Lend Lease Primelife

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SUBMISSION TO THE PRODUCTIVITY COMMISSION

Caring for Older Australians

INQUIRY INTO AGED CARE

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Primelife

Introduction and Background to Lend Lease Primelife Business Strategies

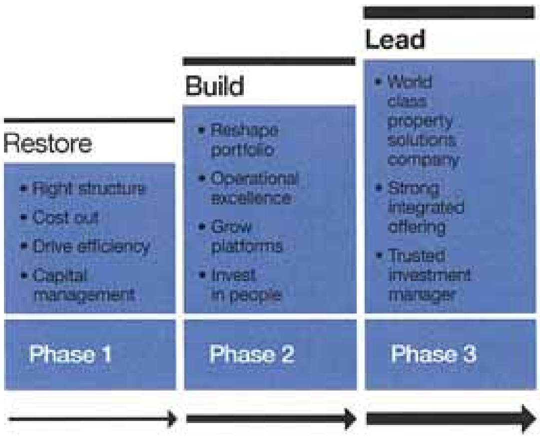
Lend Lease Primelife (LLP) manages 61 retirement villages and 32 residential aged care facilities throughout Australia and New Zealand. LLP is owned by Lend Lease Corporation and is the leading for-profit owner, operator and developer of senior living communities in Australia.

The decision to acquire Babcock and Brown Communities in 2008 reflected Lend Lease's belief in the long term viability and growth of the sector. Whilst Lend Lease was aware of industry's call for reforms in pricing and regulatory arrangements, the leadership team believed that change was likely and that a less regulated environment would create increased competition, lead to greater market responsiveness and as a result, deliver better services to consumers.

As an owner and manager of a significant number of both aged care facilities and retirement villages, LLP is uniquely placed to understand the requirements of the market and together with the resources of Lend Lease and the LLP Management Team, can facilitate the establishment of service models most relevant to the needs of consumers as well as meet the business objectives of Lend Lease.

These business objectives are consistent throughout Lend Lease's operations, which focus on generating sustainable returns for shareholders and partners through the delivery of innovative, integrated solutions. In the context of our retirement living and aged care services, these objectives are as follows:

- Delivery of flexible, responsive and integrated models that meet the expectations of current and future residents;
- Achieving an appropriate rate of return on investments through the generation of operating cashflows, the value and timing of which can be reliably predicted; and
- Drive market expansion through Lend Lease's overall *Restore, Build, Lead Strategy.*



As outlined in the *Review of Pricing Arrangements in Residential Aged Care 2004* and more recently in productivity research into aged care, the level of regulation in residential aged care has somewhat limited our ability to provide an optimal service offering to our residents.

The recommendations of the National Health & Hospital Reform Commission Report 2009 provide for a substantial departure from current demand and supply regulatory constraints and LLP considers that the potential for positive reform has never been greater. These reforms would enable LLP to more closely align its service offering to resident expectation through more tailored and integrated asset management and care service solutions.

As with any major change initiative, the detail behind reforms will be critical. This paper addresses some of the key elements deemed necessary to enable Lend Lease to improve service delivery to residents through new business models, and is intended to be a high level view, including:

a. The establishment of pricing and cost models to encourage investment in tailored resident service models;

b. Facilitating greater flexibility in the environment in which services are delivered; and

c. Reducing investment risk through more predictable operating cashflow certainty e.g. CPI and wage based indexation, and to know where the funds will be coming from. Therefore, a lower cost of funds/borrowing will exist.

