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AMP capital INVESTORS

Submission to the Productivity Commission Inquiry into Caring for Older Australians

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Summary

In the wake of an ageing population, the provision of accessible and affordable care to elderly Australians as and when required is of growing significance within the Australian health care system. While the aged care system in Australia is generally considered a valuable and valued service by communities, the current model of aged care is increasingly challenged in responding to changes in population demographics and community expectations.

AMP Capital Investors recognise the importance of achieving the right balance between delivering safe, affordable, quality services to the elderly with increased care and safety needs, while at the same time achieving a reasonable return on investment. This is necessary in order to ensure that future investment is attracted to the sector to satisfy the increasing demand for specialist care and accommodation.

In order to deliver a world-class aged care system that meets the needs of all stakeholders, AMP Capital Investors makes the following recommendations to strengthen the existing regulatory and operating environment for aged care operators.

Increased flexibility for pricing accommodation and amenity according to consumer preferences

- Introduce flexible mechanisms for the pricing of the accommodation component of aged care costs that is more aligned to consumer preferences.
- Eliminate the distinction between high care and low care for the purpose of setting and controlling accommodation charges.
- Eliminate the extra service category.
- Retain the current regulation and control of supply of aged care places through a modified Aged Care Allocation Rounds process.

Integrated sub-acute, residential and community aged care services

- Expand the "A National Health and Hospital's Network: Further Investment in Australia's Health" funding for sub-acute places in rural and remote regions to metropolitan areas to establish centres of excellence of integrated sub-acute and aged care.
- Integrate the Transition Care and ACFI funding models to remove complexity and simplify billing and payment.

Incentives for future aged care needs funding

- That the government work with the private sector to explore appropriate innovative new products that could assist individuals in financing their potential future aged care costs.

Regulatory issues

- Pilot an interface between the ACAR process and local supply and demand forecasts within each planning region.

1. Introduction

AMP Capital Investors Limited (AMP CI) welcomes the opportunity to make a submission to the Productivity Commission Inquiry into Caring for Older Australians (the Inquiry).

AMP CI is one of Australia and New Zealand's leading specialist investment managers, managing over $92 billion in assets for investors. With a team of over 200 in-house investment professionals and a carefully selected network of investment partners, AMP CI offers significant depth and breadth of investment expertise. AMP CI manages the largest aged care investment in Australia, the Aged Care Investment Trust (ACIT).

The key features of the ACIT include:

- Ownership of one of Australia's leading private sector owner and operator's of residential aged care, Domain Principal Group;
- A 25% ownership of the Victorian centred, Blue Cross Community and Residential Services;
- A long term, stable investor base of Australian owned infrastructure investors; and
- A portfolio diversified across geography, resident mix and product.

Accordingly, AMP CI is well placed to make observations in relation to the requirements to attract investment and capital funding to the Australian aged care sector.

This submission does not seek to address all the terms of reference of the Inquiry as many of these issues are covered adequately in other submissions such as those made by the Aged Care Association of Australia. Rather, we would like to focus our submission on four areas we believe are vital to current and future investors:

- The benefit of increased flexibility for pricing accommodation and amenity according to consumer preferences;
- The benefit of integrated sub-acute, residential and community aged care services;
- Incentives for future aged care needs funding; and
- Issues associated with regulation.

This submission acknowledges the broad objectives of the Australian aged care system as summarised in the Productivity Commission Issues Paper (May 2010) as the need to:

- Guarantee an acceptable standard of care
- Provide accountability and transparency
- Facilitate access to care regardless of economic and other circumstances
- Target services and funding to those with the greatest need
- Encourage diverse, flexible, efficient and responsive services that facilitate independence and choice.

2. Increased flexibility for pricing accommodation and amenity

At present, the funding of aged care does not easily distinguish between the physical accommodation and the care components. The proposals below rely on the recommendation for Government to de-couple the accommodation cost of aged care from the care costs. By aged care providers being able to differentiate their services on the basis of the physical amenity offered, this would promote the much needed investment in the industry. The significance of doing so is required if Australia is to meet the challenge that a dramatically ageing population presents.

The current capital funding model relies on bonds for low care and extra service high care residents and accommodation payment for high care and concessional low care resident. Generally, new residences incorporate a mix of low care, high care and extra service high care places to optimise the capital structure and achieve an adequate return on capital employed. However, this capital funding model is reliant on a high percentage of residents entering the residence in low care and contributing a capital payment and transitioning into high care over time.

