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What happens if a Retirement village operator becomes Insolvent or goes onto Receivership?

Village in Receivership

There have been a number of retirement village operator failures throughout Australia in recent years, and the various State Residents Associations have made a number of representations to their State Governments regarding the issues of concern for residents. Many of the representations were specific to the legislation in a particular State; however this document tries to extract some of the more general points.

“Village failures”

Instead of referring only to “receiverships”, this document refers more generally to “village failures”, as there are a range of events like receiverships that are beyond the control of residents and raise similar concerns for residents. Such events include:

- (i) operator insolvency;
- (ii) an operator deciding to run down the retirement village operation in order to put the land to a different use.
- (iii) units in the village becoming devalued or unsaleable as a result of mismanagement, internal disputes, poor maintenance, etc.

The RVRA and ARQRV believe that there is a need for a nationally consistent legislation to protect residents’ interests in all such instances.

The usual response from government & industry

When a village fails, the usual response from government and the industry is to opine that *‘residents have nothing to fear as their right to reside in the village is protected’*.

However this response reflects a fundamental misunderstanding of why residents are concerned when their village fails or begins to fail, as follows:

(1) Lifestyle issues

Retirees do not enter a village simply to secure a right to reside in a particular unit. They enter the village for the *lifestyle* that is offered by the village as a whole. The essence of all village marketing is the promise of a relaxed and secure lifestyle with ongoing access to communal facilities and services of a certain quality. Security of tenure over an individual unit does not guarantee a continuance of that standard of living. Without the promised lifestyle there is no reason to enter a village and commit to the future cost of exit fees (also known as departure fees or deferred management fees). The whole purpose of an exit fee is that it allows a retiree (who is generally capital-rich and income-poor) to obtain a lifestyle *now* that their income would not otherwise support, on the basis that they pay for it *later* from

their capital. If the village lifestyle is removed, then so is the basis for the exit fees, regardless of whether your right to occupy a unit remains secure.

When a village is in financial distress it is common for the operator (or their receiver) to cut costs by reducing service standards, limiting maintenance, and even renting out vacant units to non-residents. All such steps have a significant impact on the quality of life for the residents.

Prospective residents would be better served to instead select one of the other competing forms of retirement accommodation where the lifestyle benefits are reduced but exit fees are not charged.

By failing to ensure that the quality of life is preserved in the event of a village failure, the various State governments are undermining the ongoing viability of the retirement village industry.

(2) Security of capital

Ongoing security of tenure after a village failure is of no comfort to:

- (a) residents who have already left the village and are awaiting the resale of their unit; or
- (b) residents who need to leave the village soon (for reasons such as health problems or family relocations).

For residents in these situations, the primary concern is the security of their capital investment, as well as the timing and quantum of any exit payment. In many cases, an outgoing resident is not entitled to receive any capital payment until their unit sells, and it is common for the quantum of that payment to be directly linked to the sale price that is ultimately achieved.

A village failure will obviously impact on this process by:

- (i) making the units unsaleable (in which case the departing residents often receive no exit payment and their initial capital investment is lost); or
- (ii) delaying the sale of units (in which case the departing resident is often held in financial 'limbo' pending a sale, often with no alternative accommodation, and without the ability to use the unsold unit as security for a bridging loan); or
- (iii) devaluing the units (in which case the departing resident can receive less than they expected or needed from sale).

In response to points (i) and (ii), the government and industry groups may argue that the legislation in some States (excluding Queensland and NSW) requires an exit entitlement to be paid within a certain time regardless of whether the unit has sold. For instance in Western Australia we understand there is a 45 day time limit from the date that the resident vacates the unit (s19(3)(b)).

However such time limits offers little additional comfort because:

- (a) the legislation often allows the time limit to be avoided by appropriate wording in the residence contract (for instance in WA the time limit can be avoided by giving a resident the right to appoint an outside agent to effect a sale (s19(5)(b)));
- (b) even if the time limit does apply, an insolvent operator will be unable to make the necessary payment unless or until the unit sells anyway;

- (c) even if the time limit does apply, the *quantum* of the exit payment is not guaranteed, and the village failure is likely to cause a significant reduction in the resident's return.

The RVRA and ARQRV are firmly of the view that the legislation in each state should ensure that no resident's capital return is adversely affected by a village failure. There are obvious reasons for this:

- (i) village failures are primarily caused by mismanagement on the part of village operators rather than by residents;
- (ii) residents do not share in the profits when a village succeeds and therefore should be insulated financially when a village fails; and
- (iii) the saleability of units depends on the quality of the management, services and facilities provided by the scheme operator, so the risk associated with a delay in selling, or failure to sell, a unit should rest with the operator;

Residents entering villages are entitled to assume that when the time comes to exit, the value and saleability of their right to reside will not be artificially reduced as a result of any poor business decisions made by the scheme operator. Every resident should have a guaranteed right to require that:

- (1) their exit payment is received within a certain minimum time after they vacate, and
- (2) their exit payment is calculated by reference to a valuation conducted on the assumption that the village is succeeding, with all impacts of the village's failure ignored.

Otherwise, the legal advisors to prospective residents must warn their clients of the possibility of village failure from operator mismanagement, and the consequent risk of losing their capital. This will drive prospective residents away from retirement villages and undermine the ongoing viability of the industry.
