CATHOLIC HEALTH
Australia

Aged Care Update

Aged Care Update is published by Catholic Health Australia | **www.cha.org.au** September 3, 2014

Aged Care Update: Matters Arising from ACFA's Second Annual Report

The Aged Care Financing Authority (ACFA) recently released its 162 page second annual report on the financing of aged care. Under its charter, ACFA is required to report annually on the impact of financing and funding arrangements on the viability and sustainability of aged care and on consumer access to quality aged care.

Much of ACFA's analysis in the report draws on the 2012-13 General Purpose Financial Reports (GPFRs) and Financial Accountability Reports (FARs) submitted by residential and home care providers respectively. This is the most recent financial reporting available.

As was the case in the first report, ACFA's analysis is considerably more comprehensive for residential care because of the greater depth of information contained in GPFRs. Recognising the current data limitations, ACFA has been asked to provide advice to the Minister by 30 September 2014 on ways to improve data collection across the sector. Because of decision and implementation timelines, it will take several years before more comprehensive sector-wide data will be available.

In the meantime, ACFA's latest report provides useful indicators of performance and trends in the sector. This Update draws out some salient points which arise from the report.

Viability of Service Providers

Residential care

There was a predictable decline in financial results for residential providers in 2012-13 compared with 2011-12 as a result of the 1 July 2012 ACFI changes, primarily a 1.6% reduction in care prices. Average earnings before tax and depreciation (EBITDA) per resident fell from $9,274 to $8,600; average net profit before tax per resident fell 19.9% from $4,300 to $3,492; and the average return on assets fell from 5.5% to 4.8%. Overall, the proportion of providers with a positive EBITA fell from 70% to 66%.

The decline in average results in 2012-13 reflects expenses growing faster than revenues, with the former growing by $1,020 million (8.3%) and the latter growing by $888 million (6.8%). The biggest contributor to growth in expenses was staff expenses ($734 million).

However, the decline in 2012-13 financial results did not translate into a decline in investment in new services (see below).

In part, this may reflect some improvement in financial performance during 2013-14 revealed in surveys by private benchmarking firms which suggest that providers may have adjusted to the ACFI changes. More importantly it indicates that providers, financiers and investors responded positively in anticipation of the more market based accommodation payment arrangements and the increase in the maximum supported resident accommodation supplement which took effect from 1 July 2014.

ACFA's reporting of the maximum accommodation prices published under the new arrangements confirms the potential for a significant overall uplift in accommodation revenues and profitability. Compared with average new bonds in 2012-13 of $273,386 (or about $50/day), the average published maximum refundable accommodation deposit in July 2014 was $355,035 (or $65.07/day). This is a significant increase on the maximum daily accommodation price of $33 that previously applied for non-supported high care residents. In addition, the maximum accommodation supplement for supported residents in new and significantly refurbished homes has increased to $52.49 per day.

ACFA points out, however, that the new accommodation payment arrangements will impact differently on providers depending on, inter alia, their capital structures. Providers who have been highly leveraging bonds potentially face liquidity pressures.

In contrast to 2012-13 when the average new bond received by the not-for-profit sector ($251,000 or about $46/day) was lower than the for- profit sector ($309,000 or about $57/day), the maximum price published by not-for-profit providers under the new arrangements is higher ($ 374,611 or $68.66/day) than for for-profit providers ($333,557 or $61.13/day). The lower prices published by for-profit providers may reflect a greater number of multi-bed high care rooms operated by for-profit providers, and not-for-profit providers positioning prices to allow cross subsidisation consistent with mission objectives. Whatever the rationale behind the initial published prices, it will be some time before trends in actual prices emerge.

ACFA's analysis of revenue per resident in 2012-13 shows that the primary sources of revenue are Commonwealth ACFI payments for care (65%), resident payments for living expenses (21%) and accommodation payments by non-supported residents and by the

Commonwealth for supported residents (4 % and 6% respectively). However, the real contribution by non-supported residents is understated because the reporting on accommodation payments excludes interest earned on bond holdings and avoided capital-related costs.

