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## Submission to The Parliamentary Inquiry into Retirement Housing

I would like to make a submission to The Parliamentary Inquiry into Retirement Housing and make comment on two issues.

1. Deferred Management Fees (DMFs)
2. Maintenance Costs

### 1. DMFs

The present system of deferred management fees is both unfair and inequitable. There is no consistent system for determining DMFs from one retirement village to another or even within a given village. In the village in which I reside most residents have a DMF which is determined at 3.5%pa for a maximum of 10 years and then remains at a fixed 35% of the sale price thereafter. However, some residents have DMFs which use 3%pa for 10 years and others 5% for 10 years. Other villages I know of have 4%pa for 6 years (and fixed 24% of the sale price thereafter) and another has 5%pa for 6 Years (and fixed 30% of the sale price thereafter) to determine their DMF. All these DMF systems indicate that most residents (or their estate) may not even recover the purchase price of the unit they paid to enter the village when they exit the village, unless they reside there for many years. In many cases they receive none or very little of the capital gain in the value of the unit with all or most of the capital gain on the property going to the village owner.

A simple calculation will suffice to show this.

If P = the purchase price of the unit

S = the sale price of the unit

D = the DFM

x = annual price inflation of the unit

n = number of years the unit is owned

y = per annum percentage used to determine the DMF

N = the number of years used to determine the DMF at the rate of y pa

R = the return to the retiree (or his/her estate) on selling the unit

Then  $S = P(1+x)^n$  and  $D = N.y.S$

And  $R = (S - D)$

$$\text{Or } R = P(1+x)^n - N.y.S$$

$$= P(1+x)^n(1 - N.y)$$

As an example for my village using  $y = 3.5\%$  and  $N = 10$  years, and assuming a property inflation rate,  $x$ , of  $3\%$  pa we find the following

Years Owned	4	8	12	16	20
R/P %	96.8	91.2	92.7	104.3	117.92

Thus we see that in this simple example, assuming a property inflation rate of  $3\%$  selling after 12 years only returns  $92.7\%$  of the original purchase price to the retiree (or his/her estate). Or after 12 years an original purchase price say of  $\$400,000$  therefore returns only  $\$370,800$  out of a sale price of  $\$570,320$  whereas the village owner gets a DMF of  $\$199,600$ . This is obscene It's analogous to renting a unit for 12 years, paying a bond of  $\$400,000$ , having to pay a (deferred) rent of  $\$320$  a week, paying the rates, and the building insurance (which we do via our monthly management fees ) and only getting  $\$370,800$  of our bond returned when we leave.

It is found in this example that the retiree does not recoup their original purchase price unless he/she stays in the unit for approximately 15 years when for a purchase price of  $\$400,000$  the sale price  $S$  would be about  $\$620,000$ . But the village owner gets a DMF of nearly  $\$220,000$ .

The accompanying graphs show the ratio of the return to the retiree (or their estate ),  $R$ , to the purchase price,  $P$ , for a number of assumed property inflation rates and 3 schemes used to determine the DMF.

Figure 1 shows the percentage return  $R/P\%$  for a scheme using  $y = 3.5\%$  and  $N = 10$  years

Figure 2 shows  $R/P\%$  for a scheme using  $y = 4\%$  and  $N = 6$  years

Figure 3 shows  $R/P\%$  for a scheme using  $y = 5\%$  and  $N = 6$  years

It is seen that the minimum percentage return to the retiree naturally occurs in the year in which the DMF percentage reaches it's maximum value i.e  $N$  years. Only if the value of  $x$  is significantly greater than  $y$  will  $R$  be larger than  $P$  from year 1. In all other cases it is seen that  $R$  does not equal  $P$  (i.e  $R/P = 100\%$ ) until well after  $N$  years . In some schemes where price inflation  $x$  is small and/or  $y$  is high  $R/P$  will always be less than  $100\%$  unless  $n$  is very large.

Table 1 shows the number of years the resident must stay in their unit to recoup their purchase price ( $R/P = 100\%$ ) for the assumptions shown in the three graphs.

Price inflation x	2%	3%	4%
3.5% for 10 yrs	22	15	11
4% for 6 yrs	14	9	7
5% for 6 yrs	18	12	9

Table 1

Table 2 shows the sale price  $S$ , the return to the vendor  $R$  and the DMF after 10 years for an assumed price inflation  $x$  of 3% for the 3 DMF schemes outlined above and a purchase price,  $P$ , of \$400,000.

