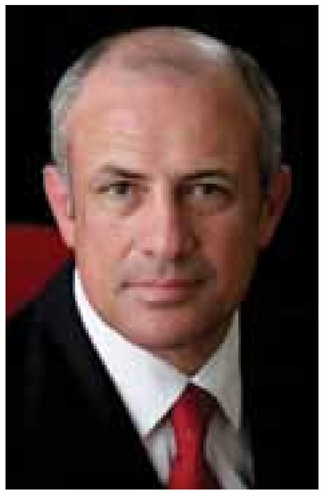
Finance

Diversified RVs: the real PC winners

Despite industry nerves around a post-PC financing environment for residential care, the news is not all bad, especially if you're a savvy retirement village operator, writes **James Underwood**.



James Underwood

Bonds from new residents currently form a major part of financing decisions for operators seeking to build new residential care services. The Productivity Commission (PC) noted an average bond of $233,000 in 2009/10. If bonds are paid in most new low care and partially extra services high care facilities, then the total cost of building a new service at, say, $200,000 per place can be almost fully paid off as the service approaches full occupancy.

What will happen to the financing of these new services under the PC recommendations?

Well, the PC recommendations so far appear likely to reduce the availability of bonds to providers. The PC gives examples of 'super bonds', where some bonds paid are much larger than the actual cost of providing accommodation. The PC also notes the huge growth in the total amount of bonds held and the very large amounts held by a handful of the biggest provider groups. The PC report goes on to explore options that can be used in addition to or instead of lump sum bonds.

The PC recommends having a 'published' periodic payment (replacing the accommodation charge), that would not be 'capped' and would be an option for all new residents, not just those in low care and extra services high care. A lump sum bond, equivalent to but not exceeding the published periodic payment, could also be offered, while retentions would be abolished.

The periodic payment could be paid directly from a resident's own income, although few pensioners are likely to have sufficient income or assets to pay this above-pension amount for very long. A form of government reverse mortgage arrangement is also discussed, though reverse mortgages have been generally difficult to market to older Australians. Finally and more particularly, people could sell their homes and place the proceeds in an Australian Pensioners Bond, a government scheme that is exempt from the Centrelink assets and income tests, and indexed to a consumer price index (CPI) to maintain real value. The periodic payment could be drawn down from this scheme.

DOING THE SUMS

Currently, the maximum accommodation payment in general high care services is the accommodation charge of $30.55 per day. This charge is widely and correctly considered inadequate to encourage building of new services. Let's say it should be twice this amount – $60 per day – for a sample new service to meet its capital costs.

A $60 per day charge over 365 days is $21,900 per annum. To make $21,900 as interest on a lump sum using the current maximum permissible interest rate (MPIR) of nine per cent per annum, requires a bond of $243,000. However, the proposed 'CPI-type' interest rate to be used for a Pensioner Bond Scheme would normally be around three per cent per annum in Australia. If three per cent per annum was used, the 'equivalent' bond would be $730,000! [see table]

Accordingly, if the lower interest rate was required to be used, few rational residents would choose to pay a lump sum. Which begs the question: what if the PC recommendations encourage a large proportion of new residents to make use of the Australian Pensioner Bond scheme to pay periodic payments in lieu of lump sums?

At first glance, providers will have to encourage financiers to accept an income stream to pay off the principal and interest on loans, instead of large chunks of lump sum payments. This is not necessarily a bad thing, as the income stream (the periodic payment) can now accurately meet the actual cost of provision of accommodation.

But what about existing services?

UNDERSTANDING THE IMPLICATIONS

Currently there is probably around $12 billion held in accommodation bonds in Australia. If 25 per cent of those bond-payers die or depart in the first year of operation of the Australian Pensioner Bond scheme, then some $3 billion may be paid out. If the interest rates are at the CPI level or, at best, neutral between bonds and periodic payments, then perhaps only $1.5billion - half that $3 billion - may come back to providers to replace those lump sum bonds.

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COMPARATIVE LUMP SUMS USING DIFFERENT INTEREST RATE

RATE	USING A "CPI-TYPE" INTEREST RATE	USING AN "MPIR-TYPE" INTEREST RATE
INTEREST RATE	3%pa.	9% pa.
PERIODIC PAYMENT	$60/day	$60/day
LUMP SUM BOND:	$730,000	$243,000

> "If I see any biggest winner from the recommended PC changes, it is the Australian retirement village sector, provided the sector moves to embrace greater levels of care."

Now, much of that $12 billion in bond money is expected to be in banks, paying down borrowings used to build those services, or actually in the 'bricks and mortar'. That is, after all, the primary purpose of bonds. So, let's say two thirds of bond money would be used to reduce borrowings and one third would just be in investments, earning interest for providers.

The upshot would be that Australia's residential aged care sector would have to borrow a further $1 billion in just 12 months, to cover the reduction in current bond holdings. That would mean borrowing $1 billion in one year that would not be used for any new buildings or upgrades at all – just to refinance reductions in bond holdings on existing bed places.

The most recent Department of Health and Ageing (DoHA) figures - 2009/10 - show that around $1 billion was spent in one year on building new residential aged care places.

So, a successful Australian Pensioner Bond scheme coupled with a low CPI-type interest rate for 'grossing-up' periodic payments could give rise to a doubling of monies needed from financiers: $1 billion for building new places and $1 billion to refinance depleted bond levels. This is before consideration of money needed for rebuilding and upgrades. On the positive side, the providers can now set the periodic payment at a commercially appropriate rate to allow an income stream that can repay principal and interest. Bankers we have spoken with are positive about this type of lending.

GOOD NEWS FOR SMART RETIREMENT VILLAGES

Here is the good news for retirement villages. Firstly, the PC recommends removing regulatory restrictions on community care packages and residential care places over a five-year period. Already retirement villages are moving to secure marketing and price advantages through access to home care packages. Success stories in southern Queensland and elsewhere have seen retirement village operators facilitating delivery of CACP, EACH, EACHD and veteran's packages in care-in-village apartment-style complexes. They are popular and some are sold out within months.

Secondly, retirement villages can continue to require that new residents pay lump sum ingoing contributions, while residential care may have to accept changing their financing model to one where many or most new residents elect to pay periodic payments.

And retirement villages can continue to require retentions in the form of deferred management fees, while the PC recommends the abolition of retentions on bonds for aged care facilities.

In short, retirement villages could readily access and commence co-located residential care services in a deregulated environment and be ideally suited to maximise occupancy from their existing aged consumer group.

LOOKING AHEAD

The need for residential aged care will grow, the market will remain vibrant and strong and the uncapping of accommodation payments will be very positive to the growth of high care services. This change, to help keep the high care building program going, is particularly important since DoHA stopped the very good alternative of expanding partial bond-taking extra services as the primary way of getting new high care places on the ground in most metropolitan areas.

However, if I see any biggest winner from the recommended PC changes, it is the Australian retirement village sector, provided the sector moves to embrace greater levels of care (and, thus, frailty) on retirement village sites.

James Underwood is Director of James Underwood & Associates.