Two current trends have tested this capital arrangement and resulted in investors reconsidering their level of investment, and the expected returns:

- Increasing admissions directly into high care; and
- Capping of extra service places allocated in 19 aged care planning regions across Australia.

2.1 Increasing High Care Admissions

The Australian Institute of Health and Welfare (Residential Aged Care in Australia 2007-2008 - A Statistical Overview) has commented:

> *"The dependency profile of newly admitted residents during 2007-08 provides a useful indication of possible future trends in residential care. The dependency levels of admitted permanent residents during the period suggest that we may expect similar proportions of people in residential aged care at high-care levels in the future. Sixty three percent of admitted permanent residents were classified as high care…."*

As aged care providers are unable to charge standard high care residents an accommodation bond, the current capital funding structure for high care residents commonly results in:

- waiting lists;
- shared rooms and en-suites;
- provision of minimum levels of amenity in terms of shared community spaces; and
- residences generally located remotely from community hubs.

These outcomes are increasingly out of step with the expectations of modern society, a society that is not adverse to actively choosing (and funding) those facilities that provide a higher standard of basic amenity than would have been acceptable a generation ago.

Further, the distinction between the accommodation funding of high care and low care has created a stratified market whereby the level of quality and availability of accommodation options varies greatly.

There is a clear need to encourage investment in this area that achieves a more attractive proposition for both providers and residents and their families. Allowing providers to distinguish between the cost of accommodation and care in their pricing for residents and ending the artificial distinction between low and high care, will result in an industry that is more attractive for investors, increases the amenity and availability to residents, as well as easing the funding pressures on government.

2.2 Capping of Extra Service Places

The designation of "extra service" as a category of residents within the aged care sector has provided the means for aged care operators to create high care places that attract a bond for each "extra service" admission. This category of resident allows the industry to cater in for a proportion of the increasing trend in permanent admissions directly to high care, whilst allowing the operator to generate an acceptable return on capital. Most tangibly, extra service places facilitate consumer choice in relation to location and level of amenities offered.

Recent policy decisions that have seen a change in how extra service positions are determined have had an adverse impact on the industry. Where previously caps on the number of extra service places were determined on a state wide basis, this is now undertaken on a planning region basis. As a result a number of regions (19) have been designated as being 'well supplied'. What this designation fails to reflect is the trend of increasing standards demanded by consumers, the ability of existing operators to upgrade their facilities to meet consumer's demands and geographic differences in resident preferences and ability to fund.

A more effective outcome for the industry would be to eliminate the category designated as extra service, including the corresponding caps on the number of these places in any region. These, together with the ability for the industry to determine accommodation pricing to reflect the standard of amenities provided would deliver the most optimal outcome whereby operators deliver facilities that cater to the changing consumer demands and achieve a reasonable rate of return on their investment.

In order to ensure that an appropriate mix of aged care places is available for all community members, a modified Aged Care Allocation Rounds process should be retained.

Recommendations:

- Introduce flexible mechanisms for the pricing of the accommodation component of aged care costs that is more aligned to consumer preferences;
- Eliminate the distinction between high care and low care for the purpose of setting and controlling accommodation charges;
- Eliminate the extra service category; and
- Retain the current regulation and control of supply of aged care places through a modified Aged Care Allocation Rounds process.

3. Integrated sub-acute, residential and community aged care services

Entering long-term aged care facilities is one of the most difficult and emotional decisions the potential resident and their family face, particularly given the increasing trend of residents entering as a high care category. Research within Australia commissioned by AMP has demonstrated that residents and their families are usually unprepared for the decision to use residential aged care solutions and the need for aged care comes as a shock to most. The decision making process is emotionally charged for all involved, with the decision to select residential aged care often not a voluntary decision.

The demands on health services in light of an ageing population will place an increasingly significant strain on the existing hospital and health care sector, demanding a greater level of resources and facilities. Aged care facilities are perfectly positioned to take a greater role in assisting government to help meet some of these needs.