	P	S	R	DMF
3.5% for 10 yrs	\$400,000	\$537,560	\$349,414	\$188,146
4% for 6 yrs	\$400,000	\$537,560	\$408,545	\$129,015
5% for 5 yrs	\$400,000	\$537,560	\$376,292	\$161,268

Table 2

It is seen that for any reasonable assumed property inflation rate and for any reasonable expectation of the length of time a resident will occupy their unit, the retiree or their estate will probably never recoup their original purchase price. In many cases MOST OF THE CAPITAL GAIN ON THE UNIT will go to the village owner while in others MORE THAN ALL THE CAPITAL GAIN goes to the village owner.

An analysis of the property inflation rate in my own village shows that the value of  $y$  depends, amongst other things, on whether one considers a one or two bedroom unit and on the length of time the unit was owned. It was found that  $y$  was mostly in the range of 1% to 5%. The average time a resident occupied the unit was around 9 years and the average value of  $y$  for all units owned for 4 years or more was approximately 2.8%. Using this value of  $y$  it is found that the value of  $R/P$  after 9

years is 87.8%. In other words on average most residents on leaving the village do not recoup their original purchase price. Or assuming a purchase price of \$400,000 the value of S after 9 years would be about \$513,000, the value of R would be about \$351,000 and the DMF approximately \$162,000. Then a new resident moves in and the cycle begins again and continues ad infinitum.

The above calculations are made using 3 existing schemes that are used to determine DMFs. Obviously here a constant price inflation rate (x) is used for each year for ease of calculation. But they clearly indicate the inequities in the present system.

Surely a fairer more equitable scheme for calculating the DMF needs to be found. Certainly the percentage rates (y) used to determine the DMF are patently too high and should not be higher than about 2%. Similarly the number of years used to determine the DMF (N) are too long and should not be longer than 5 years. Alternatively, for the sake of fairness the calculation of the DMF should only include the capital appreciation of the unit between the purchase and sale price.

## 2. Maintenance costs

Maintenance costs cover a whole range of works that need to be carried out in the village to keep it safe for the residents and make sure all essential services are provided and maintained. In our village the owner has refused to assist with any maintenance that is required in the village. Many things were not done correctly when the village was built and are now failing with the result that the residents are having to pay to have basic infrastructure replaced properly.

As an example we are having problems with leaking mains water pipes. These pipes are plastic and as such should be laid on sand or screenings. Or to quote from a plumbing advice website

"The base supporting the underground pipe must be free of large rocks, jagged material, frozen soil and organic material (ashes, wood, plant matter). Generally loads of sand or crushed rock is used to line the trench because it can be easily manipulated and provides an excellent support on which to grade the pipe. Once the inspection has taken place, the underground pipe must be covered with a minimum of 300mm of clean fill (sand, crushed rock, suitable soil) and tamped to prevent settling".

Since 03/02/2009 we have had 23 mains water repairs, the majority being due to leaks caused by the pipes not being laid in a trench as recommended above and incurring a total cost to the residents of \$76,393.80. The pipes are laying in trenches containing broken bricks, rocks and other non-recommended material. With the continual contraction and expansion of the soil due to hot dry summers and cool wet winters the bricks etc have rubbed the plastic pipes and caused small holes in them.

This has only occurred due to the pipes not being laid as recommended in the first place.

My concern is that these pipes may not have been laid correctly in the first place as a way of saving money. It is obviously cheaper to do it as it was done here rather than to do it as recommended by


the professional plumbers associations. Then when leaks occur, the residents must have them repaired in the correct way at the residents' expense.

This is not the only example in the village where something has been bodged and done in the cheapest possible way and the residents have to pay the full cost of doing the job properly.

