24 May 2013

Dr Ian Holland
Secretary
Standing Committee on Community Affairs
Legislation Committee
Parliament House
CANBERRA

Dear Dr Holland

RE: AGED CARE PACKAGE OF BILLS INQUIRY – RESPONSE FROM DEPARTMENT OF HEALTH AND AGEING TO QUESTIONS ON NOTICE

We would like to take the opportunity to comment on the Department of Health and Ageing's response to questions on notice from the Committee (Paper no. 25) in relation to accommodation payments (Attachment 4 to the Paper). We trust that our comments can still be provided to the Committee at this late stage.

While we understand the Department's view that some submissions from providers do not appear to have taken account of all the factors that might influence accommodation payments, we question some of the Department's assumptions and assertions about future costs and revenue.

The Department's response argues that provider concerns about a shift towards Daily Accommodation Payments (DAP) may be unfounded; and that the increase in the total pool of consumers who could potentially pay a Refundable Accommodation Deposit (RAD) represents a significant offset to any such shift. The Department also argues that the level of DAPs will not be restricted in the way that daily charges are currently subject to a maximum ($32.58 in March 2012 prices). We cannot disprove any of these assertions in light of them being a forecast of what might happen, but they do omit certain considerations that we would like the Committee to be aware of based on our considerable experience in managing accommodation payments.

Impact of other parts of the LLLB package

The Department correctly points out that the pool of potential refundable deposits will increase. However, they quote a figure of an 'additional approximately 94,000 operational high care places where RADs will be able to (be) paid'. The Committee should firstly note that these high care) places already exist and are occupied by residents whose accommodation payments are fixed for the term of their stay. The new payments arrangements only apply to new residents post 1 July 2014 so it is very misleading to suggest that providers will face a sudden windfall in 2014.

On the same page they refer to non-supported residents as representing 60% of residents. On those figures, the pool of potential RADs is reduced to a theoretical maximum of an additional 56,400 residents as only non-supported residents can be asked to pay an accommodation payment. Furthermore, a reasonable proportion of this notional pool of residents already pay a lump sum accommodation payment when they are in low care. The lump sum, or bond as it is currently known, rolls over when the residents become high care

residents. They cannot be asked to pay another bond so the size of the pool the Department refers to is smaller again.

It should also be noted that existing residents as at June 2014 will continue to pay a maximum daily charge of $33; and the government Accommodation Supplement for Supported Residents only increases to $52 a day for residents in new or significantly refurbished facilities (which will be the minority of facilities).

The footnote to the Department's figures further qualifies the estimate by rightly taking account of less than 100% occupancy. Additionally, a significant proportion of those non-supported residents will have insufficient assets to afford the full amount of the RAD. They will therefore have no choice but to opt for a DAP, or a part RAD that is less than the provider's advertised price plus a part DAP (refer also to comments below under **Retention amounts**). Therefore, the potential pool of additional refundable deposits available to providers is likely to be much smaller than the Department has indicated.

The Paper then estimates additional revenue to the sector at $331 million per annum if the average DAP is $50 a day. No explanation is provided to support the assumption that the average DAP might be $50 and we have been unable to arrive at the figure of $331 million using the Department's calculation. In any event, we draw the Committee's attention once again to various submissions that point to the significant financial viability risks associated with a shift to DAPs: ANZ, Grant Thornton, Aged Care Guild, Aged and Community Services Australia and others.

Retention amounts

Firstly, we agree with the Department that providers might be able to set accommodation payments at levels that will compensate for the loss of retention amounts. However, we believe the Department has significantly underestimated the effect of abolishing retentions. In the example on page 5 of Attachment 4 to its submission, losing the monthly retention of $323 is shown as requiring an increase of $50,866 on an accommodation lump sum of $100,000. No explanation is provided but our own calculation is as follows:

$323 per month = $3,876 per year

To produce an annual return of $3,876 based on a current investment interest rate of 4.6%, a RAD will need to be increased by $84,261 ($84,261 x 4.6% = $3,876).

The equivalent DAP would be $38.57 ($184,261 x 7.62% MPIR ÷ 364 days).

The Department's figure of $50,866 would require an investment return of 13.12%; three times the prevailing rate.

The option of a $100,000 RAD + a DAP would require a daily payment of $17.64 compared to the RAD only option of $184,261.

Contrary to the Department's claim on page 4 of the Attachment, residents <u>will</u> have to pay more for their accommodation than they do under current arrangements. The whole system of accommodation payments in the future is premised on increased payments.

The Department's use of a lump sum of $100,000 is also rather disingenuous as, on its own figures, the average lump sum paid in 2010-11 was $239,000. Therefore, average lump sums (RADs) could be expected to increase to a minimum of $324,000 (i.e +$84,261) to compensate for the loss of retentions alone. Other accommodation cost factors such as the true cost of land and construction, cross-subsidising Supported Residents, borrowing costs, refurbishment, upgrading etc. could immediately push the average RAD close to or above the initial Level 2 threshold of $406,036.75, effectively resulting in many more providers having to apply for approval of prices by the Aged Care Pricing Commissioner than the Government might envisage.