Already aged care facilities are set up to provide a range of specialist services on an episodic basis for residents. These services are characterised as requiring specialist capability, facilities and clinical quality management processes but do not require the high levels of technology and tertiary specialist skills and knowledge as those required in tertiary level hospitals. These services are collectively called 'sub-acute services' and include:

- Rehabilitation;
- Day respite;
- Day therapy;
- Short term respite; and
- Post-hospital transition care.

Developing the sub acute model provides the opportunity for the aged care operator to develop a relationship with an individual and their family as their care needs increase over time. The opportunity for the operator to develop a positive experience of care and accommodation with a specialist provider for the client/resident has the potential to lower the barriers most people have when considering residential aged care services, with the desired outcome that residents are more actively involved in the decision to select residential aged care as a solution to their lifestyle, safety and health needs. The consequence of a more pro active decision making process is the greater control the resident feels they have, and the greater ability to select an accommodation option that suits their lifestyle needs whilst being assured the care requirements will be well met.

The proposed integrated residential and sub acute aged business model diversifies the range of funded services provided to the target market – over 75 year olds with health, social and personal care needs. In conjunction with the recommended changes to the means by which accommodation charges are managed, it is anticipated these proposed service model changes will enable operators to vary the style and range of accommodation offers to suit clients/residents at the sub acute stage.

Residents will continue to receive government subsidies for services, and accommodation support according to means, but as with residential care, where individuals have the means they will continue to fund their accommodation. It is anticipated the accommodation options for residential services and sub acute services will be co-located, hence increasing efficiency of the sub acute service delivery model.

Recommendations:

- Expand the “A National Health and Hospital’s Network: Further Investment in Australia’s Health” funding for sub-acute places in rural and remote regions to metropolitan areas to establish centres of excellence of integrated sub-acute and aged care.
- Integrate the Transition Care and ACFI funding models to remove complexity and simplify billing and payment.

4. Incentives for future aged care needs funding

With demand for residential aged care projected to rise significantly in the wake of Australia's ageing population, and the increasing wealth of each successive generation, the move toward a 'user-pays' regime is increasingly likely. This would assist in attracting further investment in the industry, as well as relieving some of the cost burden on public finances.

There is an opportunity for government to work with the private sector to develop innovative financial products that may lessen the financial burden on the aged at a time in their life when they are most vulnerable, whilst enabling individuals to increase their individual contributions and the choice that this allows.

Already a number of existing products have characteristics that could be developed further by the private sector to reflect the services provided by the aged care sector. These products include:

- Insurance;
- Investment bonds;
- Reverse mortgages; and
- First home saver accounts.

4.1 Insurance

Insurance is a common product designed to protect the insured against known risks that may or may not eventuate for that individual. The exception to this is life insurance, where it is certain that at some point the death of the insured will occur, the unknown component is timing. Insurance as a product is reliant on a collective pooling of assets (premiums), priced according to the weighted risk of the probability of the insured event occurring.

Insurance provides an individual with financial support in order to access to a wider range of treatment options and services than available under the national Medicare system. The current private health insurance system is limited to services provided through the hospital system and clinical care providers. It is logical that should government seek to de-couple accommodation costs from care costs within residential aged care, the private insurance system could be extended to cover such services. It should be possible to transfer this responsibility to Medicare, which in turn would allow the private sector to enter this market.

In relation to accommodation costs, the private sector again would be in a position to develop a financial insurance product designed specifically to meet the needs of those who find themselves in need of residential aged care at some point in their lifetime, either for episodic or permanent care. A financial insurance product could provide either a cash-flow style or lump sum payment once the service has been provided (in the case of episodic services) or 'trigger event' conditions have been satisfied (as assessed by the insurer).

4.1.1 User incentives

As documented by numerous studies, Australia suffers from a chronic underinsurance problem. The government has recognised for some time now that Australians are only mobilised into action (on a substantial scale) in relation to insurance where an incentive to do so exists.

The push for Australians to take up private health insurance benefitted greatly from the Government decision to implement a Lifetime Health Cover that was designed to set the premium rate applicable for those taking out health insurance. An age threshold (31 years of age) encourages people to take out insurance or face an increasing rate of premiums for every year over the threshold. In addition, if an individual still does not take our health insurance and earns more than a mandated income (currently $77k for individuals and $154k for families per annum), they will be subject to a Medicare Levy Surcharge. This surcharge is an extra tax levied by the Federal government and acts as a further incentive for people to participate in the private health care system.