Given that the move to market based accommodation prices is a primary driver of improved investor and provider sentiment, it will be important for ACFA to develop an accounting methodology to measure the contribution of non-supported residents to overall service viability and to monitor the balance between care and accommodation revenues in case there is a significant cost shift from primarily Commonwealth funded and determined care prices to privately funded and provider determined accommodation prices.

The recent Budget decision to increase care prices by 2.4% from 1 July 2014 (on top of indexation) as a result of the re-purposing of the workforce supplement and the more market based accommodation payments should help strengthen the viability of providers in 2014-15 and beyond. In the case of for-profit providers, however, the 2.4% care price increase will be largely offset by the removal of the payroll tax supplement from 1 July 2015 (unless, as noted by the Commonwealth, State and Territory Governments agree to extend the payroll tax exemption to for- profit providers).

The long standing variability in financial performance across providers continued in 2012-13, with the top quartile achieving average EBITDA of $19,825 compared with - $5,276 in the bottom quartile. The implications of this variation for new investment and the sustainability of services are not adequately understood. ACFA has been asked to analyse the reasons for this variation, with an initial report to Government due by the end of 2014.

Home care

Financial performance data is only available in relation to Community Aged Care Packages (CACPs). In 2012-13, 61% of the providers of CACPs reported a surplus in net profit before tax. For- profit providers, whose share of package numbers is increasing, reported average returns well above not- for-profit providers ($869 per consumer compared with $519).

As with residential care, there was considerable variation in financial results, with top quartile CACP providers achieving an EBITA of $2,206 per consumer in 2012-13 compared with -$1,306 for the bottom quartile.

The financial results for home care providers should be taken with a grain of salt. Unlike residential providers, packages are not priced to cover a person's entire living and care needs. Instead, a care package is a financial contribution towards the purchase of care and support services to help the person to continue to live independently, if that is their choice. These services are delivered in a context where the consumer's purchasing power is blunted by constraints on the ability to exercise choice of service provider (though individual budgets under consumer directed care is a step in the right direction).

Sustainability

Preparedness to invest is a key indicator of the sustainability of aged care services. Based on the current regulated service provision target (including the regulated balance between residential care and home care places), ACFA estimates that an additional $31 billion (current prices) will be required over the next decade to supply 76,000 new residential places and rebuild existing services. This contrasts with 37,731 new residential places coming on line in the previous decade.

The encouraging news is that the pick-up in investment in 2011-12 that followed the announcement of changes to accommodation payments was sustained in 2012-13. The 2013 Survey of Aged Care Homes estimated that a total of $920 million of new building, refurbishment and upgrading work was completed during 2012-13, with an additional $1,670 million estimated to be in progress at 30 June 2013. This is an increase on 2011-12 of $57 million (6.9 per cent) and $718 million (43 per cent) respectively, and is significantly more than in the years prior to the announcement of the reforms. Building statistics from the Australian Bureau of Statistics quoted in the report confirm this trend.

ACFA also reports that the increased level of building activity in 2013-14 was complemented by a substantial inflow of new equity which is contributing to consolidation in the residential sector. The number of providers has reduced by 16% from 1,243 to 1,034 since 2006-07, even though the number of services has been expanding. In theory, consolidation in the sector should provide the platform for investment in new services.

Despite the encouraging signs, the level of investment required is daunting. It is hoped that government policies such as the abrupt termination of the dementia supplement, removal of the payroll tax supplement, reductions in ACFI care prices in 2012 and the shadow hanging over the future level of the accommodation supplement for significantly refurbished homes do not combine to undermine future investment by reinforcing sovereign risk concerns amongst financiers and equity investors.

The ACFA report highlights significant differences in capital structures for for-profit and not-for -profit providers which may have implications for their relative share of the market in future. In particular, equity as a proportion of total assets is much higher for not-for-profits (41% compared with 16% for for-profits), which suggests that for- profits are more prepared to leverage their balance sheet for fund expansion. For-profits have non-bond liabilities as a proportion of total assets of 29% compared with 12% for not-for-profits. Bonds as a proportion of total assets are 55% for for-profits compared with 47% for not-for-profits.

