

**Capital Contribution
Policy Options Paper
Residential Aged Care**

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BACKGROUND

The residential aged care sector is unique in respect of its capital creation capability, how capital is raised and the different applications between the different parts of the sector.

In 1997, the Government introduced the Aged Care Act 1997 which included the creation of a new environment for the raising of capital for the residential care sector. The Government proposed that all parts of the system have the capacity to levy a lump sum contribution from residents, to upgrade, replace, and build new residential aged care facilities for both nursing homes and hostels.

This proposal involved the deposit of the lump sum contributions from residents into a fund which was to be managed by Coopers and Lybrand. The pool could then be utilised as a source of capital funding for operators in the residential care sector based upon a discounted interest rate as opposed to standard commercial rates. As resident contributions and therefore the pool grew, providers would be able to apply to the pool to obtain funds for capital development. Under this proposal, the provider would have ultimately repaid the loan back to the pool where funds would have been held on behalf of residents' lump sum contributions.

Due to a variety of factors, this proposal was replaced by a much looser arrangement whereby hostels (low care facilities) and new extra service facilities were able to attract refundable accommodation deposits (bonds), but there was no ongoing requirement to deposit the bond into a managed fund. Nursing Homes (high care facilities) were not permitted to attract lump sum contributions (bonds), only being able to access a capped accommodation charge set by Government.

These Government decisions, while effectively providing residential low care and extra service facilities with the capability to raise capital, have drastically limited high care facilities'. The implementation of a capped accommodation charge set by Government means that though providers are required to construct residential care facilities to the same standards and size as hostels (the space per resident is also similar), the capital creation income from the accommodation charge is roughly fifty percent less than the value of the income created by the average refundable accommodation deposit (bonds).

As at 30th June 2005, the average refundable accommodation deposit received by the industry in the previous twelve months stood at \$118,000.00. Applying a conservative investment regime and including the retention amount that a provider is permitted to retain a bond of this value would generate a capital contribution over the year of approximately \$9,050.00. While a nursing home restricted to the accommodation charge which was \$16.25 per day as at 30th June 2005 would generate a capital stream over a full year of \$5,931.00.

This has led to a considerable cross subsidisation of capital infrastructure: extra service and hostel residents pay a lump sum to support nursing homes' unviable capital creation capability.

The number of stand-alone residential high care facilities that have been built in recent years is extremely low. Out of only seven high care facilities allocated places in 2004, four are within groups where investment decisions depend on low care or extra service lump sum contribution arrangements to cross subsidise the nursing home stream. All major financial institutional lenders to the residential care sector state that they will not lend to build a nursing home on a stand alone greenfield site. They will lend to purchase an existing facility or to expand an existing operation, however, none of the lenders consider the construction of a stand alone, greenfield nursing home viable within the current financial environment.

As 67% of all residents now accommodated in residential care are classified as high care, and that percentage is likely to become even greater over the next decade, there seems little logical policy or operational sense in of continuing to build large numbers of low care facilities when the demand for these is clearly in high care.

However, that is exactly what we are doing.

In the 2004 aged care approvals round, the Government allocated nearly twice as many approvals to low care beds as to high care beds. The Association asks why any rational planning system would continue to allocate twice as many beds to a sector that requires less than half the number of places, and when the real need is for additional places in residential high care, not residential low care.

The logical answer is the current differential between high care and low care capital creation capability. These differences are reflected in the planning and allocation of aged care places.

Residential aged care is investing nearly \$1b per annum in replacement, renewal and new building stock and is capitalised at approximately \$25b. Planning future building needs must be based on sound economic and rational grounds. Distortions which are created by perverse drivers on the capital side of the industry must be corrected as soon as possible.

THE PROBLEM

The continuing differential in the capital creation capability of the low care/hostel and extra service sub sectors as opposed to the high care/nursing home sub sector are a major impediment to the aged care sector. The income from the current accommodation charge is approximately 50% lower than the value of the income from an average lump sum contribution.

This imbalance must be resolved so that residential aged care can operate as a single system with the same capacities to provide building infrastructure in

the future and to achieve a reasonable return on that infrastructure investment.

Without the contribution of refundable accommodation deposits, the sector's building program since 1997 would not have occurred.

