# Chapter 6

# Accommodation payments

6.1 Coalition Senators have noted the significant number of submissions and witness statements that raised concerns with the proposed accommodation payment arrangements.

6.2 Coalition Senators support the general notion that came through clearly in many submissions and witnesses to the hearing that reform in aged care is required but any change must be sustainable and take a direction that will set up the industry for the future.

6.3 Accommodation pricing is one of those areas where the Coalition Senators believe robust but responsible changes should be made.

6.4 It is acknowledged that the Minister has reacted to recently raised concerns and sought urgent advice from the Aged Care Financing Authority with a related analysis undertaken by KPMG.

6.5 However, the KPMG report outlines issues addressing reforms but without any supporting evidence that adequate consideration has been given to the impact of those reforms. The future Budget impact of the Lifetime Caps illustrates this point.

6.6 The Coalition questions the assumptions associated with many aspects of the KPMG assessment report and notes:

- There is inadequate cash flow modelling in the KPMG report and it only attempts to deal with it in aggregate at industry level, with no attempt to model a selection of provider types;
- There are no details to support the proposed 'bonds in high care';
- It does not address the impacts of a change in consumer preference;
- It does note (page 43) the current bond pool turned over $4,133bn in FY2011/12 year (3 years) and that this turnover will increase with bonds in High Care (we believe to every 2 years);
- Providers with bonds that are not replaced with like for like will be under severe financial distress; and
- Providers lose their choice under the proposed legislation and there is concern that this is not addressed in the KPMG report.

6.7 The Government based its justification for its new arrangements to protect consumers from the so-called 'super bonds'.

6.8 At a media conference on 20 April 2012, the Prime Minister and Minister Butler jointly announced the Government's new 10 year aged care plan with specific mention of "*… bonds which can cost up to $2.6 million and bears no resemblance to the actual cost of accommodation …*"

6.9 In other evidence provided in written submission, ACSA CEO Adjunct Professor John Kelly, suggests that concerns are ill-founded about wide-spread existence of super bonds:

> ACSA members consider that this response is the Governments reaction to so-called 'super bonds'. It is however evident from the data that the incidence of these bonds is very low and there is no widespread problem. Presently, there are in the order of 21,127 accommodation bonds in Australia. The incidence of so-called 'super' bonds is very low with 124 bonds between $750,000 and $1million and 33 in excess of $1 million which represents approximately 0.7 per cent of all residential aged care accommodation bonds.[1]

6.10 In addressing a problem he perceived about super bonds – a problem which never existed - the Minister has relied largely on information he claimed in April 2012 about the prevalence of these super bonds and relies now on the KPMG report that has been questioned and criticised in some areas. He has reacted to ill-informed scare-mongering to justify the subsequent variations he has now announced to the original arrangements set out in in the bills.

6.11 The Government's assertions about so-called super bonds are at odds with the facts and the statistics provided in evidence to the Committee.

6.12 National Seniors, the largest organisation representing those over 50, advised the enquiry that it was aware of claims where new residents were encouraged by aged care facilities to provide details of their assets in order to calculate a higher bond amount from the total assets. Currently, a resident is not compelled to disclose assets on the understanding that they will pay higher default amounts for additional fees and charges.

6.13 Coalition Senators are also gravely concerned that the Government has failed to adequately consider the impacts of the proposed means testing treatment of the family home versus the treatment of the Refundable Accommodation Deposit. We believe the proposed different treatment depending on whether the asset is held in the family home or as cash in the bank leads to inequities and discrimination. This could easily result in some older Australians facing high costs when considering a move into residential aged care. The Coalition Senators recognise that this may lead to some older people putting off the decision to make that move when everything else suggests that residential care is the right option at the right time.

6.14 The clear lack of adequate analysis and detailed broad-ranging modelling ought to have been undertaken prior to these bills being presented to the Parliament.

6.15 Once again, the aged care goal posts have been shifted mid-game creating even further uncertainty for the aged care sector.

6.16 From evidence provided to the Committee, the Coalition considers it essential that further time needs to be taken to enable reconsideration of the new arrangements

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1 Adj Professor John Kelly, Chief Executive Officer, Aged and Community Services Australia, *Submission 67*, p22.

and reassess the impact on the operation of these accommodation payment arrangements on aged care services given that there was little wrong with previous arrangements and there are flaws in the justification for these new arrangements.