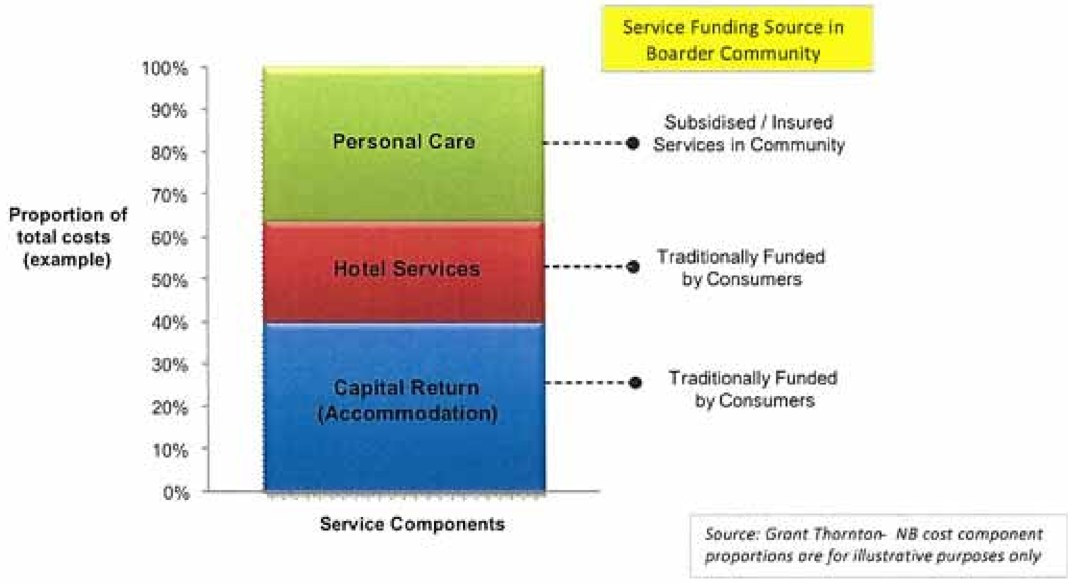
1. Pricing of Aged Care Services

In its submission to the *Review of Pricing Arrangements in Residential Aged Care 2004*, the Productivity Commission advocated the "unbundling" of aged care services, to identify and define service components and provide a rationale for the assignment of payment responsibilities between users and Government.

Under the current regulatory framework, the costs associated with personal care, hotel services and accommodation are unclear and the notional allocations are made arbitrarily based on funding sources (primarily pension levels and public subsidies), rather than the actual costs associated with the delivery of these services.

As presented in the following diagram, care costs represent only one component of residential aged care service expenditure. When viewed from a broader community perspective, accommodation and living costs (hotel services – catering, laundry, cleaning etc) are ordinarily funded by consumers. To ensure the sustainability of the industry, accurate information regarding actual component costs is essential to arrive at appropriate prices for services and to allocate responsibility for payment thereof.

Component Costs for Residential Aged Care



Lend Lease's extensive Australian and international experience and success in Public and Private Sector Partnerships (PPP's) demonstrates that the understanding of the various pricing components of the services offered, as outlined in the diagram above, is fundamental to supporting investment decisions and this in turn will mean positive outcomes for consumers, Government and suppliers. LLP believe that the lack of actual costing data is perhaps the most critical factor limiting the evolution of the aged care sector.

To determine appropriate pricing in an environment where Government is a primary funder of services, an understanding of the fundamental costs is paramount. Government's role will be to continually ensure quality care and access for people who cannot afford to pay for the services they need, not to limit the options available for those who can. Sensitivity analysis needs to be developed to accommodate variations in consumer demand and service delivery models for efficient operators. An appropriate weighted average return on capital can then be established to determine suitable price levels.

Pricing methodologies and operating principles employed for regulated monopolies, such as electricity distribution and public transport, provide a strong foundation that could be applied to the aged care sector. Lend Lease's experience indicates that regular review of pricing arrangements are necessary to recognise changing operating environments. In this regard, the basis for subsidy indexation for aged care services must be more closely aligned to the actual costs associated with service delivery. Again, an understanding of the underlying component costs would help to maintain relevant indexation bases.

The *Grant Thornton Aged Care Survey 2008* highlighted the importance of undertaking research into the cost of providing aged care services to achieve appropriate correlation between subsidy allocation and indexation. LLP considers that this initiative is paramount to provide greater certainty and transparency regarding income streams and the relevance to service delivery costs.

As described above, the identification of service cost components is also required to support policy decisions on the responsibility for funding cost components. The process would be essential in addressing the recommendation made in The National Health & Hospital Reform Commission Report 2009 in relation to consumer payments:

> *"The charging arrangements across the spectrum of aged care services can create perverse incentives so that people do not necessarily get the right care. We have recommended that payments made by consumers should be similar for similar services, regardless of whether care is provided in the community or in a residential aged care facility"*

The capacity for LLP to provide the "right care" to residents through integrated residential aged care, community care and retirement living solutions is dependent upon the establishment of robust pricing mechanisms that recognise the actual costs of delivering services and makes provision for price adjustments as input costs change, as previously stated.