Now more capital creation is required. The very low returns available to the sector from operational income makes the sectors capacity to save and/or service considerable debt difficult without the contribution of refundable accommodation deposits in high care residences. Quite simply, running a residential aged care service within the income constraints imposed by the existing scheme makes further reform unavoidable.

The following sections of this paper endeavour to raise a number of alternatives that Government could consider to ensure the sector is able to move to a sustainable capital creation environment, one which will recognise and meet the capital needs of the sector and improve the physical infrastructure available to future residential populations.

POSSIBLE SOLUTIONS

There are a number of options available to Government once it is accepted that there must be a change in the existing system. The options that are put in place must have as its core objective, The enhancement of choice to meet residents' care needs and financial circumstances in a way which treats aged care residents equally, whether high or low care.

Government must be prepared to move towards a substantially deregulated system with a much greater capacity for aged care providers to generate operational income from fees and charges to service both operation expenditure and capital expenditure

CONCESSIONAL RESIDENTS

When a resident is assessed as being exempt from paying an accommodation bond or charge, the Government currently pays a daily contribution towards the residents in high care and low care. The decision as to whether a bond or charge is payable, depends upon whether the resident on entering residential care has owned a house in the previous two years, has a spouse living in that house, has a relative entitled to a Commonwealth social security benefit in that house for at least two years and has been providing care and support to the prospective resident and/or a carer entitled to receive Commonwealth social security benefit being a non relative who has been in the family home providing care and support for five years..

These exemption provisions work effectively to ensure that residents entering residential care are not forced to sell the family home. Given the substantial protection provided, changes are not proposed to these arrangements.

ACCOMMODATION CHARGE

The accommodation charge currently applies only to high care residents. The major shortcoming of the existing accommodation charge arrangements is the fact that the amount is fixed at a maximum of \$16.63 per day (as at 1st July 2005) and cannot move above that amount under any circumstances. This has the effect of making the capital creating capabilities of low care substantially greater and therefore more advantageous than for high care.

The Association believes there is a pressing need to create a capital creation capability for both high care and low care which creates symmetry of financial contribution and systems administration.

A flexible contribution set at a more realistic maximum would achieve an accommodation contribution from residents of similar value for both high and low sub sectors.

A fairer formula for fixing this amount could be based on the formula mentioned above using the previous year annual average bond figure currently \$118,000.00 as the basis for the accommodation charge and that the charge is based on the statutory accommodation bond rate, currently 9.63%. This would make the contribution flowing from the accommodation charge more equivalent with the capital created by accommodation bonds, substantially diminishing the relative financial attractiveness of low care over high care for aged care providers.

The Association believes that a resident who does not meet the current broad exemption criteria should be required to contribute an accommodation charge up to the limit outlined above.

PERIODIC PAYMENT OF REFUNDABLE ACCOMMODATION DEPOSITS

At first sight, there appears to be little difference between the concept of the periodic payment and the concept of an accommodation charge paid on a daily basis. As applied within the residential care sector currently, the periodic payment is usually paid as an alternative to a lump sum contribution and is usually levied on the basis of the application of the statutory interest rate currently set at 9.63% on the outstanding component of any lump sum contribution. The Association contents that residential aged care clients should be able to make a contribution towards their accommodation services based upon an assessed daily accommodation charge as outlined above, or a periodic payment which is assessed as being the outstanding proportion of a refundable accommodation deposit calculated by applying the statutory interest rate currently set at 9.63%. The periodic payment would then be paid on a monthly, quarterly or half yearly basis as negotiated between the client and the aged care provider.

This option has the advantage from 1 July 2005 of providing symmetry of structure between the capital creation capabilities of low and high care. From 1 July 2005, residents of aged care facilities will have a lump sum contribution

treated as asset test exempt for pension purposes, and will have income earned from a rental property being a primary place of residence prior to admission treated as income exempt for income testing for pension purposes, if that income is applied towards a contribution for residential aged care accommodation. This is also in line with recent accommodation charge amendments where income received from a rented property, previously the principal place of residence for a residential care recipient, would be treated as income exempt for pension assessment purposes for the duration of the stay of a resident in a residential care setting.