6.17 The Coalition is further concerned that while prices will be published, there is a requirement that the potential resident and the provider must agree before entry on the maximum accommodation price to be paid and that the resident understands the various payment options. The resident can then take up to 28 days to decide on the method of payment. If no decision is made by that time, the default option is a Daily Accommodation Payment (DAP). The Coalition contends that the default should be a Refundable Accommodation Deposit (DAP – formerly a bond) as this would benefit both the resident and the provider in that it provides better sustainability of the overall bond pool.

6.18 The proposed DAP default has a strong potential to impact on cash-flows due to a very real potential for a run-down in the current $12 billion bond pool as more residents choose a DAP or make no decision and the default option applies.

6.19 Over-riding this situation is the option for a new resident to take up to six months to make a RAD payment, thus creating further financial stress to the provider.

6.20 Complicating the situation yet even further is the ability for a resident to drawdown DAPs from a RAD. The requirement to top-up the RAD "from other sources" may not be possible for all residents and there will be resultant whittling down of the RAD in these situations – once again disadvantaging the provider.

6.21 There is considerable evidence from elsewhere in the aged care sector supporting the Coalition's concerns.

6.22 Mr David Kemp from ECH Inc. expressed concerns about the relationships between the different payment types and the effects that these changes will have on part-pensioners:

> … our main concerns focus on, in particular, the rules about and the relationship between the daily accommodation payments and the refundable deposits and the use of the minimum permissible interest rate; and means testing in residential care where it excludes the value of the family home, other than the first $144,500, but does include the full value of any refundable deposit that a person might pay and excludes the rental income from the means test should someone retain their house and choose to rent it out. There are some concerns about aspects of the income testing for home care, particularly the way in which it seems to discriminate a bit against part-pensioners who are on the lower end of the scale in terms of income.[2]

6.23 Adjunct Professor John Kelly ACSA CEO raises valid questions in relation to the 28 day cooling off period and the extra regulatory burden this will have on providers:

2 Mr David Kemp, Chief Executive's Adviser, ECH Inc, *Committee Hansard*, 29 April 2013, p.47.

> They are setting up a process where a provider and a potential resident, a consumer, must agree on the refundable accommodation deposit, the daily accommodation payment and the opportunity to straddle that, if you like, in any particular way that the consumer may wish. That all has to be discussed and decided before entry into a facility. Then there is this wonderful 28-day cooling off period that I think both sides of the argument can raise pros and cons for. There is the 28-day period during which the daily accommodation payment is kicking over.
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> In fact - and this is the point that we want to make in our submission - what tends to happen is that the Centrelink processes in terms of income and assets testing assessments just take longer often and particularly, my feedback from our rural regional members is that they said they have enough trouble getting ACAT assessments let alone trying to get the Centrelink assessment side of things once a residential care resident is being considered.
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> So the issue is that, at the end of that 28 days, the automatic default is to continue paying a daily accommodation payment. There is an argument that this may lead more consumers to lock into that rather than renegotiate or reconsider paying a bond. We are being speculative everyone will take their own investment advice on that as they move forward - but it just adds to the complexity and, if you like, the extra regulatory burden that will be thrown on providers as a part of this process. [3]

6.24 Mr Mark Andrew Sudholz from the Aged Care Guild raises concerns about moving accommodation bonds from a free market position to a RAD/DAP relationship:

> When the initial submissions were made by the guild the concept on the accommodation bond was around the 95th percentile of bonds, which the industry saw was going to come out at about $490,000 or something like that. It then fell down to another cap, which was around $406,000. Now it has fallen down to a mechanism where the bond is not the driver but the DAP is the driver. We supported a free market position because that is how it has worked and worked very well in the previous environment. Now that we are in the RAD/DAP relationship there are some serious implications around that. As you look at the DAP and setting the DAP in the tiers and you have the interest rate applied to that, our projection and we have not seen any projections on this from government; it is a really big concern is that you are going to finish up with a bond of somewhere between $170,000 and $230,000 or something like that. There are two implications. It is the implication of: if you have bonds in your facilities at $400,000, you are just faced immediately or very close to immediately, with a requirement to pay $200,000 out of your own balance sheet. So, the resident that moves out gets paid back the $400,000. The resident that moves in under the assessment program will pay $200,000. The industry has to pay $200,000.[4]

3 Adj Professor John Kelly, Chief Executive Officer, Aged and Community Services Australia, *Committee Hansard*, 30 April 2013, p.52.