Furthermore, the Department's comments reflect a position that is not what is generally expected to be required with respect to sustainable accommodation income in residential

care. The Department's data on accommodation bonds shows that of all bond payments in 2010-11, 15% were less than $100,000. In the case of one of our organisations, that figure was 25%. People with such low asset levels would not be able to pay another $50,000 for the loss of retentions, let alone another $85,000, which we maintain is the correct figure (refer to above calculation). The reality for these people will be to pay a DAP, or a combination of a part DAP and part RAD. In time they will exhaust their assets and become Supported Residents, which for most providers will mean a drop in payments from the advertised DAP to the government's Accommodation Supplement of $33 a day[1].

Admittedly, the effect of the loss of retentions may be partially ameliorated by the increased pool of potential RAD payments (but see below). However, the means testing arrangements provide a significant incentive for prospective residents/families not to sell the family home and avoid paying a RAD. We acknowledge the fact that there are always a variety of (sometimes conflicting) considerations when it comes to the sale of the family home and the Department's Paper refers to these. Nevertheless, we are already experiencing a growing reluctance on the part of low care residents to pay a bond and we expect this trend will be encouraged by the new means test for residential care, whereby the value of the home above $144,500 and any rental income are exempt from that test. If the resident retains the home they are more likely not to have to pay an amount towards their care costs.

Method for converting a DAP into a RAD using the maximum permissible interest rate (MPIR)

Our concern about the method for converting a DAP to a RAD is detailed in our submission to the Committee (no. 41). The Department's supplementary paper focuses on the use of the MPIR versus other methods, such as weighted average cost of capital.

We argue that the logic of the calculation is back to front, as the RAD should reflect what are by and large, capital costs that change little over time. For example, a new aged care facility that cost $20 million might equate to $250,000 a bed. This is the true starting point for calculating the accommodation price and the DAP should be derived from the per bed cost, not the other way around. The existing legislation acknowledges this reality in the formula for converting an accommodation bond back to a daily charge, which includes the value of retentions.

We note today that in this regard, the Minister has accepted the recommendations of the Aged Care Financing Authority that accommodation pricing be 'anchored' in the RAD, rather than the DAP. This is very welcome news.

Impact on movements in the MPIR on RAD values

We acknowledge that the MPIR may move up and down over the longer term and that a decrease in the RBA base interest rate will be reflected in the MPIR, resulting in increases in the RAD that may be charged. The Department provides an example of movements in the RAD and the option of adjusting the DAP in response to interest rate changes.

Our point is why create a system with so much potential volatility and likely confusion among residents admitted at any given time, as well as risk and uncertainty with respect to providers having to spend a lot more time managing their capital and bank financing arrangements? Again, our submission details the actual fluctuations that would occur based on historical movements in the MPIR.

Use of the MPIR

We agree with the Department that in this proposed new system there are differing views on whether the MPIR is the best basis for determining equivalence between a DAP and a RAD However, the Paper refers to the MPIR as a 'market-based interest rate' but we contend that

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[1] remembering that only new and significantly refurbished homes will be eligible for the higher supplement rate of $52 a day.

this is not the case. While the starting point for determining the MPIR is the RBA's base interest rate, it then becomes a rather artificial construct by factoring in the 'general interest rate' as determined by the ATO plus an arbitrary factor of 3%.

The Department then makes the claim (page 6) that:

The situation where the RAD decreases (for a given value of DAP) due to increasing interest rates reflects the position that as interest rates rise, the amount of lump sum needed to generate a specified level of return on investment (equal to the DAP amount) falls.

This is not true. The real issue is where the provider has not fully paid for the facility and therefore has financial loans on which they pay interest and capital repayments. As official interest rates increase, their funding costs increase, **not investment returns**. An increase in the RBA's base interest rate results in an increase in borrowing rates, not a decrease. In such circumstances, banks and other lending institutions increase the interest rate on the full loan outstanding at the time, not just on the amount of the bond differential (outgoing vs incoming) that would now have to be financed. The Department has simply got this wrong. It has assumed that all bonds are invested and that the facility is fully paid off as well. If RADs are replaced by DAPs in any significant way the funding structure of providers could be seriously compromised, particularly for charitable organisations that do not have access to shareholder funding.

Downward movements in the RAD resulting from increased interest rates will result in reduced returns to the provider as borrowing costs will increase while investment rates are unlikely to change at the same rate.

Furthermore, any increases in the DAPs that might flow from decreases in the RADs will only be payable by new residents, not by anyone whose accommodation payments have already been determined. Any incremental interest rate charged in the DAP to each succeeding resident will in no way compensate for the immediate increase in the interest cost on the full value of bank loans a provider may have.

We would be happy once again to discuss these matters with the Committee should the Senators require any further clarification.

Yours sincerely,

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