



RETIREMENT VILLAGES ASSOCIATION

DISCUSSION BACKGROUND PAPER

on the

REVIEW OF THE DISCLOSURE STATEMENT

October 2011

RETIREMENT VILLAGES ASSOCIATION

PROPOSED VARIATION TO THE CODE OF PRACTICE FOR RETIREMENT VILLAGES FOLLOWING THE CHRISTCHURCH EARTHQUAKES

1. Introduction

- 1.1 The Christchurch earthquakes in September 2010, February and June 2011 presented the retirement villages industry with an unprecedented situation. The earthquakes impacted negatively on New Zealand's GDP by around 10%, and will have ramifications for years to come.
- 1.2 Around 80% of the villages in Christchurch sustained some degree of damage while three were destroyed. A fourth, in the Red Zone, faces an uncertain future. Many residents had to be moved to temporary accommodation in other villages, motels or stayed with friends and family while the damage was assessed and villages repaired. For the most part, this situation was handled well by operators who were all facing personal situations of their own, and there have been many stories of operators working with others to get villages operational as quickly as possible, with the residents safely back into their own homes. It would be fair to say that in the vast majority of the cases, people in retirement villages were able to access help and support and have their homes fixed much more quickly than the community around them.
- 1.3 For those villages which were destroyed, the industry support provided was outstanding, from offers of money to accommodation. This was provided through the Association, and the package was well-received.
- 1.4 With the earthquakes providing us with the benefit of hindsight, we welcome the opportunity to review aspects of the Code so that we can continue the role we have in providing safety and security for older New Zealanders. It is important to remember that a fundamental premise on which the Code was developed was about helping people to make their own personal but informed choices about the type of accommodation they want in their retirement. The Act and the Code were about providing that disclosure. We continue to view this as a cornerstone of the legislation.
- 1.5 The issues the RVA has identified for consideration in this review include :
- Payments to residents should a village be destroyed and not rebuilt
 - Insurance cover and valuations, including disclosure
 - The provision of temporary accommodation
 - Continued payment of village outgoings in various circumstances
 - The amortization of the Facilities Fee or Deferred Management Fee (DMF) ¹ if a resident moves out of a village

¹ Villages have different terms for the portion of the initial entry payment which is retained by the operator when the ORA is terminated. For the purposes of this paper we shall refer to the Facilities Fee etc as the DMF.

- Rebuilding a village in another location.

1.6 This variation paper, which is the result of extensive consultation within the RVA's membership undertaken earlier in 2011, will look at each of the issues in paragraph 1.5 in turn. It is intended that the changes should apply to all existing ORAs current at the date of the change, and for the future, but exclude villages affected by the Canterbury earthquakes between 4 September 2010 and June 2011.

2. Repayment of the Capital Sum should a village be destroyed and not rebuilt

2.1 The RVA's proposal requires residents whose village is destroyed in an insured event and not rebuilt to be repaid their original capital sum without the contracted deductions in their ORA being made. This addresses the inequity of residents being forced to leave a destroyed village without a full repayment of their original capital sum, and leaving them worse off than they would otherwise be. It also seeks to readdress the omission (for whatever reason) from the 2006 Code of Practice of the clause which read :

If the residential unit is not replaced following an insured event, the resident will receive the full sum paid to the operator, without any capital or other deductions normally made under the occupation right agreement.

2.2 As it stands, this clause is ambiguous - does it relate to the insurance payment the operator may receive following an insured event, or does it refer to the resident's original entry payment? It would be unwise to include it unamended for that reason.

2.3 The Association believes that the risk of a village being destroyed and not rebuilt resulting in the need to repay the full entry payment to a resident is relatively small, but it is equitable for operators to commit to doing so. We are aware that several operators already include such a clause in their ORAs. As a result we believe that we should provide leadership in this area and ensure that residents in this situation are repaid their full entry payment without deduction, and we have suggested a redraft of the 2006 Code clause accordingly.

2.4 We propose to move this clause from the current clause 22 (dealing with insurance) to clause 47 (3), which deals with grounds for termination if the unit is damaged or destroyed through no fault with the following wording :

If the residential unit is not to be replaced following an insured event within a time that is reasonable in the circumstances, upon termination of the occupation right agreement, the resident will receive back the full capital sum that they paid to the operator for their occupation rights to that residential unit, without any deduction for deferred management or exit fees (the 'fixed deduction' as defined in this Code) normally made under the occupation right agreement upon termination and repayment. The payment to the resident by the operator in this event shall be made no later than five working days after all insurance monies for land (if applicable) and buildings in respect of the insured event have been paid to the operator and / or the statutory supervisor, or within five working days from the date on which sufficient insurance monies have been received by the operator,

if sooner. For the avoidance of doubt, any due but unpaid service or weekly fees in respect of the residential unit up to the date of the insured event or any other monies owing to the operator are entitled to be collected by the operator at the time of repaying the resident their full capital sum.