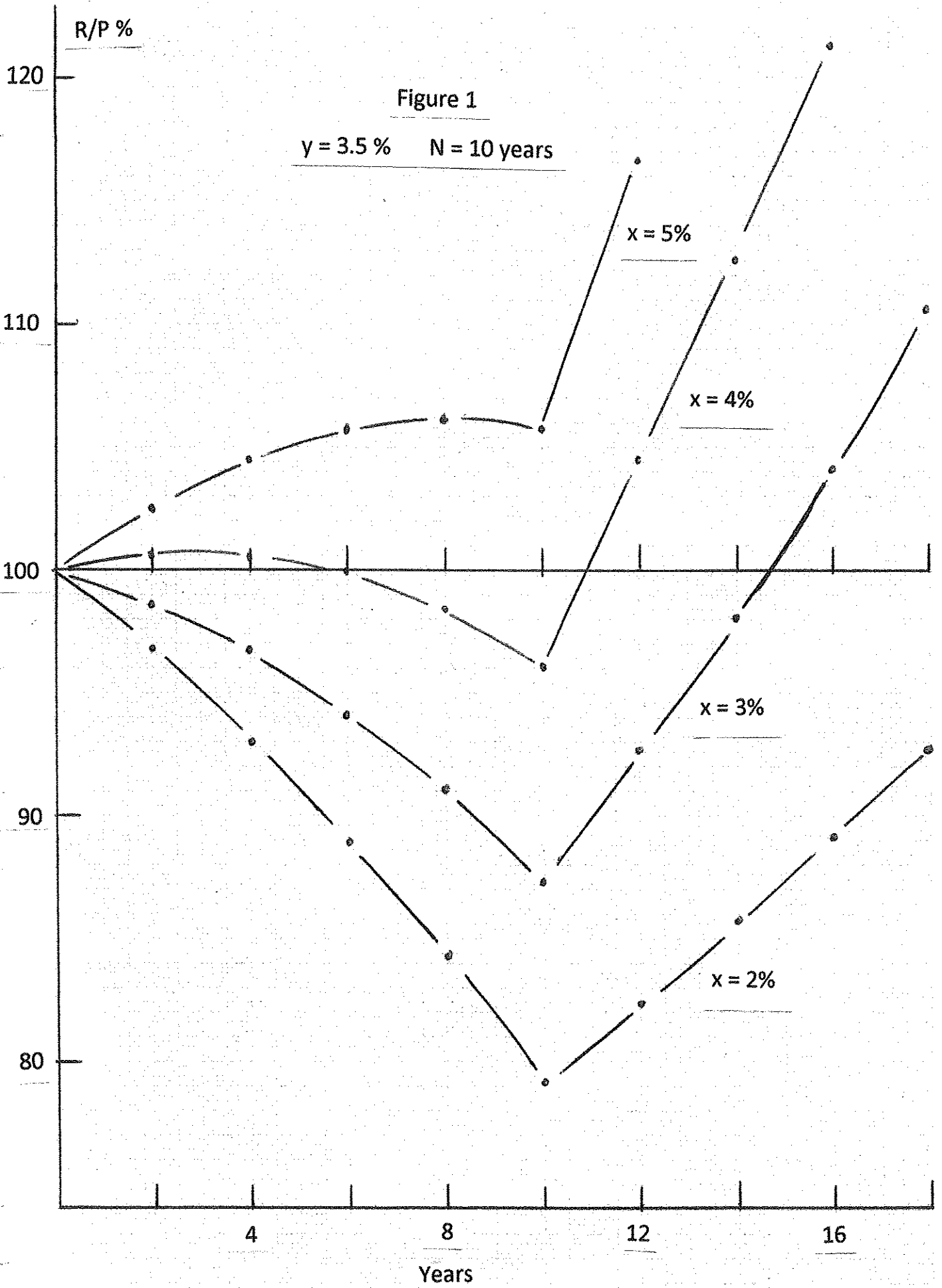
The mode of operation of the owner could be interpreted to have been to do things as cheaply as possible and get it fixed properly later at the residents' expense when things go wrong.

Surely the owners of a village should be made to pay say a percentage of their DMF to stop this sort of mode of operation. If they had to help pay for maintenance the owners would make sure that the job was done properly in the first place. I understand that in NSW this is in fact the case and part of the DMF does indeed go into the maintenance fund of the village.

Having the owners of the village contribute to the maintenance of the village is logical and equitable as maintaining the village in good order is not only beneficial to the residents but also to the owners, as a well maintained village makes the units more attractive to potential buyers, making it easier to sell units and thereby increasing the price of units and increasing their DMF.

  
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Phone 



R/P %

Figure 2

$\gamma = 4\%$      $N = 6$  years