WARD DIFFERENTIALS

Prior to the implementation of the 1997 reforms under the Aged Care Act 1997, there had been provision within aged care accommodation for ward differentials. These could be described as a pricing mechanism to reflect the quality and amenity of accommodation provided to residential aged care recipients. A four bed bay for instance, would attract a lower contribution than a single bed ensuite.

Since the 1997 reforms, the Government has driven the sector towards single bed ensuited accommodation with its higher capital and operational cost for a much larger building spread without any funding of those higher costs.

If the Government and the community wish all aged care service providers to build single room ensuited accommodation, then it is absolutely essential that the necessary capital creation capability be provided to the sector through either Government or consumer contributions to properly provide for this enhanced accommodation type to be provided to the broader community.

One alternative is to again allow providers to charge a differential rate tied to the quality of the accommodation provided. This would provide greater market influence upon the capital provision of the sector rather than the existing arrangement where accommodation is rapidly becoming uniform. Certainly, by the time the physical requirements of 2008 certification are achieved, there will be very little to differentiate the size, nature, privacy and amenity between many aged care facilities constructed within the last ten to fifteen years.

An obvious alternative for Government therefore, would be to provide some flexibility which would reward those providers who provide enhanced single room ensuited accommodation, whilst providing a smaller recompense for those providers who provide a multi bed facility, without the higher capital outlays of single room ensuited accommodation.

DEEMING PROVISIONS

In the 2004/05 budget and from 1 July 2005, the Government substantially improved the deeming regime between the accommodation contributions for low care and high care.

From 1 July 2004, the removal of the five year limitation on aged care accommodation charges, and the extension of the income exemption for pension purposes in respect of income received from a former principal place of residence are to be applauded.

Similarly, the Government's decision to treat the payment of the accommodation bond as asset test exempt for the purpose of pension assessment from 1 July 2005 is most welcome. In addition, the provision whereby income received from rental of a former principal place of residence and applied towards a periodic payment for the duration of a resident's stay in residential care has made both the bond and/or periodic payment a considerably more attractive option for residents and has created a more uniform environment between high and low care.

The Association welcomes these changes, however, believes there is room to further improve the deeming provisions and calls on the Government to recognise that there is an ongoing disparity between the pension approval criteria and the capital payment criteria in aged care. There is, we believe, a need to ensure that the provisions that apply to applications for pensions and the provisions applied to the capital payment obligations to residents in residential aged care should be the same. The current provision whereby a resident entering residential aged care is assessed on the capital capability based on disposal of asset rules that are of two years duration as opposed to application of the same rules for someone applying for pension for the disposal of asset rules is five years, does not make for sensible public policy. As ninety percent of all residents within residential aged care are pensioners, it would be logical for the provisions as applying to the assessment for pensions under social security legislation and the provisions applying to capital contribution as applying under the Aged Care Act 1997, be brought into conformity.

REFUNDABLE ACCOMMODATION DEPOSITS

Refundable accommodation deposits entry contributions are generally described in the broader community as "bonds". This name however is a misnomer, as the current scheme of refundable accommodation deposits, calls for the payment of a lump sum contribution on entering into residential care and approves of the aged care provider drawing down \$3,153 pa for a maximum of five years as a retention amount with the balance of all funds not drawn down being returned to the resident upon exit from residential care. Simply put a \$100,000 refundable accommodation deposit on entry into residential care would attract a refund on exit after five years of \$84,235. Hence the name refundable accommodation deposit is far more accurate than an accommodation bond.

Deposits have now been in place for twenty years without any failure by the aged care sector to refund these deposits and without any default or other issue regarding the administration of the scheme.

The Government is introducing an enhanced Prudential Arrangement in respect of the existing refundable accommodation deposits held by the sector. This enhanced Prudential Arrangement will ensure an avenue of last resort in the unlikely situation where an aged care provider went into receivership or administration and did not have sufficient assets with which to refund refundable accommodation deposits within the legislated timeframe.

It should be born in mind that the high level of investment being expected by Government and community over the current ten year period and ongoing over the ten year period beyond 2008, demands that aged care residential services have access to an appropriate capital stream to service that capital investment. As noted previously, without the contribution of refundable accommodation deposits over the first seven year period of the current cycle, there is simply no way that the residential aged care sector could have built the replacement, renewed and new building stock that has been constructed over the current period.

