



CHRISTADELPHIAN
AGED CARE

28 March 2011

Inquiry into Caring for Older Australians
Productivity Commission
GPO Box 1428 Canberra City ACT 2601

Submission in relation to Productivity Commission Draft Report – January 2011

Introduction

We refer to the Productivity Commission draft report, “Caring for Older Australians”, released in January 2011.

The recommendations in relation to broadening the funding base and specifically higher periodic accommodation fees versus lump sum accommodation bonds suggest that there would be a removal of the incentive for incoming residents to pay lump sum accommodation bonds.

We acknowledge that there are benefits in transitioning the aged care industry to a de-regulated cashflow funding model and that over time it would be preferable for the industry to transition away from its reliance on lump sum accommodation bonds, **provided a viable and affordable alternative capital is available.**

Unfortunately the model adopted by successive government’s policy over the past 40 years has led to the industry becoming reliant on accommodation bonds – a reliance that cannot be easily unwound in the short to medium term without significant dislocation in the industry and operator failures due to difficulty in repaying existing bond liabilities.

We are thankful for the opportunity to provide the Productivity Commission with written submissions on the draft report, and would like to make the following comments:

Accommodation - repayment of existing bonds

(With reference to Draft Recommendation 1.4)

The industry has been calling for accommodation bonds in high care to provide a funding stream for building new facilities as well as the refurbishment of older facilities.

With the worthy aim of increasing consumer choice, the Productivity Commission recommends equality between the options of accommodation charges, periodic payments and upfront lump sums. However, this can have the unintended consequence of removing any incentive for the resident to pay a bond upon entry.



The simple implication of this being, once the incentive or requirement for residents to pay bonds is removed, the current capital base of operators will progressively be eroded as existing bonds are paid out **and not repaced by bonds from incoming residents.**

Most providers today have the bulk of their bonds invested in their buildings and therefore **bond liabilities** are relatively illiquid – they rely on bonds paid out to be replaced by bonds from incoming residents. Once the incentive or requirement for an incoming resident to pay a bond is removed (as recommended), many operators would likely encounter liquidity problems as their cash resources are quickly depleted as existing bonds are paid out and there are no incoming bonds. The consequence would be significant financial distress or even collapse for many bond-holding providers.

One obvious response to this concern is: *“Providers will have to adjust their business models - the future is going to be different to the past”*. This is all well and good, assuming that the financial markets, including banks, will facilitate that change. However, we do not believe that sufficient liquidity will be forthcoming from banks or investors and even if in part **it was, it would be** at a significantly higher cost than under the current process. Not only would this result in aged care industry liquidity problems, but as more facilities came onto the market for sale (as a result of the inability of operators to meet bond repayment liabilities), the value of aged care facilities would likely decrease leading to further upheaval for the industry due to the drop in asset values.

Where could new capital funds come from when existing bond liabilities are repaid?

[a] Borrow from banks?

The natural response might be: *“Operators will just borrow from the banks against the asset security of land and buildings”*. It is not this straightforward, as providers would need to be able to transition from interest-free debt (bonds) to debt which incurs interest (bank loans) and to demonstrate a commercial ability over a prolonged period of time to service and repay that bank debt.

There is also the question of whether the commercial banks would be prepared to prudentially consider (or even be able to fund), the dramatic increase in exposure to the aged care industry as providers seek liquidity to repay bonds.

[b] Providers sell the property assets to fund repayments and rent the premises?

Another option is sale and lease back. We question the ability of most providers to pay an acceptable rental return to property investors, given the tight financial model for aged care.

In a rental model, there would also exist issues in building and compliance requirements, where landlords may not be agreeable to funding necessary compliance expenditure and providers may be reluctant to fund it due to the leased nature of the building. This would create a major operating risk for the provider running the service.



CHRISTADELPHIAN
AGED CARE

We are not aware of any significant examples of providers running operations in leased premises owned by unrelated parties on arms-length commercial terms.

[c] Private equity injection to providers?

A further approach could be to sell shares in the aged care organisation to private equity investors to obtain liquidity to fund bond repayments.

This is not an option for the majority of the aged care industry who are 'not for profit' or charitable organisations.

It may be suitable for some private operators. However, most equity investors in all sectors typically require a 15 – 25% return on their capital investment and a short to medium term exit strategy. This level of return and timeframe in aged care would be unlikely to be feasible given the tight financial model and the exit strategy may be unachievable.

Conclusion

It is clear that major changes do need to be made to the aged care industry's funding model to achieve financial sustainability and meet the growing demand for residential accommodation by Australia's ageing population.

The implementation of a capital funding model that provides little incentive for the ongoing replenishment of existing bonds will lead inevitably to the financial failure of providers unable to meet their existing bond repayments.

Any recommended changes to the industry's funding sources must provide for a financially viable transition out of large bond holdings. We believe that this transition cannot be facilitated in the short term by significant debt funding from banks or private equity injection and that the draft recommendations do not provide adequately for this situation.

We would appreciate consideration of these matters and would welcome the opportunity to further discuss our concerns if the Commission felt that this was appropriate.

Ross Peden
Chief Executive Officer

Andrew O'Toole
Chief Financial Officer