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A Solution to the Likely Loss of Capital Flowing from Elements of the Aged Care Reform Process from 1 July 2014:

A "Stop-Loss" Mechanism

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Ageing Matters

BACKGROUND

1. A key part of the government's Aged Care Reform Package is allowing new permanent residential aged care residents from 1 Jul 2014 an option on how to pay their accommodation payments.
2. New residents will have the option to pay a lump sum (called a Refundable Accommodation Deposit or "RAD") or a daily interest payment (called a Daily Accommodation Payment or "DAP") or a combination and the government has put in place an "equivalence" methodology between the two.
3. Coupled with offering this option, there are new means-testing arrangements for subsidies that make lump sum bonds subject to asset-testing but exempt the resident's former home if retained. For many new residents, this will increase the financial incentive to pay a DAP, not a lump sum.
4. Currently, very few accommodation payments are offered or paid by daily payments. Bond lump sums are the norm. As a result, the aged care sector now holds over $13 billion in lump sum bonds and this is a very important part of residential aged care capital financing.

THE CHALLENGE

As a result of the implementation of the changes, it is considered likely that there may be a substantial reduction in the proportion of new residents who pay lump sum ingoings.

This may result in a very significant loss of capital that could (i) force sale or closure of some existing services and (ii) make other providers unable to continue with the planned building of essential additional residential aged care places.

EXAMPLE ONE – 60-PLACE LOW CARE SERVICE

- Doo Wred Nu Aged Care is the approved provider of just one "stand-alone" 60-place low care service in a rural area that operates with a low annual surplus – typical of smaller rural services.
- Doo Wred Nu has 25 "supported" residents and 35 bond-paying residents.
- The local median house price is around $250,000 and the average bond held is $200,000.
- Doo Wred Nu holds $7,000,000 in bond lump sums of which $6,000,000 is in the "bricks and mortar" and $1,000,000 is held as prudent sum in the bank to cover bond repayments. Doo Wred Nu also has a $1,000,000 overdraft in place which it has never used.
- Doo Wred Nu expects to have a normal level of separations in 2014/15 being 40% of residents – or 24 persons. These 24 persons are expected to be replaced by 24 new residents, of whom ten would be "supported" and 14 would normally be expected to pay a bond lump sum.
- Doo Wred Nu expects half of these 14 new residents will elect to not pay a lump sum but pay a DAP instead (i.e. seven residents).
- Doo Wred Nu expects to see a reduction of seven x $200,000 bond lump sums or $1,400,000.
- The reduction in bond lump sums will exhaust Doo Wred Nu's prudent $1,000,000 cash holdings well before the end of the first year of the new system and put Doo Wred Nu in overdraft for the first time.
- Doo Wred Nu would wish to borrow $1,400,000 to replace the bond lump sums and will receive DAPs in lieu of RADs that provide an "equivalence" income @ 6.6% p.a. on $200,000 for these seven residents or $92,400 p.a. to use to cover the cost of the loan. Unfortunately, the extra $92,400 income p.a. just barely covers interest on the $1,400,000 loan and does not cover repayment of the loan principal.

- The bank offers a 10-year loan repayment period which means Doo Wred Nu must find $140,000 p.a. to repay the loan, before including the (reducing) interest component.
- Doo Wred Nu does not have the extra income available to cover principal plus interest repayments and is aware that there may likely be a further growth in DAP-paying resident numbers in following years. Eventually, Doo Wred Nu projects its total bond lump sum holdings would fall by half and it will need to find (and fund) an extra $3,500,000.
- Doo Wred Nu does not know what to do!

Example Two – Modern High Care Services

The same as Example One, above, for any of the 300+ services in Australia where providers already acquire the capital needed for growth by accepting bonds in high care and, by doing so, have been able to be at the forefront of building essential new places for older Australians for the last 10 years.

A Simple Solution

Many providers are seeking to have these changes withdrawn. If withdrawal is not determined by the government, then the following recommendation may assist providers without unduly limiting choices for consumers:

Establish a post 1 Jul 2014 "stop-loss" trigger point for bond lump sum levels where:

> ***if bond lump sums for a residential care provider fall to 95% of their 30 Jun 2014 bond lump sum holdings, then providers are not required to offer further DAPs. They may offer RADs only.***

Analysis

- Many providers with multiple services will see a decline in lump sum holdings in some of their services but an increase in lump sums at other services, particularly at those facilities that have not had extra services approvals in place and have mainly accepted high care residents. The "stop-loss" should therefore be determined at a provider level, not "service-by-service".
- A "stop-loss" level could be assessed and implemented immediately by a provider without seeking further government approval. Providers already submit to the government an annual statement detailing bond lump sum holdings that would allow for ready "verifiability" by regulatory agencies.
- All the many positive changes of the Aged Care Reform Process can continue to go ahead and consumer protections can be maintained whilst implementing this "stop-loss" mechanism. Major adjustments to legislation should not be required.
- The "stop-loss" will be equally accessible and beneficial across the sector: from small rural low care providers through to large metropolitan high care providers.
- For many providers, their net lump sum holdings are expected to actually increase and the "stop-loss" will not be needed
- The "stop-loss" mechanism may also be used to alleviate liquidity challenges for providers that suffer occupancy rate declines due to negative consumer reaction to the large increases in co-payments (means-tested fees) in residential care that also commnence from 1 Jul 2014.
- Determining the specific "stop-loss" trigger point for new services could be the subject of industry consultation, as could be the appropriateness of a 95% figure for existing services.