This is a matter of fundamental importance to the sector as the important contribution of refundable accommodation deposits to this substantial rebuilding process is less than widely understood. If the community wishes to avoid a UK-style boom and bust outcome for residential care, where a high level of building activity is followed by a reduction to almost zero, then either:

- the sector is allowed to expand the utilisation of refundable accommodation deposits to accommodate the rapid expansion of building infrastructure, or
- the existing restraints on the income stream are relaxed to allow operational income to service both the operational and capital needs of the sector

This would significantly change the current pricing regime and remove many of the existing restraints that Government currently places on the system and which produces a one price fits all scenario, with little flexibility for providers to be able to produce additional income to either save or service capital borrowings in order to develop the building stock that Government expects.

The Association also contends that it is extraordinarily unfair to consumers that a person entering one part of the residential care system is permitted to pay their accommodation contribution in one form, but if they are admitted to another part of the system, then those options are simply not available. If the Government, like aged care providers, wants consumers to have choices about their residential care accommodation, it is imperative that the way consumers make financial contributions to their care are equally available throughout the residential care system.

DEREGULATE INCOME STREAM

The residential aged care sector is based upon a three tier strategy namely, capped supply, capped demand and capped income. This arrangement has been the cornerstone of the Commonwealth Aged Care program for many

years and allows the Commonwealth to control demand through limiting admission numbers, supply through limiting place numbers and Commonwealth outlays through controlling the price the industry can charge

In most other business environments in Australia, a business is able to create its capital requirements from its general operating income. This is certainly not the case within residential care as the capital requirements are designated as being met from either the accommodation bond in hostels and extra service facilities or the accommodation charge in nursing homes and the concessional supplement paid by Government in both settings. Indeed, it is a matter of some dispute as to whether there is any provision within the general subsidy (operating income) of residential care facilities for the capital creation requirements of the sector. It is generally uncontested that, the sector's building program would have not been possible if the capital creation needs of the sector were to be purely met from the operating income available from the Commonwealth subsidy scheme, the concessional supplement paid by government or the accommodation charge.

There is a strong argument therefore, that the residential aged care sector be able to create from within its general operating income stream, sufficient operating income to meet its expenses whilst achieving the capacity to create sufficient income stream to meet both its existing and future capital needs. It is generally accepted and clearly confirmed by the Hogan Report that the sector is not capable of creating sufficient income from the general financial stream to achieve an operational result which would allow both operating expenses and capital creation provisions to be met from the existing scheme.

If the Government is not prepared to embrace the simple importance of refundable accommodation deposits to the capital creation needs of the sector, then it is imperative that other streams of capital creation income be developed in order to assist the sector to achieve the level of development that Government is demanding.

One method of achieving this change would be to recognise that the current capped income stream is advice created by Government to ensure that residents entering residential care are able to afford access to the system. However, if a resident was not required to pay a refundable accommodation deposit or an accommodation charge and was assessed as having the capacity to make a contribution beyond the existing scheme, then it is proposed that that resident with that financial capability should be required to do so. This would have the impact of creating an operating income for residential care which on the face at least, should be able to create sufficient operating income for both operating expenses and capital needs.

Currently, the only parts of the system that allow any flexibility in this regard are the extra service fees charged by extra service providers and the income tested fee which is charged to residents who have a capacity to pay. Unfortunately, in the 1997 reforms, the Government determined that any income received under the income tested fee would be immediately diverted

to Government coffers whilst the aged care provider would retain the same income stream as previously. In extra service, the Government retained a quarter of the extra service fee which acts as a double taxation on this group of residents.

It is suggested that the income tested fee arrangements need to be restructured, so that the Government stops applying the drawdown provisions in respect of extra service fees and allows these fees to remain with providers. In addition, the income tested fee arrangements currently in place should be substantially amended to allow a much more flexible approach to the contribution by residents which is reflective of a resident's capacity to pay.

SEPARATE CARE AND HOTEL/ ACCOMMODATION SERVICES

Currently, the residential aged care system is basically a one size fits all arrangement, other than a small number of residents who are accommodated in extra service facilities. Nowhere else in our society or economy is there a general policy that there cannot be some differentiation between hotel services and accommodation type based upon the capacity of an individual to fund an enhanced or higher grade of service provision or accommodation type.

