) and an "exit payment" upon leaving. As both the amount and timing of this payment depends on the resident's death or ill health, the payment is a de facto insurance payout.

This makes the retirement village contract a combination of the right to reside and a de facto insurance policy. But the insurance policy comes from companies that wouldn't normally be allowed to sell insurance.

Retirement villages are mostly small private companies or not-for-profit organisations. This means they aren't required to publish their annual financial statements, hold reserves, or have reinsurance arrangements like an insurance company. The consumer can't be confident that the retirement village is financially healthy and able to pay out the exit fee, due to the absence of information about their accounts and financial condition.

Fees and more fees

There is a great variation in the structure of the fees that retirement villages charge – entry fees, ongoing fees and a so-called "[deferred management fee](#)", which is an amount taken out of the money refunded to departing residents.

These fees [can be substantial](#) – the entry fee alone is often comparable with the cost of buying an apartment. Although the amount varies by location, one operator told a [Victorian parliamentary inquiry](#)

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the entry fee was equivalent to 80% of the cost of a house nearby.

A retirement village contract might have an entry fee of A\$1 million, a deferred management fee of 6% of the entry fee per year of residence, and a maintenance fee of A\$500 per month.

For a contract with a A\$1 million entry fee, after five or more years of residence, the deferred management fee is A\$300,000, so the exit payment is A\$700,000. But the deferred management fee can vary greatly. It may be 10% per year for three years, or 3% for 10 years etc.

The exit payment can also include some share of the resale value of the apartment. But the retirement village needs to be able to pay out this exit payment.

The need for proper regulation

The assets held by retirement villages are almost all invested in real estate. This is risky, as they aren't diversified and their assets can't be easily turned into cash.

When a retirement village has to pay a departing resident their exit payment it may take a long time to sell their apartment, which could involve a loss on resale. This can also lead to delays in receiving exit payments.

After signing their retirement village contract, residents are also in a weaker bargaining position than a traditional tenant in a normal pay-as-you-go rental arrangement. This is because residents have already paid their rent in advance for the rest of their life, and it usually costs a lot of money to get out of these contracts.

In some retirement village contracts the resident may be forced to spend a lot of money on renovations – such as for a new bathroom and kitchen – so that the apartment can be sold and they can get the exit payment.

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This issue is compounded by the complexity of the contracts, which can be hard [for both consumers and financial advisers](#) to understand.

This creates substantial risk for consumers, and the lack of a requirement to publish financial statements and related information makes it very difficult to assess the financial soundness of a retirement village operator.

If retirement village contracts are in fact insurance agreements, then they should be regulated differently – by the Australian Prudential Regulatory Authority and not by state governments, as is now the case.

If retirement villages were properly regulated then consumers would be better protected from failure of operators and better protected from delays and capital losses when they get their exit payment.

Timothy Kyng does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

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