DECISIONS IN RETIREMENT

Understanding life rights

INN8

NAVIGATION

INTRODUCTION

For those who have the means to save for retirement, life expectancy has increased steadily over the past century, adding pressure for accumulated wealth to last. While 'retirement' may only have lasted 10 years in 1950, we now need to plan for up to 30 years 'post-work'.

When considering retirement – or, as my financial adviser prefers to view it, independence – we often base our notion of how we intend to live out the rest of our days on our personal experience. But while everyone has a unique idea about what their future might look like, frequently reality does not match up.

Thankfully, a lifetime of consistent, prudent savings can provide enough options at retirement not to have to compromise too much on living standards. Important conversations you have with your adviser will include topics like how old you want to be when you stop working, how much you can afford to draw from accumulated savings, and what to do with your portfolio of assets on death.

In addition to the weighty issue of when to start to slow down and enjoy life, other important decisions also need to be made. These may include when to sell the family home, how to keep busy, and where to live.

PLANNING FOR THE GOLDEN YEARS

'Where to live?' is a question often over-looked or under-analysed. Most early retirees are self-sufficient, healthy and mobile, and happy to continue living like they did immediately prior to retirement. Complacency simply sets in and the decision is left too late for proper assesment of all residential options as a result of needing to be closer to professional medical care. As with anything in life, planning ahead and being informed of the options available can help you avoid any unnecessarily limitation of options.

Popular options for retirees looking to move into a retirement complex are buying a sectional title unit, a life rights investment or rental of a unit, many of which offer access to medical services on the premises.

THIS IS WHAT WE MEAN WHEN WE SAY...

Life right

This is the purchase of a right to reside in and enjoy the unrestricted use of a unit until death or, in the case of spouses, until the deaths of both husband and wife. Typically, most life rights are sold for an amount below the freehold market value since when the 'owner' dies, the right of use returns to the developer who then pays the deceased owner's estate the original purchase value. Ownership of the unit remains with the developer throughout. The developer is responsible for certain maintenance and services being supplied to the property.

Sectional title

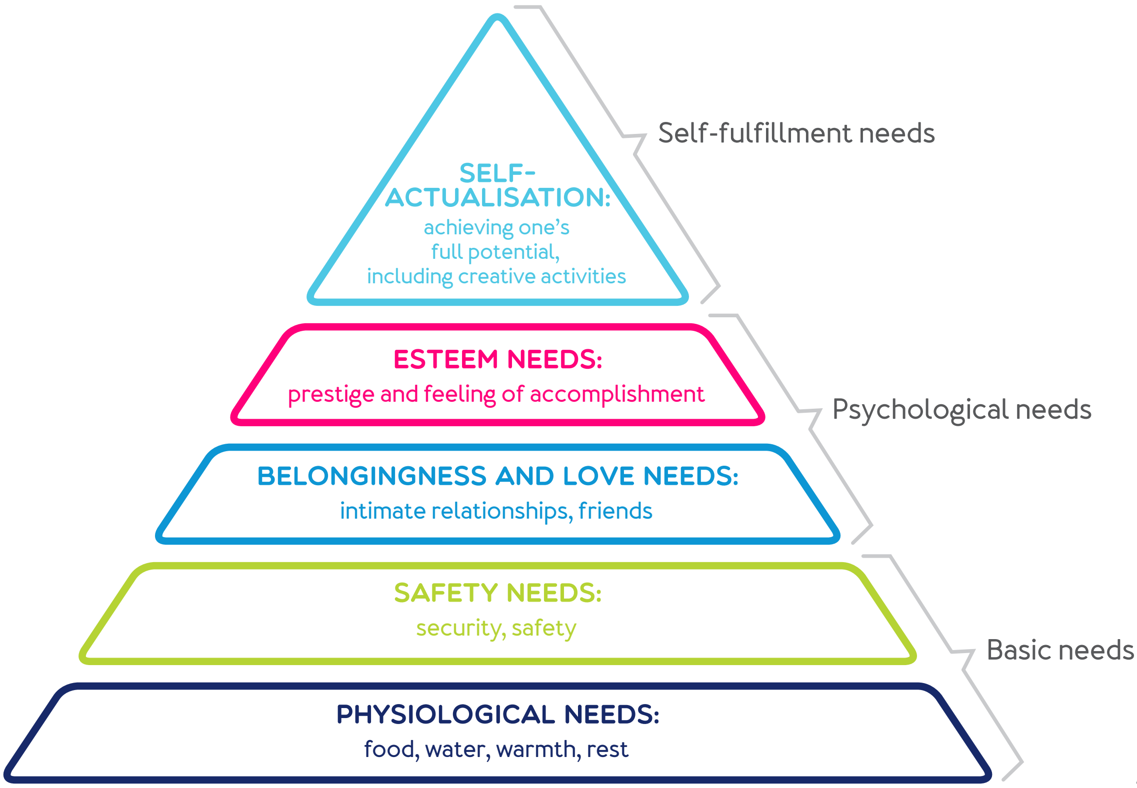
This is the purchase of a separate ownership of a unit (or section) within a complex. When you buy into a sectional title complex, you purchase a unit and an undivided share of the common property. The unit is held in the your name and forms part of your estate, and you will realise capital gains on the property and be subject to property market movements over the years. It is your responsiblilty (along with other unit owners) for normal and special levies, rates and utilities as per the rules of the complex. Units are typically purchased and transferred at a prevailing market value.

