

18th March 2011

Productivity Commission

By email: agedcare@pc.gov.au

**Re: Caring For Older Australians
Productivity Commission Draft Report**

Greengate Care is an Approved Provider focused on creating two new services, one in Maroubra (Sydney East) and the other in Woolloongabba (Brisbane South).

We have reviewed the Commission's Report and have significant concerns in relation to proposed changes to accommodation bonds and charges. There are considerable detrimental financial impacts associated with these proposal, which combined with concerns from project funders, may impact our ability to create these new services.

We do however support many of the Commission's recommendations, including removing the distinction between low and high care, removing supply constraints and the creation of an independent regulator.

The balance of this letter outlines our concerns and recommendations.

Market Based Accommodation Bonds

We support the principle "for older Australians to pay for their accommodation cost and everyday living expenses, while providing a safety net for those of limited means (P.145)".

Accommodation bonds in low care and high care extra service are market based. This system is working well and the introduction of high care extra service has been well supported by the industry, while non-bonded high care has not.

Removing the distinction between low and high care, allowing bonds on all new places is essential for the renewal and expansion of residential facilities in Australia. We concur with the majority of participants that bonds should be extended to high care (P.162).

Capping accommodation bonds and charges at cost threatens the commercial viability for funding a new service. No justification is provided for the statement that "the price charged for accommodation in residential facilities should reflect the cost of supply" (P.156).

No analysis of the success of market based bonds, especially in extra services has been provided. All care recipients are used to a market based approach. Purchasing residential housing in Australia is market based. Determining social and affordable housing rents and Commonwealth Rental Assistance is based on market rents. Determining whether a residential facility is the "highest and best" use of land is determined by the market.

If residential facility operators cannot receive market accommodation bonds, then the market value of alternative uses, especially residential apartments, will be more attractive and the facilities will ultimately be replaced by more efficient and valuable uses. This has been a trend in existing moderate to high valued inner urban areas of all major Australian cities. For aged care to remain viable and sustainable, it must be linked to the market.

Resident accommodation bonds are largely funded by residents selling their principal place of residence. The value of their home is determined by market forces and operators can determine their accommodation bond levels depending on demand for their facility, competition, desire to fill vacancies and available resident funds (largely determined by house values).

Operators compete on providing better care and accommodation, better facilities, better service and of course price. This market based approach provides care recipients with greater choice in accommodation, while ensuring a consistent minimum level of care and cross subsidisation of supported resident's accommodation.

Capital Funding and Accommodation Bonds

The Commission argues there are incentives which encourage large accommodation bonds to maximise the aged care pension and reduce a care recipient's cost of care, while also maximising provider revenue (assume this means interest on bonds less tax ie. very little) (P.169).

What the Commission has failed to recognise is the importance of accommodation bonds in funding the creation of new facilities. Tinker with accommodation bonds and there is a high likelihood of failing to address the key issue facing the industry, which is the lack of funding to renew and create new facilities to meet the anticipated demand.

The Commission's proposal to cap accommodation bonds at cost (P.172) and provide an incentive for providers to be neutral between receiving periodic charges or accommodation bonds (P.173) shows a significant misunderstanding of:

1. Role of Accommodation Bonds

Accommodation bonds are the main source of capital relied upon to create a new service. While equity and debt fund the construction phase and period when residents move into the new facility (often 12month or more), this funding ultimately must be largely re-paid.

Any funding not repaid when the facility is fully operation must earn a sustainable return on investment. Grant Thornton has advised the Commission (P.158) "the average return on investment ...was 1%".

As EBITDA is limited (Grant Thornton: \$2,934 per bed) the only sustainable investment strategy, without significantly increasing Government subsidies and/or resident co-contribution, is to:

- limit capital invested on a long term basis so return (EBITDA) on capital is improved; or
- improve EBITDA through interest on bond amounts which are in excess of capital costs (repayment of debt and equity).

When a resident departs and their bond is repaid, this capital deficiency is replaced by the incoming resident, ensuring the facility capital remains largely repaid.

2. Periodic Payment Equivalence

For a periodic payment to be equivalent to an accommodation bond they must:

- Reflect greater financial risk to an operator, as capital cost of the facility has not been repaid, an operator is exposed over a significant period (say 10 year payback) to financial and ongoing funding risks eg. fluctuating interest rates, debt refinancing uncertainties, real cost of debt (in excess of DOHA rate), variations in valuations and changes to lending criteria requiring higher levels of equity and the like;
- Reflect a cost of equity which would be in the order of 12% to 15% return on investment (similar issue to the failed Resource Super Profits Tax);
- Reflect periodic payments where the principal (cost of facility) is repaid within 8-10 years;

The market prefers making a one of payment for accommodation, as they are often concerned about rental recurrent style payments becoming unaffordable.

While the option for periodic charges should be available to residents, a truly equivalent periodic charge which addresses the above issues will be a significant cost and likely be unattractive to care recipients.

A Better Solution

If the Government is concerned about limited examples where care recipients pay inflated bonds to receive the pension and reduce their cost of their care, a better solution is to directly address this issue. Detrimently affecting the whole funding model for new aged care facilities, by capping accommodation bonds at cost, is a drastic over reaction and flawed strategy.

Example.....

Pension Means Teasing: When means testing a resident's eligibility for the pension and where their principal place of residence is an aged care bed, then any accommodation bond amount paid in excess of the medium house price of the relevant city or region (adjusted annually), would be considered an asset and not receive principal place of residence exemption.

Result

- Banks and other funders will continue to support the industry, knowing that market based bonds can repay their debt.
- Industry growth and the development of new facilities can continue to meet increasing demands from ageing population
- Pension expenditure for Government is reduced by removing the incentives for operators and care recipients to pay "above market" bonds.
- Intergenerational wealth inequities are partially addressed by ensuring affluent care recipients pay a greater proportion of their care costs.

Cost Based Assessment

Trying to document a process, system or variable rate for accommodation cost for different locations and amenity (P.171) is highly problematic and open to dispute. It cannot be representative of the actual cost of accommodation, which changes from time to time.

A variety of different issues exist in determining cost including. Does the cost of accommodation include or mean:

- management time in searching for a site, applying for places, etc?
- equity cost and what is a reasonable return, before or after tax?
- purchase price of an existing facility?
- Purchase of assets, services or places between related parties – is it at market or not?
- Operational start-up costs including market and initial operational losses?
- etc

Along with failing to address the industry issues, cost based assessment will increase regulatory issues for the Department and ongoing disputes between providers and the regulator.

We look forward to our concerns being addressed and are happy to provide detailed financial data on the impacts of a cost based accommodation bonds and charges on the creation of our new facilities.

Please contact me on 02 9256 5600 if you require any further information to resolve this or any other matter.

Yours sincerely

Greengate Care Pty Ltd

Matthew Fisher

Director