SENSE PARTNERS
UNCOMMON KNOWLEDGE

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Review of Starks opinion piece

The Retirement Village Association asked us to review Janine Starks' opinion piece, Retirement villages can afford to treat customers better, published 18 November 2023 by Stuff.[1]

Money for nothing?

In a recent opinion piece published by Stuff, personal finance columnist Janine Starks argues that retirement villages should be required to 'buy back' units from residents within 28 days of their departure because she considers that operators can afford it.

Starks suggests such a 28-day compulsory buyback period is fair because it would cost the operator just $13,500 compared to the $1,000,000 she claims they can earn per unit. (See appendix for details). Currently, operators pay departing residents an agreed, contracted amount when the unit is re-licensed to the next occupant.

The logic and comparison are flawed and misleading.

The direct cost of financing an earlier buyback may average $13,500 per unit based on the assumptions set out in the article. This comes to $65m a year when multiplied by the roughly 4,800 units that are vacated in a year.

But this cost ignores additional costs and risks of unintended consequences, which will negatively impact residents. And the $1m is an over-estimate of revenue over 8 years, which also ignores the costs of developing, operating, and maintaining retirement villages.

Compulsory buyback periods are not cost-free to residents

Operators would have to hold bigger reserves to ensure they could repay residents as required under any hard deadline in legislation and stay solvent.

With the total value of buybacks being around $2.2b per year, PwC[2] estimates the annual cost of holding additional reserves could be between $70m-$250m – significantly more than Starks' estimate.

The amount of reserves will depend on the number of months' worth of buybacks such reserves would need to cover to give investors confidence about operators' solvency. This is because the pattern of terminations is not guaranteed, and it is possible that many could occur in a short period.

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1 https://www.stuff.co.nz/business/opinion-analysis/301009872/retirement-villages-can-afford-to-treat-customers-better

2 See RVA's submission to the Social Services Select Committee on the RVR's 28 day mandatory buyback petition.

It would be misleading to imply that all these extra costs will come out of the pocket of operators. This is unlikely for industry-wide cost increases, even in competitive sectors such as retirement villages.

Residents will end up paying some share, if not all, of these additional costs. This is because operators will seek to pass on costs to maintain their margins, necessary to retain and attract investors to finance the development and operation of retirement villages.

In addition to higher fees for residents, other unintended consequences may include financial stress and closure of marginal operators. And lower margins would mean reduced investment in the sector and fewer choices for residents.

A big revenue number tells us nothing about affordability or fairness

The $1m of earnings cited in the article is not profit.

The figure is conceptually closer to revenue over 8 years, though it is significantly over-stated (see appendix).

Only the deferred management fee and weekly fees are revenue, while the development margin is once-only income. Capital gains become part of the repayment when the next resident departs. They are thus like an interest-free loan, not part of revenue.

Starks includes an estimate of the value of the interest-free loan on the initial purchase price; this is an imputed value and not strictly revenue, but we assume that, if an operator instead faced interest costs of such a loan, these would ultimately be reflected in residents' fees.

This highlights another weakness. To argue that operators can afford a 28-day buyback, Starks should have subtracted 8 years' worth of finance costs and operating expenses.

The latter include maintenance, repairs, and the cost of refurbishment to bring a unit to an 'as new' condition before it can be occupied by the next resident. It may also cover what is effectively a cross-subsidy for residents with fixed weekly fees or aged care provision.

The resulting surplus accrues to the owners of the companies as a reward for putting their money at risk. They are well incentivised to decide what to pay out as profits and what to reinvest in property, services and staff, and to keep fees competitive.

Clarity needed on what is the policy problem

The call for a compulsory 28-day buyback period seems to stem from dissatisfaction with the speed at which operators re-license units and pay back the previous residents.

But this is not an even-handed assessment of some potential market or regulatory failure that warrants legislative intervention.

It does not consider what drives the timeframes, and whether they are in fact unexpected or unreasonable (for example, compared to other similar property transactions such as selling one's home under ever-changing market conditions).

Nor does it consider whether a mandated timeframe would be effective. For example, probate processes mean that an earlier repayment would sit in the statutory supervisor's account.

In other words, it does not consider whether any benefits to residents from mandating earlier repayments would outweigh the additional costs.

We might want it all, and we might want it now – if it were free. But it is not free. Would we still want it if we had to pay for it?

These are all standard policy questions.

Crucially, operators have strong incentives to relicense units as quickly as possible. This is because it allows them to charge deferred management fees and weekly fees sooner than if they were to go slow. In the article, Starks notes that 77% of repayments are made within six months.

Further, the market is competitive. There is a range of large and smaller operators, with different offerings, and different business and fee models. Consumers thus have choices (including alternatives to retirement villages, such as home ownership or renting).

Choice and competition are important for consumers. It should also give policy-makers comfort that operators are constrained in what they charge and are incentivised to offer what consumers want – or risk losing customers.

Mandated buyback periods are not a free option. The policy rationale, costs and risks need to be considered alongside any claims of affordability and fairness.

Appendix

We tested the numbers cited in the article.

Assumptions about volumes			
Units 'sold' within	**Share**	**Number**	**Per month**
6 months	0.77	3,696	616
9 months	0.14	672	224
12 months	0.04	192	64
18 months	0.05	240	40
	1.00	**4,800**	

- Starks assumes equal distribution of sales within each of the above timebands
- Assumed payback amount on a unit with a $600,000 market value: $450,000
- Assumed cost of capital: 10%, or 0.797% per month
- $71m / (4,800-616) = $17k per departing resident. First month's 616 excluded.
- Starks' estimates are a bit lower: $13.5k per departing resident. $13.5k x 4,800= ~65m.

Months from vacating unit	# of units 'sold'	Amount paid to departed residents	Interest cost if 28-day rule
1	616	277,200,000	(Not impacted)
2	616	277,200,000	2,210,432
3	616	277,200,000	4,438,490
4	616	277,200,000	6,684,315
5	616	277,200,000	8,948,048
6	616	277,200,000	11,229,833
7	224	100,800,000	4,919,932
8	224	100,800,000	5,762,957
9	224	100,800,000	6,612,705
10	64	28,800,000	2,134,066
11	64	28,800,000	2,380,738
12	64	28,800,000	2,629,378
13	40	18,000,000	1,800,000
14	40	18,000,000	1,957,888
15	40	18,000,000	2,117,035
16	40	18,000,000	2,277,451
17	40	18,000,000	2,439,146
18	40	18,000,000	2,602,131
Total	**4,800**	**$2,160,000,000**	**$71,144,544**

- $1m 'earnings' cited are based on various value-streams over 8 years.
- Capital gains is not revenue as will be part of next resident's purchase price and repaid minus DMF. It instead becomes part of what is in effect an interest free loan.
- Imputed value of interest free loan treated *as if* revenue. If this were not available, then operators would incur interest costs instead, to then be reflected in fees.

Revenue estimates	Starks' assumptions/estimates		Comment
Initial value of unit	**600,000**	NA, interest free loan	N/A, interest free loan
1 Capital gains 8% pa	~510,000	8% pa, over 8 years	N/A, interest free loan
2 Weekly fees	62,400	150 per week, 8 years	62,400
3 Deferred Management Fee	150,000	25% of initial value	150,000
4 Value of interest free loan	~234,000	4.2%pa x 600k, over 8 years	Imputed, interest costs
5 Development margin	120,000	Once-only income	$0 in subsequent sales
(1+2+3+4+5=)	**~$1,076,400**		