Rental

This is like renting any property; a rental agreement is concluded between the owner and a 'tenant', you, who agrees to pay a periodic fee that allows you to reside in the unit and make use of certain services subject to terms and conditions stipulated in the rental agreement. The owner is responsible for certain maintenance and services being supplied to the property.

CHOICE MOTIVATIONS

Famous American psychologist Abraham Maslow created Maslow's hierarchy of needs, a widely-used assessment tool that depicts a human value system. Ranked by order importance, this is what it looks like:



Maslow (1943)

Maslow proposes that throughout our lives, we maximise our efforts to fulfil these needs – but once we retire, we are forced to re-evaluate how we can maximise this hierarchy of needs, factoring in different variables such as accumulated wealth, expected timeline and health.

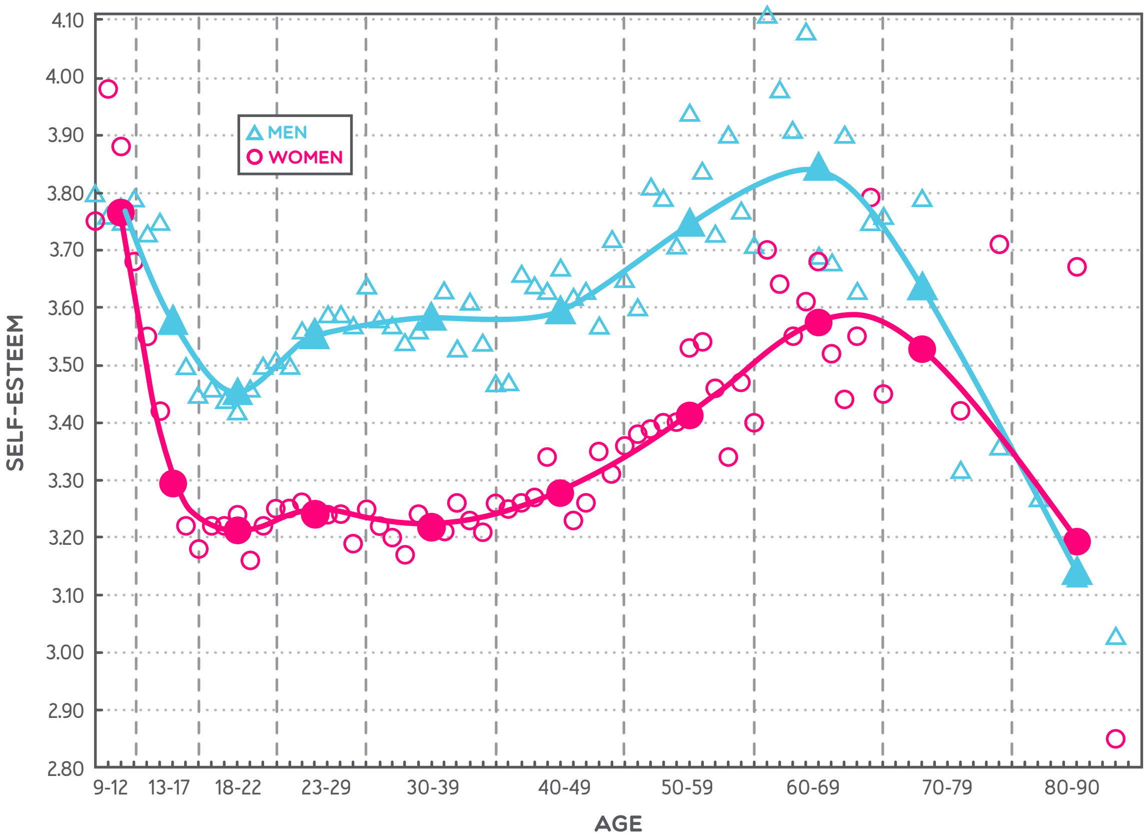
How can we use this diagram to start from the beginning again as one enters late adulthood or old age? Let's break down the needs of someone who is about to enter retirement:

Basic needs

From a South African point of view, while we need to ensure we have access to food, shelter, water, and clothing, security and safety are two important points when considering retirement. For an older person, security and safety may rank equally with food, shelter and water since older people are more vulnerable to crime. Older people also increasingly require access to good quality health and frail care facilities.

