The Sydney Morning Herald

Retirement village exit fees can have sting in the tail

If you have done research into the cost of moving into a retirement village you will know that a key part of the transaction is the exit fee.

The fee can include sharing in any capital gain or loss on a unit, marketing fees, sales commissions and renovation costs.

However, one constant is the Deferred Management Fee (DMF).

The DMF exists for two reasons.

Firstly, in the past, retirement villages generally are trying to keep the purchase price of units as low as possible, so residents can free up more equity from the sale of their home to buy lifestyle assets such as cars, boats or caravans, to spend on holidays or to invest but in recent years that has changed, many now cost the same or more than a residential complex.

The second is that villages operate under state-based legislation that requires them to run at cost. It is a bit like a body corporate; the budget of expenses for the village are divided among residents, either based on the size of their home or the number of people who live there.

So, the DMF is a combination of the future value of the unpaid amount upfront and the profit the operator did not make while you lived there.

Most people consider the DMF to be a bit of a rip off. However, it is important to understand that the model came from the not-for-profit sector, which wanted to make their villages as affordable as possible at the time, but those times have gone.

The problem is that many people moving into retirement villages do not need affordable housing. They can afford to pay the real price upfront and operatos are capitalising on this.

The other issue is that when a village discounts the upfront price, they are recovering more than that amount at the end to account for the time value of money. It is basically a loan.

By forcing you to pay now with an exit fee later, you can find yourself in a situation where your pension is reduced (or lost) and your investments cannot keep up. As a result, you are forced to eat into your capital on both sides of the transaction.

For example, let's look at Shirley, who owns a home worth $950,000. She has $250,000 of investments, $25,000 in personal assets and receives the full age pension of $25,155 a year.

The unit in the retirement village she wants to move into costs $500,000, with an exit fee of 30 per cent over five years.

When Shirley moves into the village she will have an extra $450,000 for investments but will lose all of her pension.

If she earns 3 per cent a year on her investments, then to have the same amount she had when she lived in her home, she would need to use all the income generated, plus about $12,000 a year of her capital.

While she is not at risk of running out of money, if she lives in the village for 10 years, she could easily find that her exit fee is $150,000 while, over the same time period, her investments have reduced by $120,000.