Whilst a deregulated pricing model in aged care is a good thing in meeting consumer choice and demand, I have some concerns in relation to some of the short term pressures changes in policy may have, especially in the areas of pricing re-adjustment, flights on accommodation bond capital, and not adversely effecting organisations that have done the right thing in current policy context to meet consumer preferences.

Issues:

1. Forcing a re-capitalisation of the industry by changing preference to not using facility hosted accommodation bonds
2. High capital costs of residential aged care and low relative returns to capital costs
3. Market – pricing correction period, needs to be completely separate from any policy which changes preference to how one pays
4. Extra Service Status needs to be maintained on an ongoing basis
5. One price for a facility bond is not reasonable, limits choice
6. Do not disadvantage those who have done the right thing and responded to the limitations of the current policy by creating models that work within the current system

Forcing a re-capitalisation of the industry by changing preference to not using facility hosted accommodation bonds

There is currently approximately $10-$12 billion dollars in refundable accommodation bonds being held by the Aged Care Industry. By the time any changes to regulation occur it is likely this figure will substantially increase, depending on the timeframe it could be between 20 – 30%.

These bonds have been used since 1997, as the main mechanism to fund development of new aged care facilities that meet the expectations of consumers today. Collection of accommodation bonds has been the mechanism that Financiers, such as Westpac and the other major banks have used to pay down debt associated with the capital costs of aged care. Given that the average stay in an aged care facility is usually under 3 years, when and if the government should introduce changes to policy that discourages future residents to pay by accommodation bond (whether it be changes in pension policy, encourage people to park money with the government instead or otherwise) this will call for a rapid re-capitalisation of the industry.

Forcing this quickly as a consequence of a policy event is likely to cause pressure on the industry. It is likely create cash flow models where financiers are going to call for greater equity than previously required, and may create a run on funds that have already been deposited with approved providers, that have been then tied up in other organisational development programs.

If not dealt with carefully a policy driven change in preference not to use accommodation bonds to fund aged care facilities may create undue financial strain on the industry and even call on bond fidelity guarantees if it caused unreasonable pressure on providers.

Also it should be considered that their currently may not be the infrastructure within the industry to deal with any rapid changes, i.e. enough bankers, valuers and other experts involved in a rapid recapitalisation process.

High capital costs of residential aged care and low relative returns to capital costs

It is worth noting that while other businesses operate on a cash flow model, there are not a lot of other consumer businesses which on a pro-rata basis per client have such intensive capital costs. On a per resident basis modern aged care facilities have extremely intensive construction needs, the services, being the electrical, hydraulic and mechanical requirements per room, leads to very high costs. Financiers, hence as a result of the low expected returns in aged care use the accommodation bonds to quickly reduce the risk associated with the high capital costs and low returns. The risk stands that the elderly and Australian community will over a short period of time / price correction period be not prepared to pay the real costs if bonds are not made as preferable an option.

Market – pricing correction period, needs to be completely separate from any policy which changes preference to how one pays

Whilst in the long term a user pays model is preferable, the market will need some years to create sustainable pricing models, especially given the average length of stays in care and protection of existing residents. Newer facilities who have done the right thing to meet consumer demand will be in a higher risk category, because they are already heavily vested in the current system of accommodation bonds. Where as older facilities have less to lose they are less likely to have to recapitalise, and they can be more competitive in adjusting their pricing in the market place.

It is imperative to give the market some years, say 5 years to establish a user pays market, free from reform that influences of how to pay those amounts, i.e. changes in policy that will have effect on whether people pay via accommodation bonds, or periodic payment. Should both of these occur within to close a tight time frame it will cause immense pressure on the industry. It may create a flight of capital from the accommodation bond system, before organisations have had opportunity to prove their pricing model, causing undue pressure from financiers, in a time when valuers have not had opportunity to see evidence in the market place and take even more conservative views on the market creating a credit spiral.

Extra Service Status needs to be maintained on an ongoing basis

Extra services facilities has been the response of current providers to be able to build to current market expectations. Part of that model is that there is no or reduced concessional ratios. This has been built into the model of these facilities and often the bond have a component in them for the profitability of the facility that would otherwise would not be built if this was not available for a return. Whilst the removal of ESS status is identified it is imperative that existing extra service places remain exempt going forth from the concessional ration requirements, otherwise these facilities may become retrospect fully unfeasible.

One price for a facility bond is not reasonable, limits choice

When one looks for a unit are they all priced the same? Even within a facility there are different rooms with different features, some of these features make some rooms more desirable, and some less. To have a model where there is only one advertised price, does not do justice to choice from both the lower and higher ends of rooms. For instance why shouldn't a resident who has a view, or a balcony or a north garden facing room, pay more? Why should the resident who has none of these have to pay the same amount as a resident who has them? If you had the money and you liked to read the paper in the sun, wouldn't you choose the facility who has the more expensive room with the balcony?

Do not disadvantage those who have done the right thing and responded to the limitations of the current policy by creating models that work within the current system

As mentioned before the organisations who have reacted to the current policy setting to meet consumer choice and expectations are the approved providers who have embraced extra services, to build facilities that meet consumers choices.

In turn they seem to be the most exposed to changes in policy as they have the greatest capital exposures, and should reforms have short term consequences during correction periods, they have the least ability to react flexibly due to their capital commitments. They are the ones financiers and valuers are going to put the most pressure on. They are also the ones receiving the least benefit as a result of change, because they were adaptive in their approach; It is imperative as such that in the short term you do not create untenable financial outcomes for them.

Kind regards,

Michael Kresner

managing director