Physiological needs

While, on average, self-esteem peaks at around the age of 60, a study conducted by Richard Robins in 2005 shows that it starts to drastically decrease after that. The study found that there are a number of changing factors contributing to this decrease in self-esteem: role (retirement), relationships (loss of spouse, family) and physical functioning (health problems), as well as a decline in socioeconomic status.



Mean level of self-esteem for males and females across lifespan (Robins et al., 2002). Also plotted are year-by-year means, seperately for males (open rectangles) and females (open circles).

According to a 2017 study by Michigan State University's William Chopik that focused on relationships, health and subsequent happiness, people who value family and friendship relationships are happier and healthier. This clearly shows the need for love and belonging is important at all stages of life.

It's important to consider personal preferences and circumstances when fulfilling psychological needs in retirement. On one side, there are those who may be fortunate to have a seemingly endless supply of willing, caring family members, ready to support (emotionally and financially) during their retirement. In this case, you could be 85, still in your family home receiving regular visitors and able to continue playing an active role in the community they had been a part of before retirement.

For varying reasons, some may find that their social circles shrink as they move into this phase of their lives and they no longer have the support they may have enjoyed previously. In this case, investing in a life rights arrangement is one way to secure a residence, relative safety, access to medical care and a community for emotional support.

Which category does your clients fall into?

Self-fulfilment needs

Just as younger adults require creative stimulation or outlets for their individuality and passions, older adults do, too. They require spaces and events that offer the unique ability to be themselves and to participate in actions they love.

Retiring at the age of 60 means you may well spend a third of your life in retirement, it is important that you plan the activities with which you want to surround yourself. Most retirement villages these days market themselves as “lifestyle complexes” and each offer a wealth of different attractions and clubs, such as book clubs, scrabble, themed dinners, golf courses – you get the idea.

In this case, as long as you are in an environment that continues to stimulate your brain, offering you the chance to engage in an active community you will maintain or improve the well-being and quality of your life as you age.

SO, IS LIFE RIGHTS FOR ME?

The main concern regarding life rights is how inflexible the option is; once the decision to enter a life rights contract has been made it is extremely difficult to exit. Thus, the decision to enter a life rights should be considered carefully.

Let’s take the following example: Peter just received an amazing offer to go work in the UK. He will have to immigrate to the UK if he accepts this offer. Peter’s mother currently stays a few hundred metres from his house in a life rights retirement complex. Peter would like to move his mother with him when he and his family goes to the UK. But, because his mother is in a life rights complex, the only way for her to move is to give up her right and incur a significant financial loss.

There is also a risk regarding ownership: because the developer remains the owner and is responsible for all maintenance and upkeep, there is a risk that should the developer suffer financial difficulty they will be hard-pressed to meet their obligations of maintenance and provision of essential services. In essence, you need to understand that you relinquish control as the developer has the right to amend levies as costs for certain additional services are often not included in the upfront purchase price. There is often no oversight by an independent board of trustees, governing body or regulator. This allows developers to operate as closed book businesses with no need to be transparent with regards to revenue, costs and future liabilities.

The concept of a buy back at cost is also not always what it seems to be. This can give the impression that there is limited capital loss on this option.

Here’s another example: Consider a purchase of a life rights for R1 million. After 30 years, you have enjoyed peace of mind that your residence is secure and on your death, the developer will return the original R1 million. Assuming you could have taken the R1 million and invested it at a growth rate of 6% (inflation estimate), it would have grown to R5.7 million over 30 years.

You have traded peace of mind for a relative loss of R4.7m, or +/-80% of your capital:

YEARS	NOMINAL VALUE OF R1M GROWING AT 6%	DIFFERENCE BETWEEN ORIGINAL PURCHASE PRICE AND NOMINAL VALUE OR RELATIVE 'PRICE' OF PEACE OF MIND
0	R 1 000 000	R 0
5	R 1 338 226	R 338 226
10	R 1 790 848	R 790 848
20	R 3 297 135	R 2 207 135
30	R 5 743 491	R 4 743 491

The longer a life rights is used, the less valuable the buyback becomes and the more value you have placed on being able to mitigate longevity risk.