4 Mr Mark Andrew Sudholz, Director, Aged Care Guild, *Committee Hansard*, 1 May 2013, p.38

6.25 ANZ is the major lender to the aged care sector and provided important evidence at the Committee hearing. As indicated in its submission, ANZ holds $2billion of the $5billion debt in the sector.

6.26 Mr Richard Gates, Head of Health Care Banking at ANZ gave evidence as to the effect on future sector financing of the refundable accommodation bonds, or RADs as currently described in the draft legislation. The ANZ provided a significantly detailed explanation of their concerns touching on key points:[5]

> In relation to accommodation bonds, Mr Gates raised the following concerns:
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> - that the proposed changes to the legislation will adversely affect Refundable Accommodation Deposits (RADs);
> - there is a major bias in favour of daily payment bonds;
> - a reduction in refundable bonds as the principal source of capital funding for the industry resulting in serious financial consequences;
> - a significant and surprising shift from Refundable Accommodation Deposits to Daily Accommodation Payments with this change certainly not becoming evident until very recently, when the explanatory notes to the draft legislation were released;
> - any significant shift from Refundable Accommodation Deposits to Daily Accommodation Payments will likely have a major financial impact on individual operators, the industry generally and possibly bank appetite to fund;

6.27 Mr Gates also noted that refundable bonds have been the dominant source of capital funding for both greenfield and brownfield projects in the industry over the last decade or so. This has been so particularly in the for-profit sector, which has been the main builder of new aged-care infrastructure in the last decade. Furthermore, over 90 per cent of bonds or about $12 billion today, are refundable bonds, and the vast majority of that has gone into the creation of new infrastructure.

6.28 On the debt and equity issue, Mr Gates is concerned that shifts in how accommodation is paid for by residents will impact on the established patterns of debt and equity. This will have likely negative impacts for bankers and negatively affect the past relationships and practices with their clients:

> Bank debt supporting the industry is estimated at circa $4 – 5 billion. A material reduction in RAD bonds replaced by DAP bonds will inevitably require significant bank funding. If so, this will need to be gradual and measured so the bank market can be engaged with proper planning and consultation.[6]

6.29 At the Committee hearing, Mr Gates outlined his concerns about debt and equity:

> Typically debt and equity which goes into projects is fully repaid after two years post construction. Equity can then be released to go into the next

5 Mr Richard Gates, Head-Healthcare Banking, ANZ, *Committee Hansard*, 2 May 2013, p. 14.

6 Mr Richard Gates, Head – Healthcare Banking, ANZ, *Submission 94*– p3

> project; that is the form of capital creation. A project wholly funded by daily payment bonds, if that ever happened, would take at least seven years before a provider's equity could be released to go into the next project, so there would be a fundamental shift.

6.30 Another point that Mr Gates highlighted in his evidence is that refundable bonds have been invested in hard assets and that "they do not sit out there in cash."

6.31 On the issue of interest earnings, Mr Gates stated:

> But daily payment bonds right now earn service providers the maximum permissible interest rate [MPIR] which is only seven per cent. As this is almost the same rate as the bank charges for debt funding, this small margin is not acceptable from a bank point of view. Banks typically require greater than two times debt service cover before we fund. So a material shift from refundable bonds to daily charge bonds will have an adverse effect on bank lending ratios. Interest service will potentially be adversely affected, and so will the loan-to-value ratio. A material transition from refundable bonds to daily bonds say, greater than 10 per cent over a short time frame for all operators who currently operate on a moderate to high level of bonds will clearly have a significant capital outflow, and this needs to be considered and assessed.

6.32 Mr Gates also raised ANZ concerns on the complex issue of MPIR (Maximum Permitted Interest Rate) and WACC (Weighted Average Cost of Capital) in determining ways and means of addressing the equity shortfall that will likely result from the move from RAD bonds to DAP bonds as mentioned. In evidence he stated:

> A core element of the problem is that the daily charge rate, which is the MPIR, is around seven per cent, whereas the financially equivalent return to a provider, which is their weighted average cost of capital, is more like 14 to 16 per cent. But, if the weighted average cost of capital of 14 per cent were adopted as the maximum permissible rate, that would clearly be unacceptable to residents and families.