To offset this deliberate push, those that do take out health insurance are provided a 30% rebate on premiums by the government. A similar incentive regime would be appropriate for those individuals that take out aged care insurance, given obvious benefits for the government should flow from this policy position.

4.2 Other financial product options

In addition to insurance, there are a range of other financial products that may be tailored to specifically address the requirements of the aged care industry. Some of these products already exist, albeit for a different purpose.

Examples of products that may be explored further for applicability and adaptability to the aged care industry include:

4.2.1 Investment bonds

Investment bonds are savings products that are internally taxed at a corporate income tax rate over a defined period of time. On maturity a tax-free lump sum value is available to the investor which could be used to either finance the cost of accommodation in an aged care facility. An investment bond however does not contain any risk features to protect the investor against outliving the savings.

4.2.2 Reverse mortgages

Reverse mortgages have been available in Australia for some time now, however their attractiveness for investors has been slow to develop. Reverse mortgages can be designed in a few different ways based on the preference of the investor. Essentially reverse-mortgages are entered into against the value of a property (usually the family home) and provide the asset holder with access to the capital stored in the value of the property. This product provides easier access to the stored value without having to go through the emotional and time-consuming process of physically selling the home.

A similar product is offered by Centrelink via their Pension Loans Scheme.

4.2.3 First Home Saver Accounts (FHSA)

A FHSA is a concessionally taxed savings vehicle for those saving for their first home. Investment earnings are taxed at the same rate as superannuation and there is incentive in the form of co-contributions provided by the government. Specific rules around the use of the investment ensure that should the savings not be used for the purchase of a property, it is then returned to the superannuation environment.

A similar product could be designed for the express purpose of saving for aged care costs, with similar rules and incentives via tax-concessions.

Recommendation:

That the government work with the private sector to explore appropriate innovative new products that could assist individuals in financing their potential future aged care costs.

5. Regulatory Issues

Infrastructure investors are attracted to aged care as it has a number of infrastructure investment characteristics, including:

- Regulated supply and demand ;
- The essential service nature of the business;
- Stable, non-cyclical cash flows; and
- Low occupancy risk.

Infrastructure investors are generally the large superannuation funds that are seeking to diversify their investments and looking for long term investment opportunities. Infrastructure investors are generally looking for a 20-25 year investment horizon. Although the operational risk is higher in aged care than a traditional economic infrastructure asset class, this is offset by the growth opportunity inherent in aged care.

In the event regulation was to change the infrastructure like aspects of the aged care sector, it has the potential to reduce the attractiveness of the sector for infrastructure investors. This has the potential of achieving two unintended consequences:

- Increasing the return on investment expectations i.e. increase pricing; and/or
- Decrease investment attractiveness and increase demand on government to fund aged care capital development.

There is increasing interest in the potential to increase choice for prospective residents by deregulating the supply side of aged care, such as the recent National Health and Hospitals Reform Commission (NHHRC)Final Report (June 2009) and the Productivity Commission Issues Paper (May 2010).

> **“*More aged care places to choose from:*** *that 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 wish to use their services, and older people will no longer have to accept the only place they can find. Aged care services will compete with each other to attract older people. Older people who are unhappy with their care will find it easier to shift to a different service.” (NHHRC)*

> *“Examining the current dual gate-keeping system and the scope to improve it by dispensing with the planning and allocation system (while retaining accreditation) and relying on the entitlement for aged care services established by aged care assessment teams.” (PC 2010)*

We acknowledge the rationale behind these recent recommendations. However, we believe that increasing flexibility in relation to the pricing of accommodation will achieve the increased choice prospective residents and their families are seeking whilst retaining the infrastructure like characteristics of the sector and encourage future investment from Australian superannuation funds.

A more recent trend impacting the infrastructure nature of the aged care sector has been the steadily declining national occupancy rates from 96% in 2002-03 to 93.5% in 2007-08. ACIT experiences significant variation in occupancy between planning regions and within planning regions. Whilst the large and diversified ACIT portfolio mitigates the industry wide occupancy risk, it is a trend that causes some concern to new investors.

We are interested in exploring concepts of linking the ACAR process to local health networks to ensure that demand is forecasted in a more sensitive manner to ensure that capital invested in aged care is allocated to the right regions, at the right time.

Recommendation:

Pilot an interface between the ACAR process and local supply and demand forecasts within each planning region.