Indeed, there have been a number of complaints over recent years from the families of residents who wanted additional services or enhanced accommodation in the residential setting for their family member, and have been unable purchase enhanced arrangements due to the structure of the current scheme.

In an arrangement where hotel and accommodation services were separated from care, the Commonwealth Government would remain the primary purchaser of accommodation and hotel care services for the group of residents for which the Government is fully responsible, that is the concessional resident group in the current scheme. Non-concessional residents would make contributions to cover the accommodation services in residential care. The Commonwealth Government would therefore exercise considerable price signalling power in its contracting with residential care providers to ensure appropriate and adequate hotel and accommodation services are supplied to that group of persons.

The key components of the funding system would remain unchanged with all recipients receiving a nominated care package covered by a care subsidy paid by the Commonwealth and available to all care recipients across the program.

AGED CARE CAPITAL POOL

An alternative that the Government could consider would be the allocation of a large portion of Commonwealth funds into an aged care capital pool.

An aged care capital pool could be structured as a self perpetuating fund from which aged care providers were able to access capital requirements at a discounted interest rate whilst avoiding the need to go into the capital market and pay current commercial interest rates.

This would have the benefit of allowing providers access to a designated capital creation stream. However, unless the initial fund is of an adequate size or sufficient arrangements are made to add to the fund from other streams over time, capital development in the sector may be delayed due to lack of capacity to meet the sector's investment requirements.

Alternatively, a fund of this nature could be utilised in a more limited form to assist providers in low socio economic areas, particularly rural and remote communities, where the capacity to create an income capital stream from the value of residential housing stock is heavily constrained and unlikely to be able to meet the capital raising capacity of metropolitan providers.

NOMINATED INVESTMENT ACCOUNTS

The Government introduced from 1 July 2005, a revised scheme which treated accommodation bonds as exempt for asset testing purposes in respect of assessments for the pension. However, a residential aged care recipient who sells their family home for an amount much larger than the bond payment to a residential care facility still has the difficulty of potentially breaching both the asset and income assessment rules for pension assessment purposes, and therefore losing the pension entitlement or having the pension entitlement reduced.

It is proposed that the Commonwealth Government provide for the establishment of specified financial products which would be treated as exempt for either asset or income testing purposes for pension assessment, whilst a resident is in care and those funds were being utilised towards the financial support of the resident in a residential care setting.

Such an arrangement would have significant benefits to both the resident as the sale of a family home for instance would not reduce the pension status of the resident, whilst at the same time; expand the range of choices for a resident as to how they would contribute towards their accommodation in a residential care setting.

REVERSE MORTGAGES

There are now five reverse mortgage products available in the Australian financial market. All products are geared towards a broad spectrum of potential clients in the broader community and are not solely targeting residential care. However, the development of these products adds an additional aspect to the choices available to residents on entering residential care and how these choices are exercised.

It is essential that a resident exercising an option for residential care, under an equity draw down in an asset such as a family home at a time, that a residential care accommodation payment is being made be treated in the same manner in respect of pension asset tests or income tests, as a resident exercising that choice through other avenues.

SHORT TERM ENTRY INTO RESIDENTIAL CARE

One issue that has caused considerable debate for many years has been how to treat the accommodation contributions required of a resident who may only stay in a nursing home or hostel for a short period of time. This is a difficult issue as, the duration of a residential care stay is not always apparent on admission. Even special assessment prior to or shortly after admission may be wildly inaccurate as to a prognosis of a resident and their anticipated length of stay.

The existing scheme permits a resident entering residential aged care to make an arrangement with an aged care provider to pay a refundable accommodation deposit on a periodic basis or accommodation charge, depending upon which type of facility the resident enters. The charge or bond will incur an interest penalty for any outstanding period. It is suggested that the interest rate in respect of the outstanding refundable accommodation deposits become the operative interest rate for all outstanding accommodation payments and that the existing scheme be allowed to cover any resident whose stay may be less than six months. The existing scheme permits a resident to make a commitment that allows the resident to defer payment of either the refundable accommodation deposit or the accommodation charge for a period up to six months. Whilst this deferral is in place, the interest rate is applied and becomes a charge against the resident.

It is believed that a better utilisation of this component within the existing scheme would overcome any difficulties faced by residents entering residential care where their stay is going to be of a short term nature and is expected to be less than six months.

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