6.33 Mr Gates suggested that any new means test be neutralised to avoid the apparent skew to DAP bonds.

6.34 He noted that proper modelling of resident profiles would provide this neutrality so as to avoid a material shift from refundable bonds to daily bonds provided that refundable bonds become the primary reference point for pricing enabling the DAP to move up and down with interest rates. This is how the arrangements work currently. Transitional backstop financing could be considered if there is an unintended shift from RAD bonds to a DAP with a resultant liquidity shortfall disrupting the market.

## Impact on residents – treatment of the family home

6.35 Continuing with expert evidence from ANZ, Mr Gates suggests the most obvious proposed change which may see DAP preferred over RAD are changes to the asset and income test when determining the proposed care co–contribution, the family home will be included to a value cap of $144,500 but no such cap applies to a RAD –

this proposed differentiated treatment of the family home versus the RAD is not logical.

6.36 A likely consequence of this will be that a better financial outcome for many resident profiles will be either:

- to pay a DAP (retain the family home - home not sold to pay a RAD); or alternatively
- to pay a reduced RAD topped up by a DAP.

6.37 This seems to be the view of expert financial planners who caveat this conclusion on the basis that the proposed income and assets test changes are yet to be fully disclosed.

6.38 In this scenario, the RAD does not vary for a resident who has already entered into care. It only goes up at the next entry date unlike home mortgages, which go up and down based upon the market. It is more consumer friendly in that regard.

6.39 At the time of entry into aged care, they or their family make the decision that if the RAD is too high and they cannot afford to pay the DAP, they will sell the family home and pay the refundable bond.

6.40 The Coalition agrees that residents do need options for a range of payment arrangements to best meet their individual financial situation. However, such options should not be at the financial disadvantage of the provider or the whole system runs the risk of collapse. This proposal creates too much uncertainty for providers if providers have their financial future eroded any further.

6.41 It has been stated that an approved provider must consider many aspects of risk when determining further financial investment. In addition to the obvious costs of care, other factors such as the quality of the proposed capital works, existing capital investment, local competition are all part of the overall business risk assessment. The cost of the invested capital is measured as the Weighted Average Cost of Capital (WACC) and this is significantly different to MPIR which will produce a lower equivalent periodic payment. Use of the MPIR and its lower resulting periodic payment will naturally be attractive to potential residents.

6.42 The use of the MPIR in any formula to calculate individual bond levels will erode the overall bond pool and impact on the available security for the necessary financial capital arrangements.

6.43 Further instability will flow from the quarterly changes in the MPIR forcing wild movements in RADs and rapid changes in fees and charges. This alone will add more administrative burden to providers and in difficult financial times will mean less care, less staff and poorer services due to the tightening of financial situations for providers.

6.44 The end result will be a lowering of the RAD pool of funds and thus less incentive for providers to take risks with further capital investment.

6.45 On this issue, Adjunct Professor John Kelly, CEO, ACSA, states:

> Simplistically, I understand the MPIR extends from what is used by the ATO. It is a standard interest rate that changes every quarter. It is something that you would understand government would want to use in terms of that consistent measure or translation point from an interest perspective. So that makes sense. It is just that, when you apply it in two ways to the current reform agenda in this area, what is changing is that, as I said in my submission, 90 per cent of residents currently pay a bond. It creates a platform of certainty for the banks in terms of their lending profiles and policies. We have spent a lot of time trying to understand where the banks were coming from and what their process was in terms of supporting debt funding for providers in terms of their capital expenditure. It would seem that, if there was uncertainty that entered the market from a greater number of residents moving to the daily accommodation payment, this would lessen the pool in terms of bond moneys that banks currently would use as a platform, if you like, for assessing loan-to-value ratios etcetera.

6.46 Following the KPMG advice, Minister Butler has written to the Committee and advised that the review provisions in the bills will be amended to include further review processes on the appropriateness of continuing to anchor the equivalence formula in the RAD, taking into account the impact on consumers, providers and investment in the sector.

6.47 Despite this last ditch effort at patching up, the complex issues raised by the RAD and DAP and the MPIR and WACC are not resolved.

**Recommendation**

**Given the financial concerns raised, the lack of appropriate modelling in so many areas and the overall uncertainty within the sector created by these proposed changes, Coalition Senators recommend that all changes to accommodation payments should be reconsidered pending further detailed modelling and the outcome of the review processes imbedded in the bills.**