AND THE WINNER IS…. RETIREMENT VILLAGES!

AN UNEXPECTED OUTCOME FOR GROWTH IN THE RESIDENTIAL AGED CARE SECTOR PROPOSED BY JAMES UNDERWOOD'S ANALYSIS OF PRODUCTIVITY COMMISSION RECOMMENDATIONS.

Recommended changes to periodic payments and accommodation bonds, coupled with de-regulation of numbers of home care and residential care places, are likely to have a huge impact on financing the expansion of residential aged care activities in the post-Productivity Commission (PC) environment. A surprising outcome is a possible great boon to the retirement village sector, a sector already providing almost as many aged residential places as the government-funded low and high care services.

PC RECOMMENDATIONS ON BONDS

Currently, taking bonds for new residents forms a very major part of financing decisions for operators seeking to build new residential care services. The PC noted an average bond of $233,000 in 2009/10. If most persons pay a bond in most new low care and partially extra services high care facilities, then the total cost of building a new service at, say, $200,000/place can be almost fully paid off as the service approaches full occupancy.

What will happen to financing of these new services under the PC recommendations?

Well, the PC recommendations so far appear likely to reduce availability of bond lump sums to providers. The PC goes through examples of "super bonds" where some bonds paid are much larger than the actual cost of providing accommodation. The PC also notes the huge growth in amounts of bonds held and the very large amounts held by a handful of the biggest provider groups. The PC then goes on to explore options that can be used in addition to or instead of lump sum bonds.

The PC recommends having a "published" periodic payment (as a replacement to the accommodation charge) that is not "capped" and is for use with for all new residents, not just low care and extra services residents. A lump sum bond that is equivalent to, but not more than, the published periodic payment can also be offered. Retentions are recommended to be abolished.

The periodic payment could be paid directly from residents' own income, although I note that few pensioners may have sufficient income or assets to pay this above-pension amount for very long. Some form of government reverse mortgage arrangement is also discussed, but I note that reverse mortgages have long been very difficult to market to Australia's aged persons. Finally and particularly, persons could sell their homes and place the proceeds in an Australian Pensioners Bond – a Government scheme – that is exempt from the Centrelink assets and income tests and indexed to a consumer price index to maintain real value. The periodic payment could be drawn down from this scheme.

THE APPLICABLE INTEREST RATE

Currently, the maximum accommodation payment in general high care services is the accommodation charge of $30.55/day. This charge is widely and correctly considered inadequate to encourage building of new services. Let's say it should be twice this amount – $60/day – for a sample new service to meet its capital costs.

The sum of $60/day for 365 days is $21,900 pa. To make this $21,900pa "equivalent" to a lump sum using the current maximum permissible interest rate (MPIR) of c.9% pa is $21,900/9% = $243,000. However, the proposed "CPI-type" interest rate to be used for a Pensioner Bond Scheme would normally be around 3% pa in Australia. If 3% pa were used, the "equivalent" bond would be $730,000!!!

Accordingly, if the lower interest rate were required to be used, few rational residents would pay a lump sum.

Comparative Lump Sums using Different Interest Rates

Rate	Using a "CPI-type" Interest Rate	Using an "MPIR-type" Interest Rate
Interest Rate	3%pa.	9% pa.
Periodic Payment	$60/day	$60/day
Lump Sum Bond:	$730,000	$243,000

The Impact of PC Recommendations

So, what happens if the Productivity Commission recommendations encourage a large proportion of new residents to make use of the Australian Pensioner Bond scheme and they pay periodic payments in lieu of lump sums?

Well, at first glance, providers will have to encourage financiers to accept an income stream to pay off the principal and interest on loans, instead of large chunks of lump sum payments. This is not necessarily a bad thing, as the income stream can now correctly meet the actual cost of provision of accommodation. (I.e. a periodic payment can now be set which accurately meets a provider's cost of building the new service.)

However, what about existing services?

Currently there's probably around $12billion held in bonds in Australia. If 25% of those bond-payers die or depart in the first year of operation of the Australian Pensioner Bond scheme, then some $3billion may be paid out. If the interest rates are at the CPI level, or, at best, neutral between bonds and periodic payments, then perhaps only half that $3billion – i.e. $1.5billion – may come in to providers as replacement bond lump sums. Bond holdings for current residents could reduce by $1.5billion. Now, much of that $12billion bond money is actually expected to be in banks paying down borrowings used to build those services or actually in the "bricks and mortar". That is, after all, the primary purpose of bonds. So, let's say two-thirds of bond money is used to reduce borrowings and one third is just in investments earning interest for providers.

The upshot is that Australia's residential aged care sector would have to borrow a further $1billion in just 12 months to cover the reduction in current bond holdings. That would mean borrowing $1billion in one year that would not be used for any *new* buildings or upgrades at all – just to refinance reductions in bond holdings on existing bed places.

The most recent Department figures (2009/10) identify that c.$1billion was spent in one year on building *new* residential aged care places.

So....a successful Australian Pensioner Bond scheme coupled with a low CPI-type interest rate for "grossing-up" periodic payments **could give rise to a doubling of monies needed from financiers**: $1billion for building new places and $1billion to refinance depleted bond levels. This is before consideration of money needed for rebuilding and upgrades. On the positive side, the providers can now set the periodic payment at a commercially-appropriate rate to allow an income stream that can repay principal and interest. Bankers we have spoken with are positive about this type of lending.

EFFECT ON RETIREMENT VILLAGES

The PC recommends removing regulatory restrictions on community care packages and residential care places over a five-year period. We are already seeing retirement villages move to secure marketing and sale price advantages by accessing and supporting home care packages. Great success stories are seen in southern Queensland and elsewhere with retirement villages operators accessing CACP's, EACH's, EACHD's and veterans' packages into apartment-style villages. Some of these new "care in village" apartment complexes are sold out within months!

Retirement villages can continue to require that new residents pay **lump sum ingoings**, whilst residential care may have to accept changing their financing model to one where many/most new residents elect to pay periodic payments.

Retirement villages can continue to require **retentions** in the form of deferred management fees whilst the PC recommends abolition of retentions on bonds.

Retirement villages can immediately benefit – if they wish – from having an existing consumer group that is **ideal for deregulated home care package availability**.

Retirement villages could **more readily access and commence co-located residential care services** in a "deregulated places" environment and be ideally suited to maximise occupancy from their existing aged consumer group.

CONCLUSION

The need for residential aged care is going to grow (excellent demographics!) and the market will remain vibrant and strong **and** the uncapping of accommodation payments will be very positive to the growth of high care services. This change to help keep the high care building program going is particularly important since the Department of Health and Ageing stopped the very good alternative of expansion of partial bond-taking extra services as the primary way of getting new high care places on the ground in most metropolitan areas. However, if I see any biggest winner from the recommended PC changes, it is the Australian retirement village sector, provided the sector moves to embrace greater levels of care (and, thus, frailty) on retirement village sites.

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