- 2.5 The Christchurch experience shows that provided an operator has adequate insurance, the village will be rebuilt either by the original operator, or by another party who is able to use the replacement insurance payout as a partial credit for the work. The simple reason for this is the reinstatement cover is higher than indemnity cover (based on the definition of indemnity being reinstatement less depreciation) therefore the operator is financially better off by rebuilding. In our view, it is very likely to be in the operators' and residents' interests for a village to be rebuilt and the structure of payments to residents and provisions of the Code of Practice should reflect that.
- 2.6 In the highly unlikely event that a village was destroyed and unable to be rebuilt either on that site or another, the Christchurch experience has shown us that the payout by the insurer (coupled with EQC on the land) will be greater if the valuer is instructed correctly. As a result the Association's first step to educate members about risk has been to produce a guide for members around insurance valuations for material damage and indemnity.
- 2.7 We are aware that basing payments on insurance proceeds is superficially attractive. However, there are several concerns with that approach. These are :
- Insurance payments do not distinguish the individual components of a claim. One payment is made for the village and covers not only the individual units but also the common areas, the infrastructure, underground services, business interruption, and so forth. Distinguishing individual unit payments, especially when they are part of an apartment block housing a rest home, hospital and common areas, will be a very difficult exercise to do fairly and is likely to lead to endless debates about the correct amount of payment to residents.
 - The original capital sum is a fixed amount, and being not open to dispute, is the fairest and simplest way to proceed.
 - If a village is actually destroyed and is not rebuilt, it is also important to protect the lender's liability as well as the operator's equity in the village. If it is a straight 'lifestyle' village and all proceeds are paid out to residents, the question is how much, if anything, is left for the lender and then the operator. There is a real risk that banks would not fund retirement villages because they would not know the level of the first charge to the Statutory Supervisor - i.e. the insurance payments due to residents under this model - which would be a moving target.
- 2.8 On the issue of whether residents should be paid out at market value, insurers will not (at this stage) insure for the market value of the unit in the event of a village not being rebuilt and therefore operators are limited to the indemnity value (plus land) from which must be deducted the excess (likely to increase to 5%) and any tax implications such as depreciation recovered as the non-rebuild would be treated by the IRD as a sale of the village. As noted above, banks would not want

to fund villages that provide for market value payouts as there probably will not be much left for them.

- 2.9 It is possible that there will be a shortfall between the insurance payout and the amount an operator will have to pay if it has to pay to a resident the full amount paid by that resident on entry. This may be so for newer villages. Whilst it may be possible to improve the operator's position through insurance, the cost of the insurance may be prohibitive. These are unknowns at this stage and we are aware that this is a concern for many operators. We note that operators are accepting risk in taking this approach. While residents still have some risk around the destruction of a village, it is important to note that operators also have risk.
- 2.10 Notwithstanding that, the Association is still working with insurers to ensure operators are not exposed to unnecessary risks around repaying the original capital sum.

3. Insurance cover disclosure

- 3.1 The 2008 Code requires operators to have comprehensive replacement insurance cover for accidental physical loss or damage to the village property, including residential units owned by residents. The policy must be to the statutory supervisor's satisfaction. Operators may include business interruption insurance, temporary accommodation insurance, and adequate liability insurance.
- 3.2 The Code requires operators to disclose if they are unable to obtain full replacement insurance. However, the Retirement Villages (General) Regulations 2006, in regulation 30 (a) requires the disclosure statement to explain :
- " ... what insurance cover for the retirement village the operator is to obtain or has obtained;"
- 3.3 Accordingly we consider that the Code should more accurately reflect the Regulations and disclose whether or not they have the insurances listed in 3.1 above. We suggest an amendment (*in italics*) to clause 22 (3) (a) of the Code as follows (note that sub-clause (b) remains unchanged) :

Where operators are responsible for the insurance, they :

May include business interruption insurance, temporary accommodation insurance, and adequate liability insurances *and the operator must disclose to the resident whether or not it has any such insurances.*

4. Temporary Accommodation

- 4.1 Following the earthquakes the need for accommodation was two-fold : short term for immediate needs, and longer-term as the villages were repaired or rebuilt. The extent of the damage in Christchurch meant that accommodation of any sort was at a premium, let alone anything suitable for retirement village residents. Operators found rooms in motels, other local villages assisted, residents were moved to other parts of the country or stayed with friends and family. The industry

itself offered immediate assistance to the displaced residents from any Christchurch village.

4.2 Clause 22 (8) deals with temporary accommodation and states :

The operator must inform residents in the occupation right agreement whether they will provide temporary accommodation or facilities while a residential unit or facility is being repaired or replaced after an insured event.

4.4 Clause 22 (3)(a) gives operators the option to obtain temporary accommodation cover, and we believe that this is the correct position as it allows each operator to assess the risk and take appropriate cover or self-insure if s/he decides to do so.

4.5 It is important that residents know what is available if it is needed, and Clause 22 (8) covers that position. They are then in a position to assess the risk themselves and make a decision accordingly. In any case, many residents' contents insurance policies include temporary accommodation insurance, and they should be encouraged to make sure this cover is included.