On the plus side, the knowledge that a fixed price offers a roof over your head and access to necessary services no matter how long you live gives a great level of comfort. Owners of life rights don't have to concern themselves with the administration and costs of owning a property. Maintenance is covered in the price of the life rights with the additional levies. The responsibility of maintenance is with the developer who is responsible for upkeep. The purchase of a life rights is not subject to transfer duties and VAT costs. This further emphasises the cost benefit of investing in a life rights; the purchase price is all inclusive so no additional costs except levies will be incurred.

The risk profile of individuals at retirement will vary greatly according to circumstances and accumulated wealth. Below is an assessment of whether the option selected leaves you more or less exposed to each risk identified:

RISK	LIFE RIGHT	SECTIONAL TITLE
Longevity – I outlive my accumulated savings. My home is not fit for purpose throughout retirement. I can't afford to maintain the property and services with which I entered retirement.	Leaves you less exposed. Plan as if you are going to live to be 95 or 100 years old. A life right can take the 'where am I going to live' worry off the table.	Leaves you more exposed. You will have to plan carefully to be able to afford the property you live in.
Relocation – I am very uncertain as to whether I may want to move suburb, city or country during my retirement. There is a strong likelihood that the place where I started out in retirement and where my support network exists will change over time.	Leaves you more exposed. 10 years down the line you may face the prospect of having to stay where you started while those close to you have moved away.	Leaves you less exposed. It is relatively easy to sell a sectional title unit and relocate.
Insufficient savings - I am not able to sustain my standard of living. I am having to make too many compromises around living expenses, delaying retirement, health care and residential choice.	Leaves you less exposed, for now. A life right is usually purchased at below the market value of the sectional title unit so it is possible to secure a place to stay for you (and your spouse) and free some capital to see to the most urgent of day to day necessities.	Leaves you more exposed. Since sectional title units transfer at market value, you are tying up valuable capital that could be deployed elsewhere.
Estate planning – It is very important to me that I leave a legacy to my heirs.	Leaves you more exposed. The buyback clause generally means your capital value declines in real terms over time.	Leaves you less exposed. Generally sectional title units can be sold for market value and form part of your estate.
Health – the level of health care required may exceed my initial expectations (e.g. a standard medical facility versus private nursing)	Slightly more exposed than sectional title. Mitigate this by researching the health care provider and track record of the retirement complex before committing to a life right. Are they able to sustain their service levels?	Slightly less exposed than life right. You still need to do your due diligence, but if the service provider disappoints, you can always relocate.
There are other risks in retirement such as market risk to your investments, uninsured event risk, tax and government policy risk. These apply equally regardless of which residential option you choose and we have not elaborated on them further. You should still have a frank conversation with your adviser around how to prepare for these other unforeseen events.		

FINAL THOUGHTS

The argument for and against life rights is not only a financial choice. Choosing life rights or sectional title is not about whether one offers more than the other in the form of services. Rather, it is about what is the best bouquet of services you can purchase with your accumulated wealth to fulfil your needs until death. What trade-offs are possible to mitigate against the risks which you feel are most applicable to you?

Life rights offers a discount relative to sectional title properties and can suit your lifestyle if you:

- do not foresee any risk or need for relocation after retirement;
- have prepared adequately for retirement;
- don't fear the risk of outliving your money or the feeling you will have to make compromises on living standards;
- do not want additional administration regarding property ownership; or
- your friends and family already live in a specific life rights development.

Then, life rights may be a worthwhile option to be considered.

However, when entering a life rights scheme it is important to understand your contract and to choose a trusted provider preferably with a long-term track record of good service delivery. Consider speaking to existing residents in the developments you are looking at. Evaluate the developer and the frail care facility by looking at their track record and commitment to the complex. Life rights often advertise great frail care facilities, but the level of frail care is independent of life rights or sectional titles. Most sectional title deeds have excellent frail care facilities just like life rights options.

On the other hand, a sectional title might be a more worthwhile option for you if you:

- want complete control of your wealth;
- want to own your own property;
- are comfortable managing your own longevity risk by adjusting living standards;
- assign a lower probability to outliving your wealth;
- think you might have to move during your retirement; or
- value leaving a legacy.

Planning for retirement (and constantly revisiting this plan) is important. Consult a wealth manager who can help you objectively assess your personal circumstances and your options. Remember to consult your family and gather as much information and insight as you can. Being informed and having a plan of action will mitigate the risk of having to make difficult decisions at an inopportune time.

ARE YOU A WEALTH MANAGER OF THE FUTURE?

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