2. Flexibility In Services Delivery

Whilst LLP is one of the largest operators of both residential aged care and retirement living services, there is potential for further integration between these two key service areas. LLP's intended expansion into community care services has also been restricted because of the limited availability of Government allocated packages.

The highly regulated supply of subsidised care places has created an environment where:

a. Residents in LLP villages cannot access subsidised care services that can be delivered from residential aged care facilities operating on the same site. External community care providers deliver services to LLP residents at greater cost and with less frequency than would be available through LLP's facilities; and
b. Residents in LLP assisted living accommodation (serviced apartments) must pay themselves for Government subsidised services at LLP residential aged care facilities. This creates a financial disincentive for residents to retain their independence in an environment less costly to the taxpayer.

LLP considers that the following National Health & Hospital Reform Commission recommendations are critical in addressing these issues:

> *"We recommend that the current restrictions on the number of aged care places an approved provider can offer be lifted. This means good aged care providers will be able to take as many people as possible who wish to use their services and older people will no longer have to accept the only place they can find."*
>
> *"We recommend that older people should have greater scope to choose between whether they get care in the community or in an aged care facility."*

The adoption of these recommendations would greatly enhance LLP's capacity to leverage from its extensive aged care resources to provide "best-fit" services to our residents. Obviously, the analysis of costing/price model (as described) would be a critical component in achieving this outcome.

According to the National Health & Hospital Reform Commission's statistics, 20% of acute hospital beds, be it public or private, are occupied by older Australians who would be better suited residing in residential aged care. It is imperative that good working relationships exist between aged care operators and hospitals to ensure a smooth transition of residents from one to the other.

Importantly, the admission of elderly residents into acute hospital care could be avoided in many instances.

3. Predictability of Cashflows

As outlined above, a key component of Lend Lease's business strategies centre on securing cashflows that are relatively predictable in terms of their value and timing. Greater certainty of cashflows will ensure a lower cost of capital as well as allow access to multiple sources of capital. In residential aged care, subsidy cashflows can be predicted with relative certainty but resident entry contributions cannot.

The economic downturn has resulted in delays in the payment of accommodation bonds and the impact on provider's cashflows has been significant. The recovery of late payments and interest charges is made problematic because of the resident's situation on admission and their variable lengths of stay. LLP, like many providers, often take a benevolent approach to dealing with these matters.

The adoption of recommendations made by the National Health & Hospital Reform Commission would result in a substantially greater level of entry contributions, including those payable by high care residents, which represent the majority of people admitted into residential aged care.

However, if approved providers received adequate funding through a properly costed model, the reliance on cashflow from bonds would substantially reduce:

> *"We have recommended that consideration be given to allowing accommodation bonds, or alternative approaches to payment for accommodation, for people entering high care residential care places, if the removal of regulated limits on the number of aged care places has resulted in sufficient increased competition in supply and price across the aged care sector."*

To avoid undue hardship for residents entering residential aged care, and to ensure that providers are afforded certainty regarding their entitlements to resident contributions, provision should be made for alternative financing options.

This paper, as previously stated, includes high level recommendations for approved providers and operators of residential aged care facilities regarding the costing model. Funding this model is a different issue and we would like to refer to the recommendations submitted by Deloitte to the Productivity Commission on behalf of the Aged Care Association of Australia, to which LLP has actively contributed.

For any new cost or funding models, there must be a transitional period and again we refer to Deloitte's recommendations.

4. Summary

The LLP leadership team holds a strong belief in the long term potential of the aged care sector. While the over-regulation of the industry has constrained the optimal delivery of services to consumers, the National Health & Hospital Reform Commission and Productivity Commission recommendations have identified strategies that, we believe, will address these issues.

These proposed reforms are particularly relevant to Lend Lease's overall *Restore, Build, Lead Strategy* and are critical to the LLP business because of the opportunity for greater integration between our residential aged care, assisted and independent living services. However, realising LLP's expansion and redevelopment objectives will require greater certainty regarding the predictability of future cashflows and more flexibility in service delivery options. To achieve this, understanding costing data and component information in relation to residential aged care services is paramount.

The implementation of the recommendations of the National Health & Hospital Reform Commission Report 2009 and the measures proposed in this submission will support strategic health reform that will help us align our services to consumer expectations under funding models that are sustainable both for providers as well as the Government.

LLP looks forward to discussing this submission in person at your convenience.

Primelife AGED CARE

For a better quality of life