4.6 We recommend that the Code remain unchanged in this regard.

5. Continued payments of village outgoings

5.1 Clause 54 (2) deals with continuing charges for outgoings when an ORA is terminated. The fees (if they do not cease on termination) must reduce by 50% after six months if the unit is not resold and continue to be payable at that reduced rate indefinitely (or until the unit is resold). Provided the ORA is not terminated, it would appear that an operator can continue to receive the weekly fees even if the village is destroyed.

5.2 There are, of course, continued outgoings even if the village is not habitable - rates, finances, and overheads such as staff costs may continue and are a contracted cost the residents bear. If the resident moves to another village, either owned by the operator or another organisation, there will be a new set of weekly fees to pay, in addition to those at the destroyed village.

5.3 The question then becomes to what extent should the destroyed village's fees continue to be paid following an insured event when the resident is no longer living at the village? Does the position change if alternative accommodation is provided by the operator at the operator's cost (e.g. in temporary accommodation covered by insurance)? Should the fees abate if the resident is denied access to the facilities because they have been destroyed but the unit is still habitable?

5.4 The short answer to these questions is that the operator can hold business interruption insurance to cover the overheads such as rates etc if the village is uninhabitable. As a result we suggest the following new sub-clause to clause 54 (the following clauses are therefore renumbered) :

Continuing charges if a unit or village is damaged or destroyed following an insured event

3. If a unit or village is damaged or destroyed following an insured event so as to make the residential unit uninhabitable, the weekly fees should cease from the date of the insured event, unless the operator provides temporary accommodation.

6. The amortisation of the DMF

- 6.1 Clause 54 (3-5) requires that the “fixed deduction” (or DMF in this paper) must not accrue past the date on which the resident is paid the amount payable to them on termination of the agreement. The question for consideration here is whether the DMF should continue accruing if the village is to be rebuilt?
- 6.2 The Association’s view is that if the operator is rebuilding a new village, their obligations under the ORA are being met but the resident does not have access to the amenities. Provided the resident is not re-housed in a comparable unit in another village, or in another suitable residence, the DMF should be suspended during the rebuilding process.
- 6.3 We suggest the following re-wording of clause 54 (7) :

Following an insured event and the unit or village is uninhabitable requiring the resident to move to other accommodation not provided by the operator, the accrual or amortization of the fixed deduction must be suspended until the resident can be accommodated again in the unit or in a replacement unit. Both the operator and the resident must agree to the reinstatement of the fixed deduction.

7. Rebuilding the village in another location

- 7.1 The Christchurch experience shows that an earthquake can destroy the land as well as a village to such an extent that it is impossible to rebuild, or rebuild economically, on the same site. Should this happen, the operator may find that the only available or affordable land is situated some distance away - and not necessarily even in the same urban area.
- 7.2 Clause 47 states :

1. The operator and resident may agree to terminate the occupation right agreement if the resident’s unit or the retirement village is destroyed or damaged beyond repair in specified circumstances set out in the occupation right agreement. For example, it may be that repair or reinstatement of the unit is not practicable because of the extent of the damage or destruction and because:

a the necessary building consents cannot be obtained, or

b the insurance money needed to repair or replace the unit cannot be obtained or is not enough to replace the property damaged or destroyed.

2. The operator must consult the resident to decide whether it is practicable to repair or replace the unit. Then, the operator must follow up in writing, setting out their decision. Through this process, both parties can work out an agreement to end the contract.

- 7.3 An operator's ability to manage the situation will vary according to their circumstances. What is possible for one may not be for another, and we caution against adding further prescriptive provisions in the Code; it will also be a matter of personal choice for a resident whether they want to move away from the destroyed village's location and we believe this matter should be dealt with, as it is now, in the individual ORAs. In our view Clause 47 as it currently stands handles the situation.

8. Conclusions

- 8.1 After reviewing the 2008 Code we do not think it is necessary to amend it beyond including a provision to repay residents their original entry payment (as discussed in section 2 above) and make some changes around continuing weekly fees and the amortization of the DMF in certain circumstances (as discussed in sections 5 and 6 above).
- 8.2 The requirements that already exist in the Code for full replacement insurance are sound, along with the requirement for the Statutory Supervisor to review this cover. Other insurance arrangements (such as temporary accommodation cover) are required to be disclosed and this allows potential residents to make an informed choice.
- 8.3 The statutory supervisor's role in the oversight of a village should not be underestimated, and it is our view that the Act and regulations provide the supervisor with sufficient responsibilities to make sure the village is run in a prudent and efficient manner.
- 8.4 The Association believes it should show leadership in the question of repaying the residents their full capital sum if a village is destroyed and not rebuilt. We are aware that in so doing, there is a risk of exposing operators to unfunded liabilities, but we also believe that in the highly unlikely event that a village is partially or totally destroyed and is unable to be rebuilt either on that site or another, the Christchurch experience has shown us that the payout by the insurer (coupled with EOC on the land) will be significantly greater if the valuer is instructed correctly.
- 8.5 As part of our education process we will be providing guidance on instructing the valuer, evaluating risk and ensuring the insurance matches it, and upgrading our emergency procedures.



John Collins
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