A significant contributor to sustainability when considered from the point of view of reduced Commonwealth budget outlays on aged care comes from the shift in the regulated balance of care from residential care to home care. It is estimated that this switch will reduce Commonwealth outlays by $301 million in 2016-17 (and more in the out years) as the proportion of residential paces is gradually reduced. This assumes, however, that the current regulated balance of care reflects consumer preferences.

Under the reforms, non-supported high care residents will pay considerably more towards their accommodation costs, but consumer contributions towards care costs will continue to be quite modest. In 2016-17, consumer care contributions are expected to have increased by $304 million ($181 million in residential care and $123 million in home care). This compares with estimated total

Commonwealth outlays on aged care by 2016-17 of about $16 billion. The current situation is unlikely to alter without a change of policy in relation to the wealth represented by the former principal residence.

Access to services

The recent reforms aim to improve access to services by increasing the overall provision ratio to 125 places per 1,000 people aged 70 and over by 2021-22, and increasing the proportion of home care packages to 36% or 45 places. Provision levels for operational places as at 30 June 2013 were 84.5 and 27.2 for residential care and home care respectively.

The growth in new residential places in 2012-13 was a relatively modest 0.9%, compared with an average annual growth over the previous five years of 1.5%, largely as a result of the negative investment sentiment that prevailed prior to the reforms. The growth in home care packages in 2012-13 was 1.9%.

Reflecting the higher provision target for home care packages, the number of packages released in the 2014 ACAR are a 14 per cent increase over the allocation in the 2012-13 ACAR and an eight-fold increase over the 2011 ACAR. Despite the policy to reduce the target provision ratio for residential care to 80 by 2021-22, the structural ageing of the population means that the number of residential places released through the ACAR continues to grow, with the places advertised for release in the 2014 ACAR being 20 per cent greater than the 2012-13 ACAR allocation.

Occupancy rates in residential care have been gradually falling from a peak of 96.8% in 2002 to 92.7% in 2012-13 (94.2% for not-for-profits and 90.5% for for-profits), probably reflecting a combination of the increasing overall provision target and increasing supply of home care places. The occupancy rate for home care packages in 2012-13 was 92%. Monitoring occupancy rates as the overall provision ratio increases will provide a guide to the level of unmet need for aged care and the level of budget risk for the Commonwealth if rationing of services was to be removed. Because of the potential financial risk for the Budget, the Commonwealth will not be tempted to remove service rationing without a reliable measure of unmet need.

The ACFA report contains a 'data book' which provides statistics on access to aged care services by supported residents. This data will provide the basis for ACFA to monitor the impact of the recent reforms on access by supported residents.

The 'data book' shows that around one third of aged care homes (mostly not-for-profits) always have a supported resident ratio exceeding 40 per cent, while around another third (mostly for-profits) never achieve the 40 per cent ratio needed to obtain the higher accommodation supplement. The other third of homes fluctuate above and below the 40% figure.

As at 30 June 2013, the proportion of supported residents (excluding extra service) was 43.5 per cent, compared with 37.9% in 2010-11. Over the longer term, the proportion of supported residents has tended to be just below 40%.

Workforce

The second ACFA report does not provide much more additional analysis of workforce matters due to lack of new data. The first report was informed by the 2012 National Aged Care Workforce Survey conducted by the National Institute of Labour Studies, and the next Survey is not due until 2015. ACFA will have regard to workforce statistics when developing its advice for Government on ways to improve data collection in the sector.

The second report does include new analysis on staff expenses.

Staff expenses in residential care were on average 66.4% of total expenses in 2012-13, up from 65.9% in 2011-12, or an increase of $734 million. ACFA estimates that 24% of this increase ($174 million) was due to the increase in the number of days of care provided and about 75% ($548 million) was due to a 6.7% increase in the average amount paid in wages and management fees.

Salaries as a proportion of total expenses incurred by CACP providers in 2012-13 were 54%.

Disclosure Statement: The author of Aged Care Update, Nick Mersiades, is a member of the Aged Care Financing Authority. The opinions in this Update should not be read as being an expression of the views of the Aged Care Financing Authority.