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Johnston - Aged Care Guild

Aged Care Guild

Senate Inquiry

COMMUNITY AFFAIRS SENATE COMMITTEE INQUIRY INTO:

Aged Care (Living Longer Living Better) Bill 2013;
Australian Aged Care Quality Agency Bill 2013;
Australian Aged Care Quality Agency (Transitional Provisions) Bill 2013;
Aged Care (Bond Security) Amendment Bill 2013;
Aged Care (Bond Security) Levy Amendment Bill 2013

Wednesday 1st May 2013

Presented by:

Ross Johnston, Chairman (CEO Regis Aged Care Pty Ltd)

Andrew Sudholz, Director (CEO Japara Holdings)

JAPARA

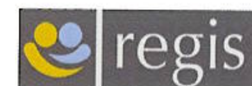
Aged Care Guild - who are we?

We are the five largest private aged care operators in Australian residential aged care market

- Allity (formerly Lend Lease Primelife)
- BUPA
- Domain Principal
- Japara
- Regis Aged Care

Achievement over the last few years

- Operate more than 10% of the total market (circa 20,000 beds)
  - approximately 30% of the private sector
- We hold circa $1.6bn in accommodation bonds (circa 13% of total bond pool)
- Given scale, each member has inherent benefit of being very diversified geographically and numerically (relative to most operators)
- We have all invested significant shareholder funds into the sector over a number of years
  - our members have developed / acquired more beds than most providers in recent years



Context

- **Situation:** Proposed legislative reforms will influence consumer behaviour such that the inflow of capital to the industry from bonds is significantly reduced/ nullified.
- **Change:** The family home is now included in the income tested fee. If the home is sold it will be included in the assets test, if not sold, value capped at $140k. [Section 44-26 A (5) of the Aged Care(Living Longer Living Better) Bill 2013]
- **Problem:** Said decline in bond inflow and by nexus, outflow of existing bond capital will cripple development, reinvestment and improvement which consequently will lead to impacts on consumer choice and lower industry viability. It may potentially also lead to a fewer number of operational beds in the near term.
- **Complication:** The triggers for review and subsequent remedy periods are lengthy and any negative impacts from reforms will be near impossible to reverse.
- **Implication:** Consumer choice and indeed services will be negatively impacted.

Greatest risk with proposed legislation

- Bonds have been used quite effectively as a source of capital by the industry for the last 16 years - this has been critical for the construction of new beds.
- The current bond pool is Circa $12b, in quantum this is circa 2-2.5 times the total debt in the industry.
- The two salient changes proposed with regards to choice of payment method and inclusion of the bond in the means test are of greatest concern to the Guild.
- The proposed changes we believe will result in;
  - a loss of control of how providers sell their beds
  - removing the control providers have over their capital structure
  - providers with bonds incurring a cash outflow which is multiples of their operating cash flow, resulting in significant financial duress
  - we believe this will be the case as the legislation includes the RAD (bond) in the assets test, this has not been the case
  - runs the serious risk that there will be a significant capital outflow from the industry
  - this can't all be funded by debt, refer above
  - raising additional equity will be extremely difficult in this environment
- Their will be considerable duress by the interim review in 2017 if the trend is to DAP's

Other considerations

- <u>Other considerations;</u>
- **We are not aware of any financial modelling done by DoHA in relation to this**
- Current operational returns are under pressure and do not justify the construction of new facilities without access to capital via lump sum bonds
- We are unclear as to how the approval of bonds in excess of $406k are to be assessed
  - The guild have in excess of $60m of bonds above $406k
  - We believe there are about $600m of bonds above $406k in the industry
- The current legislation allows consumers a cooling off period but also providers a choice as to how they sell the bed (Section 23.84 of the User Rights Principles 1997 currently provides residents with a cooling off period in relation to the resident agreement).
- The impacts on smaller providers will be significant and occur quickly
- Bonds in high care will be subject to the same choice criteria, they will not offset the cash outflows if there is a trend to DAP's
- <u>**If this is to be changed consideration should be given to allowing providers to manage the transition so it can be funded over time**</u>

JAPARA

Outcome

- Funding for new construction will be curtailed (bonded basis)
  - unmet demand due to limited new beds being constructed

- Some operators maybe under severe financial pressure due to changed capital structures as a result of significant cash outflows
  - potential closures of facilities

- Lenders forced to review lending practices (given quantum's of bond cash flows to operating cash flow)

- Bank funded development will most likely require providers to contribute significant capital prior to construction, this is not the case now

Worked example

- Assumptions as set out in our submission
- Bond for existing resident gets paid out, new resident elects a daily charge

Debt Metric	2014	2015	2016	Notes / Assumptions
Net debt ($)	5,000,000	9,500,000	12,650,000	Net debt after existing bond pool deducted
ICR	2.0	1.5	1.4	Interest cover ratio covenant 1.75x (breached)
LVR	42%	67%	81%	Loan to value ratio covenant 55% (breached)

- Result:
  - net debt increases (bond cash flows per bed are many multiples of operational cash flow)
  - critical bank covenants are placed under pressure
  - breaches will occur for some providers
  - banks will tighten lending requirements as a result, not relax them

Worked example - detail

Debt Metric	2014	2015	2016	Notes / Assumptions
Beds	100	100	100	"100 bed" example
Residents	95	95	95	95% occupancy
Bonds Held	50	35	25	50 single rooms / private ensuite, 25 twin rooms. Ave length of stay 2 years, 60% of new residents elect a DAP rather than RAD.
Average Bond Value ($)	300,000	300,000	300,000	Assume bond capping does not apply downward pressure at all levels
Total Bonds ($)	15,000,000	10,500,000	7,350,000	Total bond pool at 30 Jun
Cost per bed ($)	200,000	200,000	200,000	Total cost assumption for purpose of model
Total Cost ($)	20,000,000	20,000,000	20,000,000	Total funding requirements
Net debt ($)	5,000,000	9,500,000	12,650,000	Net debt after existing bond pool deducted
Interest @ 7% ($)	350,000	665,000	885,500	Interest cost on net debt assuming 7% interest rate
Operating Cashflow / Bed ($)	7,000	7,000	7,000	Simple assumption based on industry data per Grant Thornton report
Operating Cashflow ($)	700,000	700,000	700,000	"Normal" operating cashflow
Additional DAP @ 6.95%	n.a.	312,750	531,675	Additional operational cashflow from residents electing DAP instead of RAD
New Operating Cashflow ($)	700,000	1,012,750	1,231,675	Total cashflow used for debt covenants etc
ICR	2.0	1.5	1.4	Interest cover ratio
Value for Security purposes				
Aged Care Facility	10,000,000	12,085,000	13,544,500	"Good operator" earnings of $15k per bed + additional DAP capitalised at 15%
Other (Equity)	2,000,000	2,000,000	2,000,000	
	12,000,000	14,085,000	15,544,500	
LVR	42%	67%	81%	Loan to value ratio
Security Value per Bed Calculation				
EBITDA	15,000	18,128	20,317	
Cap Rate	15.00%	15.00%	15.00%	
Security Value per Bed	100,000	120,850	135,445	